



Uttarakhand Open University, Haldwani

MS 401

School of Management Studies and Commerce
Corporate Tax Planning



Block I Basics of Tax Planning and Management

Block II Tax Planning and Assessment of Individual and Firms

Corporate Tax Planning



Block – I

Block Title- Basics of Tax Planning and Management

Block – II

Block Title- Tax Planning and Assessment of Individual and Firms

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Course Contents

Course Name: Corporate Tax Planning

Course Code-MS 401

Course Objective: This course aims at making students conversant with the concept of the corporate tax planning and Indian tax laws, as also their implications for corporate management.

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Unit II Income from Salary

Unit III Tax Planning-Salary

Unit IV Income from House Property and Tax Planning

Unit V Profits and Gains from Business or Profession

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Unit XXI Corporate failure and contraction

Unit XXII Tax implication of foreign collaboration agreements

Unit XXIII Tax Management

Unit XXIV Non-Resident Taxation and Tax Management

Suggested Readings:

1. E.A. Srinivas, Corporate Tax Planning, Tata McGraw Hill.
2. Vinod K. Singhania, Taxmann's Direct Taxes Planning and Management.
3. V.S. Sundaram, Commentaries on the Law of Income- Tax in India, Law Publishers, Allahabad.
4. A.C. Sampath Iyengar, Law of Income Tax, Bharat Publishing House, Allahabad.
5. Taxman, The Tax and Corporate Law Weekly.
6. Bhagwati Prasad, Direct Taxes Laws Practice, Wishwa Prakashan

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Block I
Basics of Tax Planning and Management

UNIT1 NATURE AND SCOPE OF TAX PLANNING AND MANAGEMENT

1.1 Introduction

1.2 Objectives

1.3 Meaning of Tax Planning

1.4 Tax Planning for Individuals

1.5 Tax Management

1.6 Summary

1.7 Glossary

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1.9 Suggested Readings

1.10 Terminal & Model Questions

1.1 INTRODUCTION

Planning can be defined as ‘thinking in advance what is to be done, when it is to be done, how it is to be done and by whom it should be done’. Every individual has to plan his income, expenditures and savings, because every tax payer wants to minimise his/her tax liability as per the various provisions of Act. Tax planning may be defined as an arrangement of an assessee in such a way that full advantage is taken of all exemptions and deductions without violating the legal provisions of an Act. But tax planning is not possible without tax management. So, tax management is the first step towards tax planning and provides a suitable system by which all legal formalities relating with exemptions, deduction, reliefs and rebates are compiled for making tax planning successful. It includes revision, filing of return of income and corrective measures. In a summarised form, the tax planning is an arrangement of financial activities (all exemptions, deductions, rebates, reliefs etc.) in such a way that maximum tax benefits are enjoyed by the use of beneficial provisions in the tax laws, whereas in tax management the conditions are complied with (all legal formalities) to claim the exemptions, deductions and reliefs.

1.2 OBJECTIVES

After reading this unit you will be able to:

- Understand tax-liability reducing terms: tax planning, tax avoidance and tax evasion.
- Understand the concept of tax planning and its objectives.
- Understand the methods of tax planning for reducing the tax liability of the assessee.
- Understand the concept of tax management and its scope.
- Understand the basic difference between tax planning and tax management.

1.3 MEANING OF TAX PLANNING

1.3.1 ELEMENTS OF TAX PLANNING

Tax planning is an art and the exercise of arranging financial affairs in such a manner that, without violating the legal provisions in any way under tax and other laws, full advantage is taken of all tax exemptions, deductions, rebates, reliefs, allowances and other benefits under the tax law so that the burden of taxation on the tax payer is reduced to the minimum.

So, under Tax planning the tax payer would be in a position to reduce his tax liability at the lowest level without violating in any way the legal provision of the law.

The elements or characteristics of tax planning are as follows –

1. Tax planning is a well-accepted principal of law so that an assessee can arrange his affairs for minimising his tax burden. It is open to the tax payer to avoid tax, if he can do so, within the limits of law, without violating it.

2. Tax planning is a continuous process as it is done regularly for every year. It is a process which is repeated every years so that an assessee gets the maximum benefit out of it.

3. With tax planning, the assessee is in position to minimise his tax burden and thereby increase in his real income after tax, because he may invest his funds in such incentive plans which grants him the maximum tax reliefs and concessions.

4. Tax planning is based on exemptions, deductions and tax reliefs provided in the Income-tax Act.

5. Tax planning is well accepted by law, society and the nation, so it is moral and fair in nature. Under this, a tax payer takes maximum advantage of tax laws and saves more and more taxes

6. Tax planning is in accordance with Government policy for achieving specific social

and economic goals. To achieve these goals the Government has provided certain exemptions, deductions, rebates and reliefs through legislations, notifications and circulars. Thus, tax planning confirms the Government's policies.

7. The primary aim of tax planning is to reduce the tax liability. So, tax planning is done to avoid the tax and not to evade the tax.

8. Tax planning is a mental exercise and its success or failure depends upon the systematic use of the provisions of tax laws and the intelligency of the planner.

The importance of tax planning are as follows –

- (1) Tax-liability of the assessee is reduced.
- (2) Regular increase in Government revenues.
- (3) Progress of the country is possible because many schemes are framed for the assessee in tax-planning.
- (4) The society is benefitted through tax-planning because employment opportunities increase.
- (5) Development of backward and rural areas is possible because there are many incentives in Income-tax Act for the assessee, if he establishes his industry in these areas.

1.3.2 OBJECTIVES OF TAX PLANNING

Tax planning is not only the need of the tax-payers but also of the society as a whole and the Government. The exemptions, deductions, rebates and reliefs have been provided by the governing body to achieve social and economic goals. To achieve these objectives people are encouraged for their tax planning. The main objectives of tax planning are –

1. Reduction in tax liability - Every taxpayer wishes to retain a maximum part of the earnings. The basic need of tax planning is to reduce the tax liability so that enough surplus remains for his personal and social needs and also for future investments in his business. This is only possible by planning his tax affairs properly and availing the deductions, exemptions and reliefs, etc. which are admissible under the Acts.

2. Minimisation of litigation - The tax-payers try their best to pay the least tax and the tax administrators attempt to extract the maximum. Whenever a tax-payer wants to reduce his tax liability by finding a loophole in the Act and the tax administrator does not agree with the interpretation of the assessee under which he is demanding exemption or deduction, it results in litigation. A good tax planning is always based under the provisions of the taxation laws. In such a case the chances of litigation are minimised.

3. *Productive investment* - A proper tax planning brings fiscal discipline in the functioning of a tax-payer and reduces the transfer of money, from the person to the Government. The amount so saved enhances the capacity of the tax-payer for expansion and growth, which in turn increases the tax revenue of the Government.

4. *Reduction in cost* - Incidence of tax (direct and indirect) forms a part of cost of production. The reduction of tax-by-tax planning reduces the overall cost. It results in more profit and more tax revenue.

5. *Healthy growth of economy* - The tax planning plays an important role in the development of backward states/districts and development of infrastructure facilities or in other words, it takes the economy in the future direction. So, savings through tax planning devices encourage the healthy growth of economy.

6. *Employment generation* - The amount saved by tax planning is generally invested in commencement of new undertakings/business. This creates new employment opportunities in the business. Further, due to the complications in the taxation laws, some tax-payers cannot plan their financial affairs efficiently and needed the services of chartered accountants or financial planners. This encourages the employment generation.

The limitations of tax planning are -

1. When an assessee has not claimed exemption, deduction or relief for which he is entitled to, before the assessment is completed, he is not allowed to claim it as rectification of mistake or appeal or revision.

2. Other laws (like partnership law or company law) have to be considered before taking any decision in respect of reducing the tax liability. This puts a limitation on the scope of tax planning.

3. The tax incentives are allowed on fulfilment of certain conditions. Sometimes it is very difficult to fulfil those conditions and the tax-payers are not in a position to avail the incentives.

4. The direct tax laws are amended frequently either by the Direct Tax Laws (Amendment) Act or by the Finance Act. This puts a hindrance in making a long-term tax planning. The tax-payers are not sure whether the tax advantages granted at present by the legislature will continue in near future. So, they hesitate in taking a long-term decision for their economic activities resulting a slow growth of the economy.

1.3.3 METHODS OF TAX PLANNING

As we know that the prime objective of tax planning is to minimise the tax-liability. To achieve this objective, an assessee makes tax planning in different ways and forms. Some of methods/forms are -

(1) *Short-term tax planning* - Short-term tax planning means a planning for current year only. Under this, an assessee makes tax planning for the previous year and ascertains the channels of investments so that his tax-liability for the previous year is reduced to the minimum. Such tax planning is done by salaried assessees and assessees having income from irregular sources.

(2) *Long-term tax planning* - Long-term tax planning means a planning for future. Under this, an assessee makes investments in such plans/schemes which help him in reducing his future tax-liability. An assessee plans for present and future both so that his liability for the current year as well for years to come is reduced to the minimum. Such tax planning is done by the assessees carrying on business or profession or whose future income is likely to increase.

(3) *Investment tax planning* - Investment tax planning means a planning for investment's income which creates minimum tax-liability. These incomes are in form of interest or dividends which are either exempt from tax or, attract a low rate of tax. So, under this planning, investments are made in such securities whose incomes are either exempt in full or are partly exempt. Investment planning is adopted by those assessees who have some additional funds. They want to invest, but at the same time they want to keep their tax-liability to the lowest level.

(4) *Organisational tax planning* - An assessee adopts any form of organisation (Hindu undivided family, firm, company, co-operative society, association of persons etc) depends upon various factors (like size/profit of business, scope of business, number of owners in business etc) which creates his tax-liability to the minimum level. So, the selection of form of organisation is also a part of tax planning. By considering these factors a suitable form of organisation is decided which comes under the lowest tax-liability. Such a tax planning is termed as organisational tax planning.

(5) *Estate tax planning* - An assessee administers his estates in such a way that his tax-liability becomes minimum. For this purpose, he may transfer his estates or make arrangement of his estates accordingly. He may transfer high income yielding estate in the name of a person who has low tax liability. Similarly, he will keep with him only those estates which yield low income. For effective estate tax planning, full knowledge of taxation laws are essential pre-requisite.

1.3.4 TAX PLANNING, TAX AVOIDANCE AND TAX EVASION –

Tax Planning - Tax planning is an arrangement of financial activities (all exemptions, deductions, rebates, reliefs etc.) in such a way that maximum tax benefits are enjoyed by the use of beneficial-provisions in the tax laws.

Tax Avoidance - It is a method of reducing the incidence of tax by taking advantage of certain loopholes in tax laws. Under this, all facts are brought through manipulation and wrong way so that the real fact cannot be known. The Government can recover the tax saved by the assessee by making amendments in tax laws.

Tax Evasion - It is a method of reducing or avoiding tax liability by dishonest, means violation of tax laws intentionally. An assessee who is guilty of tax evasion may be punished by the way of penalty. For example, an individual engaged in private tuition or a doctor engaged himself in practicing privately, does not pay tax on his income from such source.

The differences between Tax Planning, Tax Avoidance and Tax Evasion are –

TAX PLANNING	TAX AVOIDANCE	TAX EVASION
1. It is perfectly legitimate (lawful) exercise.	1. It is perfectly illegitimate exercise.	1. It is illegal exercise for tax evading by unfair means.
2. It takes into account the advantage of beneficial provisions in tax laws.	2. It takes into account the advantage the loopholes in the tax laws.	2. Assessee may be punished in this process.
3. Tax planning reduces the tax liability.	3. Tax avoidance is reduces the tax hedging.	3. Tax evasion is tax omission.
4. It helps in balanced economic growth.	4. It borns the black economy.	4. It also borns the black economy.
5. Investment is made in approved deposits schemes.	5. Investment is made in black marketing.	5. Investment is made in black marketing.
6. It includes the complete		

<p>knowledge of tax laws.</p> <p>7. Beneficial for the assessee, society & the nation.</p>	<p>6. It includes the complete knowledge of tax laws.</p> <p>7. Not beneficial for the society & the nation.</p>	<p>6. It does not include the knowledge of tax laws.</p> <p>7. Not beneficial for the society & the nation.</p>
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Check Your Progress-A

Q1. Distinguish between tax planning and tax avoidance.

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Q2. State the objectives of tax planning.

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Q3. State the importance and limitations of tax planning.

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Q4. What is the main difference between short-term and long-term tax planning?

1.4 TAX PLANNING FOR INDIVIDUALS

Tax planning for all individual means the planning of income, investments and expenditures in such a way that the tax-liability of an individual comes to the minimum without avoiding the tax. As per Income-tax Act 1961, an individual may be an employee, a sole-proprietor, a partner in a firm, a member in a Hindu Undivided Family (HUF) or an Association Of Persons (AOP) or a Body Of Individuals (BOI) or a non-resident or otherwise. On the other hand, the individuals having income from various sources falling under different heads may sometimes find it difficult to derive maximum advantage because of the complicated provisions of taxation laws. Accordingly, they become frustrated on their efforts for tax-planning. The tax-planning in the case of an individual should cover the following aspects:

1. Planning for 'Residential status'.
2. Planning under 'Income from salary'.
3. Planning under 'Income from house property'.
4. Planning under 'Income from business or profession'.
5. Planning under 'Income from capital gains'.
6. Planning under 'Income from other sources'.
7. Planning for 'Deductions from gross total income (GTI)'

The summary about the above aspects are as follows:

1. Planning for 'Residential Status' -

Tax liability of an assessee is determined on the basis of his residential status. The term tax liability does not mean the calculation of tax but it means the scope of the total income on which an assessee is chargeable to income tax. An assessee receives or earns income from different sources. Some incomes are earned or received from source within India and some from outside India. Whether he is charged on his Indian income or on his foreign income or on both the income, it is to be determined on the basis of his residential status.

In the case of a *not ordinary resident* individual, he is liable to pay tax on all his Indian incomes and such foreign incomes which accrues or arises from a business or profession which is established in India or controlled from India. He is not liable to pay tax on his other foreign income.

In the case of a *non-resident individual*, he is liable to pay tax only on his Indian incomes.

Thus, it is clear that the tax-liability of a resident individual assessee is the maximum and that of a non-resident case, it is the minimum. Hence, an individual assessee must, if it is possible, try to have the status of a non-resident by not fulfilling of the conditions of becoming a resident. Tax planning may be done as follows:

(i) If an individual wants to enjoy non-resident status, he should not stay in India for more than 181 days during any previous year and should plan in such a way that his total stay during any four previous year preceding the relevant previous year should not exceed 365 days.

(ii) If, somehow, an individual has been in India for more than 365 days during four years preceding the relevant previous year, he should not stay in India for 60 days during the relevant previous year.

(iii) If an individual who has been in India for more than 365 days during four years preceding the relevant previous year, wants to stay in India for more than 60 days, he should plan his stay in such a way that the period of his stay in India falls in two previous-years and does not fall for 60 days in anyone previous year.

(iv) An individual, who is Indian citizen, going abroad for the purpose of employment should not stay in India for more than 181 days. Such individual is treated as resident in India if he stays for 182 days or more in India. The condition of his stay in India for 365 days during the four previous years preceding the relevant previous year does not apply. Thus, such individual is to plan in such a way that his total stay in one previous year does not exceed 181 days.

(v) A non-resident individual should avoid the foreign income from receiving in India. He should plan in such a way that first receipt of his foreign income is made outside India. Thereafter, he should remit the income to India.

2. Planning under 'Income from Salary' –

(i) A retired employee gets pension. He may get it commuted. A good tax-planning is

that if he gets such commuted part of pension which is not taxable. By doing so, his tax liability shall be less.

(ii) It shall be in the interest of the employee that he should get dearness allowance under the terms of employment.

(iii) The employee should receive commission on sale as a fixed percentage of sale, not in lump-sum amount. So that it can become part of salary.

(iv) If an employee is given an option to opt one facility *i.e.*, either House Rent Allowance (HRA) or Rent-free Accommodation. He should compute tax liability in both the situations and opt that his tax liability is minimum.

(v) If the employer contribute subscription in recognised provident fund less than 12% of salary, it may be raised upto 12% of salary.

(vi) Education allowance can be given by the employer to his employee upto a maximum exempted limit of Rs.100 per child per month.

(vii) Similarly, the employer can pay hostel allowance upto a maximum limit of Rs.300 per child.

(viii) The employee can take maximum advantage of deduction u/s 80C to reduce tax liability. The total income may be reduced upto maximum Rs.1,50,000, consequently the tax liability will be reduced.

(ix) The assessee should take mediclaim policy of his spouse or children or his parents u/s 80D so that he may avail benefit of deduction of maximum Rs.30,000.

(x) A salaried person may donate the sum to certain institutions and funds and can get benefit of deduction regarding this donation u/s 80G. It will also reduce the tax liability of the assessee.

3. Planning under ‘Income from House Property’ -

(i) The house property must be constructed by taking loan because the interest on loan is deducted while computing taxable income of house property. On the other hand, if an assessee has more than one house, he should choose the house for his self-residence which is of higher annual value because the house having higher annual value which is being used for self-residence by the owner, is not considered for tax. This will reduce the taxable income of house property.

(ii) If any assessee owns only one house, he should keep it as self-occupied house. Annual value of self-occupied house is taken to be ‘nil’. However, interest on loan, taken to purchase or construct the house, upto Rs.2,00,000 is allowed as deduction. Thus, income of this house may be in loss upto Rs.2,00,000. Such loss may be deducted from income of other house property.

(iii) The assessee should never take loan for house construction from his any friend or

relative as no deduction is allowed for such loan.

(iv) The deduction regarding municipal tax (including service tax) is allowed on actual payment. Hence, as far as possible the tax should be paid before the end of the financial year.

(v) If any house property is let out and the owner provides certain facilities to the tenant for which he has enhanced the rent of the property, then the owner assessee should enter into an agreement with the tenant specifying the rent to be charged for such facilities. Thus, rental value be separated for amenities and for house. In this way the rent charged for amenities shall not be considered for calculating annual value. If it is not done the whole rental value shall be considered for computing annual value and no deduction in respect of the expenditure for such amenities shall be allowed u/s 24. Thus, in order to minimize the tax liability, the owner should specify these charges separately.

(vi) If any interest on loan, taken to purchase or to construct the house, is payable outside India, it should be paid after deduction tax thereon. If no tax deducted at source (TDS) is made, no deduction will be available in respect of such interest. It is, therefore, necessary that TDS must be made before paying such interest.

4. Planning under ‘Income from Business or Profession’ –

(i) Form of the business should be chosen wisely and carefully.

(ii) If it is located in Free Trade Zone or backward states, he will be entitled to exemption or deduction (u/s 10A/80-IB/80-IC). It will reduce his tax liability.

(iii) He should select such type of business in which the income is either exempt or deduction is allowed at a prescribed rate from such income. For example, agricultural income is exempt and in case of hotel business, he will get deduction from gross total income.

(iv) If he needs capital, he should borrow it from friends or relatives instead of taking gifts. The interest on loan is a deductible expenditure. This will reduce his tax liability.

(v) He should not incur such expenses which are not deductible in computing business income. Similarly, he should not incur such expenses which are prohibited by law.

(vi) If the payment of an expense exceeds Rs.20,000, it should be paid by account payee cheque or account payee draft otherwise such payment will be treated as disallowed expense (not for deduction).

(vii) If an assessee requires a building, plant, machinery or furniture for his business, he should acquire it and put to use for at least 180 days during previous year, so that he may claim deduction of depreciation on it for full year.

5. Planning under ‘Income from Capital Gains’ –

(i) Long term capital gains are taxed at a lower rate. So, as far as possible the assets

should be sold off on such dates so that there may be long-term capital gains. For this, no asset can be sold within 36 months from the date of its acquisition.

(ii) For the reduction of tax liability of an assessee, he should study the various provisions of section 54 of Income-tax Act, so that maximum advantage of tax-planning under head 'capital gains' might be achieved. Under various sub-section of section 54 (54, 54B, 54D, 54EC, 54F, 54G etc), certain provisions have been provided to avail exemption in capital gain which bring reduction in tax liability like, the assessee should take benefit by investing the capital gains arising from sale of residential house in the purchase of another house.

(iii) If a shareholder has received bonus shares on his shares and he wants to sell some shares immediately, he should sell original shares so that he may get the benefit of long-term capital gain tax.

(iv) If a shareholder wants to sell listed bonus shares he should sell after holding for more than twelve months. On long-term capital gains, he will be liable to pay tax @ 10%.

(v) An assessee should purchase equity shares after 30-9-2004 and should retain these shares at least 12 months or more these could be Long-term Capital Gain. By doing it, he shall not be liable to pay income-tax on capital gains as under Income-tax Act the long-term capital gain shall be exempt provided that the shares are purchased after 30-9-2004.

6. Planning under 'Income from Other Sources' -

(i) Winnings from lotteries, crossword puzzles etc. are also taxable under this head. No expenditure is allowed as deduction. That means, if that income credited in business accounts, will be taxable under the head 'Income from other sources. So, assessee should plan accordingly.

(ii) Not only attention should be given on interest on securities for investing the money but also tax deduction at sources (TDS) on that income should be given attention.

(iii) Interest on securities is also chargeable under this head. The assessee should invest the money in such securities of which interest is exempt. These securities are mentioned in section 15 of Income-tax Act like (a) Notified securities, bonds or certificates issued by the Central Government; (b) Investment by an individual or a HUF in 7% capital investment Bonds or Notified Relief Bonds; (c) Investment by non-resident Indians on Notified Bonds etc.

7. Planning for 'Deductions from Gross Total Income (GTI)' -

(i) The individual and HUF assessee should take advantage of various deductions u/s 80 (80C, 80D, 80E, 80G etc).

(ii) While giving donation u/s 80G, donation should be given in cheque/cash. No

deduction u/s 80G is allowed if the donation is given in kind.



Check Your Progress-B

Q1. How a salaried person can do tax-planning in relation to income from salary?

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Q2. How will you do tax-planning regarding income from house property?

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Q3. How will you do tax-planning regarding income from business or profession?

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1.5 TAX MANAGEMENT

1.5.1 SCOPE OF TAX MANAGEMENT

Tax management provides a suitable system by which all legal formalities relating with exemptions, deduction, reliefs and rebates are compiled for making tax planning successful. It does not include tax planning. Its scope is limited upto keeping the records, maintaining proper accounts, filing returns, fulfilling all legal obligations and statutory conditions. Thus, tax management means the management of the affairs of the assessee in such a way that his

tax planning is successful and it becomes possible for him to minimise his tax-liability.

‘Tax management is such a suitable and timely management of financial operations by which all legal formalities and statutory requirements for availing various deductions, rebates, reliefs and incentives as given in tax laws are complied with, after careful and deep study of tax laws, and, thus, escaped from penalties and prosecutions’.

The importance of tax-management are as follows –

- (i) Tax-planning is never possible without tax-management.
- (ii) Tax-management has been considered an important part of tax-planning.
- (iii) Tax-management helps the assessee to safe from interest, penalty and prosecution.
- (iv) A good tax-management shall automatically reduce tax liability of the assessee.

Following operations are included in tax-management:

1. Deduction of tax at source [Sec. 203] – Every person deducting tax at source is required as per Section 203 to furnish a certificate to the payee to the effect that tax has been deducted along with certain other particulars. This certificate is usually called the TDS certificate. It is the duty of the deductor to deduct TDS as prescribed by Income Tax Act and will issue the TDS certificate (Form 16/Form 16A). Before filing income tax returns, it is necessary to possess Form 16, if working in an organisation or Form 16A in case of payment other than salary. Both Form 16 and 16A is a TDS certificate which clarifies us that tax deducted at source and remitted to income tax department. The due date for issue of TDS Certificate is different for different quarters. If there is a nil TDS then there is no need to file these forms. TDS rates play very important part for payer and payee to get easily and timely income tax refund. The TDS rates chart of some payment for F.Y. 2017-18 and A.Y. 2018-19 is as follows –

Section	Payment Nature	Payment in excess of	TDS Rate (%)
192	Income from Salary	-----	Avg.
192A	EPF – Premature withdrawal	Rs.50,000	
193	Interest on securities	Rs.10,000	10%
194	Dividend	Rs.2,500	10%
194A	Interest on securities by banks/post office	Rs.10,000	10%
194B	Winnings from lotteries	Rs.10,000	30%

194D	Payment in insurance commission	Rs.15,000	5%
194DA	Payment in respect of Life Insurance Policy	Rs.1,00,000	1%
194EE	Payment of NSS Deposits	Rs.2,500	10%
194H	Commission /Brokerage	Rs.15,000	5%
194I	Rent of Land, Building/furniture	Rs.1,80,000	10% (2% for Machinery)

2. Collection of tax at source (TCS) [Sec. 206C] – Every seller/person should collect tax at source from the buyer/lessee at the time of sale/lease of goods/on transactions which are specified under section 206C of the Income Tax Act, 1961. Under TCS, a seller may be central government/state government/company/partnership firm/individual/HUF whereas a buyer (other than public sector companies, central government, state government, any social club) is classified as a person who obtains goods in any sale, auction, tender. The goods and transactions classified under TCS are:

- Alcoholic liquor for human consumption
- Tendu leaves
- Timber obtained under a forest lease or other mode
- Any other forest produces not being Timber or Tendu
- Scrap (Scrap means waste from the manufacture of materials)
- Licensing or leasing of Parking Lot, Toll Plaza
- Mining and quarrying.

The certificate of collection of tax at source has to be submitted in Form No-27D by persons collecting tax at source within a week from the last day of the month in which the tax was collected. The TCS rates chart of some payment for F.Y. 2017-18 and A.Y. 2018-19 is as follows –

Section	Payment Nature	TCS Rate (%)
206C	Alcoholic liquor for human consumption	1%
206C	Tendu leaves	5%
206C	Timber obtained under a forest lease or other mode	2.5%
206C	Any other forest produce not being Timber or Tendu	2.5%

206C	Scrap	1%
206C	Licensing or leasing of Parking Lot, Toll Plaza	2%
206C	Mining and quarrying	2%

3. Advance tax [Sec. 208] – According to Section 208 of the Income Tax Act, Advance tax is the income tax payable if the assessee's tax liability exceeds Rs.10,000 in a Financial Year. Senior citizen, a resident individual who is at least 60 years of age at any time during the Financial Year and not having any income from business or profession, capital gains, interest on investments, lottery etc is not liable to pay advance tax. If you are a salaried person, you need not pay advance tax as your employer deducts tax at source (TDS). The due dates for various installments of advance tax for all assessee for F.Y. 2017-18 and A.Y. 2018-19 is as follows –

Due Date	Advance Tax Instalment Amount
15 th June	At least 15% of Tax on total income for the year
15 th September	At least 45% of Tax on total income for the year less advance tax already paid
15 th December	At least 75% of Tax on total income for the year less advance tax already paid
15 th March	100% of Tax on total income for the year less advance tax already paid

4. Tax on self-assessment – The balance tax to be paid by the assessee is known as self-assessment tax. In many cases Individual has not deposited full tax or, TDS has been short deducted. It means there is a balance tax liability due to interest u/s 234B, 234C or due to other reason. The balance tax must be deposited before return filing. Self-assessment taxes have to be paid on the 15th of September, December, March for non-corporate and 15th of June, September, December and March respectively for corporate.

5. Audit of accounts [Sec. 44AB] - Every person carrying on business, if his total sales or gross receipts in business exceeds Rs.1 crore in any previous year; or every person carrying on profession, if his gross receipts in profession exceed Rs.25 lakh in any previous year, then audit of accounts is compulsory by a chartered accountant or by a qualified auditor before the specified date.

6. Furnishing the return of income [Sec. 139(1)] - The tax manager must ensure that the return of income is furnished on or before the due date of furnishing the return u/s 139(1), otherwise the assessee will lose the right to carry-forward and set-off the losses and become

liable to punishing interest, penalty, prosecution or fine or both.

7. Documentation and maintenance of records - Documentation is an indispensable ingredient of tax management. An assessee should keep reliable, complete and updated documentation of all the relevant tax files so that the documentary evidence can be made available at a short notice whenever it is required. In absence, thereof, an assessee may lose of case for want of proper documentary evidence. The maintenance of account books, records, vouchers, bills, correspondence and agreements etc. is also a part of tax management. Wherever separate accounts are required for claiming tax benefit, it should be maintained accordingly.

8. Review of orders - It is an important function of tax-management to review the assessment order and other orders received from the tax department. If there is an apparent mistake in a order, then an application for rectification should be made. If the order is prejudicial to the interest of the assessee then, it is advisable to file an appeal for the settlement of the case.

1.5.2 TAX PLANNING VS TAX MANAGEMENT

The main differences between tax planning and tax management are -

1. *Scope* - Tax planning is a wider-term. It includes tax management. Tax management is the first step towards tax planning.
2. *Aim* - The primary aim of tax planning is minimising the incidence of tax, whereas main aim of tax management is compliance with all legal formalities.
3. *Need* - Tax planning is not essential for every assessee, while tax management is essential for every person, otherwise he may be liable for penal interest, penalty and prosecution or both.
4. *Procedure* - Tax planning is a guide in decision making while tax management is a regular feature of an undertaking.
5. *Object* - In tax planning exemptions, deductions and reliefs (financial activities) are claimed while in tax management the conditions are complied with to claim the exemptions, deductions and reliefs.
6. *Functions* - In tax planning alternative financial activities are studied and select the least incidence of tax. Whereas, tax management includes maintenance of accounts in prescribed form (Sec. 44AA), compulsory audit (Sec. 44AB), filing the required forms and returns (Sec. 139), payment of taxes, etc.
7. *Period* - Tax planning essentially looks at future benefits arising out of present actions. Tax management relates to past, present and future. In respect of appeal, revision, rectification of mistakes etc., it deals with the past. Maintenance of records, self-assessment,

filing the return and other documents, keeping pace with the changes, etc. are present activities. Follow-up plans, etc. are for future.



Check Your Progress-C

Q1. Discuss the main provisions regarding tax deducted at source.

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Q2. What are the main differences between tax planning and tax management?

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Q3. What are the due dates for filing the advance tax?

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1.6 SUMMARY

The tax planning for all individual means the planning of income, investments and expenditures in such a way that the tax-liability of an individual comes to the minimum without avoiding the tax. Under Tax planning the tax payer would be in a position to reduce his tax liability at the lowest level without violating in any way the legal provision of the law, whereas tax management is limited upto keeping the records, maintaining proper accounts, filing returns, fulfilling all legal obligations and statutory conditions. Thus, tax management means the management of the affairs of the assessee in such a way that his tax planning is successful and it becomes possible for him to minimise his tax-liability. Tax planning is not essential for every assessee, while tax management is essential for every person, otherwise he may be liable for penal interest, penalty and prosecution or both.



1.7 GLOSSARY

Tax Planning - It is perfectly legitimate (lawful) exercise. It is an arrangement of all exemptions, deductions, rebates, reliefs etc, in such a way that maximum tax benefits are enjoyed by the use of beneficial-provisions in the tax laws.

Tax Management - It provides a suitable system by which all legal formalities (relating with exemptions, deduction, reliefs and rebates) are compiled for making tax planning successful.

Tax Avoidance - It is perfectly illegitimate (unlawful) exercise. It is a method of reducing the incidence of tax by taking advantage of certain loopholes in tax laws. Under this, all facts are brought through manipulation and wrong way so that the real fact cannot be known.

Tax Evasion - It is illegal exercise for tax evading by unfair means. It is a method of reducing or avoiding tax liability by dishonest, means violation of tax laws intentionally.

Tax Deducted at Source (TDS) - Every person deducting tax at source is required as per Section 203 to furnish a certificate to the payee to the effect that tax has been deducted along with certain other particulars. This certificate is usually called the TDS certificate.

Advance Tax - Advance tax is the income tax payable if the assessee's tax liability exceeds Rs.10,000 in a Financial Year. Senior citizen, a resident individual who is at least 60 years of age at any time during the Financial Year and not having any income from business or profession, capital gains, interest on investments, lottery etc is not liable to pay advance tax.



1.8 REFERENCES

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- Singhania, V.K and Singhania, K. 2017. *Direct Taxes Law and Practice with Special Reference to Tax Planning, 57th Edition*. Taxmann Publications, New Delhi.

- Agarwal, B.K. and Agarwal, Rajeev. 2017. *Income Tax Law and Accounts*. Nirupam Sahitya Sadan, Agra.



1.9 SUGGESTED READINGS

1. <http://www.taxmann.com>.
2. CIT v. Hind Cmmission Agents (1963).
3. ITO v. Dr. K.K. Bhatnagar (2009) 32 SOT 55 (Luck.).



1.10 TERMINAL QUESTIONS

- Q1. What is tax planning? How does tax-planning differ from tax evasion?
- Q2. ‘*Tax planning is a legal and moral way of tax saving*’. Discuss this statement.
- Q3. Explain the scope of tax management.
- Q4. Tax planning is not possible without tax management. Give light on this statement.
- Q5. Discuss in short how an individual assessee will plan so that his tax-liability should be minimum.

UNIT 2 INCOME FROM SALARY

2.1 Introduction

2.2 Objectives

2.3 Meaning of Salary

2.4 Principles with Regard to Salary

2.5 Main Items Included in Salary

2.6 Summary

2.7 Glossary

2.8 Answer to Check Your Progress

2.9 Reference / Bibliography

2.10 Suggested Readings

2.11 Terminal & Model Questions

2.1 INTRODUCTION

A person has to pay tax on his total/taxable income earned by him in the previous year on the basis of his residential status. As per section 14 of Income-tax Act 1961, all incomes for the purpose of charge of income tax and computation of total income, are classified under the following five heads -

- (i) Income from salary (Section 15, 16 and 17)
- (ii) Income from house property (Section 22 to 27)
- (iii) Profits and gains of business and profession (Section 28 to 44-D)
- (iv) Income from capital gains (Section 45 to 55)
- (v) Income from other sources (Section 56 to 59)

In this unit, you will learn about the meaning of salary and the items included under the term 'income from salary'.

2.2 OBJECTIVES

After reading this unit you will be able to:

- Understand the term salary
- define allowance
- define perquisite
- Understand the concept of profits in lieu of salary
- Understand the meaning of provident fund and their types for a salaried person.

2.3 MEANING OF SALARY

Salary is the payment made by the employer to the employee in consideration of his services rendered in favour of the employer. The employer may be an individual, a firm, an association of persons etc. So, any payment received from a person other than employer, will be taxed either under the head of 'Profits and gains of business or profession' or under the head 'income from other sources'. For the purpose of income tax, salary includes the monetary values of those benefits and facilities provided by the employer which are taxable. The income-tax Act, 1961 does not define salary. It merely states as to what is included under 'income from salary'. Thus, Section 15 and 17(1) of the Act are inclusive under the term 'income from salary'.

According to Section 15 of Income-tax Act, 1961, the following shall be chargeable to tax under the head 'salary' -

- (a) Salary due - Any salary due from an employer or a former employer to an assessee in the previous year, whether it is paid or not.
- (b) Salary received – Any salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer though it is not due to him.
- (c) Arrears of salary - Any arrears of salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer, if this has not been charged to income-tax in any earlier previous year.



Check Your Progress-A

State True or False

- Q1. Section 17 of Income-tax Act, 1961 notify the basis of charge under 'salary'. ____
- Q2. The income received by the landlord from his tenant is a part of salary. ____
- Q3. For being the income taxable under the head 'income from salary', it is essential to be a relation between employer and employee. ____
- Q4. Salary to a widow shall be taxable under the head 'income from other sources'. ____
- Q5. Arrears of salary of employee is taxable. ____

2.4 PRINCIPLES WITH REGARD TO SALARY

The important principles regarding income from salary are –

i. Relationship of employer and employee – A payment will be regarded as salary only when there exist a relationship of employer and employee between the payer and the payee. If there does not exist the relationship of employer and employee between the payer and payee then, any payment made by the payer will not be taxed under 'income from salary'. For example, allowances received by MP's/MLA's; exam remuneration received by a teacher etc types of payment will be taxed under the head 'income from other sources'.

ii. Salary and wages – As per law, there is no difference between salary and wages. Wages receivable by a labourer and the salary receivable by the Prime Minister of India, are taxable under the head 'income from salary'.

iii. Salary becoming taxable on due basis – The salary becomes taxable when it becomes due. It is immaterial when will it be paid. For example, Mr. Rahim does not get salary for 2 months upto 31st March, yet it shall be included in income of this year because it has become due.

iv. More than one source of salary - An assessee may receive salary from more than one employer during the same previous year due to change in employment or due to his job

nature (part-time employee with several employers). Salary received from each employer is taxed under the head 'income from salary'.

v. Deductions from salary by the employer - Some deductions (from employee's salary) may be compulsory or optional or under a contract on behalf of employee made by the employer. In every case deductions from salary are regarded as application of income. These deductions may be employee's contribution to provident fund, rent of the accommodation belonging to the employer and occupied by the employee, installment of loan/interest (the loan being taken from the employer), premium on the life insurance policy on the life of the employee, any other deduction which the employer makes at the direction of the employee.

vi. Voluntary payments - Every payment, in cash or in kind, made by an employer to his employee in consideration of his services is taxed under the head 'income from salary'. Thus salary, perquisite or allowance may come as a gift to an employee, yet it would be taxable.

vii. Tax-free salary - If an employer pays tax-free salary to his employee, income-tax on such salary is paid by the employer on behalf of his employee. In such a case the amount of tax paid by the employer is regarded as perquisite in the hands of the employee. The employee shall pay income-tax on the salary, perquisites (including the payment of income-tax by the employer) and allowances received by him from his employer. Out of the total tax-liability of the employee, the tax paid by the employer is deducted and the remaining amount is paid by the employee. The tax paid to the department is deemed as tax paid on behalf of the employee.

viii. Loan from employer - The amount of loan taken from the employer will not be regarded as advance salary and will not be included in total income of recipient employee.

ix. Salary to partner – Any salary received by a partner from his own firm will not be chargeable under the head 'salary' and it will be taxed under the head 'income from business or profession'.

x. Surrendering of salary – If an employee surrenders his whole salary or a part of it, this surrendered salary shall be included while computing his taxable salary. If there has been a contract between the employer and employee not to take salary or partial salary, then salary not taken shall not be included in taxable income under the head 'income from salary'.

xi. Time of accrual of salary - Salary of the previous year is taxed during the current

year. Previous year begins on 1st April and ends on 31st March preceding the assessment year. Salary earned during 1st April to 31st March is included in the salary income chargeable during the assessment year. For example, if a person worked for 5 months with one employer and for 6 months with the other. In such a case his salary of 11 months will be included in his total income.



Check Your Progress-B

State True or False (Q.1 to Q.4)

Q1. Salary received from each employer is taxed under the head ‘income from salary’.

Q2. Salary received from more than one employer is taxed under the head ‘income from business or profession’. _____

Q3. Salary received by a partner from his own firm will be chargeable under the head ‘salary’. _____

Q4. Remuneration received from a teacher comes under the head ‘income from other sources’. _____

Q5. Define tax-free salary.

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2.5 MAIN ITEMS INCLUDED IN SALARY

For computing taxable income under the head ‘income from salary’, Gross Salary shall be first calculated. The term ‘gross salary’ includes the following –

- (I) Salary
- (II) Allowances
- (III) Perquisites
- (IV) Profits in Lieu of Salary

These can be depicted by the following chart –

Gross Salary			
(I) Salary	(II) Allowances	(III) Perquisites	(IV) Profits in Lieu of Salary
Salary or wages	Fully taxable	Taxable for all employees	Compensation received
Bonus	Partially exempt	Taxable for specific employees	Any payment received by an employee from his employer or former employer in appreciation of the employee's services
Fee, commission	Fully exempt	Tax-free for all employees	Amount received from a provident fund or other fund
Overtime payments			
Annuity			
Advance salary			
Annual accretion in employee's recognised provident fund			
Encashment of earned leave or leave salary			
Death-cum-retirement gratuity			
Pension			
Compensation on Retrenchment			

Amount received on voluntary retirement			
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2.5.1. SALARY

According to *Section 17(1)* of the Income-tax Act, 1961 the term '*Salary*' includes the following receipts –

i). Salary or wages – The base of appointment in any service is basic salary. The basic salary of an employee is that part of salary which does not include any type of allowance. If certain deductions are made from the salary, while making payments to the employee like deduction of contribution in provident fund by the employee, deduction of income-tax or any other deduction, then the total of these deductions is included in the net amount of salary received by an employee and thus it becomes basic salary.

ii). Bonus – Bonus paid by employer to his employees is taxable as salary, in the year of receipt.

iii). Fees, commission - The whole of the amount received by an assessee as fees, commission and other monetary receipts which are also termed as allowances are included in the total income of the assessee. The fees or commission paid to a person other than the employee, will not be taxable as salary. Commission may be based in the form of some percentage of sale or profit.

iv). Overtime payments – An employer may give to his employee the payments for the period excess of prescribed hours. Its whole amount will be included in gross salary of the employee.

v). Annuity – An employer may give annual grant to his employee which is known as 'Annuity'. It is taxable under the head 'income from salary'. Annuity may be given by the employer voluntarily or under an agreement. If the annuity is paid by LIC, it shall not be taxable under the head salary. In that case, it will be included under the head 'income from other sources'.

vi). Advance salary - Advance salary means the salary received by an employee before it is earned by him. Advance salary is included in the taxable income of the recipient, but it is not so included when it becomes due.

vii). Annual accretion in employee's recognised provident fund – There may be annual accretion in employee's recognized provident fund due to following two reasons –

(a) Employer's contribution in Provident Fund – An employer has to contribute some amount in employee's recognized provident fund which becomes employee's salary. If this amount exceeds 12% of employee's salary, this excess amount shall be included in employee's salary.

(b) Interest on Provident Fund – If the amount of interest on recognized provident fund exceeds 9.5%, this excess amount shall be included in salary.

[For this, 'Salary' means: Basic Salary + Dearness Pay + Dearness Allowance (if it is under the terms of employment) + Commission on sale at a fixed percentage].

viii). Encashment of earned leaves or leave salary - Earned leaves are the leaves which, if not availed of by an employee, are converted into equivalent cash salary and paid to the employee. If the earned leaves are encashed during service, whole amount of cash received shall be taxable to all types (Government or Non-government employees) of employees. But, when an employee takes retirement from the service or resigns from service, he is given some amount for his earned leave. It is called encashment of earned leave or leave salary. Some part of this money received by the employee is taxable and remaining part shall be exempted. The provisions of Income-tax Act, 1961 regarding exemption of encashment of earned leave are given below:

(a) Government Employee: The whole amount of sum received by the employee of Central and State Government shall be exempted.

(b) Non-government employees (including employees of Local Authority, Statutory Corporation and Enterprises of Public Sector): Least amount of following four items shall be tax-free and the remaining amount shall be included in salary.

(i) Actual amount of encashment of earned leave received, or

(ii) Salary of maximum 10 months, calculated on the basis of average salary of 10 months preceding immediately from the retirement, or

(iii) Calculated amount of encashment of leave for the approved period not taken during the service (Maximum period of 30 days for each completed year is approved for encashment of earned leave), or

(iv) Declared amount by the Government (The Central Government has right in this respect to notify in the Gazette a maximum exempted amount of leave salary). The maximum exemption is Rs.3,00,000.

[For this, 'Salary' means: Basic Salary + Dearness Pay + Dearness Allowance (If under terms of employment) + Commission at fixed rate on sale done by employee].

Illustration 1

Mr. Neeraj retired on 1.1.2016 after serving 34 years 9 months in a company. From the following particulars, compute taxable amount of earned leave:

- (i) Salary Rs.15,000p.m from 1.1.2015 to 31.12.2015.
- (ii) Leave granted one and half month for each one year's service.
- (iii) Leave taken during service for 30 months.
- (iv) Balance of leave in account 21 months.
- (v) Rs.1,68,000 received for encashment of earned leave on retirement.

Solution -

- (a) Leave (one month's leave for each completed year of service) 34 months
- (b) Leave availed 30 months
- (c) Leave due as per law $(30 \text{ days} \times 34 \text{ years}) - (30 \text{ days} \times 30 \text{ months}) = 120 \text{ days}/4 \text{ months}$
- (d) Exempted amount would be least of the following:

(i) Amount of encashment received	Rs.1,68,000
(ii) 10 month's average salary $\text{Rs.}15,000 \times 10$	Rs.1,50,000
(iii) Cash equivalent to 4 months @ average salary	Rs.60,000 (Rs.15,000×4)
(iv) Maximum exemption limit	Rs.3,00,000

So, the exempted amount of encashment is Rs.60,000 and the taxable amount will be Rs.1,08,000(Rs.1,68,000 – Rs.60,000).

ix. Death-cum-retirement gratuity – Gratuity is a gratuitous payment made by the employer to his employee, for services rendered, at the time of retirement or death, whichever is earlier, of the employee. Thus, it is a retirement benefit. It is paid by the employer either under a contract of employment or under the Payment of Gratuity Act 1972. The amount of gratuity is paid to the employee, if he survives at the time of retirement, or to his wife or children, if he dies before retirement. Some part of the gratuity is exempt and the remaining part shall be taxable.

The amount of gratuity received by employee is taxable under head 'income from salary' while the amount of gratuity received by the heirs of the employee is taxable under the head 'Income from other sources'.

For computing taxable gratuity, the employees have been divided into two categories:

(A) Government employees [section 10(10)(i)] - The employees of Central Government, State Government and Local Authority are included in this category. The whole amount of gratuity received by these employees or their heirs is exempt.

(B) Non-government employees [section 10(10)(ii) and section 10(10)(iii)] -

(i) *Employees who covered under Payment of Gratuity Act, 1972 [section 10(10)(ii)]*

- The employees working in Government factories, semi-government factories, private factories, ports, railways, etc, are covered under this Act.

Exempted Gratuity - Least amount of the following three amounts shall be exempt and remaining amount shall be included in the salary:

i) Actual amount of gratuity received; *or*,

ii) Salary of 15 days for the service of each completed year. Wages of 7 days in case of employees working in seasonal institutions (in place of 15 days)

Computation of 15 day's salary = $\frac{\text{Salary for last month (including D.A)} \times 15}{26}$; *or*,

iii) Rs.10,00,000.

Note: (a) 6 months or more than 6 months will be treated as one year and salary of last month will be taken for this purpose.

(b) For the above case, *Salary* means monthly basic salary last drawn + Dearness pay + Dearness allowance (whether it is under the terms of employment or not; and 1 month will be considered for 26 days.

(c) If an employee gets salary or wages under piece rate or contract system, average of three months salary/wages immediately preceding retirement/death shall be considered. In that case, computation of 15 day's salary will be -

$\frac{\text{Average monthly salary or wages for last 3 months} \times 15}{26}$

Illustration 2

After serving for 32 years and 7 months in Hindustan Chemicals Ltd. Mr. Ramesh, who is covered by Payment of Gratuity Act, retires from service on 30th April, 2016. The company pays him a gratuity of Rs.95,000. His monthly basic salary at the time of retirement was Rs.7,200. You are required to determine the amount of exempted gratuity under section 10(10) of Income-tax Act.

Solution -

As per the given information, Mr. Ramesh is covered under Payment of Gratuity Act, 1972. His total service period is 32 years 7 months; hence 33 years of service will be taken. For computing of 15 day's salary, salary of last month will be taken and 15/26 of this salary will be done.

$$15 \text{ day's salary} = \text{Rs.}7,200 \times \frac{15}{26} = \text{Rs.}4,153.84$$

The amount of exempted gratuity will be least of the following:

- (i) Rs.95,000 (actual amount)
- (ii) $\text{Rs.}4,153.84 \times 33 = \text{Rs.}1,37,076.72$
- (iii) Rs.10,00,000.

So, the exempted Gratuity will be Rs.95,000.

(ii) *Employees covered under Payment of Gratuity Act, 1972 [section 10(10)(iii)]* - The non-government employees, employees of a corporation established under any Act of Central or State Government are not covered under Payment of Gratuity Act.

Exempted Gratuity - Least amount of the following three amounts shall be exempt and remaining amount shall be included in the salary:

- i) Actual amount of gratuity received; *or*,
- ii). Salary for the service period on the basis of half month's salary for each completed year. (*Complete years shall be taken. Months shall not be considered even they are more than 6*); *or*,
- (iii) Rs.10,00,000.

For the above case, Salary means Basic salary + Dearness pay + Dearness allowance (if it is under the terms of employment) + Commission at fixed rate on sale.

Note: (I) The average salary of preceding 10 months immediately retirement shall be taken.

Illustration 3

After serving for 25 years and 7 months in a cloth mill of Indore, Mr. Raju retires from service on 30th April, 2016. The company pays him a gratuity of Rs.4,40,000. During 10 months ending, he was drawing a monthly salary was Rs.30,000 and conveyance allowance of Rs.3,400. You are required to determine the amount of exempted gratuity under *section 10(10) of Income-tax Act*.

Solution –

As per the given information, Mr. Raju is not covered under Payment of Gratuity Act, 1972. So, the total service period will be taken of 25 years. The average salary for 10 months is Rs.30,000.

The amount of exempted gratuity will be least of the following:

- (i) Rs.4,40,000 (actual amount); *or*
- (ii) $\text{Rs.}15,000 \times 25 = \text{Rs.}3,75,000$ (on the basis of half month's salary for each completed year of service); *or*
- (iii) Rs.10,00,000.

So, the exempted Gratuity will be Rs.3,75,000 and the taxable gratuity will be Rs.65,000(Rs.4,40,000 - Rs.3,75,000).

x). Pension – Pension is a periodical or lump sum payment made by the employer to his employee after his retirement from service. Retired employee, means an employee who has completed his full term of service and has ceased to be in service on attaining the age of superannuation or retirement. The pension is given in two forms –

a. Uncommuted Pension – Pension given on monthly basis is called uncommuted pension. The whole amount of it shall be taxable under the head ‘income from salary’.

b. Commuted Pension – Commuted means, some part of whole pension is discounted in cash. The lump-sum amount is given in cash to the employee by the employer. Its remaining part is given monthly. So, some part of commuted pension received by the employee is included in salary and some part of this commuted pension is exempt.

The exemption rules are –

i. Commuted pension to Government employees – Commuted pension received by the employee of Central Government, State Government, justices of high court/supreme court, local authority and employees of a corporation established under Central or State Act or employees of public undertaking shall be fully exempted.

ii. Commuted pension to Non-Government employees – Commuted pension received by the employee from any other employer shall be exempt upto the following limit –

(a) If the employee gets gratuity along with the pension - $1/3^{\text{rd}}$ part of total pension shall be exempt.

(b) If the employee does not get gratuity – $1/2$ part of total pension shall be exempt.

iii. Any payment, made in the form of commuted pension from pension fund created by the LIC since 1.8.1996 or any other insurer, shall not be taxable for it, it is essential that employee has given contribution himself in this fund.

Illustration 4

Mr. Dhasmana is getting a pension of Rs.12,000p.m from a company. During the previous year, he got $2/3^{\text{rd}}$ commuted pension and received Rs.7,38,000. Compute the exempted amount of pension, if (i) he also received gratuity, (ii) he did not receive gratuity.

Solution –

(i) When Mr. Dhasmana received gratuity –

Commuted value of $2/3^{\text{rd}}$ pension Rs.7,38,000

Commuted value of full pension = $\text{Rs.7,38,000} \times \frac{3}{2}$ Rs.11,07,000

Exempted amount = Commuted value of 1/3rd pension (Rs.11,07,000) = Rs.3,69,000.

(ii) When Mr. Dhasmana did not received gratuity –

Commuted value of 2/3rd pension Rs.7,38,000

Commuted value of full pension = Rs.7,38,000 $\times \frac{3}{2}$ Rs.11,07,000

Exempted amount = Commuted value of 1/2 pension (Rs.11,07,000) = Rs.5,53,500.

xi). Compensation on Retrenchment – Any compensation received by a workman under the Industrial Dispute Act 1974, at the time of retrenchment is exempt from tax to a specified limit. *Retrenchment includes* - retrenchment on account of closure of business or, transfer of employee from one service to another. The least of the following amounts shall be exempt:

(i) Actual amount of compensation received;

(ii) Salary for service period calculated on the basis of 15 day's average salary for each completed calendar year (6 months or more shall be treated as one year);

(iii) Maximum amount declared by Central Government Rs.5,00,000.

Average Salary means:

(i) In case the workman gets salary on monthly basis, then average salary of the last 3 calendar months immediately preceding the month in which the service is retrenched.

(ii) In case the workman gets wages on weekly basis, then average wages of the last 4 complete weeks immediately preceding the week in which the service is retrenched.

(iii) In case the workman gets wages on daily basis, then average wages of last 12 full working days immediately preceding the day on which the service is retrenched.

Salary means: Basic Salary + All monetary receipts + Actual monetary of perquisites (Excluding gratuity and employers contribution for employee's welfare.

Note: A workman means that workman who is covered under Industrial Dispute Act. It does not include manager, administrator whose salary is more than Rs.1,600 and who render their services for managerial affairs, personnel employed in army, police/navy services.

Illustration 5

Mr. Rajpal is employed as a clerk in a factory since 1st October, 2003. He is getting Rs.15,600p.m. as salary and Rs.2,600p.m as dearness allowance since 1st Jan., 2011. His services were terminated on account of retrenchment of employees on 1st August, 2016 and

he was paid Rs.1,44,000 as compensation. Compute his exempted amount of compensation for the assessment year 2017-18.

Solution –

Total period of service is 13 years.

Average salary is Rs.15,600 + Rs.2,600 = Rs.18,200.

Total no. of days during 3 months prior to retrenchment (May + June + July) = 92 days.

Least amount of the following shall be exempted amount of compensation –

(i) Actual amount of compensation – Rs.1,44,000.

(ii) Rs.1,15,728(on the basis of 15 day's salary for 13 years)= $\frac{18,200 \times 3 \times 15 \times 13}{92}$

(iii) Rs.5,00,000 (Maximum as per law).

Exempted compensation = Rs.1,15,728.

Taxable compensation = Rs.28,272(Rs.1,44,000 – Rs.1,15,728).

xii). Amount received on voluntary retirement – Any compensation received by an employee on his voluntary retirement or termination of service is exempt from tax to some extent as per the provisions of law.

2.5.2. ALLOWANCES

Allowance is a fixed monetary amount paid by the employer to the employee (over and above basic salary) for meeting certain expenses, whether personal or for the performance of his duties. The money paid as allowance is also part of gross salary. A salaried person may get some other cash receipts in the form of allowances besides the basic salary. Some of allowances are exempt for all types of employees while some allowances are partially exempt.

Note: The description of all types of allowances and their valuation for tax purpose is discussed in the next unit of this block.

2.5.3. PERQUISITES

Perquisite denotes a personal advantage. The term ‘perquisites’ means any benefit, attached to an office or position in addition to his salary/wages and allowances. It may be given in cash or in kind. If it is given in kind, it should be capable of being measured in terms of money. If the employee does not avail these benefits/amenities, he will not be given money in place of these. Some examples of perquisites/amenities are facility of hotel, boarding and lodging, accommodation for employees, expenses on entertainment incurred by the employer,

use of telephone, facility of guest house etc. The perquisites are chargeable under the head 'salaries' only if there are –

- allowed by an employer to his employee;
- given during the duration of his service;
- directly depending on the employment;
- being of the nature of personal benefits;
- derived by virtue of employer's authority.

Note: The description of all types of perquisites and their valuation for tax purpose is discussed in the next unit of this block.

2.5.4. PROFITS IN LIEU OF SALARY

According to Section 17(3), profits in lieu of salary include any profits in lieu of or in addition to salary/wages. It includes the followings –

(1) Compensation received - The amount of any compensation due to or received by an assessee from his employer or former employer, or in connection with the termination of his employment/modification of the terms and conditions relating to his employment, is taxable under the head 'Salary' as 'profits in lieu of salary'. It does not matter whether the compensation is received by the employee as a matter of right or is given to him voluntarily by the employer.

(2) Any payment – This includes any payment due or received by an assessee from his employer or former employer in appreciation of the employee's services. But if a sum is paid to an employee by his present/former employer not in token of appreciation of the services rendered but as a personal gift for the personal qualities of the employee, such payment is not taxable in the hands of employee under the head 'salary'.

(3) Amount received from an unrecognised provident or other fund - Any payment made from an unrecognised provident fund or other fund to the extent of employer's contributions and interest on such contributions, or any sum received under a Keyman insurance policy including the amount of bonus will be included. However, the interest on the employee's contributions to an unrecognised provident fund or superannuation fund is not exempt from tax but it is included in his total income under the head 'income from other sources'. In brief, the employer's contribution and interest thereon is taxable under the salary head and interest on employee's contribution is taxable under the head of income from other sources.

(4) Payment before joining or after retirement – This includes:

- (i) Any amount due or received by any assessee, whether in lump-sum or otherwise, before joining any employment with that person; or
- (ii) Any amount due or received by any assessee, whether in lump-sum or

otherwise, after cessation of his employment with that person.

Exceptions: The following amounts received by an employee are not included in salary income as ‘profits in lieu of salary’ because these are partially exempt and partially taxable:

(i) Death-cum-retirement gratuity (Exempt portion)	[u/s 10(10)]
(ii) Commuted pension (Exempt portion)	[u/s 10(10-A)]
(iii) Compensation (Exempt portion)	[u/s 10(10-B)]
(iv) Payment from statutory and public provident fund	[u/s 10(11)]
(v) Payment from recognised provident fund	[u/s 10(12)]
(vi) Payment from approved superannuation fund	[u/s 10(13)]
(vii) House rent allowance (Exempt portion)	[u/s 10(13-A)]

2.5.5. PROVIDENT FUND

The word ‘Provident’ means to provide for the future, hence this fund is providing on the retirement of the employee from his service along with interest. This fund is build by the deduction from the salary of the employee every month at a certain rate and the employer also makes his own contribution to this fund. These contributions are invested to earn interest, which is also credited to the employee’s provident fund account. If unfortunately, the employee dies during the tenure of his service, the amount of this fund is received by his wife and children or legal heirs, which is of great help to them. These funds are of following kinds:

(i) Statutory Provident Fund – This provident fund is maintained by Government or Semi-Government (local authorities, educational institutions, nationalized banks, etc) offices. It is that Provident Fund in which Indian Provident Fund Act, 1925 applies.

(ii) Recognised Provident Fund – This provident fund is maintained by scheduled banks, factories and business houses. These funds are recognised by the Chief Commissioner or Commissioner of Income Tax according to the provisions of Income-tax Act.

(iii) Unrecognised Provident Fund - Any institution or organization can maintain this fund. These funds are neither statutory nor recognised. It is approved by the P.F. Commissioner. This is maintained by private sector organizations.

Provisions of Income Tax regarding Provident Fund

<i>Particulars</i>	<i>Statutory Provident Fund</i>	<i>Recognised Provident Fund (R.P.F)</i>	<i>Un-recognised Provident Fund</i>
Employee’s	Employee’s	Employee’s	Employee’s contribution

contribution	contribution is included in taxable salary. Employee is paid his monthly salary after deducting his contribution to provident fund. But his full salary is included in taxable income. Thus, his contribution to provident fund is included in his salary. But the entire contribution upto Rs.1,50,000 qualifies for deduction u/s 80C.	contribution is included in taxable salary. Employee is paid his monthly salary after deducting his contribution to provident fund. But his full salary is included in taxable income. Thus, his contribution to provident fund is included in his salary. But the entire contribution upto Rs.1,50,000 qualifies for deduction u/s 80C.	is included in taxable salary. Employee is paid his monthly salary after deducting his contribution to provident fund. But his full salary is included in taxable income. Thus, his contribution to provident fund is included in his salary. But his contribution does not qualify for deduction u/s 80C.
Employer's contribution	Tax Free	Tax free upto 12% of salary. Excess over 12% of salary is included in salary.	Tax Free
Interest credit to provident fund	Tax Free	Tax free, if rate of interest doesn't exceed 9.5%. Interest in excess of above rate is included in salary.	Tax Free
Lump sum payment at the time of retirement/termination of service etc.	Tax free u/s 10(11)	Tax free u/s 10(12) provided: - the employee has served continuously for at least 5 years. - He has been removed from service on account of retrenchment, illness	Lump sum upto the amount equal to employee's contribution is exempt. Employer's contribution and interest there on is included in salary income. Interest on employee's contribution is taxable under the head 'income from other sources'.

		or closure of business.	
Salary = Basic Salary + Dearness Pay + Dearness Allowance (on the terms of service) + Commission or sales at a prescribed rate.			

Illustration 6

Shree Nagender is employed on Rs.20,000p.m. salary and Rs.1,500p.m dearness allowance. He contributes 12% of his salary and dearness allowance in a provident fund (P.F.) whereas his employer contributes 14%. Interest on provident fund is determined @ 14% which is Rs.2,402 for the previous year. This interest has been credited in fund upto 31-08-2016. He gets house rent allowance also of Rs.900p.m. He gives rent for the house used for his own residence. What would be salary for the assessment year 2017-18, if provident fund is (a) Statutory, (b) Recognised, (c) Unrecognised?

Solution –

Computation of Gross Salary

(for the assessment year 2017-18)

	Statutory P.F Rs.	Recognised P.F Rs.	Unrecognised P.F Rs.
Salary (Rs.20,000 × 12)	2,40,000	2,40,000	2,40,000
Dearness allowance (Rs.1,500 × 12)	18,000	18,000	18,000
Employer's contribution to R.P.F.			
(excess of 12% of salary)	-	5,160	-
Interest on P.F. (excess of 9.5%)	-	772	-
House rent allowance	900	900	900
Gross Salary	Rs.2,58,900	Rs.2,64,832	Rs.2,58,900

**Check Your Progress-C**

Q1. What do you mean by basic salary?

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Q2. Explain the provisions of Income tax regarding encashment of earned leave.

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Q3. Mr. Selven retired from service on 31st December, 2008. His pension was fixed at Rs.6,000p.m. He commutes half of his pension and received Rs.2,70,000. Find out the exempted amount of commuted pension, if (i) he is a government employee, (ii) he is a private employee who get gratuity, and (iii) he is a private employee who did not get any gratuity.

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Q4. Define profit in lieu of salary. What it actually includes?

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Q5. Mr. Ramesh retires from a company on 4th Jan, 2016 after serving 16 years. At the time of retirement his basic salary was Rs.4,400p.m and he was also entitled to dearness allowance of Rs.800p.m. On the retirement, he received Rs.60,000 as gratuity. He is covered by Payment of Gratuity Act. You are required to determine the taxable part of gratuity.

Q6. What are the income tax provisions regarding different types of provident fund?

2.6 SUMMARY

Salary is the payment made by the employer to the employee in consideration of his services rendered in favour of the employer. The employer may be an individual, a firm, an association of persons etc. According to section 17(1) of the Income-tax Act, 1961, Salary includes basic salary/wage, pension, bonus, commission, overtime payments, annuity, advance salary, leave salary, death-cum-retirement gratuity, compensation on retrenchment, amount received on voluntary retirement etc. Hence, it is not only includes the cash received but also the monetary value of facilities and benefits attached with the employee's work. For the income tax purpose, salary is the sum of the taxable part of basic salary, allowances, perquisite and profit in lieu of salary.



2.7 GLOSSARY

Advance salary – It means the salary received by an employee before it is earned by him.

Earned Leave – These are the leaves which, if not availed of by an employee, are converted into equivalent cash salary and paid to the employee.

Gratuity – It is a gratuitous payment made by the employer to his employee, for services rendered, at the time of retirement or death, whichever is earlier, of the employee.

Pension - It is a periodical or lump sum payment made by the employer to his employee after his retirement from service. The pension is given in two forms

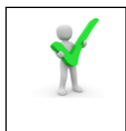
i.e., uncommuted Pension and commuted Pension.

Allowance – The fixed monetary amount paid by the employer to the employee (over and above basic salary) for meeting certain expenses (official or personal). Some of allowances are exempt for all types of employees while some allowances are partially exempt.

Perquisite - This denotes a personal advantage. The term ‘perquisites’ means any benefit, attached to an office or position in addition to his salary/wages and allowances. It may be given in cash or in kind. If it is given in kind, it should be capable of being measured in terms of money.

Profits in lieu of salary – This include any profits in lieu of/in addition to salary which includes the appreciation of the employee’s services, or the amount of any compensation received by an assessee in connection with the terms and conditions relating to his employment.

Provident fund - The word ‘Provident’ means to provide for the future, hence this fund is providing on the retirement of the employee from his service along with interest. This fund is build by the deduction from the salary of the employee every month at a certain rate and the employer also makes his own contribution to this fund. These funds are may be statutory provident fund, recognised provident fund or unrecognised provident fund.



2.8 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress –A

Ans. 1 False

Ans. 2 False

Ans. 3 True

Ans. 4 False

Ans. 5 True

Check Your Progress –B

Ans. 1 True

Ans. 2 False

Ans. 3 False

Ans. 4 True

Check Your Progress –C

Ans. 3 (i) Fully exempt (ii) Rs.1,80,000 (iii) Rs.2,70,000

Ans. 5 Rs.12,000



2.9 REFERENCES

- Mehrotra, H.C. and Goyal, S.P. 2017. *Income Tax Law and Accounts*. Sahitya Bhawan Publications, Agra.
- Singhania, V.K and Singhania, K. 2017. *Direct Taxes Law and Practice with Special Reference to Tax Planning, 57th Edition*. Taxmann Publications, New Delhi.
- Agarwal, B.K. and Agarwal, Rajeev. 2017. *Income Tax Law and Accounts*. Nirupam Sahitya Sadan, Agra.



2.10 SUGGESTED READINGS

1. CIT v.Abdul Wahid & Co. (2000) 243 ITR 467 (Mad.).
2. Circular No. 776 dated June, 08, 1999.
3. Circular No. 293 dated Feb., 10, 1981



2.11 TERMINAL QUESTIONS

Q1. What items are included under the head ‘Salaries as per Income-tax Act, 1961?’

Q2. What are included in profits in lieu of salary?

Q3. Discuss different types of provident funds of which a salaried employee may be a member.

Q4. What are the provisions of Income tax Act, 1961 regarding the commuted pension and gratuity?

Q5. Salaries arise in the hands of employees. Comment on this statement and state as to what incomes are taxable under the head salaries.

UNIT 3 TAX PLANNING - SALARY

3.1 Introduction

3.2 Objectives

3.3 Types of Allowances and Valuation

3.4 Types of Perquisites and Valuation

3.5 Deductions from Gross Salary

3.6 Summary

3.7 Glossary

3.8 Answer to Check Your Progress

3.9 Reference / Bibliography

3.10 Suggested Readings

3.11 Terminal & Model Questions

3.1 INTRODUCTION

In the previous unit, you have learnt about the concept of salary and the terms included under the term 'salary' like basic salary, allowance, perquisite, profits in lieu of salary, provident fund etc. In this unit, you will learn about the types of allowances and perquisites including their valuation for income tax purpose.

3.2 OBJECTIVES

After reading this unit you will be able to;

- know the types of allowances.
- calculate the taxable part of allowance.
- know the types of perquisite.
- calculate the taxable part of perquisite.

3.3 TYPES OF ALLOWANCES AND VALUATION

As we know that, the allowance is a fixed monetary amount paid by the employer to the employee for meeting certain expenses, whether personal or for the performance of his duties. For the purpose of tax treatment, we divide these allowances into three different categories i.e., fully taxable allowances, partially exempt allowances and fully exempted allowances.

(a) Fully Taxable Allowances - The main allowances under this category are -

i). Dearness Allowance - As is clear by its name, this allowance is paid to compensate the employee against the rise in price level in the economy. It may be paid under the terms of employment or otherwise. In both the cases it is included in salary. But where this allowance is given under the terms of employment it forms part of the basic salary. It is deemed under the terms of employment under the following conditions -

(a) When it is included in the 'salary' for the purpose of computation of annual contribution in a recognised provident fund; and

(b) When it is included in the 'salary' for the purpose of computation of all retirement benefits (like provident fund, pension, leave encashment, gratuity etc.) payable to an employee. But, if dearness allowance or dearness pay is part of salary for computing only some (not all) of the retirement benefits, then it is not considered as part of salary or under the terms of employment.

ii). City Compensatory Allowance - This allowance is paid to employees who are posted in big cities. The purpose is to compensate the high cost of living in cities like Delhi, Mumbai etc. However, it is fully taxable.

iii). Tiffin/Lunch Allowance - It is given for lunch to the employees.

iv). Non practicing Allowance - This is normally given to those professionals (like medical doctors, chartered accountants etc.) who are in government service and are banned from doing private practice. It is to compensate them for this ban. So, it is fully taxable and comes under the category of fully taxable allowances.

v). Warden or Proctor Allowance - These allowances are given in educational institutions for working as a 'warden' of the hostel or as a Proctor in the institution.

vi). Overtime Allowance - It is paid in lieu of payments for overtime salary or wages.

vii). Fixed Medical Allowance - Medical allowance is fully taxable even if some expenditure has actually been incurred for medical treatment of employee or family.

viii). Servant Allowance - It is fully taxable whether or not servants have been employed by the employee.

ix). Other Allowances - There may be several other allowances like family allowance, night allowance, education allowance, rural allowance, holiday allowance etc. These are also fully taxable.

(b) Partially Taxable Allowances - This category includes allowances which are exempt upto certain limit. The main allowances under this category are -

i). Children Education Allowance - This allowance is exempt to the extent of Rs.100 per month per child for maximum of 2 children. *For example*, an employee gets Rs.200p.m per child as education allowance for his three children. The employee gets Rs.7,200 during the previous year. The allowance chargeable to tax is Rs.4,800 as Rs.200p.m. (maximum limit) is exempt.

ii). Children Hostel Allowance - Any allowance granted to an employee to meet the hostel expenditure on his child is exempt to the extent of Rs.300p.m per child for maximum of 2 children. *For example*, an employee gets Rs.400p.m per child as hostel allowance for his three children. The employee gets Rs.14,400 during the previous year. The allowance chargeable to tax is Rs.7,200 as Rs.600 p.m. (maximum limit) is exempt.

iii). Transport Allowance - This allowance is generally given to government employees to compensate the cost incurred in commuting between place of residence and place of work. An amount upto Rs.1,600p.m paid is exempt. However, in case of blind and orthopaedically handicapped persons, it is exempt upto Rs.3,200p.m.

iv). Daily allowance - Any allowance which is granted for tour or for the period of journey in connection with transfer, to meet the ordinary daily expenses incurred by an employee during his absence from his normal place of duty, is exempt from tax to the extent the amount is utilised for the purpose. *For example*, Mr. Raju received a daily allowance at Rs.250 per day for 10 days, during his tour period, by his employer. He, during his 10 days tour, spent Rs.2,000 only. Then, the allowance chargeable to tax is of Rs.500 (Rs.2,500 – Rs.2,000).

v). Conveyance allowance - Any allowance which is granted to meet the expenditure on conveyance in performance of duties of an office is termed as conveyance allowance. It is exempt from tax to the extent it is spent on such conveyance provided that free conveyance is not provided by the employer. If the employee has been provided free conveyance the whole of such allowance will be chargeable to tax. *For example*, Mr. Singh is employed in a company for collecting the amounts from its debtors. Besides salary, he is also getting the conveyance allowance of Rs.1,000 p.m. for the purpose. During the previous year he spent Rs.10,000 on conveyance in performance of such duty. In this case, Rs.2,000 (Rs.12,000 – Rs.10,000) is chargeable to tax. If the amount spent would have been Rs.12,000 or more, the whole allowance would have been exempt from tax. But if the employee would have been provided free conveyance by the employer, the whole allowance would have been taxable.

vi). House Rent Allowance (H.R.A.) [Sec 10(13A)] - An allowance granted to a employee by his employer to meet expenditure incurred on payment of rent in respect of residential accommodation occupied by him is exempt from tax to the extent of least of the following three amounts:

- a. House Rent Allowance actually received by the assessee; *or*
- b. Excess of rent paid by the assessee over 10% of salary; *or*
- c. An amount equal to 50% of salary (if the accommodation is situated in Mumbai, Kolkata, Delhi, Chennai) or, an amount equal to 40% of salary (if the accommodation is situated in any other place).

Note:

- (a). Salary for the purpose of HRA = Basic Salary + Dearness Allowance (if part of salary) + Commission (if fixed % of turnover).
- (b). The exemption of HRA depends upon the basic salary, place of residence, rent paid and HRA received by the employee.
- (c). If an employee is living in his own house or is living in a house for which he is not paying any rent, full amount of HRA receivable by the employee is taxable.

Illustration 1

Mr. A resides in Chennai. He is paid Rs.3,60,000 as basic salary. He also gets Rs.1,00,000 as house rent allowance. The rent paid by him is Rs.75,000. Calculate exempt HRA and taxable HRA.

Solution –*Calculation of HRA*

- (i) Actual HRA received = Rs.1,00,000
- (ii) Excess of rent paid by the assessee over 10% of salary = Rs.39,000 (Rs.75,000 – Rs.36,000)
- (iii) 50% of salary (Rs.3,60,000) = Rs.1,80,000

Therefore, Rs.39,000 shall be exempted and the balance Rs.61,000 (Rs.1,00,000 – Rs.39,000) shall be included in gross salary as taxable HRA.

vii) Entertainment Allowance - This allowance is first included in gross salary under allowances and then deduction is given to only central and state government employees under Section 16(ii). [*For details, see heading no. 3.5 of this unit*].

(c) Fully Exempt Allowances - This category includes allowances which are fully exempt from tax. The main allowances under this category are -

i). Academic Allowance – This allowance is given for encouraging the various academic research. It shall be exempt upto the actual expenditure. If the academic allowances are not spent fully, remaining amount not spent shall be taxable.

ii). *Uniform Allowance* – This allowance is given to meet the expenditure in connection with purchasing and maintaining uniforms during the official duties.

iii). *Allowance to High Court Judges* – Any allowance paid to a High Court and Supreme Court Judges of whatever nature are fully exempt from tax.

iv). *Allowance received from United Nations Organisation (UNO)* – All allowances paid by the UNO to its employees are fully exempt from tax.

v). *Allowance received by a teacher from SAARC Members States* – Allowances received by a resident teacher/professor/research scholar from any SAARC Member States is exempt for first two years of their arrival in the Member States subject to the fulfilment of their conditions.

vi). *Allowance to chairman or members of UPSC* – Any allowance of the nature of transport allowance and sumptuary allowance granted to chairman or any other member of Union Public Service Commission (UPSC) is exempt u/s 10(45) of the Income-tax Act, 1961.

vii). *Foreign allowance* - This allowance is usually paid by the government to its employees being Indian citizen posted out of India for rendering services abroad. It is fully exempt from tax.



Check Your Progress-A

Q1. Define dearness allowance.

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Q2. Mr. Sinha resides in Chennai. He is paid Rs.3,60,000 as basic salary. He also gets Rs.1,00,000 as House Rent Allowance (HRA). The rent paid by him is Rs.75,000. Compute HRA which is exempt from tax.

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Q3. Discuss fully tax-free allowances.

Q4. Explain any two allowances in detail which are partially exempted.

3.4 TYPES OF PERQUISITES AND VALUATION

As we know that perquisite means any benefit in cash or kind in addition to salary and allowances. For income tax purposes, we limit the scope of perquisites to the benefits received in kind and which are convertible in terms of money. So, valuation of perquisites means the ascertainment of the monetary value of the perquisite provided by the employer to his employee. As per Section 17(2) of Income-tax Act 1961, perquisites may be classified into different categories like taxable perquisites for all employees, taxable perquisites for specific employees and tax-free perquisites for all employees. The explanation and valuation are given below for the purpose of income tax.

3.4.1. TAXABLE PERQUISITES FOR ALL EMPLOYEES

These are general perquisites. So, these are taxable in the hands of every employee assessee. The value of these facilities shall be taxable for all types of employees (Government or Private) to whom these facilities have been provided. The provisions for the valuation of perquisites are comes under Income-tax Rules, 1962. These perquisites may be followings:

(1) Rent-free Accommodation – The value of rent-free accommodation provided to the assessee by his employer is taxable perquisite in the hands of every employee (Government and Non-Government). The accommodation provided by the employer to his employee may be of any of the following two categories –

(i) Unfurnished accommodation – The accommodation which is not fitted with furniture or other facilities (like TV, AC, Refrigerator etc) is termed as unfurnished.

(ii) Furnished accommodation – The accommodation which is equipped with furniture or other facilities is termed as furnished.

[Sec.17(2)(i)]

Valuation in case of Government employees -

(a) Unfurnished accommodation - According to the license fee framed by the Government. The licensing fee (different for different types of employees as per their status) of the house is that fee which has been determined by the Government for the valuation of house.

Taxable value of house = Licensing fee of the house

(b) Furnished accommodation -

Taxable value of house = Valuation as unfurnished + 10% p.a of the cost of furniture installed in the accommodation (if the furniture is owned by the Government).

or,

Taxable value of house = Valuation as unfurnished + Actual rent/hire charges of furniture installed in the accommodation paid by Government (if the furniture has been taken on hire by the Government).

Valuation in case of Non-Government employees -

(a) Unfurnished accommodation -

When the accommodation is owned by the employer:

Taxable value of house = 15% of salary in respect of the period during which the said accommodation was occupied by the employee during the previous year.

Note: 15% of salary in cities having population exceeding 25 lakhs; 10% of salary in cities having population in between of 10 to 25 lakhs; 7.5% of salary in cities having population not exceeding more than 10 lakhs.

When the accommodation is taken on lease/rent by the employer -

Taxable value of house = 15% of salary (in all cases) or, Lease rent payable by the employer [whichever is less].

(b) Furnished accommodation -

When the accommodation is owned by the employer or the accommodation is taken on lease/rent by the employer (both cases) -

Taxable value of house = Valuation as unfurnished + 10% p.a of the cost of

furniture installed in the accommodation (if the furniture is owned by the Government).

or,

Taxable value of house = Valuation as unfurnished + Actual rent/hire charges of furniture installed in the accommodation paid by employer (if the furniture has been taken on hire by the Government).

Valuation in case of hotel accommodation – If any employee (Government or Private) has been provided with an accommodation in a hotel, then such accommodation is treated as furnished.

Taxable value = 24% of salary in respect of the period during which the said hotel was occupied by the employee during the previous year or, Actual charges payable by the employer to such hotel [whichever is less].

Note: The meaning of ‘Salary’ for the purpose of the valuation of rent-free accommodation is

-

- (i) Basic salary;
- (ii) Dearness allowances or dearness pay (if it is under the terms of employment);
- (iii) Bonus, Commission;
- (iv) All taxable allowances (excluding the not taxable portion);
- (v) All monetary payments (which is taxable).

Illustration 2

Shri Vishnu is employed in Mumbai. Particulars of his income for the previous year 2016-17 are given below:

Basic Salary	Rs.25,000p.m
Dearness Allowance	Rs.5,000p.m (40% is computed for retirement benefits)
Bonus	Rs.20,000p.a
Commission	Rs.15,000p.a
Entertainment Allowance	Rs.3,000p.m
Employer has paid personal loan of Vishnu	Rs.7,000
Fair rental value of rent of free house provided by the employer	Rs.1,00,000p.a
Value of furniture provided	Rs.2,00,000

Find out Shri Vishnu’s income from salary for the assessment year 2017-18.

Solution –

Computation of Income from Salary

(for the assessment year 2017-18)

Basic Salary (Rs.25,000×12)	Rs.3,00,000
Dearness Allowance (Rs.5,000×12)	Rs.60,000
Bonus	Rs.20,000
Commission	Rs.15,000
Entertainment Allowance (Rs.3,000×12)	Rs.36,000
Personal loan paid by employer	Rs.7,000
*Value of rent-free furnished house	<u>Rs.79,250</u>
Gross Salary	Rs.5,17,250
Less: Deductions u/s 16 (discussed in heading no. 3.5)	<u>Nil</u>
Income from Salary	Rs.5,17,250

Working Note:

1. It is assumed that the house is owned by the employer.

2. Salary for rent-free accommodation* = Rs.3,00,000(Basic Salary) + Rs.24,000(D.A) + Rs.20,000(Bonus) + Rs.15,000(Commission) + Rs.36,000(E.A) = Rs.3,95,000.

Value of unfurnished accommodation = Rs.59,250 (15% of Rs.3,95,000)

Value of furnished accommodation = Rs.59,250 + Rs.20,000(10% of furniture cost) = Rs.79,250.

3. Entertainment allowance shall not be deductible u/s 16 in case of non-government employees.

(2) Concessional Rent-free Accommodation – The value of rent-free accommodation provided to the assessee at a concessional rate by his employer is a perquisite in the hands of the employee. Normally, the employer deducts a fixed sum from the salary of his employee towards the rent of the accommodation provided to him. The sum so deducted as rent is less than the actual fair rental value of the accommodation. If the employee pays fair rent of the accommodation, it cannot be said that he is receiving any concession in the matter of rent. So, there would be no perquisite in such case. But when the rent paid by him or deducted from his salary is less than the fair rental value of the accommodation, he is said to have received concession in the matter of rent. This would be a perquisite. The

accommodation provided to an employee at concessional rent may be either furnished or unfurnished.

[Sec.17(2)(ii)]

Valuation in case of Government employees -

(a) Unfurnished accommodation -

Value of concession in rent = Licensing fee of the house

(b) Furnished accommodation -

*Value of concession in rent = Valuation as unfurnished + 10% p.a of
the cost of furniture*

Valuation in case of Non-Government employees -

(a) Unfurnished accommodation -

When the accommodation is owned by the employer -

*Value of concession in rent = 15% of salary in respect of the period during which
the said accommodation was occupied by the employee during the previous year.*

Note: 15% of salary in cities having population exceeding 25 lakhs; 10% of salary in cities having population in between of 10 to 25 lakhs; 7.5% of salary in cities having population not exceeding more than 10 lakhs).

When the accommodation is taken on lease/rent by the employer -

*Value of concession in rent = 15% of salary (in all cases) or, Lease rent payable
by the employer [whichever is less].*

(b) Furnished accommodation -

*When the accommodation is owned by the employer or the accommodation is taken on
lease/rent by the employer (both cases) -*

*Value of concession in rent = Valuation as unfurnished + 10% p.a of the cost
of furniture*

Valuation in case of hotel accommodation –

*Value of concession in rent = 24% of salary in respect of the period during which the
said hotel was occupied by the employee during the previous year or, Actual charges payable
by the employer to such hotel [whichever is less].*

(3) Payment of Employee's Obligations by Employer – Where the employer makes any such payment on behalf of his employee, then the actual amount of such payment is taxable perquisite in the hands of the employee's salary. Some examples of such obligations are:

- (i) Payment of personal loan on behalf of employee;
- (ii) Medical expenses reimbursement in excess of Rs.15,000;
- (iii) Premium paid for life insurance or an annuity of the employee;
- (iv) Payment of employee's hotel bills;
- (v) Payment of gas, electricity and water bills;
- (vi) Payment of educational fee of employee's children;
- (vii) Payment of salary of domestic servant appointed by the employee;
- (viii) Payment of income-tax on employee's salary etc.

[Sec.17(2)(iv)]

Value = Actual obligation of employee or Amount paid by the employer [whichever is less].

(4) Payment of Employee's Life Insurance and Annuity Premium – The amount payable by an employer directly or indirectly to effect an assurance on the life of employee would be taxable perquisite in the hands of every such employee. Such funds are other than recognised provident fund or approved superannuation etc. These payments shall be included in the gross salary of the employee even the payment has not been done by the employer during the previous year. It means this payment shall be taxable in the hands of employees on due basis. *For example*, the responsibility of paying insurance premium due in 18-3-2017 by the employer, is paid actually in 16-4-2017. But this premium shall be included in gross salaries of financial year 2016-17 and shall be taxable in the assessment year 2017-18. If the premium is paid by the employer under certain schemes, like employee's state insurance scheme then, it will not be the perquisite for the employee because this scheme is in the interest of the employee.

[Sec.17(2)(v)]

Value = Life or annuity premium actually paid by the employer (including any penalty or interest on it).

(5) Specified Security or Sweat Equity Shares Allotted/Transferred to an Employee – 'Sweat equity shares' means equity shares issued by a company to its employees/directors at a discount. If the employer has directly or indirectly

allotted/transferred specified security/sweat equity shares to the employee, free of cost or at a concessional rate, it will a taxable perquisites in the hands of employee.

[Sec.17(2)(vi)]

Value = Fair market value of such security as on the date of transfer by the employer – The amount actually paid by the employee in respect of such security.

(6) Employer's Contribution to an Approved Superannuation Fund – If the employer contributes some amount to the approved superannuation fund of the employee then, such contribution is also comes under taxable perquisite in the hands of the employee to the extent, it exceeds Rs.1,00,000.

[Sec.17(2)(vii)]

Value = Actual amount contributed by the employer – Rs.1,00,000.

(7) Value of Any Other Fringe Benefit - Fringe means additional or supplemented. So, fringe benefits are those benefits which are being provided to the employees by the employer in addition to their normal salaries, wages and allowances. These are paid to the employees for stimulate their interest in the work. So, the value of these fringe benefits would be included in the employee's salary (taxable perquisite) in excess of a specified limit. Some fringe benefits which are taxable in the hands of all employee are –

- Provision of interest-free or concessional loan.
- Value of travelling/touring and other expenses paid/reimbursed by the employer.
- Value of free meal (taxable, if the value exceeds Rs.50 per meal).
- Value of any gift, voucher or token (taxable, if the total value exceed Rs.5,000).
- Expenses on credit cards, club membership etc.

3.4.2. TAXABLE PERQUISITES FOR SPECIFIC EMPLOYEES

Sometimes the employer gives his employees perquisites in the form of facilities or kind instead of paying monetary obligations or reimbursement of expenses to the employees. The value of these non-monetary facilities shall be taxable only in the hands of a specific employees under *section 17(2)(iii)*. The specific employee should be a full time/part time director in the employer's company *or*, he has acquired at least 20% or more equity shares in employer's company *or*, an employee whose taxable monetary income under the head 'income from salary' exceeds Rs.50,000. So, the perquisites which are taxable in the hands of specified employees are termed as 'specific perquisites'. These are of following categories -

(1) Motor Car Facility – The taxable value of motor car provided by the employer to

his employee shall be included in employee's salary. The employer may provide any one of following types of cars to the employee. On the other hand, the employee may have his own car which may be any one of the following types:

Small Car – Small car is that which is having engine capacity upto 1.6litres (1600 cc) or less.

Large Car – Large car is that which is having engine capacity of more than 1.6litres.

The following situations may occur in this connection –

Case A – When motor car is owned or hired by the employer -

(a) *If the motor car is used for official purpose* – In this case, the total taxable value of the perquisite shall be zero provided that the employer keeps the record of this.

(b) *If the motor car is used for private affairs by the employee or his family member and the running/maintenance expenses fully paid by the employer* – In this case, the value shall be determined as the sum actually spent by the employer for running and maintenance expenses of car (including wear and tear) and the remuneration paid by the employer to the car driver (if any).

Value = Amount spent on running and maintenance expenses of motor car by the employer + Remuneration of driver(*if any*) + 10% of actual cost of car/hire charges, if car is taken on hire (normal wear and tear) – Amount charged from employee for such use.

(c) *If the motor car is used partly for official and partly for private affairs by the employee or his family member* – In this case, the total taxable value of this perquisite shall be determined under following rates -

(i) If the whole expenses (running and maintenance) related with car are borne by the employer or reimbursed to the employee –

Value = Rs.1,800p.m (if capacity of the engine of car is upto 1600cc).

Rs.2,400p.m (if capacity of the engine of car is 1600cc or more).

Rs.900p.m for driver (*if any*).

Note: If the actual expenses are more than Rs.1,800, deduction of actual expenses may be claimed provided the employer keeps some records.

(ii) If the whole expenses (running and maintenance) related with car are borne by the employee –

Value = Rs.600p.m (if capacity of the engine of car is upto 1600cc).

Rs.900p.m (if capacity of the engine of car is 1600cc or more).

Rs.900p.m for driver (*if any*).

Case B – When motor car is owned by the employee himself -

(a) *If the motor car is used for official purpose* – In this case, the total taxable value of the perquisite shall be zero provided that the employer keeps the record of this.

(b) *If the motor car is used for private affairs by the employee or his family member and the running/maintenance expenses fully paid by the employer* – In this case, the value shall be determined as the sum actually spent by the employer on the private use of car by the employee, shall be included in the employee's salary.

(c) *If the motor car is used partly for official and partly for private affairs by the employee or his family member* – In this case, the total taxable value of this perquisite shall be determined under following rates -

(i) If the whole expenses (running and maintenance) related with car are borne by the employer or reimbursed to the employee –

Value = Rs.1,800p.m (if capacity of the engine of car is upto 1600cc).

Rs.2,400p.m (if capacity of the engine of car is 1600cc or more).

Rs.900p.m for driver (*if any*).

Less: The amount recovered from the employee.

Note: If the actual expenses are more than Rs.1,800, deduction of actual expenses may be claimed provided the employer keeps some records.

(ii) If the whole expenses (running and maintenance) related with car are borne by the employee – In that case, it will not be perquisite. Hence, its valuation shall be nil/zero.

Case C – Facility to provide more than one car to the employee by the employer – If the employer has more than one car or he has hired more than one car and the employee is entitled to use any one or all car frequently, the taxable value of this perquisite shall be determined in the following manner -

(i) The valuation of one car shall be done on the assumption that this car is being used for official purpose partially and for private purpose partially. In this case, Rs.1,800p.m or Rs.2,400p.m (depends upon car cc) and Rs.900 (if driver is provided).

(ii) The valuation of remaining other cars shall be done on the assumption that these cars are being used exclusively for private purpose. This means –

Value = Total expenses paid by the employer + total remuneration of driver +

10% cost of motor car – any amount paid by the employee or received

from employee regarding this.

Note: The valuation of separate car shall be done as per process described above and the least of these valuations shall be taxable value of car. These valuations shall be in the interest of the employee.

Case D – Facility to provide any vehicle other than motor car – Where the employee owns any automotive conveyance (other than car) and running/maintenance expenses are borne by the employer, then valuation will be as follows -

(i) When it is used wholly for official purpose -

Value = Nil or Zero.

(ii) When it is used partially for official and partially for private purpose -

Value = Actual expenditure incurred by the employee – amount used for official purpose or Rs.900 (whichever is higher) – the amount recovered from the employee.

Note: (i) Car provided to a Judge of High Court/Supreme Court is exempt from tax.

(ii) *For the valuation of motor car, the expression 'month' means a full calendar month. So, any part of the month is ignored. For instance, if an assessee used a car for 10.5 months, its valuation will be taken for 10 months only.*

(2) Sweeper, Gardener, Watchman Facility - The value of the perquisite in the case of sweeper, gardener, watchman shall be:

Salary paid or payable to the servant	****
<i>Less:</i> Amount recovered from employee	<u>**</u>
Value of Perquisite	*

(3) Gas, Electricity or Water Facility – The value of the perquisite shall be:

Amount paid by the employer to the agency providing gas, electricity or water
or

where, such supply is made from resources owned by the employer	****
<i>Less:</i> Amount recovered from the employee	<u>***</u>
Value of Perquisite	*

(4) Education Facility -

(1) Where the educational institution is owned or maintained by the employer or where free educational facilities are allowed in any other educational institution by reason of his being in employment of that employer, the value for the educational facility of the employee's children shall be:

- If the cost of such education or value of the benefit per child does not exceed Rs.1,000 p.m. = NIL

- If the cost or value exceeds Rs.1,000 p.m. per child = Cost of such education in a similar institution in or near the locality – Rs.1000 - Amount recovered from the employee.

(2) Education facility provided in any other educational institution to children or other household members of the employee - The value of facility shall be the expenditure incurred by the employer.

(5) Transport Facility -

Where an undertaking is engaged in the carriage of passengers or goods and it provides to any employee/any member of his household for private journey free of cost or at concessional fare, in any conveyance owned or leased by the undertaking for the purpose of transport of passengers or goods, the value of the benefit shall be the value at which such benefit is offered by the undertaking to the public.

If any amount is paid or recovered from the employee for such benefit or amenity, it shall be deducted from the aforesaid value.

Note: In case of an employee of an Airline or the Railways, the value of transport facility shall be exempt.

Illustration 3

Shree Gupta is a GM in a transport company on a salary of Rs.11,000p.m. The company has provided him with accommodation for which 10% of his salary is deducted. Actual rent paid by the company for the accommodation is Rs.54,000p.a. He is also receiving entertainment allowance of Rs.500p.m. He is provided by the company with a car having engine cubic capacity of 1.8 litres for his personal and official use but running and maintenance personal expenses for the same are borne by the assessee himself. Member's of the assessee's family have visited a number of places in company's buses for which no fare had been charged. Total fare for all buses visits during the accounting year amounted to Rs.7,200. He is receipt of bonus equivalent to 2 months salary. Compute his Gross Salary for the previous year 2016-17.

Solution

Computation of Income from Salary

(for the assessment year 2017-18)

Salary (Rs.11,000×12)	Rs.1,32,000
Bonus (Rs.11,000×2)	Rs.22,000
Entertainment Allowance (Rs.500×12)	Rs.6,000
Use of company buses for personal use	Rs.7,200
Car (Rs.900×12)	Rs.10,800
*Value of concessional house	<u>Rs.10,800</u>
Gross Salary	Rs.1,88,800
Less: Deductions u/s 16 (discussed in heading no. 3.5)	<u>Nil</u>
Income from Salary	Rs.1,88,800

*Working Note:**1. Valuation of Concessional House* =*

Salary = (Rs.1,32,000 + Rs.22,000 + Rs.6,000) = Rs.1,60,000

15% of Salary or Rent Rs.54,000 (whichever is less)	Rs.24,000
Less: 10% of salary being rent deducted	<u>Rs.13,200</u>
Valuation of concessional house	Rs.10,800

3.4.3. TAX-FREE PERQUISITES FOR ALL EMPLOYEES

The following perquisites are exempted from tax in the hands of every employee assessee -

(1) Medical Facility – (a) for treatment within India:

- The value of any medical treatment provided free to an employee or any member of his family in any hospital maintained by the employer.
- Any sum paid by the employer in respect of any expenditure incurred by the employee on medical treatment of himself/members of his family in a hospital maintained/approved by government.
- Premium paid by the employer on the health insurance of the employee/members of his family.
- If the medical treatment of the employee/member of his family is done at any private hospital, nursing home or clinic other than above, the exemption will be restricted to Rs.15,000.

(b) for treatment outside India:

- Any expenditure incurred by the employer on the medical treatment of the employee/member of his family outside India, is exempt in full.
- Any expenditure incurred by the employer on travel and stay abroad of the employee/member of his family for medical treatment, is also exempt in full.
- Any expenditure incurred by the employer on travel and stay abroad of one attendant who accompanies the patient for his treatment, is exempt in full.

Note: The expenditure on medical treatment and stay abroad will be exempt to the extent permitted by the Reserve Bank of India; and the expenditure on travel shall be exempt in the case of an employee whose gross total income (excluding this expenditure) does not exceed Rs.2 lakh.

(2) Tour and Travel Facility - Any conveyance, tour and travel (including foreign travel) facility provided by the employer to an employee is also exempt perquisite in the hands of the employee.

(3) Accommodation in a 'Remote Area' - Accommodation provided in a remote area to an employee working at a mining site or a project execution site of similar nature is an exempt perquisite.

(4) Transport Facility – Transport/Conveyance provided by an employer to his employee from his residence to office and from office to his residence, is exempt in full.

(5) Telephone/Mobile Facility - Telephone or mobile phone provided by the employer to an employee at his residence whose bill is also paid by the employer, is regarded as tax-free perquisite. The telephone/mobile may be used for his personal purpose.

(6) Refreshment Facility - Refreshment (tea or snacks) provided to all employees during working hours in office premises is exempt from tax.

(7) Lunch/Dinner - Lunch or dinner provided to an employee during working hours is an exempt perquisite provided that cost of such lunch/dinner to the employee is Rs.50 or less per meal.

(8) Employer's Contribution - Contribution made by an employer to employee's group insurance scheme/pension scheme, is a tax-free perquisite.

(9) Payment of Accident Insurance Premium - Annual premium paid by the employer on accidental insurance policy of his employee, is a tax-free perquisite if the beneficiary is the employer.

(10) Family Planning Facility - Any amount spent by the employer on employees to encourage family planning among them and the medical aid or expenditure incurred on it, is a tax-free perquisite.

(11) Scholarship to Employee's Children - Scholarship given by the employer to the children of an employee, is a tax-free perquisite.

(12) Interest Free Loan - Any loan provided by the employer to an employee either free of interest or at concessional rate of interest is a tax-free perquisite, if the amount of loan does not exceed Rs.20,000.

(13) Refresher Course or Training Facility - Any amount spent by the employer on training of employees (including lodging and boarding expenses) for a refresher course, is a tax-free perquisite.

(14) Conference - Any expenditure incurred by the employer for an employee in connection with a conference, such as conveyance, tour and travel, hotel expenditure or boarding and lodging expenses etc are the exempt perquisite.

(15) Travelling Expenses Paid or Reimbursed - Actual travelling expenses paid or reimbursed by the employer for the journey undertaken by the employee for business purpose are exempt.

(16) Free Education Facility - If education facility is provided by the employer to his employees children in an educational institute owned or maintained by the employer, such facility is an exempt perquisite to the maximum extent of Rs.1,000 per month per child. There is no restriction on number of children.

(17) Perquisites Given in Foreign Country - Perquisites given outside India by the Government to a Indian citizen for rendering services outside India, are tax-free perquisites.

(18) Goods Sold at Concessional Rates - Goods manufactured by the employer sold to his employees at concessional rates, is a tax-free perquisite.

(19) Ration - Free rations to personnel of armed forces are a tax-free perquisite.

(20) Free Accommodation to Ministers - Rent-free furnished residence (including maintenance) provided to a Union Minister, an Officer of Parliament or to an opposition leader in Parliament is regarded as tax-free perquisites.



Check Your Progress-B

Q1. What is the maximum deduction of free meal and the value of gift under the provisions of Income-tax Act.

.....

Q2. Discuss ‘Medical Facility’ under the category of tax-free perquisite of all employees.

.....

Q3. Mr. Philips, an employee in a firm, gets Rs.3,000p.m as salary, Rs.500p.m as dearness allowance and Rs.250p.m as city compensatory allowance. He is getting entertainment allowance of Rs.500 p.m. He is also getting a bonus equal to three months salary. He resides in Kanpur (with a population of more than 25 lakhs) in a house owned by the firm. Fair rent of the house is Rs.1,000 p.m. Compute his gross salary for

the assessment year 2017-18.

Q4. State the rules of valuation of perquisite of rent-free accommodation.

3.5 DEDUCTIONS FROM GROSS SALARY

The following deductions are allowed from gross salary in computing taxable salary or income from salary of a salaried employee are -

(1) *Entertainment allowance* [Sec. 16(ii)] – If a Government (Central Government or a State Government) employee is getting any entertainment allowance, it is first included in his salary income and thereafter, before computing taxable salary, a deduction, in respect of this allowance, is allowed under the Act. This deduction is the least of the following amounts:-

(a) 1/5 or 20% of the basic salary;

or

(b) Rs.5,000;

or

(c) Actual entertainment allowance granted during the previous year.

Note:

1. Salary means the basic salary and does not include any allowance, benefit or perquisite etc. Thus, dearness pay, which forms part of the basic salary, is not included in the salary for computing this deduction.

2. Expenditures in connection with entertainment of customers, incurred by a government employee do not in any way affect this deduction. This deduction will be allowed as per rules discussed here irrespective, of the fact that some expenditure has been incurred by the

employee who is getting this allowance, on the entertainment of customers. This deduction is allowed even if no amount is spent out of this allowance.

3. This deduction cannot exceed the actual amount received as entertainment allowance.
4. No deduction on account of entertainment allowance is given to a non-government employee.

(2) *Professional tax or tax on employment* [Sec. 16 (iii)] - Any amount paid by the assessee as professional tax or on account of a tax on employment within the meaning of clause (2) of article 276 of the constitution, levied by or under any law, will be allowed as deduction from his gross salary. In this connection following points need attention:

- (i) Professional tax is deductible only in the year in which it is paid. Professional tax due but not paid during the previous year shall not be allowed as deduction.
- (ii) There is no monetary ceiling for this deduction. Thus, if an assessee pays Rs.5,000 as professional tax during the previous year, he is entitled to deduction of Rs.5,000. However, the State Govt. cannot impose more than Rs.2,500 p.a.
- (iii) If the employer pays such tax on behalf of the employee, then it is treated as general perquisite u/s 17(iv) i.e. payment of obligation. It is first included in salary as perquisite and then deduction is allowed from the gross salary.

So, the process of computation of taxable salary can be depicted by the following chart –

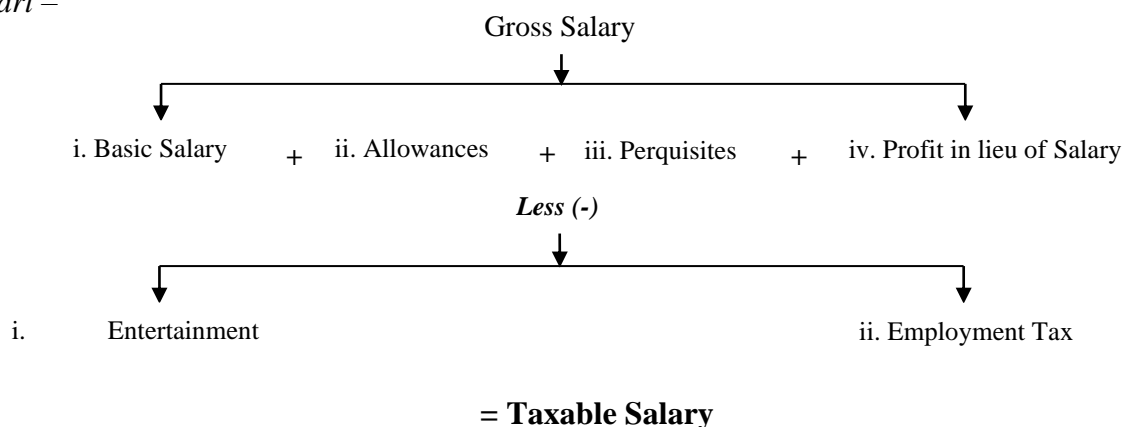


Illustration 4

The following particulars relate to the income of Mr. Rajendra for the year ending 31st March, 2017:

Basic salary @ Rs.15,000 p.m.

Dearness allowance @ 20% of salary;

Bonus and commission Rs.3,000 p.a.;

His own contribution to provident fund is equal to 12% of salary and the employer also contributes the same amount;

Interest deposited to recognized provident fund @ 8.5% Rs.3,000;

He has been provided with a facility of 1800 cc car for personal as well as official use. The entire expenses of car are borne by the employer company;

He has been provided with a furnished house in Auraiya, a city with a population of 6 lakhs, by the employer for which the employer company charges 10% of basic salary. The rental value of the house is Rs.1,250 p.m. The cost of furniture and other air-conditioning equipments equipped in the house amounted to Rs.5,000 and Rs.10,000 respectively. Their written-down value Rs.4,000 and Rs.8,000 respectively;

The employer has paid his personal loan of Rs.5,000 and also paid the life insurance premium of Rs.2,000 on his life insurance policy.

The employee paid Rs.1,500 as professional tax to the State Government.

Compute the income from salary of Mr. Rajendra for the assessment year 2017-18.

Solution

Computation of Income from Salary

(for the assessment year 2017-18)

Salary (Rs.15,000×12)	Rs.1,80,000
Dearness allowance @ 20% of basic salary	Rs.36,000
Bonus and commission	Rs.3,000
Employer's contribution to RPF in excess of 12% of salary	NIL
Car Facility (1800 cc @ Rs.2,400p.m.)	Rs.28,800
Concessional rent-free house	NIL
Personal loan paid by the employer	Rs.5,000
Life insurance premium paid by the employer	<u>Rs.2,000</u>
Gross Salary	Rs.2,54,800
Less: Professional tax (Deductions u/s 16)	<u>Rs.1,500</u>
Taxable Salary/Income from Salary	Rs.2,53,300

Working Note:

1. Value of concessional rent-free furnished house is as follows -

Valuation = 7.5% of Rs.1,83,000 (salary, bonus/commission) + 10% of cost of furniture or A.C (Rs.15,000) – Rent paid by the assessee (10% of Rs.1,80,000 of basic pay) = NIL

Illustration 5

Mrs. 'A' a resident individual, is directed in 'ABC' Ltd., New Delhi. She furnishes the following particulars for the year ending on 31st march, 2017:

Salary @ Rs.30,000 p.m.

Dearness allowance @ 10% of salary;

Children education allowance (for two children) Rs.3,600

Entertainment allowance Rs.500p.m

Payment of employee's gas, electricity and water bills Rs.4,200

Own contribution to recognized provident fund Rs.36,000 and the employer's contribution to this fund Rs.46,000

Bonus Rs.10,000

She is provided with a 1500 cc car which is owned by the employer and all the expense of its running and maintenance expenses are met by the employer. She is also provided with a driver for the said car for which no charge is made from her by the employer. 'A' uses the car for the personal purpose also.

Life insurance premium paid by the employer amounted to Rs.5,000

She is provided with rent-free unfurnished accommodation for which annual rent of Rs.60,000 is paid by the company.

Compute her taxable salary for the assessment year 2017-18.

Solution

Computation of Income from Salary

(for the assessment year 2017-18)

Salary (Rs.30,000×12)	Rs.3,60,000
Dearness allowance @ 10% of basic salary	Rs.36,000
Bonus	Rs.10,000
Education allowance (Rs.3,600 – Rs.2,400)	Rs.1,200
Entertainment allowance	Rs.6,000
Employer's contribution to RPF in excess of	
12% of salary [Rs.46,000 – Rs.43,200 (12% of Rs.3,60,000)]	Rs.2,800
Rent-free accommodation	Rs.56,580
Car Facility (Rs.1800 + Rs.900 (driver))	Rs.32,400
Life insurance premium paid by the employer	Rs.5,000
Payment of gas, electricity and water	<u>Rs.4,200</u>

Dearness Allowance **30% of basic salary**

Telephone allowance **Rs.500p.m**

Medical insurance premium paid by the employer on the health of employee **Rs.4,000**

Salary of house-keeper reimbursed by the employer **Rs.24,000**

Mr. Anuj paid employment tax **Rs.2,000.**



3.6 SUMMARY

1. Types of allowances:

(a) *Fully Taxable Allowances* - Dearness allowance, city compensatory allowance, tiffin/lunch allowance, non practicing allowance, warden or proctor allowance, overtime allowance, fixed medical allowance, servant allowance.

(b) *Partially Taxable Allowances* - Children education allowance, children hostel allowance, transport allowance, daily allowance, conveyance allowance, house rent allowance (H.R.A.).

(c) *Fully Exempt Allowances* - Academic allowance, uniform allowance, allowance to high court judges, allowance received from United Nations Organisation (UNO), allowance to chairman or members of UPSC, foreign allowance.

2. Types of Perquisites:

(a) *Taxable perquisites for all employees* - Rent-free accommodation, concessional rent-free accommodation, payment of employee's obligations by employer, payment of employee's life insurance and annuity premium, specified security or sweat equity shares allotted/transferred to an employee, employer's contribution to an approved superannuation fund, value of any other fringe benefits.

(b) *Taxable perquisites for specific employees* - Motor car facility, sweeper, gardener, watchman facility, gas, electricity or water facility, education facility, transport facility.

(c) *Tax-free perquisites for all employees* - Medical facility, tour and travel facility, accommodation in a 'remote area', telephone facility, refreshment facility, payment of accident insurance premium, family planning facility, scholarship to employee's children, interest free loan, training facility, travelling expenses paid or reimbursed, free education facility, perquisites given in foreign, goods sold at concessional rates, ration, free accommodation to ministers.

3. Deductions From Gross Salary - *Entertainment allowance* [Sec. 16(ii)] and *Professional tax or tax on employment* [Sec. 16 (iii)].



3.7 GLOSSARY

House Rent Allowance (H.R.A.) [Sec 10(13A)] – It is exempt from tax to the extent of least of the following three amounts:

- a. House Rent Allowance actually received by the assessee; *or*
- b. Excess of rent paid by the assessee over 10% of salary; *or*
- c. An amount equal to 50% of salary (if the accommodation is situated in Mumbai, Kolkata, Delhi, Chennai) or, an amount equal to 40% of salary (if the accommodation is situated in any other place).

Note: Salary for the purpose of HRA = Basic Salary + Dearness Allowance (if part of salary) + Commission (if fixed % of turnover).

Entertainment allowance [Sec. 16(ii)] – If a Government employee is getting any entertainment allowance, it is first included in his salary income and

thereafter, before computing taxable salary, a deduction, in respect of this allowance, is allowed under the Act. This deduction is the least of the following amounts:-

(a) $\frac{1}{5}$ or 20% of the basic salary;

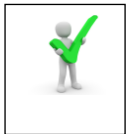
or

(b) Rs.5,000;

or

(c) Actual entertainment allowance granted during the previous year.

Note: Salary means the basic salary and no deduction on account of entertainment allowance is given to a non-government employee.



3.8 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress –A

Ans. 2 Rs.39,000

Check Your Progress –B

Ans. 3 Rs.68,100

Check Your Progress –C

Ans. 3 Rs.8,10,000 (Gross Salary), Rs.8,08,000(Taxable Salary)



3.9 REFERENCES

- Singhania, V.K and Singhania, K. 2017. *Direct Taxes Law and Practice with Special Reference to Tax Planning, 57th Edition*. Taxmann Publications, New Delhi.
- Agarwal, B.K. and Agarwal, Rajeev. 2017. *Income Tax Law and Accounts*. Nirupam Sahitya Sadan, Agra.
- Jain, R.K. 2017. *Income Tax Planning and Management*. SBPD Publications, Agra.



3.10 SUGGESTED READINGS

1. Rule 2(h) of Schedule IV Part A.
2. CIT v.S.S.M. Ligappan (1981) 7 Taxman 71 (Mad.).
3. ITO v. All India Vijaya Bank Officers Association (1997) 225 ITR 37 (Cal.).



3.11 TERMINAL QUESTIONS

- Q1. Discuss the allowances which are included in the computation of taxable salary.
- Q2. Km. Renu, resident of Goa, is employed in a company on Rs.15,600p.m. She gets dearness allowance @ Rs.3,000p.m under the terms of employment and a commission @5% on total sale effected by him which amounts to Rs.2,50,000 during previous

year. She gets house rent allowance @ Rs.2,500p.m, whereas she pays rent @ Rs.4,750p.m. Calculate taxable HRA.

Q3. Mr. Rehman, an employee in the department of education Govt. of Uttar Pradesh, gets Rs.16,000p.m. as salary and Rs.4,000p.m. as entertainment allowance. He has been provided with a concessional rent-free house, owned by the Govt. of Uttar Pradesh, for which the Govt. deducts 10% of his basic salary. Licence fee determined by the State Govt. for this house is Rs.23,500p.a. He is also provided with a 2000 cc car of the Govt. for his official & private use. All expenses of car are incurred by the Govt. Compute his taxable salary for the assessment year 2017-18.

Q4. State the provisions of Income-tax Act relating to those perquisites which are taxable in case of specific employees.

Q5. Compute taxable income under the head 'Salary' of Mr. Bhatnagar (an employee of a company) for the assessment year 2017-18:

Salary @ Rs.5,000 p.m;

Dearness allowance Rs.3,500p.m;

Entertainment allowance Rs.1,000p.m;

Employer's contribution to recognised provident fund is Rs.7,400. His own contribution was Rs.7,400;

Interest @ 10%p.a. on credit balance of recognized provident fund amounted to Rs.10,000;

City compensatory allowance Rs.5,00p.m;

Medical allowance Rs.1,200p.m;

He has been provided with a large car facility for personal as well as official use. The employer bears all expenses of the car.

He has been provided with a unfurnished house by the employer in a city (population 12 lakh). The fair rental value of the house is Rs.30,000p.a. Employer charges Rs.500p.m from him as rent.

UNIT 4 INCOME FROM HOUSE PROPERTY AND TAX PLANNING

- 4.1 Introduction**
- 4.2 Objectives**
- 4.3 Basis of Charges**
- 4.4 Essential Conditions**
- 4.5 Deemed Ownership**
- 4.6 Exempted Incomes**
- 4.7 Composite Rent**
- 4.8 Annual Value**
- 4.9 Computation of Annual Value**
- 4.10 Deductions**
- 4.11 Tax Treatment of Self Occupied Houses**
- 4.12 Important Points**
- 4.13 Summary**
- 4.14 Glossary**
- 4.15 References**
- 4.16 Suggested Readings**
- 4.17 Terminal Questions**

4.1 INTRODUCTION

The annual value of property consisting of any buildings or lands appurtenant thereto of which assessee is the owner shall be subject to Income-tax under the head 'Income from house property' after claiming deduction under section 24 provided such property, or any portion of such property is not used by the assessee for the purposes of any business or profession carried on by him.

4.2 OBJECTIVES

The contents of this unit will help you to understand;

- The meaning and chargeability of house property.
- Determination of annual value.
- Concept of let out houses and self-occupied houses.
- Deductions available from annual value.
- Computation of taxable income from house property.

4.3 BASIS OF CHARGES

As per section 22 The annual value of property consisting of any buildings or lands appurtenant thereto of which assessee is the owner shall be subject to Income-tax under the head 'Income from house property'

The basis of calculating income from house property is the annual value. This is the inherent capacity of the property to earn income. Income from house property is perhaps the only income that is charged to tax on a notional basis. The charge is not because of the region of any income but is on the inherent potential of house property to generate income. The annual value is the amount for which the property might reasonably be expected to let from year to year.

4.4 ESSENTIAL CONDITIONS

The following three conditions must be satisfied before the income of the property can be taxed under the head "Income form House Property" ;

- (i) The property must consist of buildings and lands appurtenant thereto.
- (ii) The property may be used for any purpose, but it should not be used by the owner for the purpose of any business or profession carried on him, the profit of which is chargeable to tax. If the property is used for own business or profession it shall not be chargeable to tax.
- (iii) The assessee should be the owner of such house property.

Income from buildings or lands appurtenant thereto- Income tax is payable by assessee on the income of any building or land appurtenant thereto, Income from an open land not attached to any building is not chargeable to income-tax under this head; Income from open land will be taxed under this head only when it is attached to a building. Open land attached to

a building may be in the shape of courtyard or a compound or playground or a lawn or a parking place etc. The word 'Building' has not been defined in Income tax Act, 1961. Building, as defined in different leading cases by courts, means a place regarded as building. An enclosure without roof may be regarded as building such as stadium an open air swimming pool, music house, dancing home etc. But a residential building the way to the house, gallery, kitchen-garden, play-ground, garage and a place for keeping animals etc. Income from building whether situated in India or outside India is taxable under the head 'Income from house property'. Tax on foreign buildings is chargeable from house property; A land would be called land appurtenant to building if it is indivisible part and parcel of the building for its use and enjoyment by the occupier and the land is not yielding any income assessable under the head other than 'Income from house property.'

Property is not used by the assessee for his business or profession- If the property or a portion of it is occupied by the assessee for the purpose of his own business or profession and the profits of such business or profession are taxable, the annual value of such property or such portion is not taxable under income from house property.

Assessee should be the owner of the property- An assessee is chargeable to income-tax on income from buildings or lands attached thereto if he is the owner of such buildings or lands attached thereto. Ownership means the legal ownership and not beneficial ownership; The owner is that person who can exercise the rights of the owner not on behalf of the owner but his own right. It is not necessary that the owner of a house must also be the owner of a house on land on which the house is constructed. Thus the person constructing a house on land taken on lease is deemed to be the owner of the house. Similarly, if an assessee is in occupation of a building as owner as a matter of fact, though the sale-deed any may not, yet have been executed. he would still be deemed as owner of the building and liable to tax on its income. If the property is in the name of one person whereas its real owner is somebody else. Assessing officer may find out the real owner and fix on him the tax-liability. A receiver appointed by the court to manage a property cannot be assessed as the owner of the property.

So it is clear that tax-liability on the income of the house property is of the owner of such house property. If any house property is mortgaged, the mortgagor and not the mortgagee is the owner of the house property. Similarly, lessor is the owner of the property leased to the mortgagee or lessee, it will be chargeable to tax under the head 'Income from other sources' ,if a tenant sub-lets a property and earns some income from it, such income would be taxable under the head 'Income from other Sources'.

4.5 DEEMED OWNERSHIP

Deemed ownership- According to Section 27 of the Act, the following persons are treated as deemed owner of the house property:-

- (i) Transfer without adequate consideration – An individual who transfers, without adequate consideration any house property to his or her spouse, not being 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.
- (ii) Holder of an impartible estate- The holder of an impartible estate shall be deemed to be the individual owner of all the properties comprised in the estate.
- (iii) House allotted or leased under any house building scheme- A member of a co-operative society, company or other association of persons to whom a building or part thereof is allotted or leased under a house building scheme of the society, company or association, as the case may be, shall be deemed to be the owner of that building or part thereof.
- (iv) Person in possession of any building – A Person, who is allowed to take or to retain possession of any building or part thereof in part performance of a contract, shall be deemed to be the owner of that building or part thereof.
- (v) Acquiring rights in a building- A person who acquires any rights (excluding any right by way of a lease from month to month or for a period not exceeding one year) in or with respect to any building or part thereof, shall be deemed to be the owner of that building or part thereof.
- (vi) Acquiring property under a power of attorney transaction- If a person has acquired a property under ‘power of attorney transaction’, he shall be deemed of the property although he may not be a ‘registered owner’ of the property. Thus, if under an agreement of purchase and sale, the purchaser who has not actually made payment but he is ready to make payment on its becoming due, the purchaser shall be deemed as owner of the property. Similarly, if the purchaser has taken possession of the property or has right to enter upon and exercise acts of possession effectively; he shall be deemed as owner of the property.



Check Your Progress-A

Q1. What do you mean by Annual Value?

.....

.....

Q2. What are the three conditions must be satisfied before the income of the property can be taxed under the head “Income form House Property” ?

Q3. What do you mean by Deemed ownership?

4.6 EXEMPTED INCOMES

Fully exempt incomes- The following incomes, though received from house property, are fully exempt from income-tax as per the provisions of Income-tax Act 1961:-

- (1) Income from a farm house, situated on or near the agricultural land which is used by the agriculturist for his own residence or for keeping the agricultural implements or for storing the produce of the land, is exempt from income-tax.
- (2) The annual value of any one palace in the occupation of an ex-ruler is exempt u/s 10 (19-A)
- (3) Income from house property owned by the following is exempt from tax:-
 - (i) The income of a local authority which is chargeable under the head ‘Income from house property’ is exempt u/s 10 (20)
 - (ii) Property income of an approved scientific research association is exempt u/s 10 (21).
 - (iii) Property income of any university or other institution existing solely for educational purposes and not for purpose of profit is exempt u/s 10 (23-C).
 - (iv) Property income of any hospital or other institution existing solely for philanthropic purposes and not for purpose of profit is exempt u/s 10 (23-C).
 - (v) Property income of a registered trade union is exempt u/s 10(24).
 - (vi) Property income of a person who is resident of Ladakh ,is exempt u/s 10(26A)
 - (vii) Property income of a political party, is exempt u/s 13-A.

- (viii) Property income held by a trust wholly for religious and charitable purposes is exempt u/s 11.
- (4) Income from house property used by the owner for his own business or profession, the profits of which are chargeable to tax, is exempt u/s 22.
- (5) Income from any one residential self-occupied house of the assessee is exempt from tax u/s 23 (2).
- (6) Income of a residential house owned by the assessee which could not be occupied by him or no profit could be derived from it by the assessee on account of his residing at some other place due to his employment or business purposes is exempt u/s 23 (3).

Partly exempt incomes:

The following property income are included in assessee's total income but are not liable to tax-

- (1) Income derived by a co-operative society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities is wholly deductible u/s 80-P (2) (e).
- (2) Property income of a co-operative society is fully deductible u/s 80-P (f), provided the Gross total income of the society does not exceed Rs 20,000 and the society engaged in the performance of any manufacturing operations with the aid of power.

4.7 COMPOSITE RENT

In certain cases, the owner charges rent from the tenant not only on account of rent for the house property but also on account of various facilities/services provided with the house. Such rent is known as composite rent. The said composite rent can fall under 2 categories:

- (a) Composite rent on account of rent for the property and for various facilities/ services provided along with the house like lift, gas, water, electricity, watchmen and air conditioning etc. In this case such composite rent should be split up and the portion of rent attributable to the letting of the premises shall be assessable as 'Income from House Property'. The other portion of the composite rent received for rendering facilities or services shall be assessable as "Income from Other Sources".
- (b) Composite rent on account of rent for the property and the hire charges of machinery, plant or furniture belonging to the owner. In this case if the letting of the property is separable from the letting of the other assets, then the portion of the rent attributable to the letting of the premises shall be assessable as "Income from House Property" and the other portion of the composite rent for letting other assets shall be assessable

either as “Profits and Gains of Business or Profession “ or “Income from Other Sources” . On the other hand, if the letting of the property is inseparable from the letting of other assets like machinery, furniture the entire income would be taxable as “Profits and Gains of Business or Profession” or “Income from Other Sources”.

4.8 ANNUAL VALUE

As per section 23 (1) (a) the annual value of any property shall be the sum for which the property might reasonably be expected to be let from year to year. It may neither be the actual rent derived nor the municipal valuation of the property. It is something like notional rent which could have been derived, had the property been let. In determining the annual value there are four factors which are normally taken into consideration. These are:

- ❖ **Actual rent received or receivable:** It is the actual amount of rent received from a rented property. Actual rent received /receivable is an important factor in determining the annual value of a property though this is not the only decisive factor. The actual rent could be dependent upon various considerations. There could be circumstances where the owner agrees to bear certain obligations of the tenant e.g. the water and electricity bills of the tenant may be payable by the owner. In this case the de facto rent (ie. what should have been the actual rent) will be calculated by reducing from the rent received/ receivable the amount spent by the owner on meeting the obligation of water and electricity bills of the tenant as we have to tax rent from house property under this head and not the amount recovered for other services provided in the nature of electricity and gas bills. On the other hand, if any obligation of water and electricity bills of the owner is met by the tenant, the de facto rent will be computed by adding to the rent received/ receivable ,the amount spent by the tenant in discharging the obligation of the landlord .
- ❖ **Municipal Value:** This is value as determined by the municipal authorities for levying municipal taxes on house property. Municipal authorities normally charge house tax/municipal taxes on the basis of annual letting value of such house property, which is determined by its based upon many considerations. Such valuation is a strong evidence of the earning capacity of the property.
- ❖ **Fair rent of property:** Fair rent is the rent which is similar property can fetch in the same or similar locality, if it is let out for a year.
- ❖ **Standard rent:** The standard rent is fixed under the Rent Control Act. If the standard rent has been fixed for any property under the Rent Control Act, the owner cannot be

expected to get a rent higher than the standard rent fixed, under the Rent Control Act. Therefore, this is also an important factor in determining the annual value.

4.9 COMPUTATION OF ANNUAL VALUE

The annual type of any property shall be the sum for which the property might reasonably be expected to be let from year to year. As per the act the annual value is the value after deduction of municipal taxes and unrealized rent (if any). The annual value may be determined in the following two steps-

- (1) Determine the gross annual value.
- (2) From the gross annual value deduct municipal taxes actually paid by owner paid by owner during previous year.

The balance shall be the annual value or net annual value. Annual value has to be determined for following categories of house property:

Annual Value of Let out house property:

Where the property or any part of the property is let out throughout the previous year the gross annual value shall be computed as under-

- (1) Compare fair rent and municipal valuation and select the higher.
- (2) Compare the rent so selected with standard rent and lower of the two shall be considered to be expected rent.
- (3) Compare expected rent with rent received or actual rent and the higher shall be considered to be gross annual value.

Where the property or any part of the property was vacant throughout the previous year or part of the previous year the gross annual value shall be computed as under-

In above cases expected rent shall be computed for 12 months but while computing actual rent, rent for the vacancy period shall be excluded and gross annual value shall be higher of expected rent and actual rent, but if the actual rent is less than the expected rent owing to vacancy in this case actual rent shall be gross annual value.

Annual Value of Self-occupied house property:

Self-occupied house property means the house property used by its owner for his own residential purpose. In order to determine the annual value of such house property, it has been classified into the following:

(1) **House property fully utilized throughout the previous year for self residential purpose [Sec 23(2) (a)]** – Where the property consists of a house or part of a house in the occupation of the owner for his own residence, the annual value of such house or part of the house shall be taken to be Nil, if the following two conditions are satisfied:-

- (a) the property or part thereof is not actually let during whole or any part of the previous year; and
- (b) The owner has not derived any other benefit from the property during the previous year.

It must be noted than no deduction is allowed in respect of such building. But the deduction for interest on loan taken for the purchase, construction or renewal of the building is allowed subject to maximum of Rs. 30,000 or Rs. 2, 00,000 as the case may be, for the entire previous year.

(2) **House property not fully utilized for self-residential purpose [Sec. 23(2) (b) &23(3)]** – Such house property can be divided into three groups :-

(i) **House property which is not actually occupied by the owner** – Where the property consists of house or part of a house which is not actually occupied by the owner during the previous year and the following are satisfied, the annual value of such property (house or part of the house) shall be taken to *NIL*

- (a) The house property is not actually occupied by the owner by reason of the fact that owing to his employment, business or profession carried on at any other place;
- (b) He resides at that other place in a building not owned by him;
- (c) Such house property or part thereof is not actually let-out during whole or any part of the previous year; and
- (d) The owner has derived no other benefit from such house property.

(ii) **House property a part of which is self-occupied and remaining part is let out-** Where the property consists of a house which has two or more independent residential units, one of which is self-occupied for own residential purposes and other unit or units are let-out, value of such house property, shall be computed as follows -:

- (a) Annual value of residential unit shall be taken to be ‘Nil’.
- (b) Annual value of rented unit or units shall be computed in the same manner discussed earlier in this chapter under the heading ‘annual value of let-out house property.’

(iii) **House property which is self-occupied for a part of the previous and let-out for the remaining part of the previous year-** Where the property consists of a

house which is let-out for a part of the previous year and self-occupied for the remaining part of the previous year, annual value of such house property shall be computed as if the necessary is let-out throughout the previous year. No concession for self-occupied period will be given. Its expected rent shall be taken for full year but actual rent received or receivable shall be taken only for the period for which it is actually let out.

- (3) **More than one self-occupied house properties [Sec. 23 (4)]** – If an assessee is owner of more one house and uses, then them for his own residence, the annual value of only of these self-occupied houses is taken as ‘Nil’ . Remaining houses shall be deemed to be let out and their annual value shall be calculated as let out houses. Which of the houses is treated as self-occupied are deemed to be let out house. The assessee should choose the house in such a manner that his taxable income form house property is the minimum. Such option can be changed from year to year.

MUNICIPAL TAXES:

Municipal taxes (like house tax, service tax, local tax) levied by any local authority in respect of the house property are deductible only if these taxes are borne and actually paid by the owner during the previous year. It doesn't matter whether the taxes belong to the earlier years, current year or next years.

If property is situated in a foreign country, municipal taxes levied by foreign local authority are deductible (if such taxes are paid by the owner).

UNREALIZED RENT:

Unrealized rent is the rent which the owner could not realize.

Unrealized rent shall be excluded from rent received/ receivable only if the following conditions are satisfied [**Conditions of Rule 4**]:

1. The tenancy is bonafide.
2. The defaulting tenant has vacated, or steps have been taken to compel him to vacate the property.
3. The defaulting tenant is not in occupation of any other property of the assessee.
4. The assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfies the Assessing Officer that legal proceedings would be useless.

4.10 DEDUCTIONS

STANDARD DEDUCTION:

30% of Net Annual Value is deductible from annual value irrespective of any expenditure incurred by the assessee. Thus, no deduction can be claimed in respect of expenses on insurance, ground rent, land revenue, repairs, collection charges, electricity, water supply, salary of liftman, etc.

INTEREST ON BORROWED CAPITAL:

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

Let out property: - Interest on loan is allowable as a deduction on accrual basis if the money borrowed is utilized for acquiring, constructing, repairing, renewing or reconstructing the house property. In case of let out property, the whole amount of interest on loan is allowed as deduction. Interest on a loan taken to repay an earlier loan taken for house property; is also deductible. But interest payable on unpaid interest is not deductible. If the amount borrowed is not utilized for the purpose mentioned above, deduction for interest will not be allowed and if it has already been allowed, it will be withdrawn by the reassessment. Similarly no deduction will be given for brokerage or commission for arranging the loan.

Self occupied Property:- If the loan has been utilized to acquire or construct self-occupied house property, interest on such loan is allowed as deduction upto a maximum of Rs. 30,000 per annum. Interest in excess of Rs. 30,000 p.a. will not be deductible.

But if the loan is taken for acquisition or construction of house property on or after April 1, 1999 and acquisition or construction of property is completed within three years from the end of the financial year in which the capital was borrowed, then the interest on capital borrowed will be deductible up to Rs. 2,00,000 instead of Rs. 30,000 provided the person extending loan certifies that such interest is payable in respect amount outstanding under an earlier loan taken for such acquisition or construction.

It must be kept in mind that maximum limit of Rs. 2,00,000 is only to the borrowed capital which has been taken only to acquire or to construct the house property . If the loan is taken to repair, renewal or reconstruction of the house, then the ceiling limit shall be only Rs. 30,000 even if the loan is taken on or after April 1, 1999.

In other words deduction of 30,000 is allowed for the purpose of repair, renewal, or reconstruction of the house property and deduction of 2,00,000 is allowed only for acquisition or construction of house property, subject to above conditions being satisfied.

Interest of pre-construction period:- Interest on loan, taken for the purposes of construction or acquisition pertaining to the period prior to the previous year in which such property has been acquired or constructed, will be deducted in five equal annual installments beginning with the previous year in which the house is acquired or constructed. The first installment is deductible in the year in which construction of property is completed or in which property is acquired. For this purpose 'pre-construction period' means the period beginning on the date of borrowing and ending on 31st March immediately before the date of completion of construction/date of acquisition or date of repayment of loan, whichever is earlier.

Interest of the previous year in which the construction is completed or acquisition is made is allowed as, deduction during the assessment year if the construction is completed or the acquisition is made on the last date of the previous year 2016-17 shall be deducted in the assessment year 2017-18 and the interest up to March 31, shall be 'pre-construction period interest'.

**- Computation of Taxable Income from House Property -
(For the A.Y. 2017-18)**

Gross Annual value	-	
Less: - Municipal Tax (Paid by owner during previous year)	-	-
Unrealized rent (If conditions are satisfied)	-	-
Annual value	-	
Less:- Deductions U/S 24:		
(i) Standard deduction (30% of Annual value)		
(ii) Interest on Loan	-	-
For previous year	-	-
1/5 for prior to construction		
Taxable Income from House property.	-	-

4.11 TAX TREATMENT OF SELF OCCUPIED HOUSES

Self – Occupied Property	Tax Treatment
If such property is used by the owner for the purpose of carrying on his business or profession	No income is taxable under the head “Income from house property” but taxable under the head “Profits and gains of business or profession”
[Sec. 23(2)(a)]: If such property is used throughout the previous year for own residential purposes, it is not let out or put to any other use	Annual value will be nil. Only interest on borrowed capital is deductible subject to a maximum ceiling of 30,000 or 2,00,000 depending upon the case
[Sec. 23(2)(b)]: If such property could not be occupied throughout the previous year because employment, business or profession of the owner is situated at some other place and he has to reside at that other place in a building not owned by him	Annual value will be nil. Only interest on borrowed capital is deductible subject to a maximum ceiling of 30,000 or 2,00,000 depending upon the case
When a part of the property (being independent residential unit) is self-occupied and the other part is let out	Income from the independent unit (which is self-occupied) will be taxable as self-occupied property and income from the unit which is let out is taxable as if the unit is let out
When such property is self-occupied for a part of the year and let out for the other part of the year	Taxable as a let out property
Where a person has occupied more than one property for his own residential purpose	Only one property (according to his own choice) is treated as self-occupied and all other properties will be taken as deemed to be let out

Example:

Shri Sunil sharma is the owner of house which was completed on 1st January, 2009 and let-out to a man for residential purpose on a monthly rent of Rs. 2,500. Its municipal value is Rs. 35,000. Fair rent of the locality is considered to be Rs. 40,000. The owner has paid municipal tax @ 10% of municipal value. The owner claims the following expenses: (i) Fire insurance premium Rs. 1,200; (ii) Ground rent Rs. 1750; (iii) Repairs and white-washing and painting etc. Rs. 5,000; (iv) Water connection Rs. 3,000; (v) Collection charges Rs. 1,500; (vi) Interest on loan taken from a housing board Rs. 2,250.

Determine taxable income from house property for the assessment year 2017-18

Solution:**TAXABLE INCOME FROM HOUSE PROPERTY OF SUNIL SHARMA**

(For the assessment year 2017-18)

Higher of municipal value or fair rent; or Rent received / receivable (whichever is greater)		Rs.	
			40,000
Less: Municipal taxes paid by the owner @ 10% of MV			3,500
	Annual value		36,500
		Rs.	
Less: Deductions :			
Standard deduction @30% of annual value		10,950	
Interest on loan		2,250	13,200
	Income from house property		23,300

Example:

Mr. Manoj Devgun is the owner of a house which is let-out for residential purposes. The particulars of the property are as follows:- Municipal rental value Rs. 24,000 ; Actual rent Rs.

2,500 p.m ; Rent payable under Rent control Act Rs. 28,000. Fair rent of the house is Rs. 36,000. He paid municipal taxes @ 20% of the municipal value. He also pays education & health cess @ 5% of the municipal value. The construction of the property was completed on 1st August, 2009. He incurred the following expenses which he claimed deduction -: (i) Interest on loan Rs. 6,000 (ii) Repairs & collection charges Rs 8,000; (iii) Insurance premium paid Rs. 1,000; (iv) Ground rent due for the previous year but not paid Rs 1,500; and (v) Land revenue due Rs 500.

Compute the taxable income from house property for the assessment year 2017-18.

Solution:

TAXABLE INCOME FROM HOUSE PROPERTY OF MANOJ DEVGUN

(For the assessment year 2017-18)

Higher of MV or FR not exceeding the standard rent		Rs.
Or.		
Rent received/receivable		
(whichever is greater)	Rs.	30,000
Less: Municipal taxes paid by the owner @ 20% of MV	4,800	
Education & health cess @ 5% of MV	12,00	6,000
		24,000
		Rs.
Less: Deductions :		
Standard deduction @30% of annual value	7,200	
Interest on loan for the previous year	6,000	13,200
		10,800
Income from house property		10,800

Example:

Mr. Harjeet Singh is owner of a big house, the construction of which was completed in April, 2013. 50% of the floor area is let-out for residential purposes on a monthly rent of Rs. 4,000; this portion remains vacant for 1 month during the year 2016-17. 25% of the floor area is used by the owner for his profession, while remaining 25% of the floor area is utilized for the purpose of his residence. Other particulars of the house are as follows-

	Rs.
Municipal valuation	90,000
Standard rent	1,00,000
Municipal taxes (paid)	15,000
Repairs	7,000
Interest on capital borrowed for repairs	35,000

Compute the taxable income from house property of Mr. Harjeet Singh for the assessment year 2017-18

Solution:**COMPUTATION OF TAXABLE INCOME FROM H.P OF Mr. HARJEET SINGH**

(For the assessment year 2017-18)

50% of the house : (Let-out)	Rs.
MV. (Rs. 45,000) not exceeding the standard rent (Rs. 50,000)= 45,000	
Or.	
Actual Rent received/receivable of ½ portion (Rs. 44,000, as actual rent received is less only due to vacancy, hence actual rent received will be	
Gross annual value	

		44,000
Less: Municipal taxes (1/2 of Rs. 15,000)		7,500
	Annual value	
	Rs.	36,500
Less: Deductions :		
Standard deduction @30% of annual value	10,950	
½ of interest on loan taken for repairs	17,000	
		28,450
	Income from 50% portion of house	
		8,050
25% of the house: (used for own profession not taxable under this head)		
		Nil
25% of the house: (self-occupied)		
Annual value	Nil	
Less : Deductions- Interest on loan ¼ of Rs. 35,000	8,750	
	Income from self occupied portion (loss)	
		(-) 8,750
	Income from house property (loss)	
		(-) 700

4.12 IMPORTANT POINTS

RECOVERY of UNREALIZED RENT-Where a deduction has been allowed (in the assessment year 2001-02 or earlier years) in respect of unrealized rent and subsequently during any previous year the assessee has realized any amount in respect of such rent, the amount so realized will be chargeable to tax under the head "Income from house property" without making any deduction under sections 23 and 24.

PROPERTY OF CO-OWNERS- Where a property is owned by two or more persons jointly and their respective shares are definite and ascertainable, income from such property shall not be assessed as association of persons, but the share of each such person from the property shall be included in their total income. If any portion of the house property of a co-owner is occupied by him for his own residence, that portion will be treated as self occupied house and its annual value will be NIL.

INTEREST NOT DEDUCTIBLE- Any interest chargeable under the act, which is payable outside India on which tax has not been paid or deducted at source in respect of which there is no person in India who may be treated as an agent, shall not be deducted in computing the Income from house property.

HOUSE PROPERTY IN ABROAD- Income from house property situated in abroad is taxable only in the case of residents. If such property is taxed in India it will be taxable under the head Income from house property and its annual value shall be computed as if the property is situated in India.

SELF OCCUPATION RELIEF- Self-occupation relief is available to an individual and Hindu undivided family only, because only a natural person can occupy a house for his residential purpose. Thus, a firm, a limited company, an association of persons, club, corporation or an institution can not claim this concession as they cannot occupy a house for residential purposes.

LOSS FROM HOUSE PROPERTY- Annual value of self occupied house is taken as NIL, Only interest on loan is deductible from annual value up to 30,000 or 2,00,000 as the case may be. Therefore, there may be a loss in respect of such property up to a maximum of 30,000 or 2,00,000.

4.13 SUMMARY

- The annual value of a property consisting of any buildings or lands appurtenant thereto of which assessee is the owner shall be chargeable to tax under the head Income from house property.

- A property might remain vacant for any period of time during the year. It is obvious that the owner of the house property shall not receive any rent during such period. Such a loss arising to the owner of the house property is called loss due to vacancy.
- 30% of annual value is deductible as standard deduction in respect of expenses on insurance, ground rent, land revenue, repairs, collection charges etc. Interest on borrowed capital is allowable as deduction, if capital is borrowed for the purpose of purchase, construction, repair, renewal or reconstruction of the property.
- Where the property consists of a house or part of a house in the occupation of the owner for his own residence, the annual value of such house or part of the house shall be taken to be Nil. The owner of the house property will get a deduction of interest on loan up to 30,000 or 2, 00,000.
- If a deduction has been allowed in respect of unrealized rent and subsequently during any previous year the assessee has realized any amount in respect of such rent, the amount so realized will be chargeable to tax without making any deduction.



4.14 GLOSSARY

Annual value: the annual value of any property shall be the sum for which the property might reasonably be expected to be let from year to year.

Composite rent : When the owner of the building, along with the rent of the building gets rent of other assets which have been provided to the tenant along with the building (like plant, furniture, etc) or charges for some services provided to the tenant (like Security charges, lift, maintenance, etc), then the total amount so received is called as composite rent

Fair rent: Fair rent is the rent which is similar property can fetch in the same or similar locality, if it is let for a year.

Standard rent: The standard rent is fixed under the Rent Control Act. Any landlord cannot receive any rent more than the standard rent under the rent control act.

Self occupied house property: Self-occupied house property means the house property used by its owner for his own residential purpose.



4.15 REFERENCES

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- Dr. Mehrotra, H.C, and Dr. Goyal, S.P., INCOME TAX LAW AND ACCOUNTS, Sahitya Bhawan Publications, 57th Edition.



4.16 SUGGESTED READINGS

1. WEBSITE: <http://www.taxmann.com>
2. Dr, Ahuja, Girish and Dr.Gupta Ravi,Direct Taxes Law and Practice including TAX PLANNING, Publication House: Bharat Law House Pvt Ltd., Delhi



4.17 TERMINAL QUESTIONS

- Q1.** Explain the term “Annual value “and with the help of examples explain the computation of annual value of different houses.
- Q2.** What deductions are allowed from annual value in computing taxable income from house property?
- Q3.** Explain the provisions of income tax act regarding deduction of interest on loan taken for construction of house property.
- Q4.** What is unrealized rent? How is it treated while computing taxable income from house property?
- Q5.** Shri Gopal Adhikari is the owner of two houses. He has furnished the following particulars for the financial year 2016-17

First house- Its municipal valuation is Rs 80,000. It is used by Gopal for his own residence. He paid Rs 400, Fire Insurance Premium and Rs 8,000 Municipal Tax. He also paid interest on loan of Rs. 40,000. This loan was taken to repay another loan taken for the construction of this house.

Second house- Its municipal valuation is Rs 50,000 and Standard Rent is Rs. 60,000 (Rent Control Act Applicable). It has been let out at Rs 6,000 per month. He made the following Payments:

	Rs.
Municipal Tax	14,000
Repairs	2,000
Land Revenue	400
Legal expenses incurred to get the house vacated	2,000
Ground rent	8,000

The house remained vacant for 2 months. Rs 11,000 could not be recovered from the following tenant. The tenant has vacated the house. The conditions of Rule 4 are satisfied.

Compute his taxable income from house property for the A.Y. 2017-18.

Q6. Mr. Akshat Pant has four houses, the municipal valuations of which are Rs. 20,000, Rs. 16,000, 15000 and Rs. 12,000 respectively. He lives in the first house. In the second house he runs his business. The third house let out for Rs. 1,000 per

month. A loan was taken on 1st April 2011 for the construction of the fourth house, the construction of which began on 1st May 2011 and ended on 31st January 2013. The house was let out on 1st February, 2013 @ Rs. 1,200 p.m. For the previous year 2016-17 the interest paid by him in respect of the loan amounted to Rs. 3,000 and for the previous year 2011-12 and 2012-13 the interest paid has been Rs. 3,000 and Rs. 2,800 respectively. Municipal taxes were assessed and paid @ 10% of the municipal valuation. Ascertain his income from house property for the assessment year 2017-18.

Q7. Ms. Ishita has a house property in Nainital. From the following particulars compute the taxable income from house property for the assessment year 2017-18-

Municipal value	180000
Fair rent	220000
Standard rent	200000

The house property was let out from 01-04-2016 for 16000 per month which was vacated by tenant on 30-09-2016. It remained vacant for two months and again let out for 22000 per month from 01-12-2016.

She claimed the following deductions-

Municipal taxes	20% of Municipal value
Repair and maintenance	12000
Interest on loan for repair of house property	40000

UNIT 5 PROFIT AND GAINS FROM BUSINESS AND PROFESSION

5.1 Introduction

5.2 Objectives

5.3 Meaning of Business and Profession

5.4 Principles with Regard to Profit and Gains from Business and Profession

5.5 Accounts Prepared by the Assessee for Computing Profit

5.6 Maintenance of Accounts, Compulsory Audit and Special Provisions

5.7 Summary

5.8 Glossary

5.9 Answer to Check Your Progress

5.10 Reference / Bibliography

5.11 Suggested Readings

5.12 Terminal & Model Questions

5.1 INTRODUCTION

As per Income-tax Act the 'Profit and gains of business and profession', is the third head of income. The Government of India gets maximum income in the form of Income-tax from this head of income in comparison to other heads of income. *Sections 28 to 44D* of income-tax Act, 1961 relate to this head of income. *Section 2(13)* of income-tax Act deals with the term 'business', whereas *Section 2(36)* deals with the term 'profession'.

5.2 OBJECTIVES

After reading this unit you will be able to:

- Understand the term business and profession.
- Understand the main principles with respect to income from business or profession.

- Correct the profit and loss account of the assessee.
- Understand the concept of maintenance of account and compulsory audit u/s 44AB.
- Understand the special provisions under this head.

5.3 MEANING OF BUSINESS AND PROFESSION

Business - According to Section 2(13) of the Act, business includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. The word '*business*' suggests some real, substantial which systematic or organised course of activity or conduct with set purposes of earning profits. Business does not include the activities of trade, commerce or manufacture only, but it also includes the activities of rendering services. So, business is an extensive word. Under this word, all types of business transactions, manufacture of goods, industrial activities, banking activities and transportation activities are included. *For example*, Cinema is a commercial asset and any profit derived therefrom by letting out the same would be assessable as business profit. So, there are various words which are used in the term 'business' are explained as under:

Trade: Under trade, sale-purchase of goods and commodities are included. The person who does trade is called trader, who purchases and sales the goods with the aim of earning profits.

Commerce: The word commerce is wider than the word trade. All trading activities are the part of commercial activities. Apart from it, road transport, rail transport, telephone and other communication, bank, insurance activities are included in commerce.

Manufacturing: Raw material converted into finished goods under any process is included under manufacturing; *e.g.*, preparation of sugar from sugarcane is a manufacturing or productive process. So, making or producing goods means transforming the shape of commodity in such a way that it becomes a new commercial goods for trading purposes. Thus, when raw material is changed into finished goods, it is manufacture.

Adventure: With the aim of sale and purchase in the business, the work of keeping stock is known as adventure.

Profession – In simple words, profession refers to all such human activities which are undertaken to earn a living and which are performed on account of one's intellectual skill or knowledge, acquired only after patient study and application. *For example*, Chartered Accountants, Advocates, Engineers, Architects, Financial Adviser etc are the persons whose activities are termed as profession. A company (being an artificial person) does not have a mind and body and, therefore, cannot be engaged in profession. According to Section 2(36) of the Act, *profession includes vocation. This* includes such activities which are performed by a person on account of his natural ability for some particular work. It includes all such activities which are performed for living, story or play writer, pujari doing religious work,

agency work, brokerage, music, dance, robbery, magic activities etc all are included in the activities of vocation. So, a person can have more than one vocation. Actually, the primary objective of vocation is not always to earn profits. It need not be for making any income, nor need it involve any systematic and organised activity. But if a person passes his life by such activities for which he has natural abilities and some profits arise therefrom, such profits are treated as professional income (like income of singers, artists, actors, worshippers etc). So, in profession, vocation is also included.

Note: There is difference in words of business, trade, profession and vocation, but for income-tax purposes, there is no difference in them. All the income received by any of these sources is included under the head 'Income from Business or Profession'.



Check Your Progress-A

Q1. What do you understand by the term 'business'?

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Q2. Define profession under the head of 'profit and gains of business and profession'.

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Q3. Comment on the statement 'as the profession includes vocation'.

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5.4 PRINCIPLES WITH REGARD TO PROFIT AND GAINS FROM BUSINESS AND PROFESSION

The important principles which will be kept in mind by the assessee while computing income chargeable under the head of profit and gains of business and profession are –

i. Business or profession carried on by the assessee – As per section 28 of the Act, profits and gains of only those business or profession are chargeable under the head ‘profits and gains from business and profession’ which are carried on by the assessee. Carrying on by the assessee means the ownership of the assessee. It is not necessary that the assessee should actually carry on the business or profession but he must have legal right to carry on it. He may carry on the business or profession through his agents, employees and managers. The very essence is that the assessee has right to carry on the business or profession.

ii). Business or profession should be carried on during the previous year - As per section 28 of the Act, the profits and gains of only those business or professions are chargeable to tax under this head, which were carried on at any time during the previous year.

iii). Legal or illegal business or profession – Both types of profits received are taxable under this head. But the loss of illegal business cannot be set-off out of profits of a legal business.

iv). Salary, bonus, commission, interest received to a partner from the firm - Salary, bonus, commission, interest received etc. to a partner from the firm is taxable under this head.

v). Contract not to conduct any trade – Sometimes, here may a contract between two parties that one of them shall not to carry a particular trade or he will not use any right for using technical knowledge, patent, copyright, license or similar to this nature. For not doing such trade or for depriving of using these rights, he can get cash or any commodity. This shall be taxable income to be included under the head ‘income from salary’.

vi). Speculation profits – Profits from speculation are taxable under the head the ‘profit and gains from business and profession’, but the profits or losses of speculation business are treated and taxed separately. The reason of its calculation separately is that the loss of speculation can only be set-off out of profits of speculation.

vii). Profits from all business or professions are to be taxed under one head - An assessee may own several business or professions. Every business or profession is a separate

source of income under the head 'profit and gains from business and profession'. Profits of every business or profession are computed separately and, then, aggregated in one head. If there is loss in any business or profession it will be adjusted from profits of other business or professions. However, the profits and losses of speculation business are treated separately.

viii). Business or profession established outside India - Profit and gains of a business and profession, established outside India are taxable in the hands of a resident assessee and are also chargeable to tax under the head 'profit and gains from business and profession'. Profits of a business established in India or established outside India are equally taxable under section 28 of the Act.

ix). The purpose of business or profession is not necessarily to earn profit - This is not necessary that the purpose of a business or profession carried on by an assessee, is to earn profits or that such business or profession yields profit. Co-operative societies and mutual insurance companies come under the preview of business, though they may or may not earn profit.

x). Profit of closed business or profession - Where a business or profession is closed down, any profit arising on the sale of the assets of such business or profession, is not business profit, rather it is capital gain. But if the assets include stock, the profit arising on the sale of stock shall be business profit.

xi). Computation of profits on commercial principles - Profits or losses of a business or profession should be computed on the basis of general commercial principles. Generally, accepted accounting and commercial principles should be followed while calculating business or professional profits. Capital gains and capital expenditures should be separated from revenue profits and revenue expenses. Thus, only such profits from business or profession are chargeable to tax as are computed after keeping the generally accepted commercial and accounting principles.

xii). Business incomes not taxable under this head - The following income, though arise from business, are not taxable under the head 'profit and gains of business and profession':

(a) Rent from house property is taxable under the head 'Income from house property' even if the assessee is dealing in the business of buying, selling, constructing or letting on hire of houses and the house property is kept with him as stock.

(b) Dividend on share is taxable under the head 'income from other sources' even if the assessee is dealing in purchase and sale of such shares on which dividend has arisen and

the shares are held as stock-in-trade by the recipient of dividend.

(c) Winnings from lotteries, races etc. are taxable under the head 'income from other sources' even if it is derived as a regular business activity.

xiii). Interest on securities - Normally, interest on securities is taxable under the head of 'income from other sources'. But, if the securities are kept by the assessee as stock-in-trade (when he/she deals in the purchase and sale of securities), then any interest received on such securities will be taxed under the head 'profit and gains of business and profession'.

xiv). Rewards to players - Any reward received by a professional player is taxable under this head. Any reward received by a non-professional player is deemed to be a personal gift and is not taxable.

xv). Conversion of agricultural land for commercial purposes - If an agricultural land is divided into commercial plots and are sold for construction of houses on it, the additional profit arising from such activity is treated business profits instead of capital profits.

xvi). Insurance money – If any insurance money (including bonus) is received under 'Keyman Insurance Policy' from 01-10-1996, it is taxable.

xvii). Rental income from accommodation provided to employees - It is the duty of the employer to provide residential accommodation to the employees. The housing accommodation is an amenity which is provided for the purposes of business. Thus, if the assessee employer owns certain buildings which are occupied by its employees on rent, the rental income shall be assessable as business income and not as income from house property.

xviii). Underwriting commission - Commission received or receivable by an underwriter is taxable under this head, but the commission received on the shares purchased by them is not a taxable income.

**Check Your Progress-B**

Objective Type Questions**Q.1 Rent received from tenant is taxable under –**

- (a) Income from salary (b) Income from house property
(c) Income from business and profession (d) Income from capital gains

Q.2 Winning from horse race is taxable under –

- (a) Income from house property (b) Income from business and profession
(c) Income from capital gains (d) Income from other sources

Q.3 Dividend is taxable under –

- (a) Income from salary (b) Income from business and profession
(c) Income from capital gains (d) Income from other sources

Q.4 Rewards to professional player is taxable under –

- (a) Income from salary (b) Income from business and profession
(c) Income from capital gains (d) Income from other sources

Q.5 Salary received by a partner from the firm is taxable under –

- (a) Income from salary (b) Income from business and profession
(c) Income from capital gains (d) Income from other sources

5.5 ACCOUNTS PREPARED BY THE ASSESSEE FOR COMPUTING PROFITS

Tax is not imposed on the gross receipts of business or profession under this head, but the profit is calculated for the purpose of income-tax. So, for calculating such profits or losses from his business or profession, an assessee prepares any of the following accounts:

- Profit and Loss Account or Income and Expenditure Account
- Receipt and Payment Account

Normally, the trading and manufacturing enterprises prepare profit and loss account to ascertain profit or loss, whereas Chartered Accountants, Advocates, Architects etc prepare

income and expenditure account to find out their profit or loss. The vocational persons find out their profits/losses by preparing receipt and payment account.

So, the calculation of profit can be made by an assessee with the help of Profit and Loss Account, Income-Expenditure Account and Receipt and Payment Account related to business or profession, but the profits shown by these accounts may not be correct from the point of view of Income-tax. So, from income-tax point of view, the amount of profits may differ and the accounts prepared by the assessee are to be revised, due to some reason like, there may be certain expenses, which are shown in accounts prepared by assessee, which are not allowed to be deducted totally or partially, while they have been deducted in arriving profits. In the same manner, there are certain incomes which are written in Profit and loss or Income and Expenditure Account while they are taxable under any other head of income. This is why revision in the accounts (Profit & Loss Account or Income & Expenditure Account or Receipt and Payment Account) is essential, which are prepared by the assessee. The items are as under:

- (i) Certain expenditure shown less or more than the actual amount.
- (ii) Certain expenses, allowed by Act, but assessee have not deducted them.
- (iii) Personal expenses are written in Profit and Loss Account.
- (iv) Many expenses are there which are not related to previous year.
- (v) The assessee writes certain incomes in Profit and Loss Accounts, which are not taxable under the head 'income from business or profession' but they are taxable under the head 'income from other sources'.
- (vi) There may be certain incomes which have not been included by the assessee in the accounts, while they should be included. This is why correction in accounts becomes necessary.

5.5.1 RULES OF CORRECTION IN ACCOUNTS

As per the provisions of Income-tax Act, corrected Profit and Loss Account, Income Expenditure Account or Receipt and Payment Account are prepared, so that correct amount of profit may be calculated which is taxable under the head 'income from business or profession'. The rules of correction in the accounts for the purpose of income-tax are as under:

(i) *Adding disallowed expenses* - All expenses which are disallowed by the Income-tax Act are to be added in the profits shown in the accounts prepared by the assessee provided there have already been deducted at the time of preparing Profit and Loss Account. If any expense is disallowed partially, the disallowed portion shall be added up.

(ii) *Deducting expenses to be deductible* - The expenses which are related to business and have not been deducted, now should be deducted from the profits ascertained by Profit and Loss Account.

(iii) *Deduction of taxable income under other heads* - If any income has been shown in the accounts which are not taxable under the head 'Business or Profession', such income will be deducted out of profit computed.

(iv) *Added of income* - If any income which is relating to trade has been left out it should be added in the profits shown by Profit and Loss Account.

(v) *Personal expenses* - All the personal and domestic expenses debited in Profit and Loss Account, are to be added in the profit shown by Profit and Loss Account.

(vi) *Capital losses* - Capital losses debited in Profit and Loss Account by the assessee are to be added in profit so computed.

(vii) *Payments of direct taxes* - Payments of direct taxes like income-tax if these have been debited in accounts, now will be added in profit computed.

5.5.2 PERFORMA OF REVISED PROFIT AND LOSS ACCOUNT

The performa of corrected Profit and Loss Account or Income and Expenditure Account as per rules mentioned above is as under:

	Rs.	Rs.
Net Profit as per Profit & Loss A/c or Surplus as per Income & Expenditure A/c		* * * *
Add: Expenses disallowed but debited to P & L A/c		
(i) Personal Expenses		
(ii) Income-tax		
(iii) Wealth-tax	* * *	
(iv) Charities and Donations	* * *	
(v) Capital Expenditures	* * *	
(vi) Amount transferred to Reserve	* * *	
(vii) Patents (whole amount of patent if purchased on or after 1-4-1998)	* * *	
(viii) Patents (13/14 th of whole amount if purchased before 1-4-1998)	* * *	
(ix) Preliminary Expenses (1/5 th of total expenses if incurred before or after commencement of business)	* * *	
(x) Depreciation (if considered separately)	* * *	
(xi) Technical Know-how (Excess of permissible		

limits)	* * *	
(xii) Expenses on such incomes which are taxable under other heads of income	* * *	
(xiii) Gifts & Presents	* * *	
(xiv) Other Disallowed Expenses		
(xv) Audit fees, Commission, Brokerage, Royalty, Fees for professional services (if tax is not deducted at source)	* * *	
	* * *	
Add: Incomes which are taxable under this head but not credited to P & L A/c	* * *	* * * *
Less: Incomes not taxable under this head but credited to P & L A/c		<u>* * * *</u>

(i) Rental Income (taxable under the head of 'House Property')		
(ii) Interest on Securities/Dividend (taxable under the head of 'Income from Other Sources')		
(iii) Income-Tax Refund	* * *	
(iv) Capital Gain (taxable under the head of 'Capital Gains')	* * *	
(v) Bad Debt recovered (to the extent not allowed as deduction in earlier years)	* * *	
(vi) Excise Duty/Custom Duty Refund (not allowed earlier as deduction)	* * *	
(vii) Gifts (not taxable being capital receipts)	* * *	
Less: Expenses/Losses allowed but not debited to P & L A/c		
(i) Depreciation @25% on intangible assets, e.g., Patent, Trade Mark, Copyright etc. (if asset is purchased on or after 01-04-1998 and is used atleast 180 days or more than 180 days during previous year)	* * *	
	* * *	<u>* * * *</u>
(ii) Depreciation @ $12\frac{1}{2}\%$ on intangible assets (if asset		****

is purchased after 01-04-1998 and is used less than 180 days during previous year)		
(iii) Depreciation (Separately considered)		
Taxable Profits of Business or Profession	* * *	
	* * *	* * * *
	* * *	*****

Note: (i) In case of loss, the reverse will be done or items to be added are to be deducted and items to be deducted will be added.

(ii) Read next unit for the description of expenses and deductions expressly allowed and disallowed.

5.5.3 COMPUTATION OF TAXABLE INCOME IN CASE OF RECEIPT AND PAYMENT ACCOUNT

Normally, this system is followed by professionals. Under this system, only taxable receipts and payments are taken. The performa is as given below:

	Rs.	Rs.
Gross Professional Earnings		
(a) In case of a Doctor		* * * *
(i) Sale of medicines	* * *	
(ii) Consultation fee	* * *	
(iii) Examining fee	* * *	
(iv) Operation fee	* * *	
(v) Nursing home charges	* * *	
(vi) Gifts from patients	* * *	
(b) In case of a Chartered Accountant or Advocate		
(i) Fee from clients	* * *	
(ii) Consultation fee	* * *	
(iii) Audit fee	* * *	
(iv) Fee from training institute	* * *	
(v) Gifts from clients	* * *	
Less: Allowed deductions		
(i) Rent of Dispensary (in case of a doctor)	* * *	
(ii) Salary of compounders (in case of a doctor)	* * *	
(iii) Cost of medicines (in case of a doctor)	* * *	
(iv) General expenses	* * *	
(v) Telephone expenses	* * *	
(vi) Motor car expenses (if used in profession)	* * *	
(vii) Depreciation on motor car (if used in profession)	* * *	
(viii) Depreciation on surgical equipments (in case of a doctor)		
(ix) Laboratory expenses		
(x) Interest on Loan	* * *	
(xi) Interest on professional magazines and journals	* * *	
Taxable Profits of Business or Profession	* * *	* * * *
	* * *	****

5.6 MAINTENANCE OF ACCOUNTS, COMPULSORY AUDIT AND SPECIAL PROVISIONS

5.6.1 MAINTENANCE OF ACCOUNTS

As per section 44AA, assesseees have to maintain certain accounts compulsorily regarding their business or profession. In this connection professions have been divided under following categories:

(a) Specific Profession - This includes medical, engineering or architectural profession or interior decoration or technical consultancy or any other profession as is notified by the CBDT in Official Gazette. Under this -

(i) if the total income of the assessee doing scheduled profession as notified by CBDT and the gross income is more than Rs.1,50,000 in anyone year prior to three years of previous year, then such assessee come under specific profession and they have to maintain prescribed books and other documents (like journal, ledger, cash book, original copy of bills etc.) compulsorily.

(ii) if the gross annual receipts are not more than Rs.60,000 of these professions, the keeping of the prescribed books and other documents are not compulsory, but they have to maintain such accounts and books, because on the basis of that, taxable income may be computed by the Assessing Officer (AO).

(b) Non-specific Profession - This includes those businesses or professions which are not covered by any of the category mentioned above. Under this -

(i) if any person is doing profession (except specified profession) and prior to 3 years before the previous year, the annual income is more than Rs.1,20,000 or the gross receipt is more than Rs.10,00,000p.a, the assessee is not required to maintain prescribed books and other documents, but he has to keep such essential accounts, because on the basis of that, the assessing officer may compute the taxable income of the assessee.

(ii) if the income or gross receipt of assessee is not more than the above mentioned limit, there is no need to maintain any types of account.

Note: A person carrying on medical profession shall maintain daily cash register in Form No. 3C and list of medicines stock (opening and closing stock).

(c) Business under Sections 44AD and 44AE – Where the assessee claims that the profits and gains of eligible business (Sec. 44AD) or plying, hiring or leasing goods carriage (Sec. 44AE) are lower than the deemed profits under these sections, he has to maintain the books

of account of such business.

5.6.2 COMPULSORY AUDIT [SEC. 44AB]

It is compulsory to specific persons engaged in any business or profession to get their accounts audited compulsorily. The following person shall get their accounts of previous year audited by a Chartered Accountant or by a qualified auditor before the specified date and a further report by an accountant in the prescribed form duly signed and verified by such Chartered Accountant or auditor:

(i) Every person carrying on business, if his total sales or gross receipts in business exceeds Rs.1 crore in any previous year; or

(ii) Every person carrying on profession, if his gross receipts in profession exceed Rs.25 lakh in any previous year; or

(iii) Every person carrying on the business of plying, hiring or leasing goods carriages (Sec. 44 AE), or of exploration of mineral oils (Sec. 44BB), and the assessee has claimed his income to be lower than the deemed profits or gains of such business in any previous year; or

(iv) Every person carrying on the eligible business like civil construction work (Sec. 44 AD) and he has claimed that the income of their profession is less than the deemed income, they have to get their accounts audited compulsorily and they have to produce an evidence that their income is less than the prescribed limit.

5.6.3 SPECIAL PROVISIONS

There are some special provisions for computing profits and gains in particular businesses:

(a) Special provisions for computing profits and gains of business on presumptive basis [Sec. 44AD] - This is applicable on resident individuals, HUFs and partnership firms and covers all small businesses with total turnover or gross receipts of up to Rs.1crore (except the business of plying, hiring and leasing goods carriages covered under section 44AE). The eligible rate of tax would be 8% of total turnover or gross receipts, but this scheme would not apply to an assessee who is availing deductions under section 10AA or deduction under any provisions of Chapter VI-A. The intention of widening the scope of this scheme is to reduce the compliance and administrative burden on small businessmen and relieve them from the requirement of maintaining books of account. Such assessee opting for the presumptive scheme are not required to maintain books of account under section 44AA or get them audited under section 44AB.

(b) Special provisions for computing profits and gains of business of plying, hiring or leasing goods carriages [Sec. 44AE] - This section provides for estimating business income of an owner of trucks from the plying, hire or leasing of such trucks. The scheme applies to

persons owning not more than 10 trucks at any time during the previous year. The estimated income from each truck in case of a heavy or light goods vehicle will be deemed to be Rs.7,500 for every month or part of a month during which the truck is owned by the assessee for the previous year. The assessee joining the scheme will not be required to maintain books of account under section 44AA or get them audited under section 44AB.

Illustration 1

Mr. Rastogi owns the following commercial vehicles:

(i) 2 heavy goods vehicles – for 5 months and 10 days

(ii) 2 light commercial vehicles – one for 12 months and the other for 9 months and one day.

Compute his income from business, if he opts for the scheme u/s 44AE.

Solution

His profits and gains from 2 heavy goods vehicles $\text{Rs.}7,500 \times 6 + \text{Rs.}7,500 \times 6 = \text{Rs.}90,000$.

His profits and gains from 2 light commercial vehicles $\text{Rs.}7,500 \times 12 + \text{Rs.}7,500 \times 10 = \text{Rs.}1,65,000$.

Hence, his total income from business will be Rs. 2,55,000 (Rs.90,000 + Rs.1,65,000).

Note: In second situation, the goods carrier was used for 9 months and one day. So, the income of 10 months shall be taxable.

(c) Special provision for computing the profits and gains of shipping business in case of non-residents [Sec. 44B] - In the case of a non-resident assessee, engaged in the business of operation of ships, 7.5% of the aggregate of the following amounts shall be deemed to be profits and gains of such business chargeable under the head 'profit and gains of business and profession'-

(i) the amount received or receivable, whether within India or outside, by the assessee or by 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 the assessee on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

(d) Provisions for computation of taxable income from activities connected with exploration of mineral oils [Sec. 44BB] - In the case of a non-resident assessee, engaged in the business of providing services and facilities in connection with exploitation of mineral oils, 10% of the aggregate of the following amounts shall be deemed to be profits and gains

of such business chargeable under the head 'profit and gains from business and profession' -

(i) the amount received or receivable, whether within India or outside, by the assessee or by any person on his behalf for services and facilities in connection with extraction or production of mineral oils in India; and,

(ii) the amount received or deemed to be received in India by or on behalf of the assessee for services and facilities in connection with extraction or production of mineral oils outside India.

(e) Special provision for computing profits and gains of the business of operation of aircraft in the case of non-residents [Sec. 44BBA] - In the case of a non-resident assessee, engaged in the business of operation of aircraft, 5% of the aggregate of the following amounts shall be deemed to be the profits and gains chargeable to tax under the head 'profit and gains of business and profession' -

(i) the amount received or receivable, whether within India or outside, by the assessee or by 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 the assessee on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

Illustration 2

Mr. Rajesh, a non-resident, operates an aircraft between Thailand and Delhi. He received the following amounts in the course of the business of operation of aircraft during the year ending 31.3.2017:

- (i) Rs.1 crore in India on account of carriage of passengers from Delhi.
- (ii) Rs.2 crore in India on account of carriage of goods from Delhi.
- (iii) Rs.1 crore in India on account of carriage of passengers from Thailand.
- (iv) Rs.2 crore in Thailand on account of carriage of passengers from Delhi.

The total expenditure incurred by Mr.Rajesh for the purposes of the business during the year ending 31.3.2017 was Rs.1.8 crore. Compute the income of Mr.Rajesh chargeable to tax in India under the head 'profit and gains of business and profession' for the assessment year 2017-18.

Solution

Keeping in view the provisions of section 44BBA, the income of Mr. Rajesh chargeable to tax in India under the head 'profit and gains of business and profession' is worked out hereunder -

	Rs.
Amount received in India on account of carriage of passengers from	3,00,00,000
Amount received in India on account of carriage of goods from Delhi	2,00,00,000
Amount received in India on account of carriage of passengers from	1,00,00,000
Amount received in Thailand on account of carriage of passengers from	2,00,00,000
	8,00,00,000

Income from business under section 44BBA at 5% of Rs.8,00,00,000 is Rs.40,00,000, which is the income of Mr. Rajesh chargeable to tax in India under the head 'profit and gains of business and profession' for the A.Y.2017-18.



Check Your Progress-C

Q1. Discuss the provisions for maintenance of accounts for specific provisions.

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Q2. Give a performa of corrected profit and loss account.

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Q3. Define compulsory audit u/s 44AB.

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Q4. An assessee owns a heavy commercial vehicle for 9 months 15 days and another goods vehicle for 9 months during the previous year. Compute his income applying the provisions of section 44AE.

Q5. When is the audit of accounts of a business assessee compulsory? Explain.

5.7 SUMMARY

Salary, bonus, commission, interest received etc, to a partner from the firm is taxable under the head of profit and gains of business and profession. Normally, the trading and manufacturing enterprises prepare profit and loss account to ascertain profit or loss, whereas Chartered Accountants, Advocates, Architects etc prepare income and expenditure account to find out their profit or loss. The vocational persons find out their profits/losses by preparing receipt and payment account. So, the calculation of profit can be made by an assessee with the help of Profit and Loss Account, Income-Expenditure Account and Receipt and Payment Account related to business or profession, but the profits shown by these accounts may not be correct from the point of view of Income-tax. So, from income-tax point of view, the amount of profits may differ and the accounts prepared by the assessee are to be revised. For correction in accounts, the incomes and disallowed expenses will be added, whereas undeductable expenses and untaxable incomes will be subtracted. As per section 44AB, it is compulsory to specific persons engaged in any business or profession to get their accounts audited compulsorily by a Chartered Accountant or by a qualified auditor.



5.8 GLOSSARY

Business - This includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce (road/rail transport, communication, bank, insurance activities) or manufacture.

Trade -means buying and selling of the goods or exchange of goods for money or other goods. The primary objective of these activities of buying and selling is to earn profits.

Commerce -is wider than the word trade. All trading activities are the part of commercial activities. Apart from it, road transport, rail transport, telephone and other communication, bank, insurance activities are included in commerce.

Manufacture- means making or producing goods by manual or mechanical force. Making or producing goods means transforming the shape of commodity in such a way that it becomes a new commercial goods for trading purposes. Thus, when raw material is changed into finished goods, it is manufacture.

Profession- This refers to all such human activities which are undertaken to earn a living and which are performed on account of one's intellectual skill or knowledge, acquired only after patient study and application. *For example*, Chartered Accountants, Advocates, Engineers, Architects, Financial Adviser etc are the persons whose activities are termed as profession. A company (being an artificial person) does not have a mind and body and, therefore, cannot be engaged in profession. According to Section 2(36) of the Act, *profession includes vocation*.

Vocation -includes such activities which are performed by a person on account of his natural ability for some particular work like a singer, an artist, a worshipper etc. So, a person can have more than one vocation.



5.9 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress –B

Ans. 1 (b)

Ans. 2 (d)

Ans. 3 (d)

Ans. 4 (b)

Ans. 5 (b)

Check Your Progress –C

Ans. 4 Rs.1,42,500



5.10 REFERENCES

- Jain, R.K. 2017. *Income Tax Planning and Management*. SBPD Publications, Agra.
- Singhania, V.K and Singhania, K. 2017. *Direct Taxes Law and Practice with Special Reference to Tax Planning, 57th Edition*. Taxmann Publications, New Delhi.
- Agarwal, B.K. and Agarwal, Rajeev. 2017. *Income Tax Law and Accounts*. Nirupam Sahitya Sadan, Agra.



5.11 SUGGESTED READINGS

1. Upper India Chamber of Commerce v.CIT (1974) 15ITR 263 (All.).
2. CIT V. N.Reddy (1984) 150 ITR 347 (Kar.).



5.12 TERMINAL QUESTIONS

- Q1. Explain the meaning of Vocation, Profession and Business.
- Q2. Discuss the provisions for maintenance of accounts u/s 44AA for non-specific profession.
- Q3. Write short notes on – (i) Compulsory audit, (ii) Specific profession.
- Q4. What is the method of correcting profit and loss account by a businessman from the point of Income-tax?
- Q5. Discuss the rules of correction in the accounts for the purpose of income-tax.

UNIT 6 TAX PLANNING AND PROFITS AND GAINS FROM BUSINESS OR PROFESSION

6.1 Introduction

6.2 Objectives

6.3 Expenses and Deductions Expressly Allowed

6.4 Expenses Expressly Disallowed

6.5 Summary

6.6 Glossary

6.7 Answer to Check Your Progress

6.8 Reference / Bibliography

6.9 Suggested Readings

6.10 Terminal & Model Questions

6.1 INTRODUCTION

This unit 'profit and gains from business and profession and tax planning', tell us the provisions as per Income-tax Act about the expenses and deductions which are expressly allowed (Section 30 to 37) and also the expenses which are expressly disallowed. Expenses expressly allowed means those deductions which are deductible, whereas the expenses which are disallowed are not deductible in the computation of taxable income of business or profession.

6.2 OBJECTIVES

After reading this unit you will be able to:

- Understand the expenses and deductions which are expressly allowed.
- Understand the deductions under expenditure on scientific research.
- Understand the deductions under preliminary expenses.
- Understand the expenses which are expressly disallowed.

6.3 EXPENSES AND DEDUCTIONS EXPRESSLY ALLOWED

Under *sections 30 to 37* of Income-tax Act, the expenses and deductions expressly allowed under the head 'income from business or profession' are as under:

1. Expenses relating to Building [Sec. 30] - The expenses relating to building are as under:

(a) Rent of Building - The rules of deduction of rent of building used in trade are as under:

- (i) Rented Building: The whole amount of rent is deducted.
- (ii) Self house of Assessee: No amount of rent will be deducted.
- (iii) Residence of Assessee in partial part of Building: The proportionate rent of building used in business is an allowable expense.
- (iv) Use of Building by Employees of Trade: Rent of building will be an allowable deduction of the business.
- (v) Use of Partners Building of the Business in the Partnership Business: The rent payable to partner by the firm is an allowable expenditure of the business.

(b) Current Repair to Building - Actual expenses on the repair of the business building is allowable expenditures. Expenses on white wash of the building are covered under current repair. If repair is of capital nature, its deduction will not be allowed.

(c) Rent of Land and Municipal Tax. It is allowed expenses.

2. Expenses of Machine, Furniture and Plant [Sec. 31] - The following expenses are allowed on machine, furniture and plant used in the trade of assessee:

(a) Actual expenses paid on repair and maintenance of machine, furniture and plant, if the sum spent on the repair is of capital nature, its deduction shall not be allowed.

(b) If the above assets are taken on rent basis, the actual rent paid is an allowable expenditure.

3. Depreciation [Sec. 32] – Depreciation on tangible assets (like building, plant, machine, furniture) and intangible assets (like patent, copyright, trademark) used by assessee for the business are allowable expenditure. Under this, all assets have been divided into four main categories and rates of depreciation as prescribed by Rule 5(1) are as –

Part A – Tangible Assets

Category I – Buildings

- i. Buildings which are used mainly for residential purposes - 5%
- ii. Buildings which are not used mainly for residential purposes - 10%

iii. Purely temporary erections like wooden structure - 100%

Category II – Furniture and Fittings

i. Furniture and fittings (including electrical fittings) - 10%

Category III – Plant and Machinery

i. Motors buses or lorries used in business of running them on hire - 30%

ii. Aeroplanes - 40%

iii. Air/water pollution control equipments - 100%

iv. Computers including computer software - 60%

v. Annual publications owned by assessee carrying on a profession- 100%

vi. Plant and machinery (general rate) - 15%

Category IV – Ships

i. Ocean-going ships - 20%

ii. Speed boats operating on inland water - 20%

Part B – Intangible Assets

Know-how, patents, copyrights, trademarks, licenses, franchises or any commercial rights - 25%

4. Investment in New Plant or Machinery [Sec. 32AC] – This deduction is allowed to a company assessee on the fulfilment of following conditions:

(a) The company is engaged in the business of manufacture or production of any article or thing;

(b) The company acquires and installs ‘new asset’ after 31st March, 2013 but before 1st April, 2017;

(c) The aggregate amount of actual cost of such new assets, acquired during any previous year and installed on or before 31st March, 2017, exceeds Rs.25 lakhs.

Following deduction in respect of investments in new assets is allowed:

15% of the actual cost of such new assets acquired and installed during the relevant previous year. If new asset exceeding Rs.25 crores is acquired and installed in the financial year 2014-15, 2015-16 and 2016-17, then this deduction shall be allowed during the relevant assessment years *i.e.* 2015-16, 2016-17 and 2017-18. However, if the acquisition of plant and machinery of the specified value is made in the previous year, its installation may be made upto 31-3-2017 order to avail the deduction of 15%. Thus, no deduction shall be allowed from the assessment year 2018-19.

If the installation of the new asset is in a year other than the year of acquisition, this

deduction shall be allowed in the year in which the new asset is installed. Thus, in all 15% of the cost of 'new assets' is allowed as deduction only once.

Meaning of New assets - New assets, means any new plant or machinery (other than ship or aircraft) but does not include the following:

- (i) any plant or machinery which before the installation by the assessee was used either within or outside India by any other person; or
- (ii) Any plant or machinery in any office premises or any residential accommodation or a guest house; or
- (iii) Any office appliances including computers and computer software; or
- (iv) Any vehicle; or
- (v) Any plant or machinery, the whole of the actual cost of which is allowed as deduction (whether as depreciation or otherwise) in computing the income under the head 'profit and gains from business and profession' of any previous year.

Note: (a) If the actual cost of 'new assets' is Rs.25 crores or less, this deduction shall not be allowed.

(b) No deduction under this section shall be allowed for any assessment year commencing on or after 1st April, 2018. Thus, no deduction shall be allowed from the assessment year 2018-19.

Withdrawal of deduction - This 'New assets' should not be sold or otherwise transferred within a period of 5 years from the date of its installation. If the new asset is sold or transferred within 5 years from its installation, the amount of deduction allowed to the assessee shall be deemed to be the income of the assessee of the previous year in which such sale or transfer takes place. Such deemed income shall be taxable under the head 'Profit and gains from business and profession' in addition to the capital gain which may also arise and taxable under the head 'Capital gains' on such sale or transfer.

If the new asset is sold or otherwise transferred in connection with the amalgamation or demerger within a period of 5 years from the date of its installation, the deduction allowed previously shall not be withdrawn. But amalgamated company or the resulting company, as the case may be, shall not sale or transfer such 'new asset' within 5 years from its installation by the amalgamated or merged company. Thus, the condition of 5 years shall continue to apply in the case of amalgamated or resulting company.

(5) Expenditure on Scientific Research [Sec. 35(1)] – Any expenditure, whether of revenue nature or capital nature incurred for carrying out the scientific research is termed as expenditure on scientific research. So, scientific research means the extension knowledge in

the field of natural and applied sciences including agriculture, animal husbandry or fisheries. The following deductions shall be allowed in respect of expenditure on scientific research:

(a) Revenue expenditure incurred by the assessee: Where the assessee himself is engaged in the scientific research and any revenue expenditure is incurred on scientific research related to business then, such expenditure shall be allowed as deduction. Thus, any amount spent by the assessee on payment of any salary to an employee engaged in such scientific research, or on the purchase of materials used in such scientific research, shall be allowed as deduction during the previous year.

(b) Payment to approved research association, educational or other institutions: Where the assessee is himself not engaged in scientific research and any sum is paid by him to a research association, which carry on the scientific research, or to a University/institution to be used for scientific research shall be allowed as deduction of an amount equal to 1.75 times of such sum paid. But such association or institution must be approved by the Central Government for the purpose of scientific research.

(c) Payment to an Indian company for scientific research: Any sum paid to a company to be used by it for scientific research shall be allowed as deduction of an amount equal to 1.25 times of such sum paid. For availing this deduction the company shall have to fulfill the following conditions: (i) it is registered in India; (ii) it has as its main object the scientific research and development; (iii) it is approved by the prescribed authority for the purposes of this deduction; (iv) it fulfils such other conditions which may be prescribed time to time.

(d) Payment to a University, College or other institution for social science or statistical research: Any sum paid to a research association which has as its object the undertaking of research in social science or statistical research or to a university/college or other institution for research in social science or statistical research shall be allowed as deduction of an amount equal to 1.25 times of such sum paid. But such University, College or other institution must be approved, by the Central Government for the purpose of this deduction.

(e) Capital expenditure on scientific research [Sec. 35(2)]: Deduction in respect of any expenditure of a capital nature on scientific research related to the business carried on by the assessee, shall be allowed as given below:-

(i) The whole of such capital expenditure, incurred within the three years immediately preceding the commencement of the business, shall be allowed as deduction in the previous year in which the business is commenced.

(ii) No deduction for depreciation shall be allowed in respect of the assets used for scientific research either in the year in which the capital expenditure is incurred or in a subsequent year.

(iii) No deduction shall be admissible in respect of any expenditure incurred on acquisition of land even though the land has been purchased for the purposes of scientific research.

(f) Payment to a national laboratory etc. [Sec. 35(2AA)]: Where the assessee pays any

sum to a national laboratory or a university or an Indian Institute of Technology (IIT) or a specified person (approved by the prescribed authority) with the specific direction that the said sum shall be used for scientific research programme approved by the prescribed authority then, a deduction equal to 2 times of the sum so paid, shall be allowed.

(g) Expenditure on scientific research on approved in house research and development facility [Sec. 35(2AB)]: If a company engaged in the business of bio-technology or in any business of manufacturer or production of any article or thing, not being an article or thing specified in the list of the 11th Schedule, incurs any expenditures on scientific research (excluding the cost of any land or building) on approved in-house research and development facility then, there shall be allowed a deduction of a sum equal to 2 times of expenditure; but no deduction shall be allowed in respect of such expenditure under any other provision of this Act or which is incurred after 31st March, 2017.

(h) Consequences on amalgamation [Sec. 35(5)]: If under amalgamation, the amalgamating company transfers any capital asset, either to be used for scientific research by the amalgamating company, to the amalgamated Indian company then, the amalgamated company would be entitled to all those deductions in respect of that asset which would have been available to the amalgamating company as if no transfer had taken place. The amalgamating company shall not be allowed any other deduction in respect of the asset so transferred.

(6) Expenditure on Acquisition of Patent rights or Copyrights [Sec. 35A] – Patent or copyrights means the right to use any know-how, secret formula, designs and specifications. Such capital expenditure is considered as intangible asset which is chargeable to depreciation @ 25% of its written-down value u/s 32. The capital expenditure incurred otherwise than of acquisition of these assets is not deductible and the expenditure of revenue nature is allowable u/s 37(1) of the Act. If the right has been transferred under a scheme of amalgamation, the amalgamated Indian company shall be entitled to avail the remaining instalments as deduction as these would have been allowed in case of amalgamating company. But, if this right has been transferred under a scheme of demerger, the resulting Indian company shall be entitled to avail the remaining instalments as deduction as these would have been allowed in case of amalgamating company.

(7) Expenditure on Know-how [Sec. 35AB] - Know-how means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil well or other sources of mineral deposits. This deduction is not available in respect of capital expenditure incurred on the acquisition of know-how on or after April 1, 1998. This is an intangible asset. The depreciation @ 25% of its written down value is, however, allowed in respect of such expenditure (asset) incurred on or after April 1, 1998.

(8) Expenditure incurred on Agricultural Extension Project [Sec. 35CCC] - If an assessee has incurred any expenditure on any project relating to extension and development of agriculture in the previous year, deduction of 150% of such expenditures shall be allowed under this section. Here it is notable that such project should be notified by CBDT.

(9) Expenditure incurred on any Skill Development Project [Sec. 35CCD] - If a company incurs any expenditure on a project which is related for the development of skill of the employees, a deduction of 150% of such expenditures shall be allowed. This project should be notified by CBDT. Here it is essential to mention that cost of land and building shall not be included in the expenditures of this project.

(10) Deduction in respect of Preliminary Expenses [Sec. 35D] - This deduction shall be claimed by Indian Company or resident non-corporate assessee. Preliminary expenses are incurred prior to commencement of trade or/and after which are related for the development or with the establishment of new unit. Preliminary expenses are admissible in 5 equal instalments or 1/5th of total preliminary expenses allowed every year. This deduction shall commence from the year of starting the trade completing the development work or with the year of starting the new unit.

The preliminary expenses include the following expenses:

- (i) Expenses for preparing project/feasibility report, expenses of market survey, expense on engineering services relating to trade of assessee.
- (ii) Legal expenses relating for preparing the draft of contract made between assessee and other persons.
- (iii) In the case of a company assessee the following expenses will also be included in preliminary expenses (except the above expenses): legal expenses in drafting memorandum and articles of association of company, printing expenses of memorandum and articles of association, registration fee of the company, underwriting commission and brokerage on the issue of shares and debentures of the company and expenses on preparation, typing, printing and advertisement of prospectus etc.

Maximum ceiling of deduction: The maximum amount allowable for deduction can be upto a maximum of 5% of project cost in case of non-corporate company and in case of company or at the option of the company either 5% of project cost or 5% of capital employed in the company (whichever is more in these two). In both the cases, deduction of preliminary expenses shall not exceed that amount which has been paid in actual.

Illustration 1

Mr. Amar started a new unit with a cost of Rs.50 lakh (including land, building, machinery, furniture etc). The production was started from 1st June, 2014. Rs.4 lakh were spent as

preliminary expenses prior to the starting of production. Find the allowable deduction in respect of preliminary expenses.

Solution

Actual preliminary expenses Rs.4 lakh or Rs.2.5 lakh(5% of project cost @ Rs.50 lakh) whichever is less.

So, Rs.2.5lakh will be allowed in 5 equal instalments i.e., Rs.50,000 per year will be deducted while computing profits.

(11) Amortisation of Expenditure in case of Amalgamation or Demerger [Sec. 35DD] - If an Indian company makes such payments after 31st March, 1999 wholly and exclusively for the purpose of amalgamation or demerge of any undertaking, the assessee shall be allowed a deduction of any amount equal to 1/5th of such expenditure for each of the 5 successive previous years beginning with the previous year in which the amalgamation or demerger takes place.

(12) Amortisation of Expenditure under Voluntary Retirement Scheme [Sec. 35DDA] - If an assessee is paid any sum in any previous year under scheme of voluntary retirement, a deduction of 1/5th of the amount paid by assessee shall be allowed in computing the profits of that previous year. Deduction of remaining amount shall be allowed during the next four years. No other deduction regarding these expenses shall be allowed, under the provision of Income-tax Act.

(13) Expenses on the Discovery of Minerals [Sec. 35E] - These expenses are allowed to Indian company or non-company residential person. It includes expenses on discovery of minerals or expenses incurred in the development of mines, but no deduction is allowed on capital expenses incurred on land, building etc. Deduction will be 1/10th every year of these expenses. If, in any year the income of minerals is less than 1/10th portion, the deduction will be equal to income and the balance will be carry forward upto a maximum period of 10 years only.

(14) Insurance Premium [Sec. 36(1)(i)] – The amount of any premium paid in respect of insurance against risk of damage or destruction of stores for the purpose of business or profession, shall be allowed in full, as deduction.

(15) Interest on Borrowed Capital [Sec. 36(1)(iii)] – The amount of interest paid in respect of capital borrowed for the purpose of the business or profession is allowed as deduction. But, no deduction shall be allowed regarding any amount of interest paid on borrowed capital which is taken for the extension of existing business for acquiring new asset, and such

amount of interest relates for the period beginning from the date on which the capital was borrowed to acquire the asset till the date on which such asset was put to use first time. In addition to that, expenses such as costs of stamps, registration fees, brokerage etc incurred by the assessee in connection with the raising of loans are inadmissible deductions.

(16) Discount on Zero Coupon Bonds [Sec. 36 (1)(iiia)] - Zero coupon bond is a bond issued by a infrastructure capital company, or public sector company or scheduled bank. The difference between the amount received, at the time of issue, and the amount payable on redemption or maturity by the issuing company, is termed as discount on Zero coupon bonds. Discount on Zero coupon Bonds will be allowed as deduction on prorata basis. Such deduction, shall be allowed for a period of full period of life of bonds on prorata basis. Prorata basis means that total discount of the zero coupon bonds shall be spread over a period of life of such bonds.

$$\text{Prorata Discount} = \frac{\text{Total discount on zero coupon bonds}}{\text{Full period of life of zero coupon bond (in years/ months/ days)}}$$

(17) Employer's Contribution to Recognised Provident Fund [Sec. 36(1)(iv)] - Employer's contribution towards recognised provident fund or an approved superannuation fund is allowable as deduction subject to such limits prescribed for the purpose of recognising the provident fund or approving the superannuation fund.

(18) Employer's contribution towards Pension Scheme [Sec. 36(1)(iva)] – Any sum paid by the employer by way of contribution towards a pension scheme, as referred to in section 80CCD (notified by the Central Government) on account of an employee. This contribution shall be allowed as deduction as business expenditure upto 10% of the salary of the employee in the previous year. Here, *Salary* means basic salary + dearness allowance (if it is under the terms of employment) + commission on turnover at rate of fixed percent. This excludes all other allowances and perquisites.

(19) Employer's contribution to Approved Gratuity Fund [Sec. 36(1)(v)] – Employer's contribution towards an approved gratuity fund, created by him for the exclusive benefit of his employees, is allowable as deduction to the extent of 8.33% of the annual salary of each employee.

(20) Family Planning Expenditure [Sec. 36(1)(ix)] – Any expenditure incurred by a company for promoting family planning amongst its employees, is fully allowable as deduction.

(21) Banking Cash Transaction Tax [Sec. 36(1)(xiii)] – Banking cash transaction tax paid by the assessee during the previous year on the taxable banking transactions entered into by him will be allowed as deduction while computing his income from business or profession. Thus, this deduction is available only under the head ‘income from business or profession’ only instead of other heads.

(22) Contribution towards Credit Guarantee Fund Trust [Sec. 36(1)(xiv)] – Any contribution made by a public financial institution to such credit guarantee fund trust for small industries, which is notified by the Central Government for this purpose, is allowed as deduction in computing taxable income under this head.

(23) Securities Transaction Tax [Sec. 36(1)(xv)] - Any amount of securities transaction tax paid by an assessee during the previous year in respect of taxable securities transactions entered into the course of business shall be allowed as deduction subject to the condition that such income from taxable securities transaction is included under the head ‘profit and gains from business and profession’.

(24) Commodities Transaction Tax [Sec. 36(1)(xvi)] - An amount equal to the commodities transaction tax paid by the assessee in respect to the taxable commodities transaction entered into in the course of his business, during the previous year, shall be allowed as deduction, if the income arising from such taxable commodities transactions is included in the income computed under the head ‘profit and gains from business and profession’.

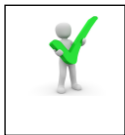
(25) Expenditure by Co-operative Society for purchase of Sugarcane [Sec. 36(1)(xvii)] - Deduction will be allowed in respect of expenditure incurred by a co-operative society (engaged in the business of manufacture of sugar) for purchase of sugarcane at a price which is equal to or less than the price fixed on approved by the Government.

(26) General Deductions [Sec. 37] – According to Section 37, any expenditure not covered under sections 30 to 36, are allowable as deduction subject to the fulfilment of following conditions:

- (i) It is not deductible under sections 30 to 36.
- (ii) It is not a capital expenditure.
- (iii) It is not a personal expenditure of the assessee.
- (iv) It is exclusively for the purpose of business or profession.
- (v) It is incurred during the previous year.

The following are the few examples of admissible general deductions under this section:

- (a) Expenses incurred in the purchase, manufacture and sale of goods
- (b) Expenses incurred in the day to day running of the business.
- (c) Royalties paid in connection with mines.
- (d) Reasonable expenses incurred on the occasion of Dussehra, Diwali, Commencement of business etc.
- (e) Welfare expenditure incurred by the assessee.
- (f) Payment of excise duty.
- (g) Annual listing fee paid to Stock Exchange by public limited company is allowable.
- (h) Expenditure incurred in alterations in the Memorandum or Articles of Association of a company subject to the provisions under Companies Act.
- (i) Los of stock by fire.
- (j) Loss of stock-in-trade by enemy bombing.



Check Your Progress-A

Q1. State the provisions of section 35A regarding the expenditure incurred on acquisition of patent rights or copyrights.

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Q2. Explain the deductions of preliminary expenses.

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Q3. State the deductions of expenditure on scientific research.

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6.4 EXPENSES EXPRESSLY DISALLOWED

The following expenses are expressly disallowed (shall not be deducted), in computing the taxable profits from business or profession, as per the provisions of the Act:

(1) Expenditure on advertisement to a political party [Sec. 37(2B)] – No deduction shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, pamphlet etc. published by a political party.

(2) In case of any assessee [Sec. 40(a)] – In case of any assessee, the following expenses are expressly disallowed:

(i) Payments outside India etc: Any interest, royalty, fees for technical services etc., which is payable outside India or in India to a non-resident/a foreign company on which tax is deductible at source and such tax has not been deducted at source or after deduction has not been paid on or before the due date of filing the return of income specified in Sec. 139(1) shall not be allowed as a deduction.

However, if in respect of any such sum tax has been deducted in any subsequent year, or has been deducted in the previous year but paid after the due date specified in Sec. 139(1), such sum shall be allowed as a deduction in computing the income of that year in which such tax has been paid.

(ii) Payments to residents: Any payment to a resident on which tax is deductible at source and such tax has not been deducted or, after deduction has not been paid on or before the due date of filing the return of income specified in Sec. 139(1), then 30% of such sum shall not be allowed as a deduction.

However, if in respect of such sum tax has been deducted in any subsequent year, or has been deducted during the previous year but paid after the due date specified in Sec. 139(1), then 30% of such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

(iii) Tax on profits and gains: Any paid on account of any tax levied on the profits and gains of any business or profession shall not be allowed as a deduction.

(iv) Amount paid to State Government: Any amount paid as royalty, license fee, service fee/charge etc., which is levied exclusively on a State Government undertaking by the State Government; or any amount which is appropriated, whether directly or indirectly, from a State Government undertaking by the State Government, shall not be allowed as a

deduction.

(v) *Salaries payable outside India or to a non-resident*: It is not allowed as a deduction, if tax has not been paid thereon nor deducted at source.

(vi) *Payment to Provident Fund*: Any payment to a provident or other funds shall not be allowed as a deduction unless it is ensured that tax shall be deducted at source from any payments made from the fund provided it is chargeable to tax.

(vii) *Tax on perquisites of employee*: Any tax actually paid by an employer on the value of perquisites provided to an employee which is exempt u/s 10(10CC).

(3) In case of a partnership [Sec. 40(b)] – In case of a partnership, the following payments made by any partnership firm shall not be allowed as deduction in computing taxable income of such firm:

(i) Any payment of salary, bonus, commission or remuneration paid to any partner, who is not a working partner.

(ii) Payment of salary, etc. to working partners will be allowed as a deduction, only if it is authorised by and is in accordance with the terms of partnership deed. It is further provided that the terms of partners deed will not have retrospective effect in this respect.

(iii) Any payment of interest, in excess of 12% p.a., to any partner, by a firm.

(iv) In the case of working partners payment of salary, bonus, commission or remuneration to all partners taken together will be allowed as a deduction subject to the following limit:

(a) On the first Rs.3,00,000 of the book profit or in case of a loss – Maximum allowable amount will be Rs.1,50,000 or @ 90% of the book profit (whichever is more).

(b) On the balance of the book profit – Maximum allowable amount will be @ 60%.

Note: (i) Book-profit means the net profit as shown in the profit and loss account computed in the manner laid down in the Act.

(ii) Working partner means a partner who is actively engaged in the business of the firm.

(4) In case of an Association Of Persons (AOP)/Body Of Individuals (BOI) [Sec. 40(ba)] – In the case of AOI and BOI (other than a company or a co-operative society) any interest, salary, bonus, commission etc, made by such association/body to a member of such association/body is expressly disallowed. Interest paid by the association/body on any loan given by its member to the association/body, is also disallowed. But the interest on loan taken by the association/body from any other concern is allowed even if any member of the association/body has any interest in that concern. In this connection the following provisions, are worth noting:

(i) If the association or body pays any interest to any of its member who also pays interest to the association/body, the interest disallowed shall be the amount by which the interest paid by the association/body to its member exceeds the interest paid by its members to the association/body.

(ii) If an individual is a member in the association/body in a representative capacity and he has given loan to the association/body in his individual capacity, the interest paid by the association/body to such member shall be allowed as deduction.

(iii) If an individual is a member in the association/body in his personal capacity, interest by the association/body to such member shall be allowed as deduction if such interest is received by him in a representative capacity.

(5) Excessive payments to a relative [Sec. 40A(2)] – If an assessee incurs any expenditure by way of payment to a relative shall be disallowed, if the Assessing Officer considers it to be excessive or unreasonable having regard to all the circumstances of the case. Only the excessive or unreasonable part is to be disallowed. For this purpose, relative means the husband/wife/brother/sister or any person which has a substantial interest in the business.

(6) Payments in cash [Sec. 40A(3)] – If an assessee makes a payment or aggregate of payments made to a person in a day of any expenditure exceeding Rs.20,000 otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft, the whole of such expenditure shall not be allowed as deduction. However, where the payment is made for plying, hiring or leasing goods carriages, the limit of disallowance shall be exceeding Rs.35,000 instead of exceeding Rs.20,000.

(7) Provision of Gratuity [Sec. 40A(7)] – If the assessee has made any provision for the payment of gratuity (other than approved gratuity fund) to his employees on their retirement/termination of their employment for any reason, such provision shall not be allowed as deduction in computing the taxable profits for business or profession.

(8) Deductions allowable only on actual payment basis [Sec. 43B] – The following amounts shall be deducted only on ‘actual payment’ basis:

- (i) Any sum payable by the assessee by way of tax or duty/fee under any law.
- (ii) Any sum payable by the assessee as an employer by way of contribution to any provident/ gratuity fund or any other fund for the welfare of employees.
- (iii) Any sum payable by the assessee as interest on any loan or borrowing from any public financial institution.
- (iv) Any sum payable by the assessee as an employer in lieu of any leave at the credit

of his employee.

(9) Other expenses – In addition to above, the following expenses and losses are also not allowable as deduction in computing the profits and gains of business or profession:

- (i) Personal expenses (drawing) of proprietor or partners.
- (ii) Amount paid as charity or gifts.
- (iii) Litigation expenses for registration of shares.
- (iv) Contribution to a political party.
- (v) Insurance premium paid by a firm on LIC policies of its partners.
- (vi) Expenditure on shifting of registered office.

Illustration 2

From the following Profit and Loss account of Mr. Amar for the year ended 31st March, 2017, find out his taxable income from business or profession head –

	Rs.		Rs.
Office expenses and salaries	65,720	Gross profit	5,28,635
General expenses	32,640	Interest on Govt. Securities (gross)	11,800
Interest on bank loan	5,480	Discount	400
Interest on capital	21,580	Bad debts recovered	1,440
Provisions for bad debts	10,835	Profit on sale of long-term investments	20,750
Bad debts	4,000	Sundry receipts	10,350
Audit fees	20,300		
Rent	12,030		
Income tax	21,760		
Charity and donation	4,485		
Legal expenses	3,370		
Compensation to a retrenched employee	41,500		
Addition to building	51,500		
Net profit	2,78,175		
	5,73,375		5,73,375

In computing the income, the following facts should be taken into consideration – (i) Rent includes Rs.600 in respect of the rent of the office building belonging to the proprietor himself. (ii) General expenses include Rs.10,000 in respect of new furniture purchased during the year. (iii) Allowable depreciation as per law is Rs.3,275. (iv) Legal expenses include a sum of Rs.1,000 being penalty by the customs authority.

Solution

Computation of Income from Business or Profession of Mr. Amar
for the assessment year, 2017-18

	Rs.	Rs.
Balance as per P & L a/c (Profit)		2,78,175
<i>Add: Expenses expressly disallowed but debited to P & L a/c:</i>		
Interest on capital	21,580	
Provisions for bad debts	10,835	
Rent of own building	600	
Cost of new furniture being capital expenses	10,000	
Income tax	21,760	
Charity and donation	4,485	
Penalty	1,000	
Addition to building being capital expenses	52,500	1,21,760
<i>Less: Income not taxable under this head but credited to P&L a/c:</i>		3,99,935
Interest on securities	11,800	
Profit on sale of long-term investments being capital gains	20,750	
<i>Less: Expenses expressly allowed but not debited to P&L a/c:</i>	3,275	
Depreciation	1,000	36,825
Depreciation on new furniture @ 10%		
Taxable income		3,63,110

Note: 1. Compensation to the retrenched employee is allowed deduction. It is presumed that the employee was retrenched in the interest of the concern.

2. Penalty imposed by the customs authority is not deductible.

3. Depreciation on new furniture purchased during the year will be allowed @ 10%.

Illustration 3

Dr. Satish is a Medical practitioner. He gives you the following summary of cash book for the year ended 31.03.2017:

	Rs.		Rs.
To Balance	10,000	By rent of clinic	18,000
To consultation fee	60,000	By purchase of medicines	38,000
To visiting fee	45,000	By staff salaries	24,000
To gifts and presents	8,000	By surgical equipments	40,000
To sale of medicine	42,000	By motor car expenses	8,000
To dividend from UTI	6,000	By purchase of motor car	1,40,000
To life insurance maturity	1,00,000	By house hold expenses	7,000
To interest from national defence bonds	6,000	By closing balance	2,000
	2,77,000		2,77,000

Other Information:

(i) 50% of the motor car expenses incurred in connection with profession. Car was purchased in December 2016.

(ii) Household expenses includes Rs.6,800 for life insurance premium.

(iii) Gifts and presents include Rs.3,000 from relatives

(iv) Closing stock of medicine Rs.12,000 and on 01.04.2016, opening stock was Rs.4,000.

Compute his professional gain for the assessment year 2017-18.

Solution

Computation of Income from Business or Profession of Dr. Satish

for the assessment year, 2017-18

	Rs.	Rs.
Gross Professional Earnings		

Consultation fee	60,000	
Visiting fee	45,000	
Gifts (Rs.8000 – Rs.3000)	5,000	
Sale of medicines	42,000	1,52,000
		0
Less: Allowed deductions		1,52,000
		0
Rent		
Medicines (Rs.4,000 + Rs.38,000 – Rs.12,000)	18,000	
Salaries	30,000	
Depreciation on surgical equipments	24,000	
Car expenses 50%	6,000	
Depreciation on car	4,000	
	5,250	
		87,250
Income from profession		64,750

Note: 1. Computation of depreciation on car –

Car has been used for less than 180 days during previous year i.e., Rs. 1,40,000 @ 7.5% = Rs. 10,500

Less: 50% for personal use @ Rs.10,500 = Rs.5,250.

Hence allowable depreciation will be Rs.5,250 (Rs.10,500 – Rs.5,250).

Illustration 4

From the following Profit and Loss account of Shri Radhey Lal (the proprietor of a flour mill) for the year ended 31st March, 2017, find out his income from business –

	Rs.		Rs.
Trade expenses	450	Gross profit	2,35,900
Establishment charges	2,200	Dividends from a co-operative society	2,600
Rent, rates and taxes	1,400	Rent from property	500
Discount and allowance	200	Bad debts recovered (allowed as deduction in an earlier year)	2,000
Income tax	700		
Advertisement expenses	1,450		
Postage and Telegrams	100		

Gifts and presents for publicity	125		
	250		
Fire insurance premium	375		
Charities	400		
Donations	250		
Repairs and Renewals	250		
Audit fees			
Net profit transferred to capital account	2,32,850		
	2,41,000		2,41,000

Solution

Computation of Income from Business of Shri Radhey Lal
for the assessment year, 2017-18

	Rs.	Rs.
Balance as per P & L a/c (Profit)		2,32,850
<i>Add: Expenses expressly disallowed but debited to P & L a/c:</i>		0
Income tax	700	
Charities	375	
Donations	400	
		1,475
		2,34,325
<i>Less: Income not taxable under this head but credited to P&L a/c:</i>		500
Income from property (being not business income)	2,600	
Dividend (being not business income)		3,100
Income from business		2,31,225

Illustration 5

From the following Profit and Loss account of Mr. Om (a cloth merchant) for the year ended 31st March, 2017, find out his income from business –

	Rs.		Rs.
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Salaries and wages	15,000	Gross profit	2,70,000
Rent and taxes	4,000	Dividends on shares (gross)	4,000
Domestic expenses	2,500	Rent from building let out	10,000
Income tax	1,200		
Postal charges	1,500		
Donation	2,500		
Life insurance premium	2,000		
Audit fees	1,500		
Bad debt reserve	1,800		
Bad debts	2,500		
Depreciation	5,000		
Net profit	2,44,500		
	2,84,000		2,84,000

Other information –

- (i) Rent and taxes includes Rs.2,000 paid as Municipal tax on building let out.
- (ii) Value of life insurance policy is Rs.18,000
- (iii) Donation was given to an approved institution
- (iv) Permissible depreciation was Rs.4,000.

Solution

Computation of Income from Business of Mr. Om
for the assessment year, 2017-18

	Rs.	Rs.
Balance as per P & L a/c (Profit)		2,44,500
<i>Add:</i> Expenses expressly disallowed but debited to P & L a/c:		0
Rent paid to the extent of municipal taxes paid	2,000	
Domestic expenses	2,500	
Income tax	1,200	
Donation	2,500	
Life insurance policy	2,000	
Bad Debts recovered	1,800	

Excess Depreciation	1,000	13,000
<i>Less: Income not taxable under this head but credited to P&L a/c:</i>		2,58,500
Rent of building not chargeable under the head business	10,000	0
Dividend on shares	4,000	14,000
Income from business		2,43,500



Check Your Progress-B

Q1. Will the provisions of Section 40A(3) be attracted in the following cases:

(i) Mr. X made a purchase of goods worth Rs.80,000 and made payment of Rs.62,000 by cheque and Rs.18000 in cash.

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(ii) Mr. X purchased a building for Rs.40 lakh and made the payment in cash.

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(iii) Mr. X a dealer in real estate purchased a building for Rs.40 lakh and made the payment in cash.

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(iv) Mr. X purchased goods worth Rs.36,000 from Mr. Y against one bill but made payment of Rs.18,000 and Rs.18,000 at different times on the same date.

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Q2. Discuss the following payments which are expressly disallowed in case of a partnership firm.

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Q3. State any four expenses or losses which are not allowed for deduction.

6.5 SUMMARY

As per Sections 30 to 37 of Income-tax Act, the important expressly allowed expenses and deductions are - Expenses relating to building [Sec. 30], Expenses of machine, furniture and plant [Sec. 31], Depreciation [Sec. 32], Investment in new plant or machinery [Sec. 32AC], Expenditure on scientific research [Sec. 35(1)], Expenditure on acquisition of patent rights or copyrights [sec. 35a], Expenditure on know-how [sec. 35ab], Expenditure incurred on agricultural extension project [sec. 35ccc], Expenditure incurred on any skill development project [sec. 35ccd], Deduction in respect of preliminary expenses [sec. 35d], Amortisation of expenditure in case of amalgamation or demerger [sec. 35dd], Amortisation of expenditure under voluntary retirement scheme [sec. 35dda], Expenses on the discovery of minerals [sec. 35e], Insurance premium [sec. 36(1)(i)], Interest on borrowed capital [sec. 36(1)(iii)], Discount on zero coupon bonds [sec. 36 (1)(iiia)], Employer's contribution to recognised provident fund [sec. 36(1)(iv)], Employer's contribution towards pension scheme [sec. 36(1)(iva)], Employer's contribution to approved gratuity fund [sec. 36(1)(v)], Family planning expenditure [sec. 36(1)(ix)], Banking cash transaction tax [sec. 36(1)(xiii)], Contribution towards credit guarantee fund trust [sec. 36(1)(xiv)], Securities transaction tax [sec. 36(1)(xv)], Commodities transaction tax [sec. 36(1)(xvi)], Expenditure by co-operative society for purchase of sugarcane [sec. 36(1)(xvii)] and General deductions [sec. 37].

The important expenses which are expressly disallowed are Expenditure on advertisement to a political party [Sec. 37(2B)], Assessee's case [Sec. 40(a)], Partnership case [Sec. 40(b)], AOP or BOI case [Sec. 40(ba)], Excessive payments to a relative [Sec. 40A(2)], Payments in cash [Sec. 40A(3)], Provision of Gratuity [Sec. 40A(7)], Deductions allowable only on actual payment basis [Sec. 43B] etc.

**6.6 GLOSSARY**

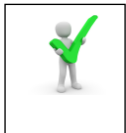
Depreciation on tangible assets (like building, plant, machine, furniture) and intangible assets (like patent, copyright, trademark) used by assessee for the business are allowable expenditure.

New assets means any new plant or machinery (other than ship or aircraft) but does not include any plant or machinery in any office premises or any residential accommodation or a guest house or, any office appliances including computers and computer software etc.

Expenditure on scientific research means any expenditure, whether of revenue nature or capital nature incurred for carrying out the scientific research. So, this includes the extension knowledge in the field of natural and applied sciences including agriculture, animal husbandry or fisheries.

Patent or Copyrights means the right to use any know-how, secret formula, designs and specifications. Know-how means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil well or other sources of mineral deposits.

Preliminary expenses are the expenses which are made under preparing project/feasibility report, expenses of market survey, expense on engineering services relating to trade of assessee, legal expenses related to preparing the draft of contract made between assessee and other persons etc. These expenses are admissible in 5 equal instalments or 1/5th of total preliminary expenses allowed every year.



6.7 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress –B

Ans. 1 (i) No. As the cash payment does not exceed Rs.20,000. It is assumed that the cheque is account payee for the payment of Rs.62,000.

(ii) No. Section 40A(3) is not applicable for purchase of a capital asset.

(iii) Yes. As building in this case is stock-in-trade, Rs.40 lakh shall be disallowed.

(iv) Yes. The payment shall be disallowed because the total amount exceeds Rs.20,000 although the payment amount is less than Rs.20,000 in once a time.



6.8 REFERENCES

- Agarwal, B.K. and Agarwal, Rajeev. 2017. *Income Tax Law and Accounts*. Nirupam Sahitya Sadan, Agra.
- Mehrotra, H.C. and Goyal, S.P. 2017. *Income Tax Law and Accounts*. Sahitya Bhawan.
- Publications, Agra.Singhania, V.K and Singhania, K. 2017. *Direct Taxes Law and Practice with Special Reference to Tax Planning, 57th Edition*. Taxmann Publications, New Delhi.



6.9 SUGGESTED READINGS

1. Motamal Jethumal v.CIT (1974).
2. CIT V.SNASA Annamalai chettiar (1947).



6.10 TERMINAL QUESTIONS

- Q1. Will the provisions of Section 40A(3) be attracted in the following cases:
- i. Mr. X purchased goods worth Rs.12,000, Rs.15,000 and Rs.10,000 against three bills from Mr. Y and made the payment of Rs.37,000 in cash at one time.
 - ii. Mr. X made a payment of Rs.40,000 as donation in cash to National Defence Fund.
- Q2. What are the admissible deductions in computing the taxable income from 'business or profession' head? Discuss.
- Q3. What expenses are disallowed to a businessmen in computing taxable profits?
- Q4. Discuss the basic concepts in determination of taxable income under the head 'business or profession'.
- Q5. State the admissible General Deductions u/s 37 under the head 'business or profession' with examples.

Block II
**Tax Planning and Assessment of Individual
and Firms**

UNIT 7 INCOME FROM CAPITAL GAIN AND TAX PLANNING

- 7.1 Introduction**
- 7.2 Objectives**
- 7.3 Basis of Charges**
- 7.4 Capital Assets**
- 7.5 Types of Capital Gain**
- 7.6 Computation of Capital Gain**
- 7.7 Transfer of Assets**
- 7.8 Cost of Acquisition**
- 7.9 Cost of Improvement**
- 7.10 Indexed Cost of Acquisition & Improvement**
- 7.11 Capital Gain Exemptions**
- 7.12 Exemptions at a Glance**
- 7.13 Summary**
- 7.14 Glossary**
- 7.15 References**
- 7.16 Suggested Readings**
- 7.17 Terminal Questions**

7.1 INTRODUCTION

Any profit arising from the transfer of capital asset is taxable under the head Income from capital gain. Capital gain is divided into two parts short term capital gain and long term capital gain.

In this unit we learn all the aspects in relation to computation of capital gain and various exemptions available from capital gain.

7.2 OBJECTIVES

The contents of this unit will help you to understand;

- The meaning and types of capital assets and capital gain
- Computation of capital gain
- Exempted capital gain
- Effect of Capital gain account scheme

7.3 BASIS OF CHARGES

Any profits or gains arising from the transfer of a capital asset in the previous year, shall be chargeable to income-tax under the head 'Capital Gains' and shall be deemed to be the income of the previous year in which the transfer took place unless such capital gain is exempt u/s 54, 54B, 54D, 54EC, 54EE, 54F, 54GA, or 54GB.

The following are the essential conditions for taxing capital gains:

- (A) there must be a capital asset;
- (B) the capital asset must have been transferred;
- (C) there must be profits or gains on such transfer, which will be known as capital gain;
- (D) Such capital gain should not be exempt u/s 54, 54B, 54D, 54EC, 54EE, 54F, 54GA, or 54GB.

7.4 CAPITAL ASSETS

According to section 2 (14) Capital asset means property of any kind held by the assessee whether connected with his business, profession or not. Capital asset may be tangible or intangible, movable or immovable, fixed or floating. It includes plant, machinery, land, building, jewellery, investment, shares, debentures, goodwill, copyright, license, permits etc.

Exception: The term capital asset does not include the following:

- (i) Commercial goods: Any stock-in-trade, consumable stores or raw materials held for the purposes of his business or profession.
- (ii) Personal Assets: Movable assets (including wearing clothes and furniture) held for personal use by the assessee or any member of his family dependent on him. Thus a car or any other vehicle, refrigerator, television or other electrical appliances are included in this.

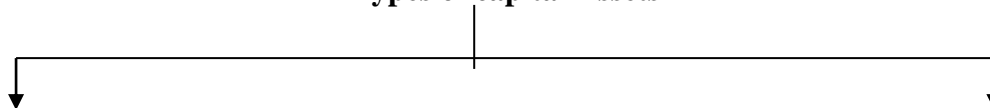
Exceptions: The following assets will not be treated as personal effect and liable to tax:

- (a) Archaeological collections, (b) drawings, (c) paintings, (d) sculptures, (e) any work of art, (f) jewellery for personal use.

jewellery includes:

- (a) Ornaments made of gold, silver, platinum, or any other precious metal, whether or not worked or sewn into any wearing apparel.
 - (b) Precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel.
- (iii) Agricultural land: Agricultural land in India provided it is not situated;
- (a) within the limits of any municipality or a cantonment board, having a population of 10,000 or more; or
 - (b) In areas lying within a distance not exceeding 8 km from the local limits of such municipalities or cantonment boards. if the agricultural land is situated within the area measured aerially specified below it shall form part of capital asset.
 - (1) Not being more than two kilo meters from the local limits and which has population of more than ten thousand but not exceeding one lakh; or
 - (2) Not being more than six kilo meters from the local limits and which has population more than one lakh but not exceeding ten lakh; or
 - (3) Not being more than eight kilo meters from the local limits and which has population more than ten lakh
- (iv) Gold bonds 6½ Gold Bonds, 1977 or 7% Gold Bonds ,1980 or National Defence Gold Bonds 1980 issued by the Central Government.
- (v) Special Bearer Bonds 1991.
- (vi) Gold deposit Bonds. Gold deposit Bonds issued under the Gold Deposit Scheme, 1999 or deposit certificate issued under gold monetization scheme notified by the Central Government.

Types of capital Assets



Short term Capital Assets

Long term Capital Assets

(1) Short-term capital asset [Section 2(42A)] – A capital asset held by an assessee for not more than 36 months immediately preceding the date of its transfer is known as a short term capital asset. However ,the following assets shall be treated as short-term capital assets if they are held for not more than 12 months (instead of 36 months mentioned above) immediately preceding the date of its transfer :

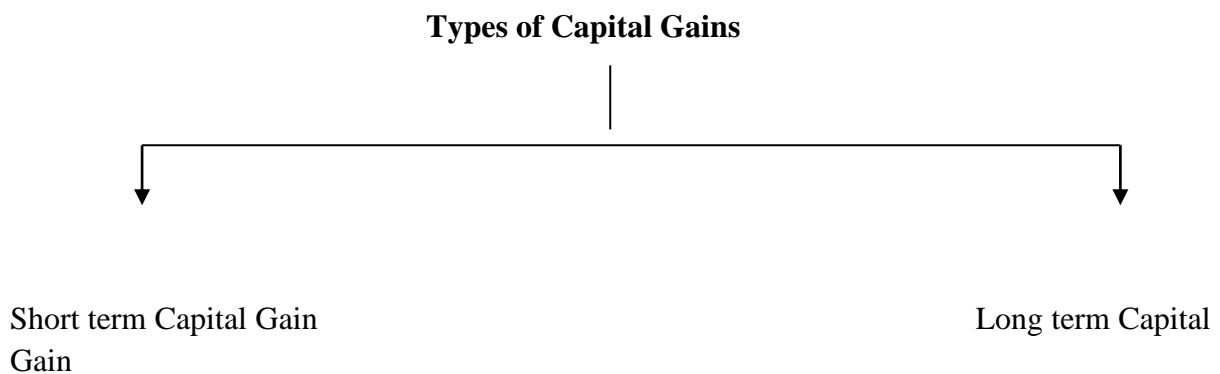
- (a) a security including shares listed in a recognized stock exchange in India.
- (b) a unit of unit trust of india

- (c) a zero coupon bond
- (d) approved mutual fund

(2) Long-term capital asset [Section 2(29A)]- It means a capital asset which is not a short-term capital asset. In other words, (if the asset is held by the assessee for more than 36 months or 12 months, as the case may be, such an asset will be treated as a long-term capital asset.

7.5 TYPES OF CAPITAL GAIN

Capital gain Arises from the transfer of short term capital asset is known as short term capital gain & capital gain arises from the transfer of long term capital asset is known as long term capital gain.



7.6 COMPUTATION OF CAPITAL GAIN

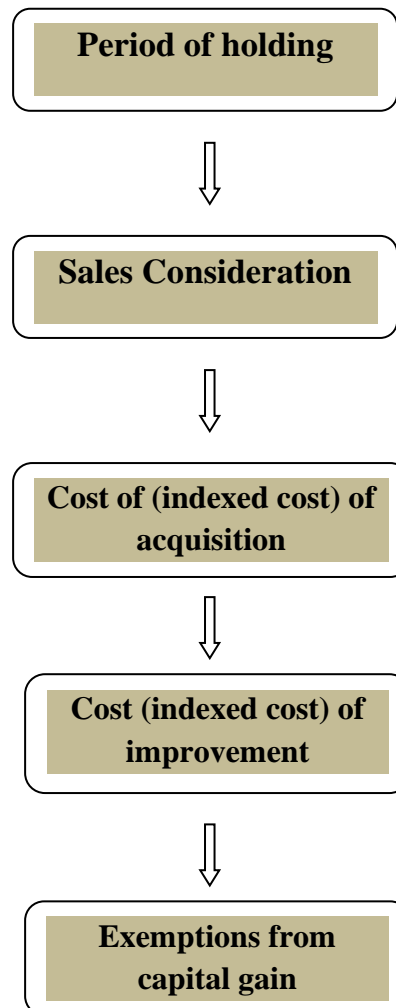


Fig 7.1Computation of Capital Gain

Calculation of Short Term Capital Gain

Computation of Taxable Income from Capital Gains

(For the A.Y. 2017-18)

Sales consideration		-
Less:- (i) Cost of acquisition	-	
(ii) Cost of Improvement	-	

(iii) Selling expenses	-	-
SHORT TERM CAPITAL GAIN		-

Calculation of Long term Capital Gain

Computation of Taxable Income from Capital Gains

(For the A.Y. 2017-18)

Sales consideration		-
Less:- (i) Indexed Cost of acquisition	-	
(ii) Indexed Cost of Improvement	-	
(iii) Selling expenses	-	-
LONG TERM CAPITAL GAIN		-

7.7 TRANSFER OF ASSETS

What is transfer [Section 2(47)] : Transfer, in relation asset, includes:

- (i) the sale, exchange or relinquishment of the asset; or
- (ii) the extinguishment of any rights therein; or
- (iii) the compulsory acquisition thereof under any law; or
- (iv) in case where the asset is converted by the owner thereof into, or is treated by him, as stock-in trade of business carried on by him, such conversion or treatment; or
- (v) the maturity or redemption of zero coupon bonds; or
- (vi) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882; or
- (vii) any transaction (whether by way of becoming a member of, or acquiring shares in a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of any immovable property.

Transaction not regarded as transfer [Section 46 and 47] : The meaning of transfer is given in section 2(47), whereas transaction although there is transfer, are covered u/ss 46 and 47. In the following transactions although there is a transfer, but these are not considered to be transfer for purposes of capital gains:

- (i) where the assets of a company are distributed to its shareholders on liquidation of a company, such distribution shall not be regarded as transfer in the hands of the company;
- (ii) any distribution of capital assets on the total or partial partition of Hindu Undivided Family;
- (iii) any transfer, of a capital asset under a gift or will or an irrevocable trust;
- (iv) any transfer, of a capital asset by a company to its 100% subsidiary company provided the subsidiary company is an Indian company;
- (v) any transfer of a capital asset by a company to its 100% subsidiary company to its holding company, if the holding company is an Indian company.
- (vi) any transfer, in a scheme of amalgamation of a capital asset by the amalgamating company to the amalgamated company, if the amalgamated company is an Indian company;
- (vii) any transfer, in a scheme of amalgamation of a shares held in an Indian company by the amalgamating foreign company to the amalgamated foreign company if-
 - (a) at least 25% of the shareholders of the amalgamating foreign company continue to remain shareholder of the amalgamated foreign company, and
 - (b) such a transfer does not attract capital gains tax in the country, in which the amalgamating company is incorporated;
- (viii) any transfer, in a scheme of amalgamation of a banking company with a banking institution sanctioned and brought into force by the Central Government of a capital asset by the banking company to the banking institution;
- (ix) any transfer, in business reorganization, of a capital asset by the predecessor co-operative bank to the SUCCESSOR CO-OPERATIVE bank;
- (x) any transfer, in demerger, of a capital, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company;
- (xi) any transfer, by a shareholder in a business reorganization of a capital asset being a share or shares held by him in the predecessor co-operative bank if the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank;
- (xii) any transfer, or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking.
- (xiii) any transfer, by a shareholder in a scheme of amalgamation, of shares held by him in the amalgamating company if:
 - (a) the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company, and
 - (b) the amalgamated company is an Indian company;
- (xiv) any transfer of bonds or Global Depository Receipts referred to in section 115AC (1) i.e . Notified bonds/GDRs of an Indian company or bonds/shares of a public sector company purchased in foreign currency, made outside India by a non-resident to another non-resident.

- (xv) any transfer of urban agricultural land in India before 1-3-1970;
- (xvi) any transfer, of a capital asset, being any work of art, archaeological, scientific or art collection, book, manuscript, drawing, painting, photograph or print, to the National Archives or any such other public museum or institution, as may be notified by the Central Government in the Official Gazette to be of national importance or to be of renown throughout any State or States;
- (xvii) any transfer, by way of conversion of bonds or debentures, debenture-stock or deposit certificates in any form, of a company into shares or debentures of that company;
- (xviii) any transfer, by way of conversion of bonds referred to in section 115AC(1) (a) (i.e. Notified bonds of public sector company bought by non-resident in foreign currency) into shares or debentures of any company (inserted by the Finance Act, 2008, w.e.f. A.Y. 2008-09);
- (xix) any transfer, of a capital asset being land of a sick industrial company made under a scheme prepared and sanctioned under section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985 where such sick industrial company is being managed by its worker's co-operative';
- (xx) any transfer, of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm.
- (xxi) any transfer under the Security Lending Scheme, 1997 for lending of any securities under an agreement or arrangement, which the assessee has entered into with the borrower of such securities and which is subject to the guidelines issued by the SEBI or RBI, in this regard; and
- (xxii) any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government. It may be observed that the above transactions are not transfer for purposes of capital gains.

7.8 COST OF ACQUISITION

Cost of acquisition is the price which the assessee has paid for acquisition of the asset; it includes all expenses incurred to acquire it. Interest paid on money borrowed for the purchase of capital asset would constitute part of the cost of acquisition. Cost of acquisition can be calculated as under:

Cost to the previous owner deemed to be the cost of acquisition. If the asset is acquired by an assessee in the following circumstances the cost of acquisition of the asset shall be deemed to be the cost for which the previous owner of the property acquired it. It will be increased by the cost of any improvement of the assets incurred by the previous owner of the assessee.

Circumstances when cost of previous owner is taken as cost of acquisition:

- (a) on any distribution of asset on the total or partial partition of a Hindu undivided family; or
- (b) by succession, inheritance or devolution; or
- (c) on succession of a sole proprietary concern by a company.
- (d) under gift or Will; or
- (e) on any distribution of assets on the liquidation of a company; or
- (f) on the transfer by a subsidiary company to its Indian company to the amalgamated company if the amalgamated company is an Indian company ; or
- (g) on the transfer of capital asset by amalgamated company to the amalgamated company if the amalgamated company is an Indian company; or
- (h) when any of the members of a H.U.F. converts his self-acquired property into H.U.F. property (The cost of the property to the H.U.F will be taken as the cost of the property to the individual converting the property) ; or
- (i) on transfer of capital asset by a private company or unlisted public company at the time of conversion into a limited liability partnership; or
- (j) under a transfer to a revocable or an irrevocable trust.

Cost of acquisition of a Capital asset acquired after 1-4-1981. If the asset is acquired by an assessee after 1st April, 1981 the purchase price plus all expenses incurred to acquire it will be treated as cost of acquisition.

Cost of acquisition of a Capital asset acquired before 1-4-1981. Where the capital asset became property of the assessee 1st April, 1981, the cost of acquisition of the asset may, at the option of the assessee, be taken to be any one of the following: (which is beneficial to assessee)

- (i) The cost of the asset to the assessee ; or
- (ii) The fair market, value of the asset on 1st April, 1981.

Cost of Share or Security :

(i) Where share or security was acquired before 1st April, 1981, the cost of acquisition will be taken the actual cost or fair market value on 1st April, 1981 whichever is beneficial to the assessee.

(ii) If it is acquired after 1st April, 1981, the actual cost will be the cost of acquisition

Cost of Bonus Shares: The cost of bonus shares or security, which is received by the assessee without any payment on the basis of his holding any financial asset, will be as under:

- (i) Where bonus share or security was received prior to 1st April 1981, the fair market value on 1st April, 1981;
- (ii) Where bonus share or security was received after 1st April 1981 = NIL

Cost of acquisition of Right Issue : In the case where an assessee by holding a share or any other security becomes entitled to subscribe additional shares or security (known as financial asset) on the basis of right issue, the cost of acquisition shall be : -

- (i) On the basis of entitlement if the assessee subscribed to right issue – Amount actually paid to acquire it.
- (ii) If the assessee renounced the right in favor of any other person – Nil.
- (iii) If the assessee has purchased the right to subscribe for the additional shares/security (financial asset) – Purchase price paid to purchase the right plus the amount paid to the company for acquiring the rights shares/security.

Cost of acquisition of Goodwill, trademark etc.: The cost of acquisition in relation to (a) goodwill of business, a trademark or brand name associated with a business ; (b) a right to manufacture, produce or process any article or thing, right to carry on any business; (c) tenancy rights; (d) stage carriage permits; or (e) loom hours shall be determined as under :

- (i) If the asset case – Nil. However this will not cover the cases specified in section 49(1).
- (ii) In any other case- Nil. However this will not cover the cases specified in section 49(1)
- (iii) Case covered under section 49(1). Cost to the previous owner.

7.9 COST OF IMPROVEMENT

Cost of improvement is capital expenditure incurred by an assessee in making any additions/ improvement to the capital asset. It also includes any expenditure incurred to protect or complete the title to the capital assets or to cure such title. Cost of improvement includes only expenditure on improvement incurred on or after April 1, 1981 (whether incurred by the previous owner or by the assessee).

7.10 INDEXED COST OF ACQUISITION & IMPROVEMENT

Indexed cost of acquisition and improvement is an amount which bears to the cost of acquisition and improvement, the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the year in which the asset was purchased or improvement to the asset took place

Cost Inflation Index:

In relation to a previous year, means such Index as the Central Government may, having regard to 75% of average rise in Consumer Price Index for urban non-manual employees for the immediately preceding previous year to such year, by notification in the Official Gazette.

Indexed cost of Acquisition

$$\text{Cost of Acquisition} \times \frac{\text{Cost Inflation Index in the year of Transfer}}{\text{Cost Inflation Index of the year of Purchase Or of 1981-82 whichever is later}}$$

Indexed cost of Improvement

$$\text{Cost of Improvement} \times \frac{\text{Cost Inflation Index in the year of Transfer}}{\text{Cost Inflation Index of the year of Improvement}}$$

Cost Inflation Index (CII) as notified by the Central Government is as under:

<i>Financial Year</i>	<i>Cost Inflation Index (CII)</i>	<i>Financial Year</i>	<i>Cost Inflation Index (CII)</i>	<i>Financial Year</i>	<i>Cost Inflation Index (CII)</i>
1981-82	100	1993-94	244	2005-06	497
1982-83	109	1994-95	259	2006-07	519
1983-84	116	1995-96	281	2007-08	551
1984-85	125	1996-97	305	2008-09	582
1985-86	133	1997-98	331	2009-10	632
1986-87	140	1998-99	351	2010-11	711
1987-88	150	1999-00	389	2011-12	785
1988-89	161	2000-01	406	2012-13	852
1989-90	172	2001-02	426	2013-14	939
1990-91	182	2002-03	447	2014-15	1024
1991-92	199	2003-04	463	2015-16	1081
1992-93	223	2004-05	480	2016-17	1125

Note: Indexation is not allowed in the following cases

1. Debentures and Bonds except capital indexed bonds issued by the Government.
2. Slump sale,
3. Transfer of UTI funds purchased in foreign currency by non resident
4. Transfer of foreign exchange asset by nonresident Indian
5. Transfer of securities of foreign institutional investors

Example: X purchased a piece of building on 02.03.1976 for Rs. 50,000. This building was sold by him on 05.10.16 for Rs. 14,00,000. The market value of the building as on 1.4.1981 was Rs. 1,20,000. Expenses on transfer were 2% of the sale price. Compute the capital gain for the assessment year 2017-18.

Solution:	Rs.	Rs.
Sale consideration		14,00,000
Less: Expenses on transfer	28,000	
Indexed cost of acquisition - Rs. 1,20,000 x $\frac{1125}{100}$	13,50,000	13,78,000
	22,000	22,000
Long term capital gain		22,000

Example: Sohan Purchased a house on 30.07.1990 for Rs. 1,10,000 and paid 10,000 for getting the property in his name. On 14.07.1991, he spent Rs. 80,000 on improvement of the house. The house was sold on 15.1.2016 for Rs. 15,00,000. Commission of Rs. 15,000 was paid on the sale of the house . Compute the capital gains. CII for the financial year 1990-91 and 1991-92 is 182 and 199 respectively.

Solution:	Rs.
Sale consideration	
15,00,000	
Less: 1. Expense on transfer	15,000
2. Indexed cost of acquisition – Rs. 1,20,000 x $\frac{1125}{182}$	7,41,758
	4,52,261
3. Indexed cost of improvement – Rs. 80,000 x $\frac{1125}{199}$	4,52,261
	12,09,019
Long term capital Gain	2,90,981



Check Your Progress-A

Q1. What are various types of Capital Gains?

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Q2. What is transfer?

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Q3. How one can calculate Indexed Cost of Acquisition & Improvement?

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7.11 CAPITAL GAIN EXEMPTIONS

Capital gains arising from the TRANSFER OF RESIDENTIAL HOUSE PROPERTY [Sec. 54]:

Capital gain arising from the transfer of a house property or land appurtenant thereto is exempt from tax provided the following conditions are satisfied:

1. A residential house property whose income is taxable under the head “Income from house property” should be transferred by an **individual or a HUF**. The exemption is available whether the residential house property is self-occupied or let out.

2. The house property which is transferred should be a **long-term capital asset**.
3. To claim exemption, the taxpayer will have to purchase another residential house property (old or new) or construct **another residential** house property within 1 year before, or within 2 years after, the date of transfer of the residential house property in case of purchase option. In case of construction option, the construction should be completed within 3 years from the date of transfer of residential house property.

Amount of exemption:

The amount of exemption is lower of the following:

- a. the amount of capital gain generated on transfer of residential house property; or
- b. If the amount of capital gain is not utilized for the purchase of new house, the taxpayer should deposit the amount in “Capital gains deposit account scheme” on or before the due date of submission of return of income which will have to be utilized for purchase/construction of the **new** (old or new) property within the specified period. On the basis of amount utilized in acquiring the new (old or new) property and amount deposited in the deposit account, the Assessing Officer will give exemption under section 54.

Consequences:

In this case, for the purpose of computing capital gain on such transfer, cost of acquisition of the new house property shall be reduced by the amount of capital gain exempt under this section i.e., section 54 earlier, and such capital gain will always be a short-term capital gain.

If the amount deposited is not utilized fully for purchase or construction of new (old or new) residential property within the stipulated period, then the amount **not so utilized** shall be treated as LTCG of the previous year in which the period of 3 years from the date of transfer of original asset expires. In such a case, the assessee can withdraw the unutilized amount at any time after the expiry of 3 years from the date of the transfer of the original asset in accordance with the aforesaid scheme.

Capital gains arising from the TRANSFER OF LAND USED FOR AGRICULTURAL PURPOSE [Sec. 54 B]:

Capital gains arising from the transfer of agricultural land are exempt from tax provided the following conditions are satisfied:

1. The taxpayer is an **individual** or Hindu undivided family

2. The agricultural land was used by the taxpayer or his parents for agricultural purposes for a **period of two years** immediately preceding the date of transfer.
3. The taxpayer has purchased another land for agricultural purposes within a period of **2 years** from the date of such transfer. In case capital gain arises on compulsory acquisition of agricultural land by the Government, the time limit of 2 years shall apply from the date of receipt of compensation. The new land may be in urban area or rural area.

Amount of exemption:

- a. the amount of capital gain generated on transfer of agricultural land is exempt up to the cost of new agricultural land.
- b. If the taxpayer is not able to acquire the new agricultural land than taxpayer should deposit the amount in “Capital gains deposit account scheme” on or before the due date of submission of return of income which will have to be utilized for purchase of new agricultural land within the specified period. On the basis of amount utilized in acquiring the new agricultural land and amount deposited in the deposit account, the Assessing Officer will give exemption under section 54B.

Consequences:

In case the new agricultural land is transferred within a period of 3 years of its purchase, the capital gain which was exempt earlier under section 54B shall be reduced from the cost of the new agricultural land for the purpose of computation of capital gain in respect of the new agricultural land and it will be a short-term capital gain.

It is to be noted that if the new agricultural land is situated in a rural area, the gain arising on its transfer is not chargeable to tax as an agricultural land situated in a rural area is not a “capital asset” under section 2(14).

By withdrawing from the deposit account, new agricultural land can be purchased within the period given above.

If the amount deposited is not utilized fully for purchase of new agricultural land within the stipulated period, then the amount not so utilized shall be treated as capital gain of the previous year in which the period of **2 years from the date of transfer of original asset expires**. It will be **taxable as long-term or short-term capital gains depending upon the original capital gain**.

Capital gains on COMPULSORY ACQUISITION OF LAND AND BUILDING, forming part of industrial undertaking [Sec. 54D]:

Capital gain arising by way of **compulsory acquisition** of land or building if the following conditions are satisfied:

1. The taxpayer may be an individual, HUF, firm, company or any other person.
2. The land or building should be used by the assessee for the purpose of industrial undertaking for at least two years before the date of compulsory acquisition.
3. Assessee has purchased any other **land or building** within a period of **3 years** from the date of **receipt of compensation** or constructed a building within such period.
4. Newly acquired land or building should be used for the purposes of shifting or re-establishing the said undertaking or setting up another industrial undertaking.

Amount of exemption:

- a. If the amount of capital gain is less than the cost of new asset the entire capital gain shall be exempt.
- b. If the amount of capital gain is greater than the cost of new asset the cost of new asset shall be exempt.
- c. If the amount of capital gain is not utilized by the assessee before the filing of return the taxpayer should deposit the amount in “Capital gains deposit account scheme” on or before the due date of submission of return of income which will have to be utilized for purchase/ construction of new land and building within the specified period. On the basis of amount deposited in the deposit account, he will be entitled for exemption.

Consequences:

If the new land and building is transferred within a period of 3 years from the date of its acquisition (or completion of construction), the capital gain which was exempt under this section earlier, shall be reduced from the cost of the new asset for the purpose of computation of capital gain in respect of the transfer of the new asset.

By withdrawing from the deposit account, new land and building can be purchased within the period given above.

If the amount deposited is not utilized fully for purchase/ construction of new land and building within the stipulated period, then the amount not so utilized shall be treated as capital gain of the previous year in which the period of 3 years from the date of receipt of compensation expires. It will be taxable as long-term or short-term capital gains depending upon the original capital gain.

Capital gain from transfer of LONG TERM CAPITAL ASSET FOR SPECIFIED ASSETS [Section 54EC]:

Long term capital gain arising from the transfer of any capital asset is exempt in the following circumstances:

1. The taxpayer may be an individual, firm, company or any other person.
2. The asset transferred is a **long-term capital asset**.
3. The assessee should invest the amount of capital gain in **long-term specified assets**.

Within **6 months** from the date of transfer of the asset,

“Long-term specified assets” means any bond redeemable after **3 years** issued by:

- a. the National Highways Authority of India (**NHAI**); or
- b. the **Rural Electrification Corporation Ltd**

Amount of exemption:

- a. If the amount of capital gain is less than the cost of long term specified asset the entire capital gain shall be exempt.
- b. If the amount of capital gain is greater than the cost of long term specified asset the cost of new asset shall be exempt.

The following points should be noted in this regard:

1. The cost of specified assets which is considered for the purpose of section 54EC shall not be eligible for deduction under section 80C.

2. The investment made (on or after April 1, 2007) in the long-term specified assets noted above by an assessee during any financial year cannot exceed 50 lakh.

Consequences:

If the specified assets are transferred (or converted into money or any loan/ advance is taken on the security of specified assets) within a period of 3 years from the date of their acquisition, the amount of capital gains arising from the transfer of original asset which was not charged to tax, will be deemed to be the income by way of LTCG of the previous year in which specified assets are transferred.

Capital gains on transfer of a LONG-TERM CAPITAL ASSET OTHER THAN A HOUSE PROPERTY [Sec. 54F]:

Any long term capital gain from the transfer of any capital asset, other than residential house property shall be exempt if following conditions are satisfied:

1. The taxpayer is an **individual or HUF**.
2. The capital asset which is transferred is a long-term capital asset but **other than a residential** house property.
3. To claim exemption, the taxpayer will have to purchase another residential house property or construct **another residential** house property within 1 year before, or within 2 years after, the date of transfer of the residential house property in case of purchase option. In case of construction option, the construction should be completed within 3 years from the date of transfer of asset.
4. The assessee does not own more than one residential house on the date of transfer of asset other than the house purchased for claiming exemption under this section.

Amount of exemption:

- a. If the net consideration of asset is less than the cost of new house, the entire capital shall be exempt.
- b. If the net consideration of asset is greater than the cost of new house then the exemption shall be allowed in the same proportion in which the cost of new house bears to the net sales consideration.

- c. To claim exemption under section 54F, the taxpayer should deposit the amount in “Capital gains deposit account scheme” on or before the due date of submission of return of income which will have to be utilized for purchase/ construction of the new house within the specified period. On the basis of amount deposited in the deposit account, the Assessing Officer will give exemption under section 54F.

Consequences:

In the following circumstances, exemption granted under section 54F may be withdrawn:

Defaults	Consequences
If the assessee transfers the new house within 3 years of its purchase/ construction	Capital gain which arises on the transfer of the new house will be taken as STCG . Besides, the capital gain which was exempt under section 54F shall be treated as LTCG of the year in which the new house is transferred.
If the assessee purchases, within a period of 2 years from the date of transfer of original asset, or constructs within a period of 3 years from the date of transfer of such asset, a residential house other than the new house	Capital gain which was exempt under section 54F shall be deemed to be income by way of LTCG of the year in which another residential house is purchased or constructed.

By withdrawing from the deposit account, new house can be purchased/ constructed within the period given above.

If the amount deposited is not utilized fully for purchase or construction of new house within the stipulated period, then the following amount shall be treated as **LTCG** of the previous year in which the period of 3 years from the date of transfer of original asset expires.

Capital gain on transfer of assets in cases of shifting of industrial undertakings from urban areas [Section 54G] :

Any capital gain, (short-term/long-term), arising to any industrial undertaking from the transfer of asset being machinery or plant or building or land or any rights in building or land effected in the course of or in consequence of shifting from an urban area to any other area, shall be exempt if following conditions are satisfied:

1. the transfer is effected in the course of or in consequence of shifting the undertaking from an urban area to any other area.
2. asset transferred is machinery; plant, building, land or any right in building or land used for the business of industrial undertaking in an urban area.
3. the capital gain is utilized within one year before or 3 years after the due date of transfer for the specified purpose. specified purpose includes the following :
 - (a) for purchase of new machinery or plant for the purpose of business of the Industrial Undertaking in the area to which the said undertaking is shifted;
 - (b) acquisition of building or land or construction of building for tax payer's business in that other area;
 - (c) expenses on shifting of the old undertaking and its establishment to other area; or
 - (d) Incurring of expenditure on such other purposes as specified by the Central Government for this purpose.
 - (e) The newly acquired asset must be held by the assessee for three years from the date of their acquisition.

Quantum of deduction:

1. If the capital gain, on transfer of the original asset, is equal to or less than the cost and expenses incurred for the above specified purposes, the entire capital gain shall be exempt.
2. If the capital gain on transfer of the original asset, is greater than the cost and expenses incurred for the specified purposes than the exemption shall be allowed to the extent of the cost and expenses incurred.
3. Where the capital gain is not utilized by the assessee towards the cost and expenses incurred in relation to all or any of the above purposes before the due date of filing of return, it is deposited by him in the Capital gain account scheme, he will be entitled to exemption.
4. If the amount deposited is not utilized fully or partly for above purposes within three years from the date of transfer then the amount not so utilized shall be charged as capital gain.

Exemption of capital gain on transfer of assets of shifting of industrial undertaking from urban area to any Special Economic Zone [Section 54GA]

Any capital gain arising from the transfer of a capital asset being machinery or plant or building or land or any rights in building or land except furniture and fitting used for the purposes of the business of an industrial undertaking situate in an urban area, effected in the course of or in consequence of shifting of such industrial undertaking to any Special Economic Zone whether developed in any urban area or any other area, shall be exempt to the extent, such capital gain is invested for the specified purpose with in 1 year before or 3 years after the due date of its transfer.

The conditions for claiming exemptions are as under:

1. the transfer is affected in the course of or in consequence of shifting the undertaking from an urban area to any Special Economic Zone. The Special Economic Zone may be developed in any urban area or any other area.
2. asset transferred is machinery ,plant, building, land or right in building or land used for business of industrial undertaking in an urban area;
3. the capital gain arising on the asset transferred may be short-term or long-term capital gain. Normally, it will be short-term capital gain because most of the asset of the industrial undertaking will be depreciable assets.
4. the capital gain is utilized within 1 year before or 3 years after the due date of transfer for the specified purpose.

Specified purpose includes the following:

- (a) for purchase of new machinery or plant for the purpose of business of the industrial undertaking in the Special Economic Zone to which the said undertaking is shifted;
 - (b) Acquisition of building or land or construction of building for the purpose of the assessee's business in the Special Economic Zone.
 - (c) expenses on shifting of the old undertaking and its establishment to the Special Economic Zone; and
 - (d) incurring of expenditure on such other purposes as specified by the Central Government for this purpose.
5. If the amount on net consideration which has been received by the company for the issue of equity shares by the individual or HUF is not utilized by the company for the purchase of a new asset (eligible plant and machinery) before the due date of furnishing the return of income under section 139, the unutilized amount should return furnished by the assessee shall be accompanied by proof of such deposit having

been made. The amount so utilized and the amount so deposited in the deposit scheme shall be deemed to be the cost of new asset (eligible plant and machinery)

Exemption of Long-term capital gain on transfer of residential property invested in a new manufacturing SME company [Section 54GB]

Any capital gain of individual or HUF arising from the transfer of a long-term capital asset being a residential property (a house or plot of land) shall be proportionate to the net consideration price so invested in the subscription of equity shares of a new start-up SME company in the manufacturing sector company before the due date of furnishing the return of income under section.

The above exemption shall be allowed if the following conditions are satisfied:

1. There should be a long-term gain from the transfer of a residential property (i.e. a house or plot of land)
2. Such long-term capital gain should arise to an individual or HUF.
3. The amount of net consideration should be utilized by the individual or HUF before the due date of furnishing of return of income for subscription in equity shares of a eligible company. If the full amount of net consideration is not utilized for subscription in equity shares, the exemption shall be allowed proportionate to the amount so invested.
4. The amount of subscription as share capital is to be utilized, by the company for the purchase of new asset (eligible plant and machinery) within a period of one year from the date of subscription in the equity shares.
5. The equity shares of the company or the new asset acquired by the company should not be sold or otherwise transferred by the individual/HUF or the company as the case may be a period of 5 years from the date of their acquisition.

Eligible company: It means a company which fulfils the following conditions:

- (1) It is a company incorporated in India during the period from 1st April of the previous year relevant to the assessment year in which capital gain arises to the due date of furnishing the return of income.

- (2) It is engaged in the business or manufacture of an article or thing.
- (3) It is a company in which the assessee has more than 50% share capital or more than 50% voting rights after the subscription in shares by him.
- (4) It is a company which qualifies to be a small or medium enterprise.

7.12 EXEMPTIONS AT A GLANCE

Exemptions: Exemptions of capital gains available only to individual and/or HUF assessee
Section 54, 54B and 54F

Provisions	Capital gains on sale of residential property used for residential property Section 54	Capital gains on sale of urban agricultural land and used for another agriculture land Section 54B	Capital gain on sale of LTCA not to be charged in case of investment in residential house: Section 54F
(a) Assessee	Individual/HUF	Individual	Individual/HUF
(b) Asset transferred	Residential house property being buildings or lands appurtenant thereto	Agricultural land used by individual or his parent for agricultural purposes during 2 years preceding date of transfer	Any capital asset not being residential house property Exemption is not available if assessee owns more than 2 residential houses including a new house.
(c) Nature of Asset	LTCA	LTCA/STCA	LTCA
(d) New asset to be purchased/construction	Residential house property i.e. buildings or lands appurtenant thereto	Agricultural land (in urban or rural area)	Residential house property i.e. buildings or lands appurtenant thereto
(e) Time-limit for purchase/construction	Purchase: Within 1. year before or 2 years after the date of	Purchase within 2 years from the date of transfer.	Purchase : Within 1 year before or 2 years after date of transfer ; and

	transfer. Construction: complete construction within 3 years year from date of transfer		Construction : Complete construction within 3 year from date of transfer.
(f) Deposit scheme (Discussed later)	Applicable	Applicable	Applicable
(g) Amount of Exemption	Lower of – Capital gains or investment in	Lower of – capital gains or cost of new asset	Cost of new house x Capital gains ÷ Net Consideration

Exemptions: Exemptions in respect of capital gains available only to all assessee: Section 54D, 54EC, 54G and 54GA

Provisions	Compulsory acquisition of land & buildings Section 54D	Investment in certain bonds: Section 54EC	Shifting of undertaking to rural area: Section 54G	Shifting of undertaking to SEZ: Section 54GA
(a) Assessee	Any Person	Any Person	Any Person	Any Person
(b) Asset transferred	Compulsory acquisition of land or building which was used in the business of industrial undertaking during 2 years prior to date of transfer.	Any long capital asset.	Transfer of plant, machinery or land or building for shifting industrial undertaking from urban area to rural area.	Transfer of plant, machinery or land or building for shifting industrial undertaking from urban area to Special Economic area.
(c) Nature	Short term/ Long	Long term	Short term/	Short term/

of Asset	term		Long term	Long term
(d) New asset to be purchased/constructed	New land or buildings for the industrial undertaking	Bonds, redeemable after 3 years issued- (a) by National highway Authority of India; or (b) by Rural Electrification Corporation, maximum exemption limit being Rs. 50 lakhs (Amended by F.A 2007 w.e.f. 1-4-08	(a) Purchase construction of plant, machinery, land or building in such rural area or, (b) Shifting original assets to that area or, (c) Incurring notified of transfer	(a) Purchase constructed of plant, machinery, land or building in such SEZ or, (b) Shifting original assets to SEZ or, (c) Incurring notified of expenses.
(e) Time-limit for purchase/ construction	within 3 years from date of receipt of initial compensation.	Within 6 months from the date of transfer of original asset.	Within 1 year before or 3 years after the date of transfer	Within 1 year before or 3 years after the date of transfer

7.13 SUMMARY

- Any profit arising from the transfer of capital asset is taxable under the head Income from capital gain. Capital gain is divided into two parts short term capital gain and long term capital gain.
- Capital asset means property of any kind held by the assessee whether connected with his business, profession or not.
- Cost of acquisition is the price which the assessee has paid for acquisition of the asset; it includes all expenses incurred to acquire it. Interest paid on money borrowed for the purchase of capital asset would constitute part of the cost of acquisition.
- Cost of improvement is capital expenditure incurred by an assessee in making any additions/ improvement to the capital asset.
- Various types of exemptions are available u/s 54, 54B, 54D, 54EC, 54EE, 54F, 54GA, and 54GB for purchase or investment in different assets.



7.14 GLOSSARY

Holding period: The total period for which asset was held by assessee together with the period of ownership of previous holder is called period of holding.

Exchange: Exchange means voluntary conveyance of property in the goods by one person to another for consideration in kind.

Transfer Expenses: These are “expenditure incurred wholly and exclusively in connection with such transfer” means expenditure incurred which is necessary to affect the transfer. Such as brokerage or commission paid for the sales, cost of stamp, traveling expenses incurred in connection with transfer.

Extinguishment: It means to put a total end to something. Destruction or annihilation of contract, rights, interest, debt or other obligation by law.



7.15 REFERENCES

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7.16 SUGGESTED READINGS

1. WEBSITE: <http://www.taxmann.com>

2. Dr. Ahuja, Girish and Dr. Gupta Ravi, Direct Taxes Law and Practice including TAX PLANNING, Publication House: Bharat Law House Pvt Ltd., Delhi.



7.17 TERMINAL QUESTIONS

- Q1. What is “Capital gain”? Discuss the types and procedure of computation of capital gain.
- Q2. Explain the term “Cost of acquisition” with regards to various types of capital assets.
- Q3. Discuss the various types of exemptions available for various capital assets.
- Q4. R acquired a residential house on 1.8.1978 for Rs. 2, 00,000. He spent Rs 25,000 on 01.6.1980 for the improvement of this house property. A further amount of Rs. 50,000 was sent by him on 15.10.1985 on improvement of the house. R gifted the said property to his son B on 11.11.1994. B also spent the following amounts on improvement of the house.

<i>Date of expenditure</i>	<i>Amount</i>	<i>Rs.</i>
15.7.1995	80,000	
18.6.2016	60,000	

B sold the above house on 30.11.2016 for a sum of Rs. 45, 00,000. Expenses on transfers were 2% of the sale consideration. Compute the capital gain for the necessary year 2017-18, assuming the fair market value of the house as on 1.4.1981 to be Rs. 3, 00,000.

- Q5. X Purchases the following capital asset:

	Year of Cost Fair market	Purchase value on	1 st April, 1981
Jewellery	1976-77	80,000	96,000
House	1979-80	2, 58,000	1, 87,000

X dies on Aug 16th 1994 and as per his Will assets are transferred to his son B. B sells these assets on 10 June 2012 for a total consideration of Rs. 48,00,000 (gold: Rs.. 30,00,000, house: Rs. 18,00,000) . Find out the amount of capital gains chargeable to tax for the assessment year 2017-18.

Cost inflation index for this purpose is 100 for 1981-82 and Rs. 1125 for 2017-18.

UNIT 8 INCOME FROM OTHER SOURCES AND TAX PLANNING

8.1 Introduction

8.2 Objectives

8.3 Basis of Charges

8.4 Chargeable Incomes (Specific)

8.5 Chargeable Income (Others)

8.6 Deductions Allowed

8.7 Deductions Disallowed

8.8 Interest on Securities

8.9 Grossing Up of Interest

8.10 Deduction of Tax at Source

8.11 Persons Not Subject To TDS

8.12 Grossing Up of Lottery, Crossword, and Gambling, Other Games Etc.

8.13 Bond Washing Transactions

8.14 Summary

8.15 Glossary

8.16 References

8.17 Suggested Readings

8.18 Terminal Questions

8.1 INTRODUCTION

“Income from other sources” is the residual head of income. Hence, any income which is not specifically taxed under any other head of income will be taxed under this head.

In this unit we learn all the aspects in relation to income from other sources and various provisions for tax planning for this head.

8.2 OBJECTIVES

The contents of this unit will help you to understand;

- Income taxable under this head.
- Provisions of dividend, interest and other incomes.
- Various types of securities.
- Tax deduction at source

8.3 BASIS OF CHARGES

As per section 56(1), income of every kind, which is not to be excluded from the total income under this act, shall be chargeable to income-tax, under the head “Income from Other Sources” if it is not chargeable to Income-tax under any of the first four head’s specified in the section 14.

In other words, the following conditions must be satisfied before an income can taxed under the head “Income from other Sources”:

- (i) There must be an income;
 - (ii) Such income is not exempt under the provisions of this Act;
 - (iii) Such income is not chargeable to tax under any first four heads viz., “Income from Salary”, Income from house property, Income from business or profession and income from capital gain.
- Income from other sources is, therefore, a residuary head of income.

8.4 CHARGEABLE INCOMES (SPECIFIC)

The following incomes shall be chargeable to income tax under the head ‘Income from Other Sources’:

- (1) Dividends (Dividend received from domestic and Indian company is exempt from tax under section 10(34).
- (2) Income from winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.

- (3) Any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set-up under Employees' State Insurance Act 1948.
- (4) Income by way of interest on securities.
- (5) Income from machinery, plant or furniture let on hire if the income is not chargeable to income tax under the head 'Profits and Gains of Business or Profession'.
- (6) Income from letting on hire machinery, plant or furniture and also buildings, and the letting of the buildings is inseparable from the letting of the said machinery plant or furniture. if it is not chargeable to income tax under the head 'Profits and Gains of Business or Profession' .
- (7) Income received under a Keyman insurance policy including bonus on such policy, if such income is not chargeable to income tax under the head 'Profits and Gains of Business or Profession' or under the head Salaries'.
- (8) An individual or HUF receives ,in any previous year from any person or persons :

<i>Asset</i>	<i>Amount to be included in income</i>
(a) Any sum of money, without consideration, the aggregate value of which exceeds 50,000	The whole of the aggregate value of such sum.
(b) Any immovable property (i) without consideration , the stamp duty value of which exceeds 50, 000;	The stamp duty value of such property.
(ii) for a consideration which is less than the stamp duty value of the property by an amount exceeding 50, 000.	The stamp duty value (on the date of agreement) of such property as exceeds such consideration.
(c) Any property other than immovable property:	
(i) without consideration, the aggregate fair market value of which exceeds 50,000,;	The whole of the aggregate fair market value of such property.
(ii) for a consideration of which is less than the aggregate fair market value of the property by an amount exceeding 50,000.	The aggregate fair market value of such property as exceeds such consideration.

But the above provisions shall not apply to any sum of money or any property received:

- (a) from a relative; or
- (b) under a will or by way of inheritance ; or
- (c) on the occasion of the marriage of the individual; or
- (d) in contemplation of death of the payer; or
- (e) from any local authority; or

- (f) from any trust or institution registered u/s 12AA; or
- (g) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust institution referred to in Sec. 10(23)

Explanation:

(A) Property means the following capital asset of the assessee, namely

- (a) immovable property being land or building or both
- (b) shares and securities;
- (c) jewellery;
- (d) archaeological collections;
- (e) drawings;
- (f) paintings;
- (g) sculptures;
- (h) any work of art; or
- (i) Bullion

(B) Relative, means:

(a) In case of an individual :

- (i) spouse of the individual :
- (ii) brother or sister of the individual;
- (iii) brother or sister of the spouse of the individual;
- (iv) brother or sister of either of the parents of the individual;
- (v) any lineal ascendant or descendant of the individual;
- (vi) any lineal ascendant or descendant of the spouse of the individual;
- (vii) Spouse of the person referred to in (ii) to (vi)

Example: Mr. X gets the following gifts in the previous year 2016-17. What shall be the taxability of gift under each situation for the assessment year 2017-18

- (j) Gift of Rs. 60,000 on Aug .12 2016 from his friend
- (ii) Gift of Rs. 21,000 each from his two friends on Dec. 25, 2016 on his marriage.
- (iii) Gift of Rs. 68,000 on Oct 5, 2016 from brother of his father
- (iv) Gift of Rs. 35,000 on Nov 11, 2016 from friend of his wife on the occasion of his marriage.
- (v) Gift of Rs. 26,000 on Jan 15, 2017 from father in law of his brother
- (vi) Gift of Rs. 41,000 on May 31, 2016 from his friend.

Solution:

Computation of Taxable Gifts of Mr. X**(For the assessment year 2017-18)**

Particulars	Amount (Rs.)
(i) Gift from friend	
{ Aggregate of sum of money received in the previous year	60,000
Exceeds Rs. 50, 000 }	
(ii) Gift on occasion of marriage from friends	Exempt
(iii) Gift from brother of father (Being from relative)	Exempt
(iv) Gift on occasion of marriage from friend of wife	Exempt
(v) Gift from father in law of brother (Being from non-relative)	26,000
(vi) Gift from friend	41,000
	<hr/>
Income from other sources	1, 27,000
	<hr/>

Note: Since aggregate of sum of money received as gift exceeds Rs. 50,000 entire amount of Rs. 1, 27,000 is taxable.

9. Where a firm or a company (not being a company in which public are substantially interested) receives from any person or persons any property, being shares of a company (not being a company in which the public are substantially interested)

(i) without consideration, the aggregate fair market value of which exceeds Rs 50,000, the whole of the aggregate fair market value of such property;

(ii) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding Rs. 50,000, the aggregate fair market value of such property as exceeds such consideration.

However this provision shall not apply to such property received, where the transfer is not regarded as transfer u/s 47 in the cases of amalgamation, demerger or business reorganization.

10. Interest received on compensation or on enhanced compensation shall be deemed to be the income of the previous year in which it is received.

11. W.e.f A.Y. 2013-14, the following shall also be treated as income:

Where a closely held company issues shares to a resident person for a consideration exceeding the face value of such shares, the deemed income shall be consideration received-fair market value of the shares.

However, this provision shall not apply where the consideration for issue of shares is received (i) by a venture capital undertaking from a venture capital company or a venture capital fund; or (ii) by a company from a class or classes of persons as may be notified by the Central Government.

Explanation; Fair market value of the shares shall be the value

- (i) as determined in accordance with prescribed method; or
- (ii) as determined on the basis of assets, including intangible assets being good will, know-how patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, on the date of issue of shares, whichever is higher.

8.5 CHARGEABLE INCOMES (OTHERS)

There are some other incomes which are also chargeable under the head income from other sources'. For example:

- (1) All interest other than interest on securities, such as, interest on bank deposits, interest on loan, etc.
- (2) Income of a tenant from sub-letting the whole or a part of the house property.
- (3) Remuneration received by a teacher or a lawyer for doing examination work
- (4) Income of Royalty.
- (5) Interest on securities of foreign government
- (6) casual income (Income of non-recurring nature)
- (7) Income from letting of a business as whole
- (8) Interest paid by the government on excess payment of advance tax
- (9) Directors fees:
- (10) Rent of land not appurtenant to any building or Ground rent
- (11) Agricultural Income from land situated outside India.
- (12) Income from markets, ferries and fisheries, etc.
- (13) Income from leasehold property.
- (14) Income received after discontinuance of business
- (15) Remuneration received for writing articles in Journals.
- (16) Income from undisclosed sources :
 - (i) Cash credits which are unexplained. (Sec. 68)
 - (ii) Unexplained Investments (Sec. 69)
 - (iii) Unexplained Money. (Sec. 69A)
 - (iv) Unexplained Expenditure. (Sec. 69C)
 - (v) Amount borrowed or repaid on Hundi otherwise than through an account payee cheque drawn on a bank.
- (17) Interest received by an employee on his own contributions to an unrecognized provident fund

- (18) Salary of a Member of Parliament, Member of Legislative Assembly or Council.
- (19) Insurance Commission not chargeable under the head 'business or profession'
- (20) Rent of trademark.
- (21) Director's Commission for giving guarantee to bank
- (22) Director's Commission for underwriting shares of a new company.
- (23) Gratuity received by a director who is not employee of the company.
- (24) Family, pension received by the widow and heirs of deceased employees. However, the following family pensions are exempt:
 - (i) Pension received by the widow of an employee of the U.N.O.
 - (ii) Family pension received by any member of the family of gallantry awardees.

[Sec. 10(18)]

'Family' means:

- (a) the spouse and children of the individual; and
- (b) the parents, brothers and sisters of the individual, wholly or mainly dependent on the individual.
- (iii) Family pension received by the widow or children or nominated person of a member of the armed forces (including para-military forces) of the union, where the death of such member occurred in the course of operational duties shall be exempt provided the prescribed conditions are satisfied.
1/3 of family pension and 15000 whichever is less is exempt from tax.

- (25) Amount withdrawn from deposit in National Savings scheme, 1987 on which deduction u/s 80CCA has been allowed including interest thereon.
- (26) *Receipts by Cricketers selected to play for India:*
 - (a) *Test Matches in India* . Amount actually received by the player from the Cricket control board is taxable after allowing a deduction of an amount equal to 75% of such receipt in respect of reasonable expenses incurred to earn such income.
 - (b) *Other Matches in India*. Generally the entire receipts by the player (from the Board will be deemed to have been spent, for earning such income and hence not taxable.
 - (c) *Matches outside India*. A player will be allowed a deduction of 50% of the amount received for playing in foreign countries and the balance will be taxable.
- (27) Tips received by a waiter or taxi-driver, not being given by his employer.

8.6 DEDUCTIONS ALLOWED

The income chargeable under the head 'Income from other Sources' shall be computed after making the following deductions:

- (1) In the case of interest on securities/dividend any reasonable sum paid by way of commission or remuneration to a bank or any other person for the purpose of realizing such income on behalf of the assessee is deductible.
- (2) Interest on loan taken for the purpose of investment in securities/shares will be deductible if it is actually used for the aforesaid purpose. If dividend is exempt, aforesaid deductions will not be allowed.
- (3) If employees' contribution to provident fund, etc. are treated as the income of the assessee (employer) and it is included in his income from other sources, a deduction of the sum, credited by the employer to the employee's account in the relevant fund on or before the 'due date', will be allowed under this head.
- (4) In the case of income in the nature of family pension received by the widows or heirs of deceased employee, a deduction of a sum equal to 33¹/₃% of such income or Rs 15,000, whichever is less, will be allowed.
- (5) In the case of income from letting of machinery, plant or furniture with or without buildings, which is chargeable to tax under the head 'Income from Other sources' the deductions in respect of the following shall be allowed in the same manner as they are allowed under the head 'Profits and Gains of Business or Profession' :
 - (i) Expenditure incurred regarding current repairs of machinery, plant, furniture or building.
 - (ii) Insurance premium paid regarding building, machinery, plant or furniture against risk of damage or destruction of the assets.
 - (iii) Depreciation on building, machinery, plant or furniture.
- (6) In case of sub-letting of a house the rent, repairs charges, etc. regarding sub-let portion are deductible.
- (7) Although income from units is exempt in the hands of the unit holders, but the mutual funds or specified company shall be liable to pay additional income tax on the amount of income distributed by it.
- (8) From interest received on compensation or enhanced compensation, fifty % of such income shall be deducted and no other deduction shall be allowed in this respect.
- (9) Any other expenses, not being in the nature of capital expenses, incurred wholly or partly for the making of taxable income in the previous year shall be allowed as deduction.

8.7 DEDUCTIONS DISALLOWED

The following amounts shall not be deductible in computing income under the head 'Other Sources':

- (1) Any personal expenses of the assessee.
- (2) Any interest chargeable under this Act, which is payable outside India and has been paid without deduction of tax at source or without paying tax thereon.
- (3) Any sum paid on account of Wealth tax.
- (4) Cash payments exceeding Rs. 20,000 /, Rs. 35,000. Sec. 40A(3) provides for the disallowance of 100% expenditure in respect of which payments is made in a sum exceeding Rs. 20,000/, Rs. 35,000 otherwise than by an account payee cheque on a bank or by an account payee bank draft.
- (5) Expenses incurred in relation to exempted income, in not deductible.
- (6) Expenses or losses in connection with income from lottery, crossword puzzles, races including horse races, card games, gambling or betting of any nature, shall not be deductible in computing the said income. However, this prohibition will not apply in respect of the income of an assessee, being the owner of horses maintained by him for running in horse races, from the activity of owning and maintaining such horses.



Check Your Progress-A

Q1. Discuss Basis of Charges.

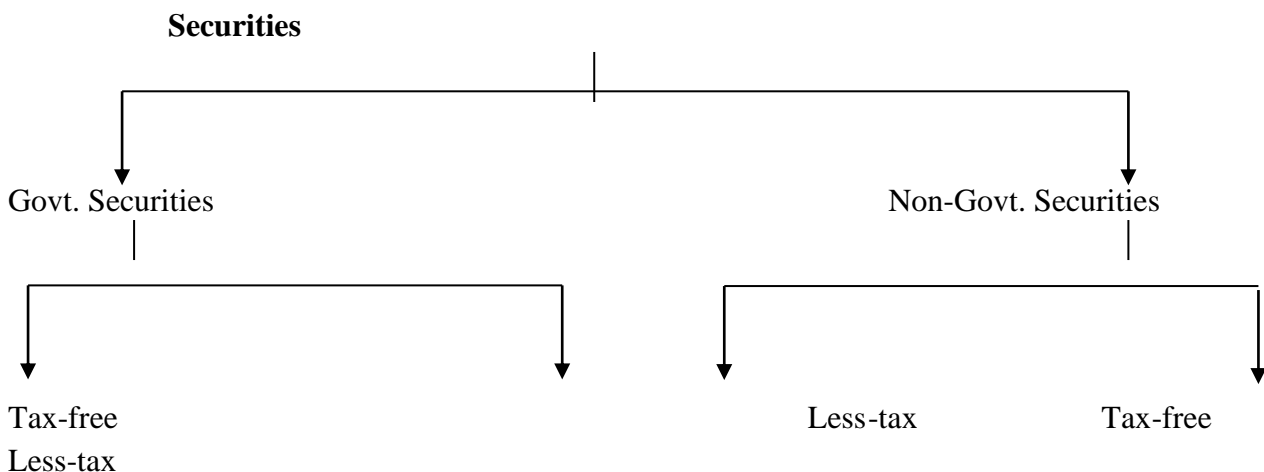
Q2. Briefly explain Chargeable Incomes (Specific).

Q3. What are the Deductions Allowed under the head 'Other Sources' ?

8.8 INTEREST ON SECURITIES

Kinds of Securities

From Income- tax point of view, the securities may be classified as under:-



Securities are of four types :

(1) Tax-free Government Securities: These securities are those, the interest on which is fully exempt from tax under section 10(15) . Interest is neither included in total income nor it is taxed.

Interest on the following securities, bonds, deposits, etc is fully exempt from tax :

- (i) 12-Year National Savings Annuity Certificates.
- (ii) National Defence Gold Bonds, 1980.
- (iii) Special Bearer Bonds, 1991.
- (iv) Treasury Savings Deposit Certificates (10Years)

- (v) Post office Cash Certificates (5Years)
- (vi) National Plan Certificates (10Years)
- (vii) National Plan Savings Certificates (12Years)
- (viii) P.O. National Saving Certificates (12Years/7 Years)
- (ix) P.O. Savings Bank Account:
 - (a) Individual account – Maximum exemption limit Rs. 3,500.
 - (b) Joint account – Maximum exemption limit Rs. 7,000.
- (x) P.O. Cumulative Time Deposit Account (15Years)
- (xi) Fixed Deposit Scheme governed by the Post office (fixed Deposit) Rules, 1968.
- (xii) Fixed Deposit Scheme governed by the Government Savings Certificates (fixed Deposit) Rules, 1968.
- (xiii) Special Deposit Scheme, 1981
- (xiv) Public Account in P.O. (Upto Rs. 5,000) [Notification No. G.S.R. 607(E) dated 9.6.1989 178]
- (xv) Gold Deposit Bonds, 1999.
- (xvi) Bonds issued by local authority and specified by the Central Government.

(2) **Less Tax Government Securities:** Such securities are issued either by the Central Government or a State Government. These are taxable securities, but no tax is deducted at source on such securities. Hence, the interest on such securities will not be grossed up.

(3) **Tax –free Non-Government Securities:** These are issued by a local authority or statutory corporation or a company, in the form of debentures or bonds. Really speaking their interest is not tax-free, because tax due on this interest is payable by the company, or local authority or corporation concerned. These are called tax-free, because the assessee has not to pay tax on it from his own pocket. The tax paid by the company on this interest is deemed to have been paid on behalf of the assessee, hence the amount of tax paid on any interest due to an assessee is grossed up amount is included in his income. The amount of tax paid by the company on this interest is deducted from the total tax payable by the assessee. for example, if a company has issued 10% Tax-free Debentures, the debentures holder will receive the entire amount of interest calculated at 10% but the amount to be included in the income of the debenture holder will be the amount actually received by him as interest plus income tax thereon paid by the company.

(4) Less -Tax Non-Government Securities: These may be called “Taxable Securities”. In the case of these securities, income tax is deducted at source on the amount of interest calculated at the percentage stated on the securities and balance of the amount of interest left after deduction of the aforesaid income tax is paid to the security-holder.

If the rate percent of interest is given it is not grossed up as it is already the gross amount be grossed up.

In any case, it is the gross amount of interest that is included in the income of an assessee.

8.9 GROSSING UP OF INTEREST

Tax is to be deducted at source on interest on securities at the prescribed rates of tax. For income tax purpose what is to be charged to tax is the gross amount of interest.

The following are the rules of grossing up interest on securities:

- (1) If the rate of interest is given, only the interest on tax-free commercial securities is grossed up and interest on all other securities is not grossed up.
- (2) Interest on tax-free commercial securities is always grossed up whether its rate per cent is given or the amount received is given
- (3) Interest on less-tax securities is grossed up when the amount received is given.

Net interest can be gross up as under:

$$\frac{\text{Net Interest} * 100}{100 - \text{Rate of TDS}}$$

Example:

Compute the taxable income of Shri. Ram lal under the head ‘Income from other Sources’ for the year ending 31st March, 2017. His investments were:-

- (a) 5% Government securities Rs. 70,000;
- (b) 7.5% Agra Municipal Bonds Rs. 50,000;
- (c) 9% Debentures of a company Rs. 30,000;
- (d) 7% Capital Investment Bond Rs. 20,000

He paid Rs. 125 commission to bank for collecting interest. He paid Rs 1,000 interest on loan taken to purchase 5% Government securities.

Solution:**Computation of Taxable Income from Other Sources***(For the assessment year, 2017-18)*

5%	Government securities		Rs.	3,500
7.5%	Agra Municipal Bonds			3,750
9%	Debentures of a company			2,700
				9,950
				9,950
Less	:	Collection	charges	
125				1,125
	Interest	on	loan	
1,000				8,825
				8,825
	Income from other sources			8,825

Note: (1) Interest on 7% Capital Investment Bonds is exempt u/s 10 (15), hence, it will not be included in the total income

(2) All securities are less-tax securities. Hence, percentage interest shall be the gross interest.

8.10 DEDUCTION OF TAX AT SOURCE

The tax payer pays tax on income of previous year. The government collects amount of tax directly from the source to avoid delay payment and tax evasion. The recipient of income receives net amount of income. TDS is deduct at the time of receipt of income. The person

responsible for deduction of tax at source issues a certificate, meaning there in the amount of tax deducted, to the person from whose interest such deduction is made.

Some of the examples of tax deduction at source are salary payment, interest on securities, lottery, crossword, horse race, game show, insurance commission, contract payment etc. According to section 193 of the Act. The person who pays, any interest on security to a resident shall deduct income-tax there from. Such deduction of tax is called as '*deduction of tax at source*'. Such amount of tax shall be deducted at the time of credit of such interest to the account of payee, or at the time of payment thereof in cash or by a cheque or draft or any other mode, whichever is earlier. Tax so deducted and deposited is treated as tax deposited on behalf of the person from whose interest it has been deducted at source. Such person at the time of his own assessment will get rebate, of this amount from his income-tax liability. The rates of deduction of tax at source are determined by the Finance Act passed every year.

The following provisions relate to the deduction of tax at source: -

- (1) As per section 193, the person responsible for paying any income by way of interest on securities shall deduct income tax, at the rates given in Part II of the First Schedule to the Finance Act, on the amount of interest payable at the time : -
 - (a) When such interest is credited to the account of the payee, or
 - (b) When such interest is paid in cash by issue of a cheque or draft or by any other mode (whichever is earlier)
- (2) As per section 203; every person who deducts tax at source shall furnish to the person from whom such deduction is made, a certificate to the effect that tax has been deducted specifying therein the amount so deducted, the rate at which the tax has been deducted and such other particulars as may be prescribed. Such certificate is issued in Forms 16 –A
- (3) When there are two or more joint owners of a security, the payment of interest and the deduction of tax at source shall be deemed to be in the proportion of their ownership.

8.11 PERSONS NOT SUBJECT TO TDS

If the securities are held by the following persons, no deduction of tax at source will be made because if the securities are held by these persons, interest on securities is exempt from tax under section 10, 11 and 13 A: -

- (i) Local authority u/s 10(20);
- (ii) Approved scientific research association u/s 10(21);
- (iii) Any regimental fund or Non-public Fund u/s 10(23AA);
- (iv) Any institution established solely for the development of khadi or village industries u/s 10(23B);

- (v) Authority established for khadi or village industries u/s 10 (23BB)
- (vi) Anybody for the administration of public religious trusts or endowments u/s 10 (23BBA);
- (vii) The Prime Minister's National Relief Fund, the Prime Minister's fund for (Promotion of Folk Art), the Prime Minister's Aid to student fund, u/s 10(23C);
- (viii) Registered trade union u/s 10(24);
- (ix) Statutory provident fund, recognized provident fund, approved superannuation fund and approved gratuity fund u/s (25);
- (x) Member of a schedule tribe u/s 10(26);
- (xi) Anybody corporation or institution for promoting the interest of members of scheduled castes or scheduled tribes u/s 10 (26B);
- (xii) Public charitable and religious trust or institution u/s 11;
- (xiii) Any political party registered with the election commission of India u/s 13A; and
- (xiv) Any notified fund, body or authority.

8.12 GROSSING UP OF LOTTERY, CROSSWORD, GAMBLING, OTHER GAMES ETC.

Tax is also to be deducted at source on income from lotteries, horse races, t.v.show, crosswords etc.at the prescribed rates of tax. For income tax purpose what is to be charged to tax is the gross amount of winning.

If winning from above does not exceed 10000 or winning from race does not exceed 5000 no tax shall be deducted at source

If such winning exceeds the above limits than tax shall be deducted at prescribed rates and in this case the gross amount shall be included in the income.

Net amount can be gross up as under:

$$\frac{\text{Net Amount} * 100}{100 - \text{Rate of TDS}}$$

Example:

Mr. Sunil Kumar resident Indian provides The particulars of his income for the financial year 2016-17 are as follows :-

- (1) Received Rs. 24,000 @ 2,000 p.mm as family pension from the Government.

- (2) Received a sum of Rs. 14,000 for writing articles in various journals.
- (3) Received a sum of Rs. 6,000 as royalty from Mehta & Company to whom he has given right to publish his book on Commerce.
- (4) He has some machines which he lets-out on rent. The rent received in this respect amounts to Rs. 31,400. Repair charges on machines are Rs. 2,400.
- (5) Received Rs 10,800 as rent from agricultural land given to a contractor.
- (6) Interest received on Post-office Savings Bank Account Rs. 1,600.
- (7) Remuneration received for TV show Rs. 3,000.

Compute his taxable income under the head 'Income from other sources' for the assessment year 2017-18.

Solution:

Computation of Taxable 'Income from other Sources' of Mr. Sunil kumar

(For the assessment year, 2017-18)

Family pension @ 2,000 p.m.	Rs.
Rs.	
Less: Standard deduction 1/3 of pension or Rs. 15,000 (whichever is less)	16,000
8,000	14,000
Remuneration for writing articles	6,000
Royalty received from Mehta & Company	29,000
Rent on machines	10,800
Less: Repairs	2,400
	Exempt
Rent from agricultural land	3,000

Interest on Post-Office saving Bank A/c	78,800
Remuneration from TV show	
Income from other sources	

Note: (1) Rent from agricultural land given to kiln contractor is taxable under this head, because the land is not given for agricultural purposes.

(2) Interest on Post-Office Saving Bank Account is exempt u/s 10(15).

8.13 BOND WASHING TRANSACTIONS

It is a device to avoid tax by high income group of assessee by transferring securities to low-income class of assessee on the eve of the due date of interest. Generally, interest on securities is payable half-yearly or yearly and these dates are fixed. As the whole amount of interest is regarded as the income of the person who happens to be the owner at the time when the interest becomes due, some tactful persons sell their securities a few days before the expiry of the due date of interest. Thus, they do not remain the owner of the securities on the due date. They sell their securities to such persons whose total income including the income from interest on securities either does not exceed the minimum taxable limit or if it exceeds that limit it is lesser than that of the seller so that either no tax will be payable on the interest or it will be payable at the lower rate. Thus, the seller escapes tax completely; and buyer also does not pay tax on it as his income limit, he will pay tax at lower rate of tax, which is, in fact, secretly paid by the seller on behalf of the buyer. Thus, by this device, the Income Tax Department suffers loss of revenue. In order to prevent this device of avoiding tax, it has been provided that the Assessing Officer can include such an income from interest on securities in the total income of the person who is actually the owner of the securities and who wants to escape tax by adopting this device.

Exceptions: The Assessing Officer shall not apply the above rule in the following cases:

- (1) If the assessee proves to the satisfaction of the Assessing Officer that there has been no avoidance of income tax; or
- (2) If the assessee proves that the avoidance of income tax is exceptional and not systematic; and there was no avoidance of income tax in any of the three preceding year.

In connection with such transactions the Assessing Officer has the power to enforce the assessee to furnish the required information.

8.14 SUMMARY

- Income of every kind, which is not to be excluded from the total income under this act, shall be chargeable to income-tax, under the head “Income from Other Sources” if it is not chargeable to Income-tax under any of the first four head’s of Income.
- Any expenses, not being in the nature of capital expenses, incurred wholly or partly for the making of taxable income in the previous year shall be allowed as deduction.
- Expenses incurred in relation to exempted income, in not deductible.
- Expenses or losses in connection with income from lottery, crossword puzzles, races including horse races, card games, gambling or betting of any nature, shall not be deductible in computing the said income.
- Tax deduction at source means payment of tax at the time of receiving of Income. The main purpose of deduction of tax directly from the source to avoid delay payment and tax evasion. The recipient of income receives net amount of income. TDS is deduct at the time of payment.



8.15 GLOSSARY

Dividend: a sum of money paid regularly (typically annually) by a company to its shareholders out of its profit (or reserves).

Security: Security means a document acknowledging the debt taken by government or other organization from the general public. It is held by an investor or creditor as guarantee of his right to receive payment.

Casual Income: Casual income is a non recurring income that is not likely to occur again in a year. It is an income which is earned by chance

Unexplained Money: Where in any year the assessee is found to be the owner of money, jewellery, or other valuable article which is not recorded in the books of account.



8.16 REFERENCES

- Dr. Singhanian, Vinod Kumar, and Dr. Singhanian, Kapil, Direct taxes law and practice with special reference to tax planning, 57th Edition, published by Taxmann Publications (P.) Ltd., Delhi.
- Dr. Ahuja Girish and Dr. Gupta Ravi, Systematic approach to Income Tax, Wolters Kluwer Publications.
- Dr. Mehrotra, H.C, and Dr. Goyal, S.P., INCOME TAX LAW AND ACCOUNTS, Sahitya Bhawan Publications, 57th Edition.



8.17 SUGGESTED READINGS

1. WEBSITE: <http://www.taxmann.com>
2. Dr, Ahuja, Girish and Dr. Gupta Ravi, Direct Taxes Law and Practice including TAX PLANNING, Publication House: Bharat Law House Pvt Ltd., Delhi.



8.18 TERMINAL QUESTIONS

Q1. What Incomes are taxable under the head “Income from other sources”? State at least five items which can be included under this head.

Q2. Give all the provisions in details, in respect of various types of Dividend.

Q3. Which deductions are allowed in computing taxable income under the head “Income from other sources” Explain?

Q4. Write short notes on the following:

- (a) Tax Deduction at source
- (b) Bond washing transactions
- (c) Interest from securities

(d) Rules of grossing up of income

Q5. Mr. Roshan Walia provides the following particulars of his income for the financial year 2016-17 are as follows:-

(1) Interest on government securities	12000
(2) Winning from lottery.	23000
(3) Interest on Post office saving deposit.	6000
(4) Dividend from co-operative society.	4500
(5) Agriculture income from Nepal.	45000
(6) Director fee.	18000

Compute his taxable income under the head 'Income from other sources' for the assessment year 2017-18.

UNIT 9 ASSESSMENT OF INDIVIDUALS AND FIRMS

9.1 Introduction

9.2 Objectives

9.3 Tax Incidence on Individuals

9.4 Taxable Income and Tax Liability

9.5 Meaning and Scheme of Taxation of Firms

9.6 Computation of Income and Tax of Firm

9.7 Assessment of Partners of a Firm

9.8 Summary

9.9 Glossary

9.10 Reference / Bibliography

9.11 Suggested Readings

9.12 Terminal & Model Questions

9.1 INTRODUCTION

An individual means a woman, man, minor child or any human being. An individual has to pay income tax on his total income at a graded scale of tax rates ruling during the concerned assessment year. In addition to his own income under different heads, an individual may also get a share of income from his membership in the various other institutions and some incomes of others are also to be included in the total income.

On the other hand, partnership is a relationship between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. These persons are called *partners* and collectively they are called *firm*. In income tax, the term partner also includes, a minor admitted to the benefits of partnership, and a partner of a limited liability partnership.

9.2 OBJECTIVES

While proceeding in this unit we will learn how to calculate the total income and tax liability of an individual and firm i.e. assessment of an individual and firm. The content of this unit will help us in:

- Ascertaining the various incomes which are to be included in total income of an individual as well as a firm.
- The income of others that are to be included u/s 60-65 in the appropriate heads while computing the income under various heads.
- Treatment of unabsorbed losses and allowances brought forward from earlier years.
- Computation of total income of an individual and the tax liability therewith
- Computation of the income of the firm and the tax liability

9.3 TAX INCIDENCE ON AN INDIVIDUAL

Para -285: While computing taxable income of an individual, the nature of income of an individual along with its treatment is the area to be focused upon. In this respect the following points are to be considered:

- a) The income earned by the taxpayer will include all other incomes except income exempt u/s 10 to 13A and incomes to be included in income of others by virtue of sections 60 to 64.
- b) Share of profit from a Hindu undivided family is exempt under section 10(2).
- c) Share of profit from a firm assessed as a firm is exempt under section 10(2A).
- d) Salary and interest from the aforesaid firm is taxable as business income.
- e) Share of profit from association of persons/body of individual is not taxable in the hands of the recipient if the association or body is taxable at maximum marginal rate.
- f) Income earned by others and included in the income of the taxpayer by virtue of sections 60 to 64, shall be included in the income of the taxpayer.

9.4 TAXABLE INCOME AND TAX LIABILITY

Para – 286: HOW TO COMPUTE TAXABLE INCOME:

The following steps to be followed while computing taxable income of an individual:

Step 1: The first step is to find out **income under the different heads** (five heads) of **income**. Income of any other person, if includible under sections 60-64, will be included under respective heads.

Step 2: Next step is adjusting the losses of **current year and earlier years**. The income after adjustment of losses is the Gross total income of current year.

Step 3: From the Gross total income the following **deductions are available for the assessment year 2018-19:**

Section	Nature of Deduction
80C	Payment of insurance premium, contribution to PPF etc.
80CCC	Contribution to notified pension fund
80CCD	Contribution to pension scheme of the Central Government
80CCG	Investment made under notified equity saving scheme
80D	Payment on account of medical Insurance premium
80DD	Maintenance including medical treatment of handicapped dependants
80DDB	Expenditure on medical treatment
80E	Repayment of loan taken for higher education
80EE	Interest on loan taken for residential house property
80G	Donation to charitable institutions and funds
80GG	Rent paid
80GGA	Donation for scientific research and or rural development
80GGC	Contribution to political parties
80-IA	Profits and gains from Industrial undertakings engaged in infrastructure development , etc.
80-IAB	Profits and gains from industrial undertaking engaged in development of specific economic zone.
80-IB	Profits and gains from certain industrial undertakings other than infrastructure development undertakings
80-IBA	Profits and gains from housing projects
80-IC	Profits and gains of undertakings in certain States

80-ID	Profits of hotels and convention centre
80-IE	Profits of undertakings in North Eastern states
80JJA	Profits from the business of collecting and processing of bio-degradable waste
80JJAA	Employment of new employees
80QQB	Royalty income of authors
80RRB	Royalty on patents
80TTA	Interest on deposits on savings account
80U	Income of blind or handicapped persons

Step 4: The balance should be **rounded off to the nearest Rs. 10.** It is known as net income or total income or taxable income.

TAX LIABILITY OF AN INDIVIDUAL:

Para-287: The final tax liability is determined after computing the net income and tax payable thereon (annexure -1). In case if the individual has agricultural income then in order to arrive at tax on non agricultural income, due consideration should be given to the rules mentioned in para 280.1 (agricultural income).

Final tax liability shall be determined as under-

Tax on Net Income	.....
Less: Rebate Under section 87A (applicable in case of a resident individual whose net income is Rs. 3,50,000/- or less)	.....
Balance	.....
Add: Surcharge (applicable @ 15 % if net income exceeds Rs. 1 crore and 10 percent between 50 lacs to 1 crore)	.....
Total	.....
Add: Education cess and secondary and higher education cess (3 percent )	.....
Total Tax	.....
Less : Tax rebate or relief under sections 86,89,90,90A and 91 (paras 326,4,60 and 530)	.....
Tax	.....

Add: Interest payable under section 234A, 234B, 234C (as per para 385)	.....
Total	.....
Less: Prepaid Tax	.....
<ul style="list-style-type: none"> • Tax deducted at source on his own income and on income of others included in his taxable income • Tax collected at source • Advance Tax 	
Tax payable at the time of submission of Income	.....

Alternate Minimum Tax: From the Assessment Year 2013-14, tax payable by a non-corporate assessee cannot be less than 18.5 % (+SC+EC+SHEC) of “adjusted total income”.

Para 287.1: Special provisions related to Non Residents Individual (Sections 115C to 115-I)- Para 287.1-1: The benefit of special provisions can be claimed by non-resident Indians. A non resident Indian means:

- a. Citizen of India who is a non resident,
- b. a person of Indian origin who is a non resident,

A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grandparents, was born in undivided India.

Para 287.1-2: Incomes which are qualified for special treatment

Following incomes in respect of non resident individuals fall under the provisions of sections 115C to 115-I:

- a. Investment income derived from a “foreign exchange assets”.
- b. Long term capital gains on sale or transfer of “foreign exchange assets”.

Foreign exchange asset: It means those specified assets which the assessee has acquired or purchased with, or subscribed to in, convertible foreign exchange.

The following are “**specified assets**” for this purpose:

- a. Shares in an Indian company (public or private);
- b. Debentures issued by an Indian company which is not a private company;
- c. Deposits with an Indian company which is not a private company, it may be even deposit with SBI or any other banking company;
- d. Any security of central government;

- e. Such other assets as the central government may specify in this behalf by notification in the Official Gazette (no notification has been received so far).

Para 287.1-2a: How to calculate Investment Income and Long Term Capital Gain of non resident Indians?

Ans: While computing the investment income of a non- resident Indian, no deduction in respect of any expenditure or allowance shall be allowed under any provision of the Act. Moreover, no deduction under sections 80C to 80U shall be allowed in respect of investment income.

Para 287.1-2b: Similarly, long term capital gain on sale or transfer of foreign exchange assets shall be calculated subject to following points:

- a. The benefit of indexation is not available.
- b. No deduction is permissible in respect of long term capital gain under section 80C to 80U.
- c. By investing sale consideration in another asset, the nonresident Indian can claim exemption under section 115F.

Para 287.1-3: Tax on Investment Income and Long Term Capital Gain: Non resident Indians are chargeable to tax on investment income and long term capital gain at the rate 20 percent and 10 percent respectively.

Note: Para 287.1-4: A non-resident assessee is not required to file the return of income u/s 139(1), where the tax deductible at source from his only income from foreign exchange assets or income by way of long term capital gain arising on the transfer of foreign assets or both has been deducted. On the other hand if the non-resident Indian has any other income in India then it is treated as separate block and accordingly tax is charged with other provisions of the act.

Para 287.1-5: Benefit available even after the assessee becomes resident: Under following circumstances the provisions shall continue to apply to a non resident in relation to such income for that assessment year (and for every subsequent assessment year) until the transfer or conversion into money of such assets:

- a. A non resident Indian during any previous year becomes assessable as resident in India in any subsequent year.
- b. Simultaneously he may furnish to the Assessing Officer along with his return of income, (for the assessment year in which he is so assessable) a declaration in writing in respect to the special provisions which shall continue to apply to him in relation to the investment income derived from any foreign exchange asset (debentures and deposit with an Indian public limited company and Central Government securities).

Mere transfer of such deposit (as long as the source of deposit was convertible foreign exchange) from one bank to other would not affect its identity and the assessee is entitled to concessional rate of tax on interest earned from such deposits.

Para 287.1-6: However a non resident Indian may choose that the special provisions should not apply to him. In cases where such an option is exercised by a non resident Indian , the whole of his total income including income from foreign exchange assets and long term capital gains arising on transfer of a foreign exchange asset is charged to tax under the general provisions of the Act.

Tax on Income from Global Depository Receipts purchased in foreign currency or capital gain arising from their transfer (section 115ACA)

The applicability of this section depends upon the following conditions:

1. The assessee is an individual and resident in India.
2. He is an employee of an Indian company engaged in specified knowledge based industry or service , or an employee of its subsidiary engaged in specified knowledge based industry or service.
3. Such resident employee has been issued G.D.R.s by the aforesaid Indian company in accordance with such employee's stock exchange option scheme as the Central Government may, by notification in the Official Gazette specify in this behalf.
4. Such G.D.R.s have been purchased by such resident employee in foreign currency, as specified by the Central Government under " the issue of Foreign Currency Convertible Bonds and Ordinary Shares" vide Notification No. 348/2001, dated 12.11.2001.

If the above conditions are satisfied then if the total income of such resident employee includes:

a. Income by way of dividends (other than dividends referred to in section 115-O), on Global Depository Receipts of an Indian company engaged in specified knowledge based industry or service , issued in accordance with such employee's Stock Exchange Option Scheme as the Central Government may, by notification in the Official Gazette, specify in this behalf and purchased by him in foreign currency;

Or

b. Income by way of long term gains arising from the transfer of Global Depository Receipts ,

The income tax payable in such case will be 10 percent on income mentioned in clause (a) as well in clause (b) and on other incomes included in total income the tax payable will be on normal rates.

Moreover, where the gross total income of such resident employee includes any income as mentioned in clause (a) and clause (b) above, any deduction under any provision shall be allowed only by reducing the amount of such income from the gross total income and considering the reduced gross total income as the gross total income of the assessee. No deduction under any provisions of the act is allowed in respect of income by way of dividend from Global Depository Receipts.

Specified Knowledge based industry or service means :

a) Information technology software, information technology service, b) entertainment service, c) pharmaceutical industry, d) biotechnology industry and e) any other industry or service as may be specified by the Central Government, by notification in the official Gazette.

Para 287.2: TAX ON INCOME FROM PATENT (Section-115BBF)

The new section 115BBF, inserted with effect from Assessment Year 2017-18, implies where the total income of the “eligible assessee” includes any income by way of royalty in respect of patent developed and registered in India , then such royalty in respect of patent shall be taxable (at the option at the assessee) at a rate 10 percent (+SC+EC+SHEC). Points to be considered are as follows in this context:

1. The Gross amount of royalty will be taxable and no expenditure or allowance shall be allowed of such royalty.

2. Eligible Assessee: A person resident in India and is a patentee.
3. The 10 percent concessional rate is applicable in respect of royalty, when at least 75 percent of the expenditure in respect of the invention for which patent is granted is incurred in India.
4. Patent means a patent for any invention granted under the Patents Act 1970. While invention means a new product or process involving an inventive step and capable of industrial application.
5. **“Patentee” means the person, being the ‘true and first inventor’** of the invention whose name is included on the patent register as the patentee in accordance to the Patents Act and includes every such person where more than one person is registered as patentee under the Act.
6. **Royalty** means any lump sum money received for the transfer of all or any rights **(including the granting of the license) in respect of a patent, imparting of any information** concerning the work of, or the use of a patent, or rendering services in connection with the above activities.

Royalty does not include income of the recipient taxable under the head “Capital Gains”.

The above tax treatment is **optional** and in order to avail the benefit of section 115BBF, the assessee shall exercise the option in prescribed manner on or before the due date for furnishing the return of income for the relevant previous year.

Consequences of availing the above option: As and when the above option is exercised, certain restrictions will apply in future pertaining to taxation of royalty income from patents as mentioned below:

- “When an eligible assessee opts for taxation of royalty income in accordance with the provisions of section 115BBF for a particular year and offers royalty income from patents for taxation for any 5 consecutive subsequent assessment years **not in accordance with the provisions of the aforesaid section, the assessee shall not be eligible to claim benefit of the provisions of section 115BBF for 5 subsequent assessment years**(i.e., subsequent to the assessment year relevant to the previous year in which such income has not been offered to tax in accordance with the provisions of section 115BBF)”.

Special provisions for persons governed by Portuguese Civil Law:

The person who are governed by the Portuguese Civil Code of 1860 and are residing in the state of Goa and Union territories of Dadra and Nagar Haveli and Daman and Diu are

governed by the system of Community of property .But the Total Income will not be assessed as that of such community of property. Income of husband and wife under each head of income other than salary shall be apportioned equally between the husband and wife and the income so apportioned shall be included separately in the total income of husband and wife respectively. Income from salary will, however continue to be assessed in the hands of the husband or wife who actually earned the salary.

Annexure: 1

Tax Rates for Assessment Year 2018-19 shall be calculated as follows:

Particulars	Rs.	Rs.
1.Find out the gross total income		
2. Less: Deduction under section 80C- 80U		
3. Find out net income (1-2)		
4.Divide the net income into the following-		
4.1 Income subject to special tax rates mentioned in para 0.1-6		
4.2 Remaining income subject to normal rates		
5. Find out income tax on net income-		
5.1 Tax on income specified in 4.1 at the rates provided in para 0.1-6		
5.2 Tax on remaining income at the normal rate given in para 0.1-1 or 0.1-2 or 0.1-3 or 0.1-4 or 0.1-5		
6. Less: Rebate under section 87A (applicable in the case of a resident individual having net income)		
7.Income-tax after rebate under section 87A{(5)-(6)}		
8.Add:Surcharge @ 0%,2%,5%,7%,12%or 15% of (7)		
9.The total of {(7)+(8)}		
10.Add : Education cess {2% of (9)}		
11.Add: Secondary and higher education cess {1% of (9)}		
12. Find out the total {(9)+(10)+(11)}		
13.Deduct: Rebate under section 86,89,90,90A or 91		
14.Tax Liability {(12)-(13)}		
15.Add: Interest/ penalty , etc		

16. Less: Prepaid taxes {i.e., advance tax, self assessment tax, TDS, TCS, MAT/AMT credit }		
17. Tax payable {(14)+(15)-(16)}		

Notes:

- (2) cannot exceed (1).
- Surcharge is applicable as a % of income-tax {i.e., (7)}. These rates are-

For Individual :

- If net income does not exceed Rs. 1 crore – 10%
- If net income exceeds Rs. 1 crore – 15%.

Income Tax

0.1.1 . The tax rates applicable to individuals for the assessment year 2018-19 are as follows:

For a resident senior citizen (who is 60 years or more at any time during the previous year but less than 80 years on the last day of the previous year

Net income Range	Income- tax rates	Surcharge	Education Cess	Secondary and Higher secondary education cess
Upto Rs. 3,00,000	Nil	Nil	Nil	Nil
Rs.3,00,000- Rs. 5,00,000	5 percent of (total income minus Rs.3,00,000)	Nil	2% of income tax	1 % of income tax
Rs.5,00,000 - Rs. 10,00,000	Rs. 10000 + 20% of (total income minus Rs. 5,00,000)	Nil	2% of income tax	1 % of income tax
Exceeds Rs. 10,00,000	Rs. 110000+ 30% of (total income minus Rs. 10,00,000)	Nil	2% of income tax	1 % of income tax

For a resident super senior citizen (who is 80 years or more at any time during the previous year i.e born before April 1, 1937)-

Net income Range	Income- tax rates	Surcharge	Education Cess	Secondary and Higher secondary education cess
Upto Rs. 5,00,000	Nil	Nil	Nil	Nil
Rs.5,00,000- Rs. 10,00,000	20 percent of (total income minus Rs.5,00,000)	Nil	2% of income tax	1 % of income tax
Exceeds Rs. 10,00,000	Rs. 100000 + 30% of (total income minus Rs.10,00,000)	Nil	2% of income tax	1 % of income tax

For any other resident individual (born on or after April 1, 1957), any non- resident individual, tax rate is as under:

Net income Range	Income- tax rates	Surcharge	Education Cess	Secondary and Higher secondary education cess
Upto Rs. 2,50,000	Nil	Nil	Nil	Nil
Rs.2,50,000- Rs. 5,00,000	5 percent of (total income minus Rs.2,50,000)	Nil	2% of income tax	1 % of income tax
Rs.5,00,000 - Rs. 10,00,000	Rs. 12500 + 20% of (total income minus Rs. 5,00,000)	Nil	2% of income tax	1 % of income tax
Exceeds	Rs. 112500+ 30%	Nil	2% of income	1 % of income

Rs. 10,00,000	of (total income minus Rs 10,00,000)		tax	tax
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Notes:

- 1. Rebate under section 87A-** A resident individual (whose net income does not exceed Rs.3,50,000) can avail rebate u/s 87A.It is deductible from income tax before calculating education cess. The amount of rebate is 100 percent of income tax or Rs.2500, whichever is less.
- 2. Surcharge:** Surcharge is 15 percent of income tax if net income exceeds Rs. 1 crore. It is subject to marginal relief (in case of a person having a net income of exceeding Rs. 1 crore, the amount payable as income tax and surcharge shall not exceed the total amount payable as income tax on total income of Rs. 1 crore by more than the amount of income that exceeds Rs 1 crore). Surcharge is 10 percent of the Income Tax, where taxable income is more than Rs. 50 lacs and upto Rs. 1 crore.
- 3. Education cess:** It is 3 percent of income tax and surcharge.
- 4. Alternate minimum tax:** Tax payable by a non – corporate assessee cannot be less than 18.5 percent (+SC+EC+SHEC) of “adjusted total income” as per section 115JC.

9.4 .1 ILLUSTRATIONS**Question 1.**

The taxable income of an individual is Rs. 9, 70,000 from the business and Rs. 60,000 from House property for the previous year 31st March, 2018. His wife is also employed and is getting a salary of Rs. 16500 per month. Prepare his assessment for the relevant assessment year.

Solution:**Computation of Total Income and Tax Liability**

1.	Income from House property	Rs. 60,000
2.	Income from Business	Rs. 9,70,000
	Total Income	Rs.10, 30,000

Income tax on first Rs. 5, 00,000 (Rs. 2, 50,000 exempt and On Rs. 2, 50,000 @5 %)	Rs. 12500
Income tax on Rs. 5, 00,000 @ 20%	Rs. 100,000
Income tax on balance of Rs. 30,000 @ 30%	Rs. 9000
	Rs. 1, 21,500
Add: Surcharge	
NIL	
	Rs. 1, 21,500
Add: Education Cess	Rs. 3645
Tax Liability	Rs. 1, 25,145

Question 2:

Smt. Radha , the singer, of the age of 45 years has furnished the following information for the assessment year 2018-19:

<i>Gross Total Income</i>	<i>Rs. 6, 30,000</i>
<i>Contribution to RPF</i>	<i>Rs. 20,000</i>
<i>Contribution to PPF</i>	<i>Rs. 10,000</i>
<i>Life insurance premium (on own & husband's life)</i>	<i>Rs. 8000</i>
<i>NSC VIII issue being purchased</i>	<i>Rs. 10,000</i>
<i>Interest accrued on NSC</i>	<i>Rs. 5,000</i>
<i>Repayment of housing loan. The house was completed in 2010 And is used for self residence</i>	<i>Rs. 15000</i>
<i>Compute tax liability by the assessee.</i>	

Solution**Computation of Tax Liability**

Gross Total Income	Rs. 6, 30,000
Less: Deduction u/s 80C	
Qualifying amount u/s 80C:	
Contribution to RPF	Rs.20, 000
Contribution to PPF	Rs. 10,000
Life insurance premium	Rs. 8, 000
NSC VIII Issue	Rs. 10,000

Interest accrued on NSC	Rs. 5,000	
Repayment of housing loan	Rs. 15,000	Rs. 68,000
	Total Income	Rs.
5,62,000		
Tax on Rs. 5, 62,000:		
Tax on Rs. 2,50,000		NIL
Tax on Rs. 2,50,000 @ 5 %		Rs. 12500
Tax on Rs. 62,000 @ 20%		Rs. 12,400
		Rs. 24,900
Add: Surcharge		
Add: Education cess @ 3`%		Rs. 747
	Tax Liability	Rs. 25647



Check Your Progress-A

Question 1.

The gross total income of a permanently disabled Smt. Savita, who is an Indian resident and whose age is 40 years, for the year ended on 31st March, 2018, consists of the following:

- (i) Income from House Property computed: Rs. 63,000
- (ii) Income from Business: Rs. 5,37,000
- (iii) One fourth share of A.O.P. which has been taxed at maximum marginal rate Rs. 20,000
- (iv) One third share in profit from a firm Rs. 34000
- (v) Her Gross total Income is Rs. 6,54,000

Compute her tax liability for assessment year 2018-19.

Note: Share from A.O.P. is exempt.

Question 2

An individual has submitted the following particulars for the assessment year 2018-19

- (i) Income from salary Rs. 95,000
- (ii) Income from House Property Rs. 44,000 (computed).
- (iii) Income from Business Rs. 4,20,000
- (iv) Long Term Capital Gains Rs. 20,000
- (v) Income from Lottery and Bittings Rs. 69,000
- (vi) Agricultural Income Rs. 15,000

You are required to compute his Gross tax liability.

Question 3:

Exemption limits in the case of a resident women below 60 years of age for the assessment year 2018-19 is:

- a) Rs. 2,50,000
- b) Rs.1,60,000
- c) Rs. 2,40,000
- d) None of the above.

Answer:

Question 4:

The rate of education cess is :

- a) 4%
- b) 10%
- c) 2%
- d) 3%

Answer:

Question 5:

What is the rate of surcharge applicable to individuals having total income exceeding Rs. 1 Crore?

- a) 10%
- b) Nil
- c) 5%

d) 2.5%

Answer:

Q6. State the rates of income tax for individuals.

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Q7. What are the tax implications for income from Global Depository receipts?

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Q8. What are the steps to compute total income and tax liability of an individual?

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Q9. How do you explain the tax on investment income and Long Term Capital Gains of an individual?

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Q10. What are the benefits that are available to a non resident assessee even after he/she becomes resident assessee in India?

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9.5 MEANING AND SCHEME OF TAXATION OF FIRMS

Meaning: Section 4 of the Indian Partnership Act, 1932 defines partnership as “relationship between persons who have agreed to share the profits of business carried on by all or any of them acting for all”. Persons who have entered into partnership with one another are called individually partners and collectively a firm and the name under which their business is carried is called the firm name.

An individual who is major and of sound mind can be partners of a firm. A minor can be admitted to the benefits of partnership but there should be at least two partners. A Hindu Undivided Family cannot be partner in a partnership firm; however the manager of the family or any other member of the family can enter into partnership for or behalf of the family with a stranger. A firm cannot enter into a partnership but the partner of a firm can become partner of another firm. A company is a separate entity and possesses a legal personality and hence two or more companies can become partners in a firm, a company can also form partnership with an individual.

Scheme: The salient features of the scheme of taxation of firm are as under:

1. The firm is taxed as separate entity. There is no such distinction between registered and unregistered firms.
2. The assessing officer has no power available under the current scheme of taxation to verify the genuineness of a firm.
3. From the Assessment Year 2010-11, the above provisions are also applicable in the case of limited liability of partnership.
4. The share of a partner in the income of the firm is not included in computing his total income.
5. Any salary, bonus, commission or remuneration paid /payable to partners is allowed as a deduction to the firm. However, the deduction is subject to certain restrictions in the hands of firms. The amount which is allowed as deduction to the firm is taxable in the hands of the partners.
6. Where a firm pays interest to any partner, the firm can claim deduction of such interest from its total income. The maximum rate of interest that can be allowed to a partner is 12 percent per annum.
7. The income of a firm is taxed at a flat rate of 30 percent.

Conditions when remuneration/interest is deductible

Deductions in respect of payment of remuneration and interest can be claimed by an assessee only when:

- Conditions of section 184 and
- Conditions of section 40(b) are satisfied.

There are five basic conditions to be satisfied under section 184

1. A firm must be evidenced by an instrument (partnership deed).
2. Individual share of partners must be specified in the instrument.
3. Certified copy of the instrument must be submitted.
4. Revised instrument must be submitted whenever there is a change in the constitution of firm/profit- sharing ratio.
5. There should not be any failure as is mentioned in section 144.

Conditions for claiming deduction of remuneration to partners under section 40(b)

1. Payment should be made to a working partner: working partner is an individual who is actively involved in conducting the affairs of the business or profession of the firm actively.
2. Remuneration must be authorized by partnership deed.
3. It should not pertain to the prior period to partnership deed.
4. Remuneration should not exceed the permissible limit:

Maximum amount applicable from the assessment year 2010-11 –

Book Profit	Profit Amount deductible in respect of remuneration to partners under section 40(b)
If book profit is negative	Rs. 1,50,000
In case book profit is positive:	
i. On first Rs.3lacs of book profit	Rs.1,50,0000 or 90 percent of book profit, whichever is more
ii. On the balance of the book profit	60 percent of book profit

Book Profit: It would be determined as under:

- Computation of net profit of the firm as per profit and loss account.
- Adjustments to be made as per sections 28 to 44DB.
- Remunerations to partners to be added if debited to the Profit and Loss account.

Conditions for claiming deduction of interest to partners under section 40(b)

The following specific conditions to be fulfilled to obtain deduction of interest paid to the partners:

- Payment of interest should be authorized by the partnership Deed.
- Payment of interest should be in relation to the period after the partnership deed.
- Rate of interest should not increase 12% per annum, if however interest payable exceeds simple interest of 12 percent per annum, the excess amount is not deductible.
- Where an individual is a partner in a firm on behalf, or for the benefit, of any other person, interest paid by the firm to such individual (otherwise than as partner in a representative capacity), is not taken into account for the purpose of section 40(b).
- Where a firm pays as well as receives interest from the same partner, interest received by the firm will be chargeable to tax. Interest paid to the same partner will be allowed within the four-corners of section 40(b).

Carry forward and set off of loss in the case of change in the constitution of firm:

Section 78 provides that where there is change in the constitution of the firm on account of death/retirement, the firm shall not be entitled to carry forward of so much of the loss as is attributable to such partner. As in the case of unabsorbed depreciation and unabsorbed capital expenditure on scientific research, section 78 is not applicable, therefore these unadjusted allowances can be carried forward by the reconstituted firm.

9.6 COMPUTATION OF INCOME AND TAX OF FIRM

In computing the firm's income, first income from different heads of income is to be computed excluding incomes exempt under sections 10-13A. The payment of remuneration

and interest to partners is deductible if conditions of section 184 and sec 40(b) are satisfied. All the adjustments for brought forward losses and disallowances are to be made. The amount so derived is Gross total income and from the gross total income the deductions under section 80GGA to 80JJAA is to be made in order to arrive at net income of the firm.

Computation of tax of firm

On the income so computed above, tax is payable as under:

1. Short term capital gain u/s111A – 15% tax rate.
2. Long term capital gain – 20%
3. Winnings from lottery – 30%
4. Other income (not being income which is subject to special tax rate)-30%

Add: Surcharge @ 12% if total income exceeds 1crore.

Add: Education and secondary and higher education cess @ 3 percent on (total income + surcharge).

Note: A limited liability partnership (from the assessment year 2012-13) or any firm (from the assessment year 2013-14) is subject to alternate minimum tax at the rate of 18.5% (+EC+SHEC) of “adjusted total income”.

9.7 ASSESSMENT OF PARTNERS OF A FIRM

Assessment of partners of a firm

In computing the income of a partner from the firm the following points are worth noting:

- a) **Remuneration:** Wherever salary, bonus, commission or other remuneration received by a partner as per the provisions of the partnership deed, it is not taxable under the head ‘salaries’, because a partner of the firm is not the employee of the firm.
- b) **Interest:** When any interest is received by a partner as per the provisions of the deed(not exceeding 12 %), such income is also treated as a part of the business income and included under the head Profits and Gains of Business and Profession.
- c) **Rent:** If any partner lets out his buildings to the firm, the rent received by him will be taxed under the head “Income from house property”.
- d) **Share of profit:** The share of profit of a partner in the firm is exempt under section 10(2A). Hence, it will not be included in his income.
- e) **Deductions:** The following deductions may be claimed:

1. Any interest paid by him on capital borrowed by him for the purpose of investment in firm.
2. Any interest paid by him on his deficit capital is deductible.
3. Any other expense incurred by the partner to earn the remuneration from the firm, for example; travelling expenses, maintenance of car etc is deductible.

TREATMENT OF FIRM'S LOSSES:

Losses brought forward by the firm shall be dealt with as under:

- 1) Speculative business losses can be set off against the speculative business income of the firm in subsequent 4 years
- 2) Non-speculative business losses can be set off against any business profit of the firm in subsequent 8 years.
- 3) Long-term Capital losses can be set off against long-term capital gains in the period specified in (2).
- 4) Short term capital losses can be set of against long term capital gains as well as short term capital gains of the firm in the period specified in (2).
- 5) Unabsorbed depreciation can be set-of against business or any other income of the firm.

Computation of Book Profit:

While computing firm's income book profit has to be determined to comply with the provisions of section 40(b). Hence, a proforma for this purpose is being given below:

Computation of Book Profit

Net profit as per P&L account	Rs.XXXX
Add:	
(i) Inadmissible items (not covered u/s 30-44D).	Rs. XXXX
(ii) Remuneration to partners if debited to P&L	Rs. XXXX
(iii) Disallowance of interest in excess of 12 % p.a.	Rs. XXXX
Less:	
i. Admissible items which are disallowed in (i) above	Rs.XXXX

- ii. Income from all other sources credited to P& L A/c. Rs. XXXX

Book Profit **Rs. XXXX**

Computation of the Total Income of the Firm

Book Profit of the Firm	Rs. XXXX
Less: Remuneration paid to working partners	
Least of the following:	
(a) Actual remuneration	XXX
(b) Statutory limit u/s 40 (b)	XXX
XXX	
Profits & Gains of Business or Profession of the firm	Rs. XXXX
Add: Income from all other sources	Rs. XXXX
Gross Total Income	Rs. XXXX
Less: Deductions u/s 80C to 80U	Rs. XXXX
Total Income	Rs. XXXX
Less: Tax payable by the Firm	Rs. XXXX
Distributable Income to be distributed among the partners according to their Profit sharing ratio	Rs. XXXX

9.7.1 ILLUSTRATIONS

Question 1.

The total income of a firm XYZ in which X, Y, Z, are the partners and the partners share profits and losses in the ratio 1:2:3, was as per P&L A/c Rs. 1, 31,800 for the previous year 2017-18. In computing the total income of Rs. 1, 31,800, the following have been debited to the P&L A/c:

Salaries of Rs. 1, 30,000 and Rs. 1, 20,000 to X and Y respectively.

Interest on capital calculated @ 20% of Rs. 3,500, Rs. 14,000, and Rs. 10,500 to X, Y and Z respectively. Bonus to Z Rs. 15,000.

Commission of Rs. 5,000, Rs. 12,500, and Rs. 17,500 to X, Y and Z respectively

Z had borrowed capital for his investment in the firm and had paid interest of Rs. 7500 separately to the lender.

Compute the total income of the firm and taxable income of the three partners in the firm. All are working partners. The firm fulfills the conditions of section 184.

Solution:

Computation of Book Profit

Net profit as per P&L A/c		Rs. 131800
Add: Items not allowed:		
(i) Salaries to X	Rs. 130000	
(ii) Salaries to Y	Rs. 120000	Rs. 250000
(iii) Bonus to Z		Rs. 15000
(iv) Commission to X	Rs. 5000	
Y	Rs. 12500	
Z	Rs. 17500	Rs. 35000
(v) Interest on capital in excess of 12%		
X	Rs. 1400	
Y	Rs. 5600	
Z	Rs. 4200	Rs. 11,200
	BOOK PROFIT	Rs. 4, 43,000

Computation of the Total Income of the Firms

Book Profit		Rs. 443000
Less: Remuneration to working partners:		
(i.e., Salary + Bonus+ Commission)	Rs. 300000	
Or		
90 percent of 1 st Rs 300000 of book profit	Rs.270000	

60 percent of balance Rs 143000 of book profit Rs. 85800

Rs. 355000

Whichever is less

Rs. 300000

Total Income Rs.143000

Taxable Income of partners from the firm under the head Business

Particulars	X	Y	Z
Interest on capital	2100	8400	6300
Remuneration	135100	132500	32500
Total	137100	140900	38800

Notes: Share of partners in the total income of the firm Rs. 143000 after deducting tax payable is exempt u/s 10(2A).

Z had paid interest on capital borrowed Rs.7500, hence his taxable income would be Rs. 38,800-7500=Rs. 31300.

Question 2:

A, B and C are partners in a firm (which fulfils the conditions of section 184) sharing profits and losses in the proportion of 3:2:1 respectively. The firm's Profit & Loss account for the year ended 31st March 2018 showed net profit of Rs. 2,44,000 after debiting, inter alia in the following amount.

- 1) *Salary of Rs. 4000 p.m. paid to C.*
- 2) *Rent of Rs. 19000 paid to A for the portion of the building owned by A in which the firm's office was situated. Fair rent value of the building Rs. 10,000.*
- 3) *Interest on Capital of Rs. 1000, Rs. 2000, and Rs. 30000 to A, B and C respectively.*
- 4) *Commission paid to B Rs. 40,000*
- 5) *Expenses on current repairs of the business premises belonging to partner A, Rs. 1000.*
- 6) *Donation to approve bodies Rs. 5000.*
- 7) *Salary to B's son Rs. 72000. B's son is qualified management graduate and was serving another concern on Rs. 5800 p.m.*

8) The net profit of Rs. 2, 44,000 included Rs. 12000 from interest on Government Securities.

Compute total income of the firm for the Assessment Year 2018-19 assuming that it is professional firm.

Note: Salary to B's son is admissible expenditure as he is not the partner in firm and he is getting the salary based on his technical skills.

Interest on capital is assumed to be not more than prescribed rate: hence will not be added for determining book profit.

Solution:

Computation of Book Profit

Profit as per P&L A/c		Rs. 2, 44,000
Add: Inadmissible expenses:		
Salary to C	48000	
Commission to B	40000	
Expenses on repairs	1000	
Donations	5000	
Excess rent to A	9000	Rs. 1, 03,000
		Rs. 3, 47,000
Less:		
Income not taxable under Business Head:		
Interest on Govt. securities		Rs. 12000
		Rs. 3, 35,000

Computation of Firm's Business Profit

Book Profit		Rs. 3, 35,000
Less: Allowable Remuneration u/s 40(b) :		
Least of the following:		
(i) Actual under the Deed	88,000	
Or		
(ii) Statutory limit:		
90% of first Rs.3, 00,000 of Book Profit	2, 70,000	
60% of next Rs. 35,000 of Book Profit	21,000	2, 91,000
		Rs. 88,000

Firm's Business Profit	Rs. 2,47,000
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Statement of Total Income

Business Income	Rs. 2, 47,000
Other Sources: Interest on Govt . Securities	Rs. 12000
	Rs. 2, 59,000
Less: Deduction u/s 80 G: 50% of Rs. 5,000	Rs. 2500
Total Income	Rs. 2,56,000

**Check Your Progress-B****Q1. Who can be a partner of a firm?**

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Q2. How the total income of a firm is computed? Give a proforma of such computation?

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Q3. From the following information compute the total Income of the firm and tax payable by it for the assessment year 2018-19:

- (i) Profit from an industrial undertaking Rs. 40,000
- (ii) Profit from business of Poultry breeding Rs. 20,000
- (iii) Short term capital gains Rs. 20,000
- (iv) Long term capital Gains Rs. 40,000
- (v) Interest from Bank Rs. 6,000

(vi) Loss from House Property Rs. 10,000 on account of interest on loan taken to construct the property.

(vii) Donation to approved Charitable Institution by cheque Rs.15000

Hint: Total Income Rs. 1, 12,200

Question 4: A, B and C are partners of a firm with equal shares. The profit and loss account for the year ended 31st march 2018 shows a net profit of Rs. 99,750 after debiting the following as per deed:

(i) Salaries of Rs. 20,000 and Rs. 15,000 to A and B respectively.

(ii) Bonus to 'C' Rs. 15,000.

(iii) Rs. 5000 for interest on capital to 'A' calculated @ 20 %.

(iv) Rs. 10,000 for rent of the business premises paid to B.

(v) Commission of Rs. 5000 to 'C'.

Compute Book Profit and the total income of the firm for the A.Y. 2018-19 assuming that it is a professional firm and all are working partners.

Answer: Book Profit Rs. 1, 56,750: Total Income Rs. 101,750.

9.8 SUMMARY

- i. A firm shall be assessed as a firm if the partnership is evidenced by an instrument and the individual shares of the partners are specified in that instrument.
- ii. An individual, company and the trust can be the partner in a firm.
- iii. Book Profit means the net profit as per Profit & Loss Account for the relevant previous year computed in accordance with sections 30 to 44D as increased by the aggregate amount of remuneration paid to all the partners of the firm if such amount has been deducted while computing the net profit.
- iv. Remuneration, Interest and Rent are the important points to be taken into consideration while computing the income of a partner.
- v. An individual includes a woman, man, minor child or any human being, while considering the total income of an individual.

- vi. In case of an individual resident in India , whose total income doesn't exceeds Rs. 3,50,000, shall be entitled to a deduction of Rs. 2500 or income tax payable whichever is lower.
- vii. Any amount payable (tax, interest, penalty, fine, etc) and the amount of refund due shall be rounded off to the nearest multiple of Rs. 10.



9.9 GLOSSARY

Surcharge – an additional charge or payment.

Rebate – a partial refund to someone who has paid too much for tax, rent or a utility.

Royalty-it is a payment made to the legal owner of the property .patent, copyright etc; who wish to make use of it for any desirable activities.

Patent- a government license that gives the holder exclusive rights to a process, design or new invention for a designated period of time.



9.10 REFERENCES

- Ahuja, Dr. Girish and Gupta, Dr. Ravi, *DIRECT TAXES Law & Practice* including *TAX PLANNING* ,26th Edition, Publication House-New Delhi; Bharat Law House Pvt. Ltd.
- C.S. Agrawal, K.K., *Income Tax*, Publication date: 28 September 2016.
- Dr. Mehrotra, H.C, and Dr. Goyal, S.P., *INCOME TAX LAW AND ACCOUNTS*, Sahitya Bhawan Publications, 57th Edition.



9.11 SUGGESTED READINGS

1. WEBSITE: <http://www.taxmann.com>
2. E-mail : sales @taxmann.com
3. *Direct Taxes Ready Reckoner* by Dr. Vinod Singhanian and Dr. Kapil Sighania.



9.12 TERMINAL QUESTIONS

Question 1:

From the following information compute the total income and tax liability of Mr. Raj Kumar, who is 70 years old and disabled, for the A.Y. 2018-19?

Income from house property (computed) Rs. 70,000

Income from Business Rs. 9, 85,000

Capital Gains:

Short term Capital Rs. 10000

Long term capital gain Rs. 15,000

Bank interest on saving account Rs. 14,000

Answer: Gross total income -10, 79,000

Question 2:

State whether the following statements are true or false:

1. Surcharge is levied when the total income of an individual exceeds Rs. 2,50,000
2. A partner is liable to pay tax on his share income received from the firm.
3. An individual resident in India and non –resident in India pays tax at the same rates.

4. Education cess is imposed @ 3 percent.

Question 3:

Mr. Gupta is a retired officer. He is 66 years old. He gets pension of Rs. 35,000 p.m. He is owner of a house property and receives Rs. 15,000 p.m. from that as rent. Besides this he earned income of Rs. 10,000 as interest on Govt. securities. Find out his tax liability for the assessment year 2018-19.

Question 4:

Under sections 40 (b) what items are disallowed as deduction while computing firm's income from business or profession?

Question 5:

X, Y and Z are partners of a firm with equal shares. The profit and loss account for the year ended 31.03.2018 shows a net profit of Rs. 2, 80,000 after debiting Rs. 7,000 for interest paid to X at 20 percent; Rs. 60,000 for salary paid to Y and Rs. 44,000 for rent of the business premises paid to Z. Compute the book profit of the firm. The firm fulfills the condition of section 184.

Answer: Book Profit -3, 42,800.

UNIT 10 SET OFF AND CARRY FORWARD OF LOSSES AND CLUBBING OF INCOME

10.1 Introduction

10.2 Objectives

10.3 Set off and Carry Forward of Losses

10.4 Clubbing of income

10.5 Other Deemed Income

10.6 Summary

10.7 Glossary

10.8 Answer to Check Your Progress

10.9 Reference/ Bibliography

10.10 Suggested Readings

10.11 Terminal & Model Questions

10.1 INTRODUCTION

Generally, an assessee is taxed in respect of the income earned by him or her from the various heads which you also learnt in the previous units. However, there may be cases when, when an assessee has to pay tax on the income belonging to others. Income Tax Act ensures through its provisions that assessee is unable to reduce tax liability by shifting his/her income on to his or her family members or by arranging their sources of income in such a way that tax incidence falls on others. So, to counteract such practices of tax avoidance, necessary provisions have been included in sections 60 to 64 of the Income Tax Act. Further, Income tax Act also provides assessee provisions to reduce the losses. In this unit you will be learning how losses of one source can be set off from within the source and from the other sources, depending upon the provisions of the Act. Further, you will also learn that if losses could not set off due to unavailability of the profit, then how it can be carried forward to be set off against the income or profits in the next assessment year.

10.2 OBJECTIVES

After reading this unit, you will be able to;

- understand intra source adjustment, inter source adjustment and order of set-off.
- state the provisions for set off and carry forward of losses.
- learn when income of some other person is included in the income of assessee.

10.3 SET OFF AND CARRY FORWARD OF LOSSES

Income tax is assessed collectively from the various heads which results in the total income earned in a previous year. The total income of an assessee is computed from Income from Salaries, Income from House Property, Income from Business and Profession, Income from Capital Gains and Income from Other Sources. Out of these head, possibility may arise of facing losses from one or more sources. In such a situation, the Act provides assessee provision to reduce the said loss. In such conditions, losses are set off and the taxable income of the assessee is the net of the income earned and losses deducted, this is termed as set-off if the loss is reduced from the net income in the same year when it is incurred. When losses incurred during the previous years are adjusted against the income in the current year, this is termed as carry forward of losses. The rules regarding set-off and carry forward of losses are covered under section 70 to 80 of the Income Tax Act. 1961

Provisions relating set-off of losses-

I. Set off of loss from one source against income from another source under the same head of income. [Section 70]-Inter Source Adjustment

If the net result for any assessment year in respect of any source falling under any head of income, other than "Capital Gains", is a loss, the assessee shall be entitled to have the amount of such loss set off against his/her income from any other source under the same head. This means that if in any year an assessee has incurred loss from any source under a particular head of income, then s/he is entitled to adjust such loss against income from any other source falling under the same head. This is termed as inter source adjustment.

However, the following exceptions are there for this rule;

- (a) Loss from speculation business cannot be set-off against income from other business or profession. This loss can be set-off only against the profits in a speculation business.
- (b) Loss computed that pertains to any specified business referred to in section 35AD shall not be set off except against profits and gains, if any, of any specified business under section 35 AD. (section 35AD is applicable in respect

of certain specified businesses like setting up a cold chain facility, setting up and operating warehousing facility for storage of agricultural produce, developing and building a housing projects, etc.).

- (c) Long-term capital loss can be set-off only against long-term capital gain. For example Mr. X faced a short term capital loss of as Rs 25,00,000 and long term capital gain of Rs. 60,00,000 then Mr. X can set off this short term capital loss from long term capital gain Therefore, the net long term capital gain of Mr. X shall Rs. 35,00,000. In an another case Mr. Y earned short term capital gain of Rs. 50,00,000 and long term capital loss of 20,00,000 then it shall not be possible for Mr. Y to set off long term capital loss from short term capital gain. The capital gain of Rs 50, 00,000 shall be taxable and the long term capital loss shall be carried forward.
- (d) Any loss incurred in business of owning and maintaining race horses can only be set off against income from owning and maintaining race horses. Loss of such kind can be set off against income from such source only.
- (e) As per section 58(4) a loss cannot be set off against winnings from lottery, crossword puzzles, gambling, card games, races, betting and similar activities of any sort or nature. Further, losses of such kind cannot be set-off against such income or any other income. Further, no loss under any head can be set-off against such incomes.

II. Set off of loss from one head against income from another head [Section 71]Inter Head Adjustment

After making intra-head adjustment (if any) the next step is to make inter-head adjustment. Where in respect of any assessment year the net result of the computation under any head of income, other than "Capital gains", is a loss and the assessee has no income under the head "Capital gains", s/he shall, subject to the provisions of this Chapter, be entitled to have the amount of such loss set off against his income, if any, assessable for that assessment year under any other head.

This means that if in any year, the taxpayer has incurred loss under one head of income and is having income under other head of income, then he can adjust the loss from one head against income from other head, E.g., Loss under the head of house property to be adjusted against salary income. Further, an assessee has to first make intra-head adjustment before making inter-head adjustment.

However, the following exceptions are there for this rule;

- a) Loss from speculative business cannot be set off against any other income. However, non-speculative business loss can be set off against income from speculative business.

- b) Loss computed in respect to any specified business referred to in section 35AD cannot be set off against any other income. (section 35AD is applicable in respect of certain specified businesses like setting up a cold chain facility, setting up and operating warehousing facility for storage of agricultural produce, developing and building a housing project, etc.).
- c) Loss under head "Capital gains" cannot be set off against income under other heads of income.
- d) Loss from the business of owning and maintaining race horses cannot be set off against any other income.
- e) No loss can be set off against income from winnings from lotteries, crossword puzzles, race including horse race, card game, and any other game of any sort or from gambling or betting of any form or nature.
- f) Loss from business and profession cannot be set off against income chargeable to tax under the head "Salaries".

With effect from 1 April, 2018 i.e., with effect from Assessment Year 2018-19 subsection (3A) has been inserted with states that the net result of the computation under the head "Income from house property" is a loss and the assessee has income assessable under any other head of income, the assessee shall not be entitled to set off such loss, to the extent the amount of the loss exceeds two lakh rupees, against income under the other head. This means that loss under the head "Income from house property shall be set off against any other head of income shall be made up to Rs 2, 00,000 for any assessment year.

Carry Forward of Losses

If the losses are unable to set off against the income under the same head or under different heads in the same assessment year because of deficient income, then such losses are allowed to be carried forward to be claimed as set-off from the income in subsequent assessment years (Subject to the conditions given in the Act). This is termed as 'Carry Forward of Losses'. The following losses can be carried forward;

- i) Loss under the head Income from House Property
- ii) Loss under the head "Profits and gains of business and profession".
- iii) Loss under the head "Capital Gains".

- iv) Loss under the head “Income from other sources” only pertaining to the activity of owning and maintain race horses.

Losses incurred under any other head cannot be carried forward and set-off.

III. Carry forward and set off of business losses other than speculation loss[Section 72]

Where for any assessment year, the net result of the computation under the head "Profits and gains of Business or Profession" is a loss to the assessee, not being a loss sustained in a speculation business, and such loss cannot be or is not wholly set off against income under any head of income in accordance with the provisions of section 71, so much of the loss as has not been so set off or, where s/he has no income under any other head, the whole loss shall, subject to the other provisions shall be carried forward to the following assessment year, and—

- (i) it shall be set off against the profits and gains, if any, of any business or profession carried on by him and assessable for that assessment year;
- (ii) if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on:

Provided that where the whole or any part of such loss is sustained in any such business as is referred to in section 33B which is discontinued in the circumstances specified in that section, and, thereafter, at any time before the expiry of the period of three years referred to in that section, such business is re-established, reconstructed or revived by the assessee, so much of the loss as is attributable to such business shall be carried forward to the assessment year relevant to the previous year in which the business is so re-established, reconstructed or revived, and—

- (a) it shall be set off against the profits and gains, if any, of that business or any other business carried on by him and assessable for that assessment year; and
- (b) if the loss cannot be wholly so set off, the amount of loss not so set off shall, in case the business so re-established, reconstructed or revived continues to be carried on by the assessee, be carried forward to the following assessment year and so on for seven assessment years immediately succeeding.

(2) Where any allowance or part thereof is, under sub-section (2) of section 32 or sub-section (4) of section 35, to be carried forward, effect shall first be given to the provisions of this section.

(3) No loss (other than the loss referred to in the proviso to sub-section (1) of this section) shall be carried forward under this section for more than eight assessment years immediately succeeding the assessment year for which the loss was first computed.

Carry forward and set off of accumulated loss and unabsorbed depreciation allowance in amalgamation or demerger, etc. [Section 72 A]

The accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or allowance for unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected. The other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly if the following conditions are satisfied;

- i) Where there has been an amalgamation of (a) a company owning an industrial undertaking or a ship or a hotel with another company; or (b) a banking company referred to in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949) with a specified bank; or (c) one or more public sector company or companies engaged in the business of operation of aircraft with one or more public sector company or companies engaged in similar business,
- ii) The Amalgamating Company has been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years
- iii) The Amalgamating Company has held continuously as on the date of the amalgamation at least three-fourths of the book value of fixed assets held by it two years prior to the date of amalgamation;
- iv) The Amalgamated Company holds continuously for a minimum period of five years from the date of amalgamation at least three-fourths of the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation.
- v) The Amalgamated Company continues the business of the amalgamating company for a minimum period of five years from the date of amalgamation.
- vi) The Amalgamated Company fulfils such other conditions as may be prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.

However, if the conditions are not complied with, then the set off of loss or allowance of depreciation made in any previous year in the hands of the amalgamated company shall be deemed to be the income of the amalgamated company chargeable to tax for the year in which such conditions are not complied with.

Accumulated Loss and Unabsorbed Depreciation in case of demerger [Section 72 A (4)]

The accumulated loss and the allowance for unabsorbed depreciation of the demerged company shall be allowed to be carried forward and set off in the hands of the resulting company if such loss or unabsorbed depreciation is directly

relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company. If such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

Further, the Central Government may through notification in the Official Gazette, specify such conditions as it considers necessary to ensure that the demerger is for genuine business purposes.

Accumulated loss and unabsorbed depreciation in case of succession of a firm or a proprietary concern by a company [Section 72 A(6)]

When there has been reorganisation of business and a firm is succeeded by a company as per the conditions of Section 47 (xiii) and (xiv), then , the accumulated loss and the unabsorbed depreciation of the predecessor firm or the proprietary concern shall be deemed to be the loss or allowance for depreciation of the successor company for the purpose of previous year in which business reorganisation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly;

But if any of the conditions laid down in Section 47 (xiii) and (xiv) are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor company, shall be deemed to be the income of the company chargeable to tax in the year in which such conditions are not complied with.

(6A) Where there has been reorganisation of business whereby a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to clause (xiii) of section 47, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance for depreciation of the successor limited liability partnership for the purpose of the previous year in which business reorganisation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly :

Provided that if any of the conditions laid down in the provision to clause (xiii) of section 47 are not complied with, the set off of loss or allowance of depreciation

made in any previous year in the hands of the successor limited liability partnership, shall be deemed to be the income of the limited liability partnership chargeable to tax in the year in which such conditions are not complied with.

For the purposes of this section 72A, 72AA and 72AB, the following explanation is given;

- "accumulated loss" means so much of the loss of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, under the head "Profits and Gains of Business or Profession" (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of section 72 if the reorganisation of business or conversion or amalgamation or demerger had not taken place.
- Further for aforesaid purpose; an "industrial undertaking" means any undertaking which is engaged in the manufacture or processing of goods; or the manufacture of computer software; or the business of generation or distribution of electricity or any other form of power; or the business of providing telecommunication services, whether basic or cellular, including radio paging, domestic satellite service, network of trunking, broadband network and internet services; or mining; or the construction of ships, aircrafts or rail systems;

(b) "unabsorbed depreciation" means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the reorganisation of business or conversion or amalgamation or demerger had not taken place;

(c) "specified bank" means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955) or a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959) or a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970) or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980).

Provisions relating to carry forward and set-off of accumulated loss and unabsorbed depreciation allowance in scheme of amalgamation of banking company in certain cases. [Section 72AA]

Where there has been an amalgamation of a banking company with any other banking institution under a scheme sanctioned and brought into force by the Central Government under sub-section (7) of section 45 of the Banking Regulation Act, 1949 (10 of 1949), then the accumulated loss and the unabsorbed depreciation of such banking company shall be deemed to be the loss or allowance for depreciation of such banking institution for the previous year in which the scheme of amalgamation was brought into force and other provisions of this Act relating to set-off and carry forward of loss and allowance for depreciation shall apply accordingly.

Provisions relating to carry forward and set off of accumulated loss and unabsorbed depreciation allowance in business reorganisation of co-operative banks.

The assessee, being a successor co-operative bank are allowed to set off the accumulated loss and the unabsorbed depreciation of the predecessor co-operative bank as if the amalgamation had not taken place, and all the other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly. But, the provision of this section shall apply if the predecessor co-operative bank has been engaged in the business of banking for three or more years; and has held at least three-fourths of the book value of fixed assets as on the date of the business reorganisation, continuously for two years prior to the date of business reorganization. Further, the successor co-operative bank holds at least three-fourths of the book value of fixed assets of the predecessor co-operative bank acquired through business reorganisation, continuously for a minimum period of five years immediately succeeding the date of business reorganization. The Successor continues the business of the predecessor co-operative bank for a minimum period of five years from the date of business reorganisation; and fulfils such other conditions as may be prescribed to ensure the revival of the business of the predecessor co-operative bank or to ensure that the business reorganisation is for genuine business purpose.

IV. Losses in Speculation Business [Section 73]

Section 73 deals with the provisions for Loss from Speculative Business. Under this section, any loss, computed in respect of a speculation business carried on by the assessee, shall not be set off except against profits and gains, if any, of another speculation business. If for any assessment year any loss computed in respect of a speculation business has not been wholly set off then the remaining amount of loss or

the whole loss where the assessee had no income from any other speculation business, shall be carried forward to the following assessment year, and it shall be set off against the profits and gains, if any, of any speculation business carried on by him assessable for that assessment year. Further, if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on. **Moreover**, in respect of allowance on account of depreciation or capital expenditure on scientific research, the provisions of sub-section (2) of section 72 shall apply in relation to speculation business as they apply in relation to any other business. **Further**, no loss shall be carried forward under this section for more than four assessment years immediately succeeding the assessment year for which the loss was first computed.

V. Carry Forward and Set off of capital loss [Section 74]

If the net result of the computation under the head "Capital Gains" is a loss to the assessee, then the whole loss shall be carried forward to the following assessment year however, the other provisions relating to carry forward and setoff shall also be considered. The following shall be kept in the mind before carrying forward and setting off of capital losses;

- (a) Loss incurred from short-term capital asset, shall be set off against income, if any, under the head "Capital gains" assessable for that assessment year in respect of any other capital asset.
- (b) Loss related to a long-term capital asset, shall be set off against long term capital gain. It could not be set off from short-term capital asset.
- (c) if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on.
- (d) Short term or long-term capital loss can be carried forward for eight assessment years immediately succeeding the assessment year for which the loss was first computed.

Such loss shall only be carried forward if the return is filed within the time limit of Section 139(1). However, if the return of loss is filed after the due date, the delay may be accepted if a few conditions are satisfied.

(as cited by Singhania, Direct Taxes Ready Reckoner, Assessment Year 2017-18 and 2018-19, Taxmann Publications (P) Ltd., New Delhi A-231Para 98.2)

Losses of firm [Sec 75]

Where the assessee is a firm, any loss in relation to the assessment year commencing on or before the 1st day of April, 1992, which could not be set off against any other income of the firm and which had been apportioned to a partner of the firm but could not be set off by such partner prior to the assessment year commencing on the 1st day of April,

1993, then, such loss shall be allowed to be set off against the income of the firm subject to the condition that the partner continues in the said firm and to be carried forward for set off under sections 70, 71, 72, 73, 74 and 74A.

Set off losses of discontinued business [Section 41]

When the business or profession is no longer in existence and there is income chargeable to tax then any loss, not being a loss sustained in speculation business, which arose in that business or profession during the previous year in which it ceased to exist and which could not be set off against any other income of that previous year shall, so far as may be, be set off against the income chargeable to tax under the sub-sections of Section 41.

Carry forward and set off of losses in case of change in constitution of firm [78(1)]

If there has been any change in the constitution of a firm due to retirement or death of the partner then the firm is allowed carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the previous year.

Carry forward and set off of losses in case of change in the succession. [78(1)]

Where any person carrying on any business or profession has been succeeded in such capacity by another person otherwise than by inheritance, the successor cannot carry forward and set-off the losses incurred by the firm before such succession.

When any person carrying on any business or profession has been succeeded by another person due to inheritance, then the successor can carry forward and set off the losses incurred by the firm before such succession.

Carry forward and set off of losses in the case of certain companies [Section 79]

When a change in shareholding has taken place in a previous year in the case of a company, not being a company in which the public are substantially interested, no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless the following condition is satisfied that on the last day of the previous year the shares of the company carrying not less than fifty-one per cent of the voting power were beneficially held by persons who beneficially held shares of the company carrying not less than fifty-one per cent of the voting power on the last day of the year or years in which the loss was incurred

Provided that nothing contained in this section shall apply to a case where a change in the said voting power takes place in a previous year consequent upon the death of a shareholder or on account of transfer of shares by way of gift to any relative of the

shareholder making such gift:

Provided further that nothing contained in this section shall apply to any change in the shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company subject to the condition that fifty-one per cent shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or the resulting foreign company.

Following section 79 shall be substituted for the existing section 79 by the Finance Act, 2017, w.e.f. 1-4-2018 :

Carry forward and set off of losses in case of certain companies.

79. Notwithstanding anything contained in this Chapter, where a change in shareholding has taken place in a previous year,—

(a) in the case of a company not being a company in which the public are substantially interested and other than a company referred to in clause (b), no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year, unless on the last day of the previous year, the shares of the company carrying not less than fifty-one per cent of the voting power were beneficially held by persons who beneficially held shares of the company carrying not less than fifty-one per cent of the voting power on the last day of the year or years in which the loss was incurred;

(b) in the case of a company, not being a company in which the public are substantially interested but being an eligible start-up as referred to in section 80-IAC, the loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year, if, all the shareholders of such company who held shares carrying voting power on the last day of the year or years in which the loss was incurred, —

(i) continue to hold those shares on the last day of such previous year; and

(ii) such loss has been incurred during the period of seven years beginning from the year in which such company is incorporated:

Provided that nothing contained in this section shall apply to a case where a change in the said voting power and shareholding takes place in a previous year consequent upon the death of a shareholder or on account of transfer of shares by way of gift to any relative of the shareholder making such gift:

Provided further that nothing contained in this section shall apply to any change in the shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company subject to the condition that fifty-one per cent shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or the resulting foreign company.

VI. Carry Forward and set-off from house property [Section 71B]

When the net result of computation under the head "Income from house property" is a loss and such loss cannot be or is not wholly set off against income from any other head of income in accordance with the provisions of section 71, the remaining loss shall be carried forward to the following assessment year, not being more than eight assessment years immediately succeeding the assessment year for which the loss was first computed.

VII. Set-off losses from activity of owning and maintaining race horses [74A(3)]

In the case of an assessee who is the owner of horses maintained by him for running in horse races and the loss is incurred by the assessee in the activity of owning and maintaining race horses in any assessment year, then such losses shall not be set off against income from any source, rather it shall be set off only against the income, if any, from the activity of owning and maintaining race horses in that year. However, subject to the other provisions, the such loss can be carried forward to the following assessment year and it shall be set off against the income, if any, from the activity of owning and maintaining race horses assessable for that assessment year ; Provided that the activity of owning and maintaining race horses is carried on by him in the previous year relevant for that assessment year ; and if the loss cannot be wholly so set off, the balance amount of loss shall be carried forward to the following assessment year and so on; so, however, that no portion of the loss shall be carried forward for more than four assessment years immediately succeeding the assessment year for which the loss was first computed.

Loss on Sale of Shares, Securities or Units [94(7)]

This section states that the loss, if any, arising to him/her 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 purposes of computing his/her income chargeable to tax. However, the following conditions are satisfied;

- (a) any person buys or acquires any securities or unit within a period of three months prior to the record date;
- (b) such person sells or transfers such securities within a period of three months after such date; or such unit within a period of nine months after such date;
- (c) the dividend or income on such securities or unit received or receivable by such person is exempt,

Loss arising in the case of bonus stripping

This has been inserted to prevent bonus stripping. As per this section the following conditions need to be satisfied;

- (a) The Assessee buys or acquires any units within a period of three months prior to the record date;
- (b) The Assessee is allotted additional units without any payment on the basis of holding of such units on such date;
- (c) Such person sells or transfers all or any of the units within a period of nine months after such record date.

In all the conditions mentioned above are satisfied then, the loss, if any, arising to him/her on account of such purchase and sale of all or any of such units shall be ignored for the purposes of computing his/her income chargeable to tax and notwithstanding anything contained in any other provision of this Act, the amount of loss so ignored shall be deemed to be the cost of purchase or acquisition of such additional units referred to in clause (b) as are held by him on the date of such sale or transfer.

The Act specifies that ;

- "interest" includes a dividend;
- "record date" means such date as may be fixed by a company for the purposes of entitlement of the holder of the securities to receive dividend; or a Mutual Fund or the Administrator of the specified undertaking or the specified company as referred to in the Explanation to clause (35) of section 10, for the purposes of entitlement of the holder of the units to receive income, or additional unit without any consideration, as the case may be;
- "securities" includes stocks and shares.

Submission of return for losses [Section 80]

As per Section 80, carry forward of losses is allowed only when such loss has been assessed by assessee in pursuance of a return of loss submitted by assessee on or before the due date for filing returns as per the provisions of sub-section (3) of section 139. This states that if the assessee is unable to file his//her return on or before the last date, then the following losses cannot be carried forward;

- a. loss of a speculative or non-speculative business (not being unabsorbed depreciation, etc.).
- b. short or long-term capital loss; and
- c. loss (not being unabsorbed depreciation, etc., from the activity of owning and maintaining race horses).

However, this condition does not apply to a loss from house property carry forward under section 71B and unabsorbed depreciation carry forward under section 32(2).

*By filing a loss return in pursuance of a notice under section 148 but beyond time available for filing a voluntary return under section 139(1), the assessee cannot be entitled to determination of loss for the purpose of carry forward and set off-Koppind (P.)Ltd. v. CIT [1994] 207 ITR 228/77 Taxman 359 (Cal.). However, CBDT has power under section 119(2) to condone delay in case of a return which is filed late and where a claim for carry forward of losses is made-Lodhi Property Co. Ltd. v. Department of Revenue[2010] 191 Taxman 74 (Delhi), Bombay Mercantile Co-op. Bank Ltd. v. CBDT [2010] 195 Taxman 106 (Bom.). Moreover, disentitlement for carry forward of loss under section 80 comes into play only when the original income tax return disclosing loss sought to be carried forward is not filed within time prescribed under section 139(1); date of filing of revised return is not to be considered for this purpose - CIT v. Ashok Walia [2013] 60 SOT 72 (Kol.).



Check Your Progress-A

Q1. What do you mean by set off of losses?

Q2. Explain the provisions regarding Section 70 regarding Set off of loss from one source against income from another source under the same head of income.

Q3. Loss of speculation can be set –off against:

- a) Capital Gain
- b) Business and Profession
- c) Speculative Business
- d) All the above

Q4. Which of the following Section deals with the provisions for Loss from Speculative Business?

- a) Section 73
- b) Section 72
- c) Section 58
- d) All the above

Q5. Loss from speculation business cannot be set-off against income from other business or profession. This loss can be set-off only against.....

- a) Profits from capital gains
- b) Profits in a speculation business
- c) Profits from non-speculation business
- d) None of these

Q6. The process of adjustment of loss from a source under a particular head of income against income from other source under the same head of income is called _____.

- a) Inter-head adjustment
- b) Intra-head adjustment
- c) Carry forward of loss
- d) Clubbing of income

10.4 CLUBBING OF INCOME

Generally, an assessee shall be paying taxes on the income so earned by him/her. Whereas there may be cases when income of other person is included (i.e., clubbed) in the taxable income of the taxpayer and in such a case s/he will be considered as liable to pay tax in respect of his/her income (if any) as well as income of other person too. As per provisions of Income Tax Act, this process is called 'clubbing of income'. The provisions regarding clubbing of income are given under Section 60 to 64. Deemed income means to include the incomes of the assessee in the name of other persons which have been mentioned under sections 60 to 64 and section 68 to 69 D.

Incomes of other persons to be included in assessee's income-

Transfer of income but not transfer of Assets (Section 60)

If a person transfers income from an asset to another person and the asset is owned by him, then the income from such an asset is taxed in the hands of the transferor (i.e., person

transferring the income). The income shall be included in the taxable income of the transferor. Mr. Sushant earned Rs 50,000 from House owned by him. He transferred the entire income of Rs. 50,000 to Mr. Ramesh , his relative . In this situation rent of Rs 50,000 shall be considered as taxable income of Mr. Sushant.

Revocable Transfer of Assets (Section 61)

All income arising to any person by virtue of a revocable transfer of assets shall be chargeable to income-tax as the income of the transferor and shall be included in his total income.

Meaning of revocable transfer (Section 63) -A transfer shall be considered to be revocable if it contains any provision for the re-transfer directly or indirectly of the whole or any part of the income or assets to the transferor, or gives the transferor a right to re-assume power directly or indirectly over the whole or any part of the income or assets. Further, "transfer" includes any settlement, trust, covenant, agreement or arrangement.

Section 62 provide exceptions to the rule. Income arising by virtue of a transfer shall be chargeable to tax in the hands of the transferee and shall be included in his/her total income.;

- a) when the transfer is made by the way of trust which is not revocable during the lifetime of the beneficiary .
- b) In the case of any other transfer, which is not revocable during the lifetime of the transferee or
- c) Transfer is made before the 1st day of April, 1961, which is not revocable for a period exceeding six years.

Provided that the transferor derives no direct or indirect benefit from such income in either case. Further, it has to be kept in mind that as and when the power to revoke the transfer arises, all income arising to any person by virtue of such transfer shall be chargeable to tax in the hands of transferee and shall then be included in his/her total income.

Income arising to spouse (Section 64)

Any income arising to the spouse by the way of salary, commission, fees or any other form of remuneration received from a concern in which the individual assessee has substantial interest (person having 20% voting power or 20% share in profit] will be included with the income of spouse. However, any income arising to the spouse where the spouse possesses technical or professional qualifications and the income is solely attributable to the application of his or her technical or professional knowledge and experience; such income shall be assessed as the personal income of the spouse. As per explanation 1, spouse refers to husband or wife whose total income (excluding the income referred to in that clause) is greater; and where any such income is once included in the total income of either spouse, any such income arising in any succeeding year shall not be included in the total income of the other spouse unless the Assessing Officer is satisfied, after giving that spouse an opportunity of being heard, that it is necessary so to do. As per the explanation 2 an individual shall be

deemed to have a substantial interest in a concern i) when in a case where the concern is a company, if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than 20% of the voting power are, at any time during the previous year, owned beneficially by such person or partly by such person and partly by one or more of his relatives and (ii) if such person is entitled, or such person and one or more of his relatives are entitled in the aggregate, at any time during the previous year, to at least 20% of the profits of such concern.

Income from assets transferred without adequate consideration by an individual to his/her spouse [Section 64(1)(iv)]

When an individual transfers (directly or indirectly) his/her asset (other than house property) to his or her spouse otherwise than for adequate consideration or in connection with an agreement to live apart, then income from such asset will be clubbed with the income of the individual (i.e., transferor). Income from transfer of house property without adequate consideration will also attract clubbing provisions, however, in such a case clubbing will be done as per section 27 and not under section 64(1)(iv). The clubbing provisions of section 64(1)(iv) will apply even if the form of asset is changed by the transferee-spouse.

The clubbing provisions of section 64(1)(iv) are not applicable if the transfer of asset is for adequate consideration or if the transfer of asset is in connection with an agreement to live apart. If the asset is transferred before marriage, no income will be clubbed even after marriage, since the relation of husband and wife should exist both at the time of transfer of asset and at the time of accrual of income or if on the date of accrual of income, transferee is not spouse of the transferor (i.e. the relation of husband and wife does not exist).

Income to the spouse or son's wife from investments of the transferred assets [Section 64 iv and vi, Explanation 3]

When the assets transferred directly or indirectly by an assessee to his spouse or son's wife are invested by the transferee;

- a) In any business where investment is not in the nature of contribution of capital as a partner in a firm for being admitted to the benefits of partnership in a firm, then to calculate the amount to be clubbed in the hands of the transferor the following approach shall be adopted;

The value of the assets transferred
 as on the first day of the previous year
 \div \times Income from the business to the
 transferee
 The total investment in the business by the
 transferee as on the first day of the previous year

(ii) in the nature of contribution of capital as a partner in a firm, the amount shall be calculated as under and it shall be included in the total income of the transferor

Such capital contribution of the transferee as
 On the 1st day of previous years from the firm
 \div \times Total income receivable by the transferee
 The total capital contribution of the transferee
 as on the first day of the previous year

The share of income that has been received from the assets so transferred shall be included in the total income of the individual in that previous year.

Income from assets transferred to son's wife or daughter-in-law [Section 64 1 (vi)]

If an individual transfers assets directly or indirectly transfers assets without adequate consideration on or after the 1st day of June, 1973 to son's wife that mean his/her daughter in law , income arising from such assets is included in the total income of the transferor.

Income from assets transferred to a person for the benefit of spouse [Section 64(1) (vii)]

If any asset is transferred directly or indirectly without adequate consideration to a person or an association of persons for the immediate or deferred benefit of his/ her spouse, income arising from the transferred asset is included in the total income of the transferor to the extent of such benefit.

Income from assets transferred to a person or association of persons for the benefit of son's wife- [Section 64 1 (viii)]

If an individual transfers any assets to any person or association of persons directly or

indirectly on or after the 1st day of June, 1973 without adequate consideration for the immediate or deferred benefit of his son's wife, any income from such assets shall be included in the total income of the transferor to the extent of such benefit.

Income from Converted Property [Section 64(2)]

When an individual being a member of a Hindu undivided family converts his own earned property to H.U.F. on or after 1st January, 1970. This is called converted property. The income arising from such converted property will be the income of the transferor and not of the family. Hence such income shall be taxable in the hands of transferor. But, if the converted property is partitioned amongst members of the family, the income derived from such converted property as received by the spouse of the transferor will be taxable in the hands of transferor.

Income of Minor Child [Section 64(IA)].

Income that arises or accrues to the minor child shall be included in the income of his parents (whosoever has greater income). However, minor child not being a child suffering from any disability of the nature specified in section 80U. But the following income shall not be included in the total income of the parent;

- a) Income which accrues or arises to the minor child out of his/her manual work done by him/her.
- b) Income which accrues or arises to the minor child out of the activity involving application of his skill, talent or specialised knowledge and experience.

In the case, if the marriage relations are not maintained the income of minor child shall be included in the income of those parents (father or mother) who has looked after the child in the previous year.

Exception. In the following situations, the income of minor child shall not be included in the income of parents:

- i) Income earned by a minor out of his physical labour, skill and specialised knowledge.
- ii) If a minor has income of more than Rs. 1,500.
- iii) The income of disabled minor who are mentioned u/s 80U.

For the purposes of this sub-section, the income of the minor child shall be included, —

(a) where the marriage of his parents subsists, in the income of that parent whose total income (excluding the income includible under this sub-section) is greater; or

(b) where the marriage of his parents does not subsist, in the income of that parent who maintains the minor child in the previous year,

and where any such income is once included in the total income of either parent, any such income arising in any succeeding year shall not be included in the total income of the other parent, unless the Assessing Officer is satisfied, after giving that parent an opportunity of being heard, that it is necessary so to do.

10.5 OTHER DEEMED INCOMES

As per the sections 60 to 65 of Income Tax Act, there are certain incomes that are related to other persons but for the purpose of calculation of taxes, they are included in the income of the assessee. However, there are certain incomes which apparently are not income of the assessee but they are considered as the income of the assessee. In fact, these are hidden income. Those incomes and investments which are not shown in records, are called deemed incomes. The description of these incomes has been given in *sections* 68 to 69D of the Act.

1. Cash credits [Section 68]

If any amount is credited in the book of accounts and assessee does not give appropriate explanation about the nature and source thereof or s/he is unable to give satisfactory explanation as per Assessing Officer then, the sum so credited may be charged to income-tax as the income of the assessee of that previous year .

2. Unexplained investments [Section 69]

Where in the financial year immediately preceding the assessment year the assessee has made investments which are not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of the investments or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the value of the investments may be deemed to be the income of the assessee of such financial year.

3. Unexplained money, etc.[Section 69A]

If in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and such money, bullion, jewellery or valuable article is not recorded in the books of account maintained by him for any source of income, and the assessee offers no explanation about the nature and source of acquisition of the money, bullion, jewellery or other valuable article, or the explanation offered by him in the opinion of the Assessing Officer is not satisfactory, then the money and the value of the bullion, jewellery or other

valuable article may be deemed to be the income of the assessee for such financial year.

4. Amount of investments, etc., not fully disclosed in books of account.

69B. Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article, and the Assessing Officer finds that the amount expended on making such investments or in acquiring such bullion, jewellery or other valuable article exceeds the amount recorded in this behalf in the books of account maintained by the assessee for any source of income, and the assessee offers no explanation about such excess amount or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the excess amount may be deemed to be the income of the assessee for such financial year.

5. Amount of investments, etc., not fully disclosed in books of account[Section 69 B]

If in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article, and the Assessing Officer finds that the amount expended on making such investments or in acquiring such bullion, jewellery or other valuable article exceeds the amount recorded in this behalf in the books of account maintained by the assessee for any source of income, and the assessee offers no explanation about such excess amount or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the excess amount may be deemed to be the income of the assessee for such financial year.

6. Unexplained expenditure, etc.[Section 69C]

If in any financial year an assessee has incurred any expenditure and s/he offers no explanation about the source of such expenditure or the explanation provided is not satisfactory, then the amount covered by such expenditure may be deemed to be the income of the assessee for such financial year.

Further, 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.

7. Amount borrowed or repaid on hundi[Section 69 D]

If any amount is borrowed on a hundi from, or any amount due thereon is repaid to, any person otherwise than through an account payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying the amount aforesaid for the previous year in which the amount was borrowed or repaid.

However, if in any case any amount borrowed on a hundi has been deemed under the provisions of this section to be the income of any person, such person shall not be liable to be assessed again in respect of such amount under the provisions of this section on repayment of such amount.

Explanation. —For the purposes of this section, the amount repaid shall include the amount of interest paid on the amount borrowed.



Check Your Progress-B

Q1. What do you mean by clubbing of Income?

Q2. What are the other deemed incomes?

Q3. How income of minor child accounted as per Section 64(A)?

Fill in the blanks

Q4. Income that arises or accrues to the minor child shall be included in the income of his/her.....

Q5. Income to the spouse or son's wife from investments of the transferred assets is given in Section.....

Q6. As per Section 60, If a person transfers income from an asset to another person and the asset is owned by him, then the income from such an asset is taxed in the hands of thetransferor.

Clubbing of losses

Under Section 64, the income of specified persons is liable to be included in the total income of the individual. Further, for the purpose of including the income of specified persons in the income of the individual, the word income will include a loss.

Recovery of Tax [Section 65]

Where, by reason of the provisions contained as per section 60 to 64 and section 27(i) , a person is deemed as owner of house property, in such a case as per section 65, the actual receiving hand of the income is liable to pay tax assessed in regard to the income included in the income of other person on the service of notice of demand by Assessing Officer.

Provided that where any such asset is held jointly by more than one person, they shall be jointly and severally liable to pay the tax which is attributable to the income from the assets so included.

Epitome of Rule of carry forward of losses

Section	Nature of loss to be carried forward	Number of years loss can be carried forward	To be set-off against
Section 71B	Loss from House Property	8 Years	Income from house property
Section 73	Speculation Loss	4 Years	Speculation Profits
Section 72	Unabsorbed depreciation, capital	No time limit	Any Income (not being salary income from the assessment

	expenditure on scientific research and family planning		year 2005-06)
73A	Loss from specified business under section 35AD	Indefinite period	Profit from specified business under section 35AD
	Other remaining business loss	8 years	Any business profit (whether from speculation or otherwise)
74	Short Term Capital loss	8 years	Income under the head Capital Gains
74	Long term Capital Loss	8 years	Long term capital gains
74A	Loss from the activity of owning and maintaining race horses	4 Years	Income from the activity of owning and maintain race horses

10.6 SUMMARY

In this unit you learnt about set off of and carry forward of losses and also learnt about clubbing of income for the calculation of taxes. You learnt that sometimes an assessee is taxed in terms of the other's income. In such conditions, losses are set off and the taxable income of the assessee is the net of the income earned and losses deducted, this is termed as set-off if the loss is reduced from the net income in the same year when it is incurred. When losses incurred during the previous years are adjusted against the income in the current year, this is termed as carry forward of losses. You all learnt in the previous units that generally, an assessee shall be paying taxes on the income so earned by him/her. But in this unit you learnt that there may be cases when income of other person is included (i.e. clubbed) in the taxable income of the taxpayer and in such a case s/he will be considered as

liable to pay tax in respect of his/her income (if any) as well as income of other person too. As per provisions of Income Tax Act, this process is called 'clubbing of income'. The provisions regarding clubbing of income is given under Section 60 to 64.



10.7 GLOSSARY

Carry Forward of Losses -If the losses are unable to set off against the income under the same head or under different heads in the same assessment year then such losses are allowed to be carried forward to be claimed as set-off from the income in subsequent assessment years.

Clubbing of Income- Incomes which apparently are not income of the assessee but they are considered as the income of the assessee. In fact these are hidden income. Those incomes and investments which are not shown in records, are called deemed incomes.

Revocable transfer -A transfer shall be considered to be revocable if it contains any provision for the re-transfer directly or indirectly of the whole or any part of the income or assets to the transferor, or gives the transferor a right to re-assume power directly or indirectly over the whole or any part of the income or assets.



10.8 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress –A

Q3. Ans-c

Q4. Ans-a

Q5. Ans-b

Q6. Ans-b

Check Your Progress –B**Fill in the blanks**

- Q4.** Parents (whosoever has greater income).
- Q5.** [Section 64 iv and vi, Explanation 3]
- Q6.** transferor (i.e., person transferring the income).



10.9 REFERENCES

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10.10 SUGGESTED READINGS

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10.11 TERMINAL QUESTIONS

- Q1. What do you mean by set off losses? Explain any two provisions related to set off losses.
- Q2. Discuss in detail the provisions regarding carry forward of losses relating short-term and long-term assets.
- Q3. What are the Restrictions to be kept in mind while making intra-head adjustment of loss? What are deemed incomes? In what circumstances the income of one person is treated as the income of another?
- Q4. What do you mean by clubbing of income? In what circumstances is the income of one person treated as income of another?
- Q5. What do you mean by Revocable Transfer of Assets? Explain the provisions relating to the Revocable Transfer of Assets.
- Q6. Write short note on the following:
- i) Deemed Income
 - ii) Recovery of Tax [Section 65]

UNIT 11 CORPORATE TAX IN INDIA

11.1 Introduction

11.2 Objectives

11.3 Definition of Company

11.4 Residence of a Company [Section -6(3)]

11.5 Taxable Income and Tax Liability

11.6 Carry Forward and Set Up of Losses

11.7 Minimum Alternative Tax

11.8 Tax on Distributed Profit of Domestic Companies

11.9 Tax on Income Received from Venture Capital Companies

11.10 Tax on Income Distributed to Unit Holders

11.11 Additional Tax on Distributed Income - Buy-Back of Unlisted Shares

11.12 Summary

11.13 Glossary

11.14 References

11.15 Suggested Readings

11.16 Terminal Questions

11.1 INTRODUCTION

A company is a juristic person having an independent and separate legal entity from its shareholders. Income of the company is computed and assessed separately in the hands of the company. The company is liable to pay tax at a flat rate like a firm. For the purpose of assessment of companies the understanding of the meaning of a company and various types of companies is very essential.

In this unit we learn all the aspects in relation to assessment of company viz. meaning, residence, types and tax liability of company i.e. corporate tax in India.

11.2 OBJECTIVES

The contents of this unit will help you to understand;

1. The meaning and types of companies,
2. Residence of the company and the computation of income
3. How carry forward and set off of losses is done in case of certain companies,
4. Deemed Dividend, liability of Directors and dividend received from foreign companies,
5. The rates and taxes to determine the tax liability along with deductions.

11.3 DEFINITION OF COMPANY

As per section 2(17), company means:

- (i) Any Indian company, or
- (ii) Any body corporate incorporated by or under the laws of a country outside India, or
- (iii) Any institution, association of body which was assessed as a company for any assessment year under the Income tax Act ,1922 or was assessed under this Act as a company for any assessment year commencing on or before 1.4.1970, or
- (iv) Any institution, association or body, whether incorporated or not and whether Indian or Non Indian, which is declared by a general or special order of CBDT to be a company.

11.4 COMPANY'S RESIDENCE U/S 6(3)

Under section 6(3), a company is said to be a resident in India in any previous year if:

- (i) it is an Indian company, or
- (ii) During that year, the control and management of its affairs is situated wholly in India.

A company is never not ordinarily resident .A company which is not resident according to the aforesaid conditions is called a non-resident company.

Types of Companies:

1. **Companies in which the public are substantially interested:** In the following cases, a company is said to be a company in which the public are substantially interested:

- a) it is a company owned by the Government or the Reserve Bank of India or in which not less than 40 % shares are held by the Government or the Reserve Bank of India or a corporation owned by the R.B.I. ;or
- b) it is a company which is registered under section 25 of the Companies Act ,1956;or
- c) it is a company , having no share capital and is declared by order of the Central Board of Direct Taxes to be a company in which the public are substantially interested; or
- d) it is a mutual benefit finance company , i.e., a company which carries on , as its principal business, the business of acceptance of deposits from its members and which is declared by the Central Government to be a Nidhi or Mutual Benefit Society;
- e) it is a company where in the shares carrying not less than 50% of the voting power are held by one or more co – operative societies throughout the relevant previous year; or
- f) it is a company which is not a private company under the Companies Act , 1956, and its equity shares were, as on the last day of the relevant previous year , listed in a recognized stock exchange in India; or
- g) it is a company which is not a private company and whose equity shares carrying not less than 50 % (40% in case of an industrial company) of the voting power were beneficially held throughout the previous year by the government, a statutory corporation or any other company in which the public are substantially interested or a wholly owned subsidiary of such a company.

Note: If the majority of the equity shares of a public company are held by a foreign company in which the public are substantially interested, such a company would be a company in which the public are substantially interested.

- **Widely –held company:** This is the popular name of a company in which the public are substantially interested.
- **Closely–held company:** This is a popular name of a company in which the public are not substantially interested.

2. Indian Company: the Company which is formed and registered under the Companies Act 1956 is termed as an Indian Company. It includes:

- a) a corporation established under a Central or State Act and
- b) Any institution, association or body which is declared by the Central Board of Direct Taxes to be a company under section 2(17).
- c) In the case of State of Jammu and Kashmir, a company formed and registered under any law for the time being in force in that state is called an Indian company.

- d) In the case of Dadra and Nagar Haveli, Goa, Daman and Diu and Pondicherry, a company formed and registered under any law for the time being in force.

In all cases the registered or principal office of the company, corporation, institutions, associations or body has got to be situated in India.

3. Public Sector Company: Any corporation established by or under any Central or State Act or a Government Company as defined in section 617 of the Companies Act , 1956.

4. Domestic Company: An Indian Company or any other company which, in respect of its income liable to tax under this Act, has made the prescribed arrangements for the declaration and payment, within India, of the dividends payable out of such income.

5. Foreign Company: A foreign company is a company which is neither an Indian Company nor has made the prescribed arrangements for the declaration and payment of dividends within India.

6. Company registered under section Companies Act, 1956: It is a company formed to promote art, charity, commerce, religion or any other useful object, nor for profit , and which intends to apply its profit , if any, or other income towards the further improvement of such objects and prohibits the payment of any dividend to its members. Such a company can be registered under section 25 of the companies Act, 1956.

Principal Officer-

Principal Officer means:

- (i) The secretary, treasurer, manager or agent of the company, or
- (ii) Any person connected with the management or administration of a company upon whom the Assessing Officer has served a notice of his intention of treating him as the Principal Officer of the Company.

Person who has substantial interest in the company:

It means a person who is the beneficial owner of equity shares carrying not less than 20 percent of the voting power.

11.5 TAXABLE INCOME AND TAX LIABILITY

The total income of accompany is also computed in the manner in which income of any assessee is computed. A company is assessed in its own name; i.e. a company pays tax on its income as a distinct unit. A tax paid by a company is not deemed to have been paid on behalf of its shareholders. It is determined as follows:

1. First ascertain income under the different heads of income.
2. Income of other persons may be included in the income of the company under sections 60 and 61(para 206 and 207)

3. Current and brought forward losses should be adjusted according to the provisions of sections 70 to 80 (as per para 226 to 233). Para 335 of section 79 provides all the provisions regarding set off and carry forward of losses of closely held companies.
4. The total income so derived under computation of different heads of income is “Gross Total Income”.
5. Following deductions are allowed from the Gross total income so computed, under section 80C to 80 U:-

Section	Nature of Deduction
80G	Donations to charitable institutions and funds (para 242)
80GGA	Donations to scientific research or rural development (para 244)
80GGB	Contribution to political parties (para 245)
80-IA	Profits and gains from industrial undertakings engaged in infrastructure , etc (para 253)
80-IAB	Profits and gains by an undertaking or enterprise engaged in development of special Economic Zone (para 253A)
80-IAC	Profits and Gains derived from eligible start-up(para 253B)
80-IB	Profits and gains from certain industrial undertakings and other than infrastructure development undertakings (para 254A)
80-IBA	Profits and gains from housing projects (para 254A)
80-IC	Profits and gains of certain undertakings in certain states (para 255)
80-ID	Profits of hotels and convention centres (para 255A)
80-IE	Profits of undertakings in North Eastern States (para 255B)
80JJA	Profits from the business of collecting and processing of bio-degradable waste (para 256)
80JJAA	Employment of new employees (para 257)
80LA	Income of offshore Banking units (para 259)

6. The resulting sum is net income.

Para 334.1 Tax Liability: Tax Liability of a company is calculated as under:

Computation 1-Under Normal provisions	Computation -Under minimum alternate tax
1.Find out taxable income under normal provisions	8.Find out book profit (para 336.2)

2. Find out income-tax at the rate of (25% /30%-in case of domestic companies), (40% in the case of foreign company) of income computed under (1). There is no exemption limit.	9. Find out 18.5% of book profit.
3. Add Surcharge	10.Add: Surcharge
4.Find the summation of point 2 and 3	11.Find out (9)+(10)
5. Add education cess at the rate 2% of (4) and secondary and higher education cess @ 1% of (4).	12.Add: education cess at the rate of 2 % of (11) and secondary and higher education cess at the rate 1% of (11)
6. Deduct tax rebate or tax credit under sections 86, 90,90A and 91E.	12. Compute (11) + (12).
7. Find out (4) + (5)-(6). This figure cannot be less than zero.	

Tax Liability of a company is (7) or (13), whichever is more.

Para 334.2 Special Tax Rates:

Under different provisions of the Act, there are some cases where income is taxable at special rates. Such as, long term capital is taxable at the rate of 20% by virtue of section 112. Short term capital gains (if securities transaction tax is applicable) are taxable at the rate of 15% under section 111A. Royalty income in certain cases is taxable in the hands of a foreign is taxable in the hands of a foreign company at the rate of 10%.



Check Your Progress-A

Q1. Define a widely held company?

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Q2. How a company has been defined under section 2(17)?

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Q3.What do you mean by a company in which the public are substantially interested?

Q4. When a company is said to be a resident in India?

11.6 CARRY FORWARD AND SET-OFF OF LOSSES

Section 79 governs carry forward and set off of losses in the cases of certain companies if the following conditions are satisfied:

Condition 1.

The taxpayer is a company in which the public are not substantially interested.

Condition 2.

The persons beneficially holding 51 percent of the voting power on the following two dates are different:

- a. On the last day of the previous year in which the loss was incurred;
- b. On the last day of the previous year in which the company wants to set off the brought forward loss.

If the above both the conditions are satisfied, brought forward losses cannot be set off. If however, after change in shareholding, the assessee becomes a 100 percent subsidiary of a company in which the public are substantially interested, then the provisions of section 79 would not be applicable—held in the case of *Classic Shares & Stock Broking Services Ltd. v CIT* [2007]11 SOT 377 (Mum.).

Para 335.1: Exceptions to above rules:

The aforesaid rule is not applicable in the following two cases—

- i. Where a change in voting power takes place in a previous year consequent upon the death of a shareholder or on account of transfer of shares by way of gift to any relative of the shareholder making the gift, the aforesaid restriction contained under section 79 will not apply.
- ii. The provisions of section 79, as given in para 35, are applicable only in the case of carry forward of losses. As carry forward of unabsorbed depreciation allowance , capital expenditure on scientific research or family planning stands on altogether different footings, their carry forward and set off are not governed by section 79- held in the case of **CIT V. Concord Industries Ltd.[1979] 119 ITR 458 (Mad.)**, **CIT v. Shri Subhulaxmi Mills Ltd. 9[2001] 119 Taxman 281 (SC)**.
- iii. In the cases of **amalgamation/ merger of foreign holding company**, the provisions of section 79 will not be applicable, if the below mentioned conditions are satisfied:
 - **Condition 1:** The taxpayer (i.e., the company in which loss is incurred) is an Indian company in which public are not substantially interested.
 - **Condition 2:** It is a subsidiary of a foreign company.
 - **Condition 3:** Persons holding 51 percent or more shares in the amalgamating /demerged foreign company become shareholders in the amalgamated /resulting foreign company.

If all the above mentioned conditions are satisfied, the provisions of section 79 shall be ignored and brought forward loss can be set off and carry forward.



Check Your Progress-B

Q1. X and Y are two shareholders of Z ltd., a closely held company. X holds 55 percent share capital. On January 30, 2018, X transfers his shares to A. Z ltd. Wants to set off brought forward loss of Rs. 4,00,000 (business loss : Rs. 1,00,000; unadjusted depreciation :Rs. 3,00,000) of the previous year 2016-17 against the income of the previous year 2017-18 (i.e., Rs. 9 lakhs). Can it do so?

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Q2. What are the exceptions to section 79 in respect of carry forward and set-off of losses?

11.7 MINIMUM ALTERNATE TAX

Section 115JB regulates the provisions regarding minimum alternate tax. Up to the assessment year 2001-02, these provisions were covered by section 115 JA. These provisions are as follows:

- Finding out the normal tax liability ignoring provisions of minimum alternate tax.
- Finding the book profit.
- Now finding out minimum alternate tax.
- If tax computed as per the normal provisions is more than or equal to tax computed as per MAT, the provisions of minimum alternate tax is not applicable.

The provisions regarding minimum alternate tax will be discussed in detail in Unit XIII.

Para 336.4: Report from a chartered Accountant:

Every company to which section 115JB applies, shall furnish a report (in Form No. 29B), from a chartered accountant certifying that the book profit has been computed in accordance with the provisions of section 115JB. The report should be submitted along with the return of income.

Hints for Tax Planning:

The following broad propositions should be kept in mind in order to minimize tax incidence under section 115JB-

- In case of uncertainty regarding the recognition of revenue, the provisions as per AS 9 issued by the Chartered Accountants of India should be followed.
- Depreciation must be calculated as per the written down method for accounting purpose.
- It is advisable that as far as possible depreciable asset should be sold at profit only in that year in which the company incurs loss on account of sale of another depreciable asset, this will nullify the effect of section 115JB on computation of tax liability.
- As a measure to reduce book profit, goodwill, appearing in balance sheet, may be written off.

- If income tax paid/payable is shown on the debit side and income tax refund appears on the credit side of the profit and loss account, then net profit is to be increased by the amount of income tax paid/payable without adjusting income tax refund.

11.8 TAX ON DISTRIBUTED PROFITS OF DOMESTIC COMPANY

Section 115-O: The Domestic Company shall, in addition to the income tax chargeable in respect of its total income, be liable to pay additional income-tax on any amount declared, distributed or paid by such company by way of dividend (whether interim or otherwise), whether out of current and accumulated profits. Such additional income tax will be chargeable at the rate 15% plus surcharge at the rate of 5% (7.5% for A.Y. 2011-12 and 10 percent upto A.Y. 2010-11), plus education cess @ 2 percent plus SHEC @ 1 percent of the amount so declared, distributed or paid.

For the purpose of **computation of tax on distributed profits**, the amount of dividend distributed by the domestic company during the financial year shall be **reduced** by the following:

- a. The amount of dividend, if any received by the domestic company (holding company) during the financial year, if –
 - i. Such dividend is received from its subsidiary;
 - ii. The subsidiary has paid tax under this section on such dividend and
 - iii. The domestic company (holding company) is not subsidiary of any other company.
- b. The amount of dividend, if any, paid to any person for or behalf of the New Pension Scheme trust referred to in section 10(44)

However, that the same amount of dividend shall not be taken into account for reduction more than once.

What is Dividend?

Dividend declared, distributed or paid on or after June 1, 1997 but before April 1, 2002 or after March 31, 2003 is subject to dividend tax (for meaning of 'dividend' refer para 193.2)

For the purpose of section 115-O the expression 'dividend' shall have the same meaning as given to 'dividend' under section 2(22), but it shall not include sub clause (e) of section 2(22).

Nature of Tax: The levy of additional tax is in addition to normal tax payable by a company. This additional tax incidence cannot be avoided even if no income tax is payable by a domestic company on its total income computed under the provisions of the Act. Moreover, brought forward MAT credit under section 115JAA cannot be adjusted against the additional tax on dividend.

Relief in the case of inter corporate dividend in some cases: Section 115-O(1A)

This section provides a relief when a holding company has received dividend from its subsidiary company and in the same financial year the holding company declares dividend to its shareholders. When dividend is declared, distributed or paid by the holding company to its shareholders, dividend tax shall be payable to the following format-

Particulars	Rs.
Dividend declared , distributed or paid by the holding company to its shareholders (a)	XXXX
Less: Dividend received by holding company from its subsidiary from its subsidiary company in the same financial year (b)	XXXX
Balance [i.e. (a)-(b) on which dividend tax is payable by the holding company	XXXX

The aforesaid relief is available only in the situations given below:

1. Subsidiary company is a domestic company and it has paid tax under section 115-O when dividend is paid to the holding company and holding company is not subsidiary of any other companies (applicable from April 1, 2008 to June 30, 2012).
2. Subsidiary company is a domestic company and it has paid tax under section 115-O when dividend is paid to the holding company (applicable from July 1, 2012).
3. Subsidiary company is a foreign company and dividend received by the holding company from the subsidiary company is taxable in the hands of holding company under section 115BBD (applicable from June 1, 2013).

For the aforesaid purposes, a company shall be a subsidiary of another company, if such other company holds more than half more than half in nominal value of the equity share capital of the company.

Rate of Dividend Tax:

Particulars	Dividend tax (as a % of dividend)	Surcharge (as a % of dividend)	Education cess (as a % of dividend tax and surcharge)	Total (as a % of dividend)
From April 1, 2007 to March 31,2010	15	10	3	16.995
From April 1, 2010 to March 31,2011	15	7.5	3	16.60875
From April 1, 2011 to March 31, 2013	15	5	3	16.225
From April 1, 2013 to September 30,2014	15	10	3	16.995

From October 1,2014 to March 31,2015	17.64706	10	3	19.99412
From April 1, 2015	17.64706	12	3	20.35765

Time limit for deposit of additional income tax:

Such additional tax will have to be paid by the principal officer of the domestic company and the company within 14 days from the date of:

- Declaration of any dividend ;or
- Distribution of any dividend ; or
- Payment of any dividend,

Whichever is earliest.

Tax on dividend paid by a domestic company shall be taken as the final tax payment in respect of the amount declared, distributed or paid as dividend. In respect of tax so paid, no credit is available to the company paying tax, or the recipient of dividend or to any other person.

- ❖ Whereas in the case of a resident individual/HUF/firm, aggregate dividend income from domestic companies in excess of Rs 10,00,000 is chargeable to tax at the rate of 10 percent (+SC+EC+SHEC) with effect from the assessment year 2017-18. This additional tax in the hands of shareholders under section 115BBDA is applicable even if the company is subject to dividend distribution tax under section 115-O.

Dividend Tax is not deductible:

The company (or the shareholders) cannot claim any deduction from taxable income in respect of dividend tax levied under section 115-O. Moreover, no deduction is available from the tax on dividend under any provision.

Interest for non-payment of tax (section 115P):

If the company or the principal officer fails to pay the whole or any part of dividend tax within the specified time limit, then it or he shall be liable to interest in addition to dividend tax as mentioned below:

Rate of Tax	1 percent or part thereof
Amount on which interest is chargeable	Amount of tax as reduced by the amount paid within the time-limit
Period for which interest is payable	Interest is chargeable for the period commencing from the next date after the last

	date of payment and ending on the date of actual payment.
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When company is deemed to be in default (section 115Q):

In case a domestic company or principal officer of a domestic company does not pay tax on distributed profits within the specified time-limit, then he or it shall be deemed to be an assessee in default in respect of the amount of tax payable by him or it. Consequently, all provisions regarding collection and recovery of tax contained in the Act would apply.

Penalty:

Failing to comply with the provisions of section 115-O, the person shall be liable to pay as penalty of a sum equal to an amount of tax which he failed to pay. The penalty is however not applicable, if the assessee proves that there was reasonable cause of failure.

Prosecution:

If a person fails to pay to the credit of the Central Government the tax payable by him, as required by or under provisions of section 115-O, he 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.

However, no person will be punishable if he proves that there was a reasonable cause for the default/failure.

Judicial rulings:

Some of the relevant judicial rulings to be kept in mind:

1. Section 115-O (1) is a specific provision overriding, in case of conflict, general provisions. This provision is applicable whether shares are held as investment or stock –in-trade-CIT v. S.G. Investments & Industries Ltd.[2004]89 ITD 44 (Kol.).
2. Dividend tax paid by company under section 115-O cannot be regarded as tax paid by shareholders-Harish Krishnakant Bhatt v. ITO [2004] 91 ITD 311 (Ahd.).



Check Your Progress-C

Q1. Why does a company need a report from a chartered accountant?

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Q2. Define dividend.

Q3. What are the cases where relief in the case of inter corporate holding is possible?

Q4. When a company is liable to pay interest on dividend tax and what is the interest rate?

11.9 TAX ON INCOME RECEIVED FROM VENTURE CAPITAL COMPANIES AND FUNDS

Section 115U and Rule 12C:

Notwithstanding anything contained in any other provisions of this Act, any income received by a person out of investments made in a venture capital company or venture capital fund shall be chargeable to income tax in the same manner as if it were the income received by such person had he made investments directly in the venture capital undertaking.

In other words, such income shall be taxable in the hands of the investor instead of the venture capital company/fund although such income is received not from the venture capital undertaking but from Venture Capital Company /fund. For instance; if such venture capital

company/fund had derived income of Rs. 8, 00,000 from dividend on shares from a venture capital undertaking and Rs, 10, 00,000 as interest on investment by way of loan to such an undertaking, now if a person receives an income of Rs. 1, 80,000 from such company or fund would deemed to have received dividend on shares Rs. 80,000 and interest income Rs. 100,000. Hence, the amount of Rs 80,000 being dividend income is exempted u/s 10(34), if the venture capital undertaking from which the dividend income had been derived by the venture capital company/fund had paid tax under section 115-O on dividend paid by it. However, Rs. 100,000 being interest received will be taxable as income from other source.

Furnishing statement in Form No. 64:

The person who is responsible for making payment of the income on behalf of venture capital company/fund **and** the venture capital company /fund shall furnish , by 30th November of the financial year following the previous year during which such income is distributed, to-

- i. the person receiving such income, and
- ii. to the jurisdictional Chief Commissioner/Commissioner , a statement in Form No. 64 and duly verified by an accountant in the manner as provided therein, giving all the details of the nature of income paid during the previous year and such other relevant details as may be prescribed.

Further in this statement , the amount of income derived by the company and income from long-term capital gains , short term capital gains, dividends and other income (interest, etc.) is required to be shown separately.

Some Relevant Points:

Meaning of Venture capital company :

A company which has been granted a certificate of registration under the Securities and Exchange Board of India Act 1992, and regulations made there under, and which fulfils the conditions as may be specified, with the approval of the Central Government, by the Securities and Exchange Board of India, by notification in the official Gazette, in this behalf.

Meaning of Venture Capital Fund:

The fund which is operating under a trust deed registered under the provisions of the Registration Act, 1908 and has been granted a certificate of registration under the Securities and Exchange Board of Indian Act, 1982 and regulations made there under; Moreover, it should fulfill the conditions as may be specified with the approval of the Central Government, by the securities and Exchange Board of India, by notification in the Official Gazette, in this behalf.

Meaning of Venture Capital Undertaking:

A domestic company whose shares are not listed on a recognized stock exchange of India and which is engaged in the business for providing services, production or manufacture of articles or things or does not include such activities or sectors which are specified in the negative list

by the Board with the approval of the Central Government by notification in the Official Gazette in this behalf.

11.10 TAX ON INCOME DISTRIBUTED TO UNITHOLDERS

Section 115R, 115S and 115T deals with the provisions of income distributed to unit holders.

The income distributed to a unit holder of the Unit Trust of India or a Mutual Fund shall be charged to tax under section 115R. Tax under section 115R is applicable only on income distributed by way of dividend to unit holders of mutual funds or UTI. It is not applicable on payments pertaining to redemption/ repurchase of units or allotment of additional units by way of bonus units –**Circular No. 6/2014**, dated February 11, 2014.

- The person responsible for making the payment of income distributed by the UTI and mutual fund shall be liable to pay the tax to the credit of the Central Government within 14 days from the date of distribution or payment of such income, whichever is earlier.
- No deduction under any other provisions of the Act shall be allowed to the Unit Trust of India or to a Mutual Fund in respect of the income which has been charged to the aforesaid tax.
- If the person or UTI or Mutual Fund liable to make the payment fails to so pay the tax to the credit of the Central Government, he or it shall be liable to pay simple interest at the rate of 1 percent every month or part thereof on such amount of tax which has not been paid or was not paid in time.
- The person responsible for making payment of the income distributed by the UTI or the Mutual Fund, as the case may be, shall be liable to file a statement of distributed income in Form No. 63(for UTI) or Form No. 63A (for mutual fund) giving all the required details.

11.11 ADDITIONAL INCOME TAX ON DISTRIBUTED INCOME FOR BUY-BACK OF UNLISTED SHARES

Section 115QA: provides that where a domestic company distributes income to shareholders on buy back of its shares and these shares are not listed in any recognized stock exchange in India, such company shall be liable to pay an additional tax at the rate 20 percent (+SC+EC+SHEC) on distributed income.

“Buy Back” means purchase by the company of its own shares in accordance with the provisions of section 77A of the Companies Act or any law for the time being in force relating to companies.

“Distributed Income” means the consideration paid by the company on buy back of shares as reduced by the amount received by the company for issue of such shares, determined in the manner as may be prescribed.

The additional income-tax under section 115QA shall be in addition to the income tax chargeable in respect of the total income of such company and shall be remitted within 14 days of the date of payment of consideration. **No credit shall be claimed** either by the company or by the person in respect of the tax paid. Accordingly, no deduction under any provisions shall be allowed.

Section 115QB: provides for the levy of interest, in case of failure of payment of tax within the time limit. Interest will be chargeable at the rate of 1 percent per month (or part of the month) for the period beginning immediately after the last date on which tax was payable and ending with the date of actual payment.

Section 115QC: provides that in case of failure of payment of tax , the principal officer of the company and the company shall be deemed to be an assessee in default in respect of the amount of tax payable and all provisions of the Act relating to recovery and collection of taxes shall apply.



Check Your Progress-D

Q1. How would you deal with additional income tax on dividend income for buy-back of unlisted shares?

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Q2. What do you understand by Venture Capital Company, venture capital fund and venture capital undertaking?

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Q3. What is the treatment of tax on income distributed to unit holders?

Q4. What is the meaning of buy-back of shares and distributed income?

Q5. Briefly explain the sections 115QA, 115QB and 115QC.

11.12 SUMMARY

- 1) Company means: i) an Indian company, or ii) any body corporate incorporated in a foreign country, or iii) any institution or body, whether incorporated or not , but declared by the order of the Board to be a company for any assessment year.
- 2) Residence of a company: It is resident in India in any previous year if it is an Indian company or its control and management is situated wholly in India. It is never not ordinarily resident.
- 3) Computation of total income: It is computed in the same manner as that of an individual. Briefly the procedure is that at first the taxable income is determined under each head of income. All these taxable incomes are aggregated and then any brought forward losses or allowances are deducted. The balance is gross total income. From G.T.I. the deductions under sections 80G, 80GGA, 80GGB, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID, 80-IE, 80JJA, or 80LA are made. The balance left is Total Income.
- 4) Company in which the public are substantially interested: It means-a) a company owned by the government or the Reserve Bank of India to the extent of at least 40% of its shares, or b)a company registered under section 25 of the Companies Act , or c)

a company without share capital but declared by the Board to be a company in which the public are substantially interested, or d) a mutual benefit finance company, or e) a company whose shares carrying not less than 50 % of the voting power is beneficially held by one or more co-operative societies throughout the relevant previous year, or f) a company which is not a private company and either its equity shares are quoted on stock exchange in India or its equity shares carrying at least 50% voting power were beneficially held throughout the previous year by Government, a statutory corporation or a widely –held company or its wholly –owned subsidiary company.

- 5) Indian Company: It means a company formed and registered in India. It includes statutory corporation.
- 6) Domestic Company: It means an Indian company or any other company which has made prescribed arrangements for declaration of dividends in India in respect of its taxable income in India.
- 7) Public Sector Company: It means any statutory corporation or a government company.
- 8) Assessment: It is compulsory for a company to file return of its income. The return has to be filed by 30th September of the assessment year.
- 9) Computation of Tax: The income tax is always payable by a company on its total income (25% in case of domestic company having turnover less than 50 crores and 30% in case turnover exceeds 50 crores).
- 10) Minimum tax on Book profit will be 18.5% +SC @ 5%/10% as the case may be , if book profit exceeds one crore rupees.



11.13 GLOSSARY

Dividend: a sum of money paid regularly (typically annually) by a company to its shareholders out of its profit (or reserves).

Legal entity: An association, partnership, proprietorship, trusts, or individual that has legal standing in the eyes of law.

Subsidiary: Subordinate, secondary ancillary, in short a company controlled by a holding company.

Prosecution: the institution and conducting of legal proceeding against some one in respect of a criminal charge.



11.14 REFERENCES

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- Nabhi's Income Tax ,Guidelines and Mini Ready Reckoner
- C.S. Agrawal, K.K., Income Tax, Publication date: 28 September 2016.
- Dr. Mehrotra, H.C, and Dr. Goyal, S.P., Income Tax Law and Accounts, Sahitya Bhawan Publications, 57th Edition.



11.15 SUGGESTED READINGS

1. WEBSITE: <http://www.taxmann.com>
2. E-mail : sales @taxmann.com
3. Dr. Bangar, Vandana and Dr. Bangar, Yogendra, Income Tax, Bangar's Taxation Part-1.
4. Dr, Ahuja, Girish and Dr.Gupta Ravi,Direct Taxes Law and Practice including Tax Planning, Publication House: Bharat Law House Pvt Ltd., Delhi.



11.16 TERMINAL QUESTIONS

- Q1.** What are the salient features of assessment of Joint Stock Companies?
- Q2.** Give all the provisions in details, in respect of tax on income distributed to unit holders.
- Q3.** Explain how you will deal with tax on income received from venture capital companies and venture capital funds.
- Q4.** What is dividend relief in the case of inter-corporate dividend in some cases?

UNIT 12 COMPUTATION OF THE AMOUNT OF CORPORATE TAX LIABILITY

12.1 Introduction

12.2 Objectives

12.3 Concept of Corporate Tax

12.4 Taxable Income and Tax Liability

12.5 Assessment of Companies

12.6 Tax on Distributed Income of Domestic Companies

12.7 Summary

12.8 Glossary

12.9 Answer to Check Your Progress

12.10 References

12.11 Suggested Readings

12.120 Terminal Questions

12.1 INTRODUCTION

A company is liable to pay tax on every rupee of its total income at a flat rate, without their being any exemption limit. This tax is also known as corporate tax. In addition to such tax, if the company is a domestic company, it shall be liable to pay tax under section 115-O on the amount distributed as profits to its shareholders. However, the income of the company which is distributed to its shareholders as dividends is exempt under section 10(34) in the hands of the shareholders, unless it is in the nature of dividends other than the dividends referred to in section 115-O.

In the last unit we came to know about all the aspects to be looked upon for computation of taxable income and tax liability of a company. Now learning is to be made on how to compute the taxable income and tax liability of a company.

12.2 OBJECTIVES

The objective of this unit is to provide a thorough knowledge as how to:

- Compute the total income of company.
- Compute the taxable income of company.
- Compute the dividend distribution tax of company and
- Carry forward and set off of losses in case of companies.

Hence, we will learn how to determine the tax liability of a company.

12.3 CONCEPT OF CORPORATE TAX

A corporate tax is a levy placed on the profit of a company to raise taxes. After operating earnings is calculated by deducting expenses including the cost of goods sold and depreciation from revenues, enacted tax rates are applied to generate a legal obligation the business owes the government. Rules surrounding corporate taxation vary greatly around the world and must be voted upon and approved by the government to be enacted. Paying corporate taxes can be more beneficial for business owners when compared to paying additional individual income tax.

As per section 2(17), company means:

- (i) Any Indian company, or
- (ii) Any body corporate incorporated by or under the laws of a country outside India, or
- (iii) Any institution, association of body which was assessed as a company for any assessment year under the Income tax Act, 1922 or was assessed under this Act as a company for any assessment year commencing on or before 1.4.1970, or
- (iv) Any institution, association or body, whether incorporated or not and whether Indian or Non Indian, which is declared by a general or special order of CBDT to be a company.

12.4 TAXABLE INCOME AND TAX LIABILITY

The total income of a company is also computed in the manner in which income of any other assessee is computed.

The first and the foremost step in this direction is to ascertain Gross Total Income. Income computed under four heads (salary head is not applicable), is aggregated. While aggregating the income, section 60 and 61 shall be applicable. Further, effect to set off of losses and adjustment for brought forward losses will also be done. From the gross total income so computed, the following deduction of Chapter VIA should be allowed:

1. 80 G Donations to certain funds / charitable institutions, etc.
2. 80GGA certain donations for scientific research or rural development.
3. 80GGB Contributions given by companies to political parties
4. 80 IA Profits and gains of new industrial undertakings or enterprises engaged in
Infrastructure development, etc
5. 80-IAB Deduction in respect of profits and gains by an undertaking or enterprises engaged in the development of Special Economic Zone.
6. 80-IB Profits and gains from certain industrial undertakings other than infrastructure development undertakings.
7. 80IC Deduction in respect of certain undertakings or enterprises in certain special category states.
8. 80-ID Deduction in respect of profits and gains from business of hotels and conventions centre's in specified area.
9. 80-IE Special provisions in respect of certain undertakings in North Eastern States.
10. 80JJA Deduction in respect of profits and gains from business of collecting and processing of bio-degradable waste.
11. 80-LA Deductions in respect of certain incomes of offshore Banking Units and International Financial Services centre.
12. 80JJAA Deduction in respect of employment of new workmen.

The result is net income.

Tax Liability: Tax Liability of a company is calculated as under:

Computation 1-Under Normal provisions	Computation -Under minimum alternate tax
1.Find out taxable income under normal provisions	8.Find out book profit (para 336.2)
2. Find out income-tax at the rate of (25% /30%-in case of domestic companies), (40% in the case of foreign company) of income computed under (1). There is no exemption limit.	9. Find out 18.5% of book profit.
3. Add Surcharge	10.Add: Surcharge
4.Find the summation of point 2 and 3	11.Find out (9)+(10)
5. Add education cess at the rate 2% of (4) and secondary and higher education cess @ 1% of (4).	12.Add: education cess at the rate of 2 % of (11) and secondary and higher education cess at the rate 1% of (11)

6. Deduct tax rebate or tax credit under sections 86, 90,90A and 91E.	12. Compute (11) + (12).
7. Find out (4) + (5)-(6). This figure cannot be less than zero.	

Tax Liability of a company is (7) or (13), whichever is more.

Special Tax Rates:

Under different provisions of the Act, there are some cases where income is taxable at special rates. Such as, long term capital is taxable at the rate of 20% by virtue of section 112. Short term capital gains (if securities transaction tax is applicable) are taxable at the rate of 15% under section 111A. Royalty income in certain cases is taxable in the hands of a foreign is taxable in the hands of a foreign company at the rate of 10%.

Some other relevant points:

- Carry forward and set off of losses in case of certain companies(section 79): In the case of closely held companies where a change in shareholding has taken place in a previous year , no loss under any head incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless on the last day of the previous year in which loss is set off and on the last day of the previous year in which the loss was incurred , the shares of the company carrying not less than 5 1% of the voting power were beneficially held by the same person.
- In other words, where a change in voting power of more than 49 % of the shareholding of a closely held company has taken place between two relevant dates (the last day of previous year in which set off is claimed and the last date of the previous year in which the loss was incurred), the assessee will not be entitled to claim set off of such losses.
- This provision shall not apply to a change in the voting power consequent upon:
 - a. The death of a shareholder, or
 - b. On account of transfer of shares by way of gifts to any relative of the shareholder making such gift.
- Further section 79 shall not apply to any change in the shareholding of an Indian company which is subsidiary of a foreign company arising as a result of amalgamation or demerger of a foreign company subject to the condition that 51 % of the shareholders of the amalgamating or demerged foreign company continue to remain the shareholders of the amalgamated or the resulting foreign company.
- Deemed Dividend (section 2(22(e))
Any payment by a company, not being a company, not being a company in which the public are substantially interested, of any sum by way of advance or loan to a

shareholder holding nor less than 10% voting power or to a concern in which such shareholder is a member or a partner and in which he has substantially interest or any payment by any such company on behalf or for the individual benefit of any such shareholder , to the extent to which company in either case possesses accumulated profit shall be treated as deemed dividend.

- **Liability of Directors of private company in liquidation (section 179):** Where any tax due from a private company in respect of any income of any previous year cannot be recovered , then , every person who was a director of the private company at any time during the relevant previous year shall be jointly and severally liable for payment of such tax unless 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.

12.5 ASSESSMENT OF COMPANIES

The principal officer of the company is required to file the return of total income of the income of the company on or before 31st October of the assessment year. A company is assessed like any other assessee. However, its liability differs in two respects:

- **No exemption Limit:** A company does not enjoy any exemption limit.
- **Flat Rate of Tax:** A company pays income-tax at a flat rate instead of slab rate.



Check Your Progress-A

Q1. What are the deductions allowed from Gross Total Income to a company?

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.....

.....

Q2. State the cases along with the tax rates where special tax rates are applicable?

.....

.....

Q3. What do you mean by Deemed Dividend?

Q4. What are the provisions for carry forward and set off of losses under section 79 of the Act?

ILLUSTRATIONS

Q1. *X and Y are two shareholders of Z ltd, a closely held company. X holds 55 per cent share capital. On January 30, 2018, X transfers his shares to A. Z Ltd. wants to set off brought forward loss of Rs. 4,00,000(business loss: Rs. 1,00,000; unadjusted depreciation : Rs. 3,00,000) of the previous year 2016-17 against the income of the previous year 2017-18(i.e., Rs. 9 lakh).Can it do so?*

Answer:

Z ltd is a closely held company in which shareholders having 51 % voting right on March 31, 2017 and March 31, 2018 are not the same. Consequently, section 79 is applicable. Unadjusted depreciation can be set off but not brought forward loss. Income of the previous year 2016-17 will be Rs. 6 lakh (i.e., 9 lakh- 3 lakh).

Q2. *C ltd. showed a net profit of Rs. 3, 35,000 for the year 2017-18. Scrutiny of the accounts revealed the following:*

Debits to Profit & Loss account:

- a. Donation paid to approved Public Charitable Trust by cheque -Rs. 20,000*
- b. Provision for Income Tax –Rs. 1,00,000*
- c. Family planning expenses-Rs. 25000*
- d. Capital expenditure on Family Planning – Rs.1,00,000*

Credits to Profit and Loss Account

- a) *Bad Debts allowed earlier recovered during the previous year Rs. 10,000*
- b) *Interest on Bank Deposits –Rs. 30,000*
- c) *Long term capital gains –Rs. 1,00,000*
- d) *Dividend from an Indian Company –Rs. 20,000(Gross)*

There was (a) Unabsorbed depreciation Rs. 35,000 and (b) Unabsorbed capital loss Rs. 40,000 brought forward from the earlier assessment year.

Compute total income of the company for the assessment year 2018-19

Answer:	Rs.
Net Profit	3, 35,000
Add: Disallowed expenses:	
Donation	Rs.20, 000
Provision for Income Tax	Rs. 1, 00,000
Capital expenditure on F.P. (allowable 20%)	Rs. 80,000
	2, 00,000
	5, 35,000
Less: Income not chargeable under this head:	
Interest	Rs. 30,000
LTCG	Rs. 1, 00,000
Dividend	Rs. 20, 000
	1, 50,000
	3, 85,000
Less: Unabsorbed Depreciation	35,000
Business Income	(a) 3, 50,000

Capital Gains:

LTCG	1, 00,000
Less: B/f Capital loss	40,000
	(b) 60,000

Income from other sources

Interest	30,000
----------	--------

Dividend –Exempt	----
	(c) 30,000
Gross Total Income (a+b+c)	4,
40,000	
Less: Deduction u/s 80G (Donation): 50% of Rs. 20,000	10,000
Total Income	4, 30,000

Q3. *Andhra Sugars Ltd. manufactures and sells sugar. The profit and loss account of the company for the year disclosed a net profit of Rs. 5, 00,000. This was arrived at after debiting the following:*

1. *Expenses incurred on the cultivation of 5,000 quintal of sugarcane (The average market price is Rs. 10 per quintal)- Rs. 25,000*
2. *Expenses incurred on the salaries and wages of staff involved in the installation of new machinery Rs. 5000*
3. *Pension paid to Mr. Joseph, a retired employee living in London with no deduction of income tax at source. Rs. 60,000*
4. *Income tax Rs. 1,00,000*
5. *Dividends paid Rs. 50,000*
6. *Depreciation on fixed assets used in Business Rs. 75000*
7. *Legal expenses incurred on income tax appeal Rs. 15000*
8. *Entertainment expenses Rs. 18000*

Other Details:

- 1) *Bad debts previously written-off and allowed as deduction recovered in the previous year Rs. 30,000 was not shown as receipt in profit and loss account.*
- 2) *Allowable depreciation on fixed assets used in the business for the relevant previous year is Rs. 1, 00,000.*
- 3) *Profit and Loss account is credited with Rs. 30,000 dividends received from an Indian Company and Rs. 15,000 dividends received from a foreign company.*

Compute total income of the company for the assessment year.

Answer:

Computation of Total Income

	Rs.	Rs.
Profit		5, 00,000
Add: Cultivation expenses		25,000
		5, 25,000
Less: Average market price		50,000
		4, 75,000
Add: Items:		
Expenses on installation of new machinery Rs.5, 000		
Pension allowed as amount is less than exemption limit Rs.--		
Income Tax Rs.1, 00,000		
Dividend Rs.50, 000		
Depreciation-Considered later Rs. 75, 000		
Income tax appeal expenses –allowed --		
Entertainment Expenses- allowed--		
Bad debts recovered Rs.30, 000		2, 60,000
		7, 35,000
Less: Depreciation	1, 00,000	
Dividend	45,000	1, 45,000
Income from Business	(a)	5, 90,000
Income from Other Sources		
Dividend from Indian Company	Exempt	
Dividend from foreign company	15,000	15,000
	(b)	15,000
Total Income (a+b)		6, 05,000

Question 4:

The book profit of a company in the previous year 2017-18 computed in accordance with section 115JB of the Income tax Act is Rs. 12, 00,000. Its total income under the Income Tax Act for the same period is computed at Rs. 3, 50,000. Is the company liable to pay Minimum Alternate Tax? If yes, how much has to be paid?

Answer:**Computation of taxable Income**

Total Income Rs. 3, 50,000:

Tax @ 25%	Rs. 87,500
Add: Surcharge	NIL
Add: Education Cess	Rs. 2625
	(a) Rs.90,125

Book Profit Rs. 12, 00,000:

Tax @ 18.5%	Rs. 2,22,000
Add: Surcharge	NIL
Add: Education Cess @ 3%	Rs. 6,660
	(b)Rs. 2,28,660

Tax Payable (a) or (b), whichever is more. Company is liable to pay MAT Rs. 2, 28,660.

(Note: Assuming the turnover does not exceeds 50 crores therefore tax applied is 25% and taxable income does not exceeds 1 crore, therefore no surcharge applicable).

Question 5:

From the following information compute tax payable by Z Ltd. for the Assessment Year 2018-19:

1. Total Income of the company for the P.Y. 2017-18-Rs. 6,00,000
2. Book Profit u/s 115JB of the company for the P.Y. 2017-18-Rs. 8,00,000
3. Carried forward credit u/s 115JAA from the A.Y.2017-18-Rs.1,50,000

Answer:**Computation of Tax Payable**

(For the Assessment year 2018-19)

Tax on total income of Rs. 6, 00,000 @ 25.75%	(a) Rs. 1, 54,500
Tax on Book Profit of Rs. 8, 00,000 @ 19.055%	(b) Rs. 1, 52,440
MAT CREDIT set –off (a-b)	(c) Rs. 2060
Tax Payable (a-c)	Rs. 1, 52,440
MAT Credit carried forward for the A.Y. 2019-20 (Rs. 1, 50,000-Rs. 2060)	Rs. 1, 47,940

Question 6:

A Domestic company in which public are substantially interested submits the following particulars of its income of the previous year ended March 31, 2018:

- i. Profits of business after deduction of donations to approved charitable institution Rs. 1,90,000
- ii. Donation to charitable institution by cheque Rs. 30,000
- iii. Interest on Govt. Securities Rs. 10,000
- iv. Dividend from a domestic company (Gross) Rs. 60,000
- v. Long-term capital gain Rs.50,000
- vi. Book Profits u/s 115JB Rs. 8,00,000

During the financial year 2017-18 the company deposited Rs. 15,000 in Industrial Development Bank of India. The company distributed gross dividend of Rs. 1, 00,000 on 6.12.2017.

Compute the taxable income of the company and tax payable by it for the assessment year 2018-19.

Answer:**Computation of Total Income**

(For Assessment Year 2018-19)

Business Income:	Rs.	Rs.
Business Profit	1, 90,000	
Add: Donations:	30, 000	2, 20,000

Capital Gain: Long Term		50,000
Income from other sources:		
Interest on Govt. securities	10,000	
Dividend from a domestic company	Exempt	10,000
		2, 80,000
Less: Deduction u/s 80G: Donation 10% of (Rs. 2, 80,000-50,000 LT CG) = Rs. 23,000		
Deduction: 50% of Rs. 23,000		11,500
	Total Income	2, 68,500

Computation of Tax Payable

(For the Assessment Year 2018-19)

Total Income Rs. 2, 68,500

Tax on Rs. 50,000 LT CG @20% Rs. 10,000

Tax on Other Income Rs.2, 18,500 @ 30% Rs.65, 550

Rs. 75,550

Add: Surcharge nil

Add: Education Cess Rs. 2,267

(a) Rs.77,817

Book Profit Rs. 8, 00, 000

Tax on Rs. 8, 00, 000@ 18.5% Rs. 1, 48,000

Add: Surcharge nil

Add: Education Cess Rs. 4,440

Tax Payable under MAT (b) Rs. 1, 52, 440

Tax payable is (a) or (b), whichever is more, Rs. 1, 52, 440.

Note:

- i. No deduction is available to the company regarding deposit in Industrial Development Bank of India.
- ii. Company is also liable to pay tax on Rs. 1, 00, 000 (gross dividend distributed) u/s 115-O @ 15% + surcharge @ 10% + Education cess @ 3%.
- iii. Total income does not exceeds 1 crore therefore surcharge is not payable.

Question 7:

X co. ltd. has provided the following information for the year ended 31.03.2018:

1. *Total Income computed as per provisions of the Income –tax Act Rs. 20,00,000*
2. *Profit as per profit and loss account –Rs. 50,00,000*
3. *(A) Items debited to profit and loss account :*
 - (a) Provisions for Income-tax Rs. 6,50,000*
 - (b) Dividend distribution tax Rs. 40,000*
 - (c) Provision for Deferred tax Rs. 60,000*
 - (d) Securities transaction tax Rs. 1,00,000*
 - (e) Provision for gratuity on actuarial valuation Rs. 1,50,000*
 - (f) Dividend declared Rs. 2,50,000*
 - (g) Expenditure to earn agriculture income Rs. 1,00,000*
 - (h) Depreciation Rs. 4,50,000*
(This includes depreciation of Rs. 2, 00,000 on revaluation of assets)
- (B) Items credited to profit and loss account:*
 - (a) Transfer from special reserve Rs. 2, 00,000*
 - (b) Agricultural Income Rs.4, 00,000*
 - (c) Long term capital gains exempt from tax u/s 10(38) Rs. 2, 00, 000*
4. *Brought forward Business loss as per books of account Rs. 8, 00, 000*
5. *Brought forward depreciation as per books of account Rs. 7, 00, 000*

You are required to compute:

- (a) Tax payable by the company*
- (b) Tax credit to be carried forward if any.*

Answer:**Computation of Book Profit U/s 115JB**

Net profit as per Profit and Loss account Rs.50, 00,000

Add:

Provision for income tax Rs. 6, 50,000

Dividend distribution tax Rs. 40,000

Provision for deferred tax Rs. 60,000

Dividend declared Rs. 2, 50,000

Expenditure to earn agricultural income Rs.1, 00,000	
Depreciation Rs. 4,50,000	Rs.15, 50,000
	Rs. 65, 50,000
Less:	
Transfer from special reserve Rs. 2, 00,000	
Agricultural income (exempt) Rs. 4, 00,000	
LTCG exempt u/s 10 (38) (liable to MAT) –	
Depreciation Rs (4, 50,000-2, 00,000)=Rs. 2,50,000	Rs. 8,50,000
	Rs. 57, 00,000
Less: B/f business loss or depreciation as per books of account, (Whichever is less)	Rs. 7, 00, 000
Book Profit	Rs. 50, 00, 000

Computation of Tax Payable

(a) Tax on Book Profit Rs. 50,00 ,000 @ 18.5%	Rs. 9,25,000
Add: Education cess @ 3%	Rs. 27,750
	Rs. 9, 52,750
(b) Tax on total income Rs. 20,00,000 @ 25.75% (Including education cess)	Rs.5, 15,000
Tax payable (a) or (b), whichever is more	Rs. 9, 52,000
Tax credit to be carried forward (Rs. 9, 52,750--Rs. 5, 15,000)	Rs. 4, 37,750



Check Your Progress-B

Question 1: Compute the assessable income of Right Ltd., based on the under mentioned particulars relating to the year ended 31.03.2018:

Net Profit without adjustments for following where applicable Rs. 3,46,000

- (1) Salary, rent, electric charges etc.- Preproduction expenses –previously allocated to Capital Assets – Rs. 3,00,000
- (2) Depreciation for the year (including that on Roads , drive- ways and compound wall Rs. 5,000)as per rules – Rs. 15,000
- (3) Capital Employed – Rs. 3,04,000
- (4) Brokerage for obtaining loan of Rs. 10 lakhs -Rs. 10,000
- (5) Propaganda to prevent seizure of business by Govt.- Rs. 15,000
- (6) Legal expenses for evicting quarters who took illegal possession of it –Rs. 16,000
- (7) Entertainment Expenses- Rs. 26,000
- (8) Forfeiture of security deposit paid to a customer for non-fulfillment of contract – Rs. 5,000.

Question 2:

Sahas company Ltd. is a widely –held domestic company. The following are the particulars of its income in respect of the previous year 2017-18.

- (a) Income from Business – Rs. 1,10,00,000
- (b) Interest on Govt. Securities-Rs. 20,000
- (c) Short-term capital gains –Rs. 30,000
- (d) Long-term capital gains -Rs. 66,000
- (e) Dividend from a domestic company –Rs.20,000
- (f) Dividend from Foreign company –Rs. 20,000
- (g) Book Profit u/s 115JB-Rs. 80,00,000

During the previous year 2017-18 the company donated Rs. 50,000 to National Defence Fund by cheque .Compute the company's total income and tax payable for the assessment year 2018-19. (Dividend from domestic company is gross amount).

Question 3:

Preeza Ltd. is an Indian Company Manufacturing Textiles. For the year ended 31st March 2018, the profit & loss account showed a net profit of Rs. 10, 25,000 after debiting the following:

- (a) Dividends Rs. 2, 00,000 paid to shareholders for the accounting year 2016-17.*
- (b) Interest Rs. 10,000 paid on loan taken for the payment of company's income tax.*
- (c) Rs. 10,000 paid to legal advisers in respect of proceedings before income tax authorities.*
- (d) Penalty of Rs. 24,000 for importing yarn in contravention of import regulations.*

Compute taxable income of the company.

12.6 TAX ON DISTRIBUTED PROFITS OF DOMESTIC COMPANIES

Section 115-O: The Domestic Company shall, in addition to the income tax chargeable in respect of its total income, be liable to pay additional income-tax on any amount declared, distributed or paid by such company by way of dividend (whether interim or otherwise), whether out of current and accumulated profits. Such additional income tax will be chargeable at the rate 15% plus surcharge at the rate of 5% (7.5% for A.Y. 2011-12 and 10 percent upto A.Y. 2010-11.....from April 1, 2015 onwards 12%), plus education cess @ 2 percent plus SHEC @ 1 percent of the amount so declared , distributed or paid.

For the purpose of **computation of tax on distributed profits**, the amount of dividend distributed by the domestic company during the financial year shall be **reduced** by the following:

- a. The amount of dividend , if any received by the domestic company (holding company) during the financial year, if –
 - i. Such dividend is received from its subsidiary;
 - ii. The subsidiary has paid tax under this section on such dividend and
 - iii. The domestic company (holding company) is not subsidiary of any other company.
- b. The amount of dividend ,if any , paid to any person for or behalf of the New Pension Scheme trust referred to in section 10(44)

However, that the same amount of dividend shall not be taken into account for reduction more than once.

What is Dividend?

Dividend declared, distributed or paid on or after June 1, 1997 but before April 1, 2002 or after March 31, 2003 is subject to dividend tax (for meaning of 'dividend' refer para 193.2)

For the purpose of section 115-O the expression 'dividend' shall have the same meaning as given to 'dividend' under section 2(22), but it shall not include sub clause (e) of section 2(22).

Relief in the case of inter corporate dividend in some cases: Section 115-O (1A)

This section provides a relief when a holding company has received dividend from its subsidiary company and in the same financial year the holding company declares dividend to its shareholders. When dividend is declared, distributed or paid by the holding company to its shareholders, dividend tax shall be payable to the following format-

	Rs.
Dividend declared, distributed or paid by the holding company to its shareholders (a)	XXXX
Less: Dividend received by holding company from its subsidiary company in the same financial year (b)	XXXX
Balance [i.e. (a)-(b) on which dividend tax is payable by the holding company	XXXX

The aforesaid relief is available only in the situations given below:

1. Subsidiary company is a domestic company and it has paid tax under section 115-O when dividend is paid to the holding company and holding company is not subsidiary of any other companies (applicable from April 1, 2008 to June 30, 2012).
2. Subsidiary company is a domestic company and it has paid tax under section 115-O when dividend is paid to the holding company (applicable from July 1, 2012).
3. Subsidiary company is a foreign company and dividend received by the holding company from the subsidiary company is taxable in the hands of holding company under section 115BBD (applicable from June 1, 2013).

For the aforesaid purposes, a company shall be a subsidiary of another company, if such other company holds more than half more than half in nominal value of the equity share capital of the company.

Rate of Dividend Tax:

Particulars	Dividend tax (as a % of dividend)	Surcharge (as a % of dividend)	Education cess (as a % of dividend tax and	Total (as a % of dividend)

			surcharge)	
From April 1, 2007 to March 31,2010	15	10	3	16.995
From April 1, 2010 to March 31,2011	15	7.5	3	16.60875
From April 1, 2011 to March 31, 2013	15	5	3	16.225
From April 1, 2013 to September 30,2014	15	10	3	16.995
From October 1,2014 to March 31,2015	17.64706	10	3	19.99412
From April 1, 2015	17.64706	12	3	20.35765

Time limit for deposit of additional income tax:

Such additional tax will have to be paid by the principal officer of the domestic company and the company within 14 days from the date of:

- a. Declaration of any dividend ;or
- b. Distribution of any dividend ; or
- c. Payment of any dividend,

Whichever is earliest.

Tax on dividend paid by a domestic company shall be taken as the final tax payment in respect of the amount declared, distributed or paid as dividend. In respect of tax so paid, no credit is available to the company paying tax, or the recipient of dividend or to any other person.

- ❖ Whereas in the case of *a resident individual/HUF/firm*, aggregate dividend income from domestic companies in excess of Rs 10,00,000 is chargeable to tax at the rate of 10 percent (+SC+EC+SHEC) with effect from the assessment year 2017-18. This additional tax in the hands of shareholders under section 115BBDA is applicable even if the company is subject to dividend distribution tax under section 115-O.

Dividend Tax is not deductible:

The company (or the shareholders) cannot claim any deduction from taxable income in respect of dividend tax levied under section 115-O. Moreover, no deduction is available from the tax on dividend under any provision.

Interest for non-payment of tax (section 115P):

If the company or the principal officer fails to pay the whole or any part of dividend tax within the specified time limit, then it or he shall be liable to interest in addition to dividend tax as mentioned below:

Rate of Tax	1 percent or part thereof
Amount on which interest is chargeable	Amount of tax as reduced by the amount paid within the time-limit
Period for which interest is payable	Interest is chargeable for the period commencing from the next date after the last date of payment and ending on the date of actual payment.

ILLUSTRATION

Question 1:

From the following information determine the tax payable u/s 115-O by a domestic company on dividend distributed by it:

- It received dividend from its subsidiary company (which paid dividend distribution tax u/s 115-O) Rs. 3,00,000 on 10.11.2017
- It distributed dividend Rs. 28,00,000 on 15.12.2017 to its shareholders
- Out of Rs. 28, 00,000 the company paid dividend Rs. 5, 00,000 to a person on behalf of the New Pension System Trust.

Solution:

Computation of Tax Payable by a Domestic Company on Dividend Distribution

Dividend distribution		Rs.	28,
00,000			
Less: Dividend received from subsidiary Company	Rs. 3,00,000		
Dividend paid on behalf of the New Pension			
System Trust	Rs. 5,00,000	Rs.	8, 00,
000			
Dividend distributed to Share Holders		Rs.	20, 00, 000

Tax on Gross Dividend

$$\begin{aligned}
 & \text{Rate of tax} \quad \times 20,00,000 \\
 & 100 - \text{Rate of tax} \\
 = & \quad 20.35765 \quad \times 20,00,000 \\
 & 100 - 20.35765 \\
 = & \text{Rs.} 511226
 \end{aligned}$$

Question 2:

From the following information compute the tax liability of X Ltd (a closely held company) for the A.Y. 2018-19.

1. Accumulated profits of the company on 31.03.2017 Rs. 30,00,000
2. On 20.1.2018 the company redeemed bonus preference shares issued to equity shareholders Rs. 8,00,000
3. On 15.02.2018 the company declared dividend in its annual general body meeting payable to shareholders Rs. 10,00,000
4. A shareholder holding 15% equity shares in the company borrowed on 31.10.2017 @ 12% p.a. interest.

Solution:**Computation of Tax Liability of X Ltd.**

1. Redemption of Bonus Shares	
{Treated as dividend distribution u/s 2(22) (a)}	Rs.8,00,000
2. Dividend declared	Rs. 10,00,000
Dividend to Shareholders	Rs. 18,00,000

Tax on Gross Dividend Distribution:

$$\begin{aligned}
 & \text{Rate of Tax} \quad \times 18,00,000 \\
 & 100 - \text{Rate of Tax} \\
 = & \quad 20.35765 \quad \times 18,00,000 \\
 & 100 - 20.35765 \\
 = & \text{Rs.} 4,60,104
 \end{aligned}$$

Notes:

- i. The tax shall be paid within 14 days from the date of declaration or payment of dividend, whichever is earlier.
- ii. Loan to the shareholder holding at least 10 percent of equity shares, is deemed dividend u/s 2 (22) (e). On such dividend, shareholder is liable to pay tax and not the closely-held company.



Check Your Progress-C

Q1. What do you mean by Dividend Distribution Tax?

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Q2. Show in a chart the rate of dividend distribution tax along with rate of surcharge and education cess applicable as per Income tax Act from the Assessment Year 2007-08 till date.

Answer:

Assessment Year	Dividend tax (as a % of dividend)	Surcharge (as a % of dividend tax)	Education cess(as a % of dividend tax and surcharge)	Total(as a % of dividend)

Q3. Discuss the provisions of Section 115P.

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12.7 SUMMARY

- 1) A company means: an Indian company, any- body corporate incorporated in a foreign country, or any institution or body, whether incorporated or not, but declared by the order of the Board to be a company for any assessment year.
- 2) Computation of total income: It is computed in the same manner as that of an individual. Briefly the procedure is that at first the taxable income is determined under each head of income. All these taxable incomes are aggregated and then any brought forward losses or allowances are deducted. The balance is gross total income. From G.T.I. the deductions under sections 80G, 80GGA, 80GGB, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID, 80-IE, 80JJA, or 80LA are made. The balance left is Total Income.
- 3) Computation of Tax: The income tax is always payable by a company on its total income (25% in case of domestic company having turnover less than 50 crores and 30% in case turnover exceeds 50 crores).
- 4) Minimum tax on Book profit will be 18.5% +SC @ 5%/10% as the case may be , if book profit exceeds one crore rupees.
- 5) **Section 115-O:** The Domestic Company shall, in addition to the income tax chargeable in respect of its total income, be liable to pay additional income-tax on any amount declared, distributed or paid by such company by way of dividend (whether interim or otherwise), whether out of current and accumulated profits. Such additional income tax will be chargeable at the rate 15% plus surcharge at the rate of 5% (7.5% for A.Y. 2011-12 and 10 percent upto A.Y. 2010-11.....from April 1, 2015 onwards 12%), plus education cess @ 2 percent plus SHEC @ 1 percent of the amount so declared , distributed or paid.



12.8 GLOSSARY

Dividend: a sum of money paid regularly (typically annually) by a company to its shareholders out of its profit (or reserves).

Domestic Company: A company that conducts its affairs in its home country. A domestic corporation is often taxed differently than a foreign corporation.

Tax credit: A tax credit is an amount of money a tax payer is able to subtract from taxes owed to the government.

Corporate Tax: A corporate tax, also called corporation tax or company tax, is a direct tax imposed by a jurisdiction on the income or capital of corporations or legal entities.



12.9 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress –A

Answer1: Total Income Rs. 2,59,000.

Answer2: Total Income Rs. 1, 10, 86,000.



12.10 REFERENCES

- Student's Guide to *INCOME TAX* by “Dr. Vinod K. Singhanian and Dr. Monica Singhanian”.
- *Direct Taxes Ready Reckoner* by Dr. Vinod Singhanian and Dr. Kapil Sighania.
- Jain, Dr. R.K., *Income Tax Planning and Management*, SBPD publications.
- Dr. Mehrotra, H.C, and Dr. Goyal, S.P., *INCOME TAX LAW AND ACCOUNTS*, Sahitya Bhawan Publications, 57th Edition.



12.11 SUGGESTED READINGS

1. *Direct Taxes Ready Reckoner* by Dr. Vinod Singhanian and Dr. Kapil Sighania.

2. WEBSITE: <http://www.taxmann.com>
3. E-mail : sales @taxmann.com



12.12 TERMINAL QUESTIONS

Question 1:

Compute the taxable income of Prabhakar ltd. for the previous year 2017-18 from the following Profit & Loss account and additional information:

Particulars	Amount	Particulars	Amount
To Salaries and Bonus	1,00,000	By Gross Profit	5,00,000
To Office Rent	10,000	By Interest	10,000
To War Risk Insurance	10,000	By Short –term capital gains	15,000
To Postage & Stationery	10,000		
To General Reserve	20,000		
To Reserve for Dep.	25,000		
To Income tax 2016-17	50,000		
To Provision for Income tax (C.Y.)	2,00,000		
To Net Profit	1,00,000		
Total	5,25,000		5,25,000

Additional Information:

- (a) The general reserve include Rs. 5000/- for advertising, Rs. 1000/- for charitable trust, Rs.3000/- paid to a Motor-car company for exchanging the old car for a new one ;
Rs. 1000/- for charity and Rs. 5000/- for miscellaneous repairs.
- (b) The amount of depreciation admissible under the Income Tax Act is Rs. 15000/- only.
- (c) The amount of interest is from Govt. securities.

Solution:

Computation of Income from Business

(For Assessment Year 2018-19)

Net Profit as per P/L A/c		Rs.	1,
00,000			
Add: Items not allowed:			
a) Reserve for Depreciation	Rs.25,000		
b) Income tax (2016-17)	Rs.50,000		
c) Provision for Income tax 2017-18	Rs. 2,00,000		
d) Donation	Rs.1,000		
e) Payment for car being Capital Expenditure	Rs. 3,000		
f) Charity	Rs.1,000	Rs.	
2,80,000			
			Rs.3, 80,000
Less:			
a) STCG	Rs.15,000		
b) Interest on Securities taxable under the head Income from other Sources	Rs. 10,000		
c) Depreciation allowed	Rs.15,000	Rs.40,000	
Income from Business		Rs.	3,
40,000			

Statement of Total Income

1. Income from Business		Rs.	
3,40,000			
2. Capital Gains-Short-term		Rs. 15,000	
3. Income from other sources :Interest on Securities		Rs. 10,000	
Gross Total Income		Rs.	3,
65,000			
Less: 50% of Donations u/s 80G, i.e., 50% of Rs. 1000		Rs.	500
	Total Income	Rs.	
3,64,500			

Question 2:

The profit and loss account of XY Ltd., a company in which the public are substantially interested (manufacturing an article not included in the list given in schedule XI) for the year ended 31st March ,2018 shows a net profit of Rs. 15,00, 000. The credit and debits in the profit and loss account include the following items among others:

Credits:

- i. Dividend from an Indian Company (gross) Rs.1, 00, 000
- ii. Net Rent from House property (let out to outsiders) after debiting repairs Rs. 1,000 and Municipal Tax Rs. 3000—Rs. 23,000

Debits:

- i. Provision for taxation Rs. 20, 00, 000
 - ii. Cost of maintenance of liaison office in New York for promoting exports Rs. 60,000
 - iii. Legal expenses for contesting a suit for eviction from a premises used as a show-room Rs.3,000
 - iv. Expenses from obtaining a loan from a financial institution for acquiring new machinery Rs.20, 000
 - v. Amount embezzled by the cashier of the company, which is irrecoverable Rs. 15000
- Entire amount of dividend income from another Indian Company has been distributed as dividend to its shareholders on 10.09.2017.

Compute the total Income of the Company for the relevant Assessment Year.

Answer: Rs.33, 93,800.

UNIT 13 MINIMUM ALTERNATE TAX

13.1 Introduction

13.2 Objectives

13.3 Concept of Minimum Alternative Tax (MAT)

13.4 Provisions and Exceptions of Mat for Payment of Tax

13.5 Determination of Book Profit

13.6 Power of Assessing Officer to Alter Net Profit

13.7 Conversion of Net Profit into Book Profit

13.8 Some Other Relevant Provisions

13.9 Case Laws

13.10 Summary

13.11 Glossary

13.12 Answer to Check Your Progress

13.13 Reference / Bibliography

13.14 Suggested Readings

13.15 Terminal & Model Questions

13.1 INTRODUCTION

In the last unit we learnt about the computation of the amount of corporate tax liability. While computing the tax liability an important aspect to be considered is the Minimum Alternate Tax (Section 115JB). MAT is a way of making companies pay minimum amount of tax.

MAT is applicable to all companies except those engaged in infrastructure and power sectors. Income arising from free trade zones, charitable activities, investments by venture capital companies is also excluded from the purview of MAT. However, foreign companies with income sources in India are liable under MAT.

13.2 OBJECTIVES

The objective of this unit is to:

- explain what MAT is,
- the reasons for its introduction and ,
- Who is liable to pay tax under the provisions?

Normally a company is liable to pay tax on the income computed in accordance with the provisions of Income Tax Act, but the profit and loss account of the company is prepared as per the provisions of the Companies Act. As a result of the exemptions, deductions and other incentives under the Income Tax Act, there was an emergence of zero tax companies, which in spite of having high book profit are able to reduce their taxable income to nil.

13.3 CONCEPT OF MINIMUM ALTERNATE TAX

In order to bring the zero tax companies under the Income Tax net, section 115JA was introduced from assessment year 1997-98. Now ,all the companies having book profits under the Companies Act shall have to pay a minimum alternate tax at 18.5%.From assessment year 2001-02 onwards section 115JB regulated the provisions regarding minimum alternate tax.

13.4 PROVISIONS AND EXCEPTIONS OF MAT FOR PAYMENT OF TAX

Para 336: *The provisions of Minimum Alternate in brief are given below:*

Section	Applicability for which assessment year	When these provisions are applicable	Result
115JA	1997-98 to 2000-01	If income of a company under normal provisions is lower than 30 percent of “book profit”	30 percent of “book profit” shall be deemed as total income of the company
115JB	2001-02 onwards	If tax liability of the company under normal provisions is lower than 18.5 percent (+SC+EC+SHEC) of “book profit”	‘Book profit’ shall be deemed as total income and 18.5 percent of “book profit” should be deemed as tax liability.

Para 336.1: Provisions in brief:

- Find out the normal tax liability as per **para 334.1**, ignoring provisions of minimum alternate tax.
- Computation of book profit as per **para 336.2**.
- Computing the minimum alternate tax as in **para 334.1**.
- If the tax computed under the normal tax liability is more than or equal to the tax calculated under MAT, the provisions of minimum alternate tax are not applicable.
- If the tax computed under the normal tax liability is less than the tax computed under MAT, the provisions of minimum alternate tax are applicable as follows :

1. It will be assumed that the “book profit” of the company is the taxable income.
2. The liability of the company is 18.5 per cent (+SC+EC+SHEC) of “book profit”.
3. The Tax computed is hence the minimum alternate tax which the company is liable to pay.
4. The extra tax that the company has to pay because of minimum alternate tax will be available for “tax credit” under section 115JAA.

13.4.1 EXCEPTIONS OF MINIMUM ALTERNATE TAX

The provisions of minimum alternate tax are not applicable under the following circumstances:

- a. The provisions of minimum alternate tax are not applicable in case of income arising after March 31, 2005 but before April 1, 2011 from any business/ services in the hands of entrepreneur/developer in a special economic zone.
- b. The provisions are not applicable where the income of a shipping company which is subject to the provisions of “tonnage income” of Chapter XII-G (i.e. sections 115V to 115VZC) is arising after March 31, 2004(i.e. assessment year 2005-06 onwards)
- c. Where the income accruing or arising to a company from life insurance business referred to in section 115B after March 31, 2000 (i.e. assessment year 2001-02 onwards), the provisions of minimum alternate tax is not applicable.
- d. With effect from the assessment year 2001-02, the provisions of minimum alternate tax are not applicable to a foreign company under the following cases:
 - i. The assessee is a resident of a country /specified territory with which India has an agreement under section 90/90A and the assessee does not have a permanent establishment in India in accordance with the provisions of such agreement;

- ii. The assessee is a resident of a country with which India does not have an agreement referred to above and the assessee is not required to seek registration in India under any law for the time being in force relating to companies.

13.5 DETERMINATION OF BOOK PROFIT

How to Determine Book Profit?

Section 115JB: “Book Profit” as required for the computation of tax liability under minimum alternate tax is arrived after making specified adjustments to net profit as per profit and loss account. For this purpose, profit and loss account should be prepared within the parameters of Schedule VI to the companies Act, 1956.

Schedule VI of the companies Act is not applicable in the case of insurance, banking and electricity companies. In the case of these companies, different benches of the Tribunal held that the provisions of minimum alternate tax are not applicable. Superseding the ruling of Tribunal, section 115JB has been amended by the Finance Act, 2012, with effect from assessment year 2013-14, to align the provisions of Income Tax Act with the Companies Act, 1956.

The amended version of section 115JB provides that the book profit in the case of:

- a. Any insurance or banking company or any company engaged in the generation or supply of electricity shall be calculated on the basis of profit and loss account prepared in accordance with the provisions of their regulatory acts, or
- b. Any other company shall be calculated on the basis of profit and loss account prepared in accordance with schedule VI of the Companies Act, 1956.

13.6 POWER OF THE ASSESSING OFFICER TO ALTER NET PROFIT

In the following cases, the Assessing Officer shall have the power to rework or rewrite the profit and loss account:

- (1) Where the profit and loss account submitted is not as per Part II and Part III of the Schedule VI of the Companies Act.

- (2) Where the accounting policies and accounting standards or rate of depreciation adopted are different from those adopted for the profit and loss prepared for annual general meeting.

13.7 CONVERSION OF NET PROFIT INTO BOOK PROFIT

Adjustment to Net Profit To Convert It Into Book Profit

Net profit as shown in profit and loss account shall be adjusted as follows:

POSITIVE ADJUSTMENTS: Net profit as shown in profit and loss account (prepared in accordance with the provisions of Parts II and III of the sixth Schedule to the Companies Act) is to be increased by the following amounts if debited to the profit and loss account:

Amount to be added back if debited to profit and loss account:

1. Income tax paid or payable and the provisions thereof (income tax, interest under the income tax Act, dividend tax under section 115-0, distribution tax under section 115R including surcharge, education cess and secondary and higher secondary cess if debited to profit and loss account shall be added back). No adjustment is required for penalty/ fine under the Income-tax Act.
 2. Amounts carried by any reserves, by whatever name called.
 3. Amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities.
 4. Amount by way of provision for losses of subsidiary companies.
 5. Amount or amounts of dividends paid or proposed.
 6. Amount of expenditure relatable to certain income (if such income is not subject to minimum alternate tax)
 7. Amount of depreciation.
 8. Amount of deferred tax and the provisions thereof and the amount or amounts set aside as provision for diminution in the value of any asset.
- 8A. Amount standing in revaluation reserve relating to revalued asset on the retirement or disposal of such asset.
- 8B. Amount of income /loss in the case of units referred to in section 47(xvii).

NEGATIVE ADJUSTMENTS: Net profit as shown in the profit and loss account is to be reduced by the following amounts:

Amount to be deducted from Net Profit:

9. Amount withdrawn from reserves or provisions, if any such amount is credited to the profit and loss account.
10. Income exempt from tax:
 - a. Long term capital gain exempt under section 10(38) for the assessment years 2005-06 and 2006-07.
 - b. Incomes exempt under section 10(23G) up to the assessment year 2004-05.
 - c. Income exempt under the other clauses of section 10.
 - d. Income exempt under sections 10A and 10B up to the assessment year 2007-08.
 - e. Incomes exempt under sections 11 and 12.
 - f. Share of profit from an AOP on which no income tax is payable in accordance with the provisions of section 86 (applicable from the assessment year 2016-17).
 - g. In case of a foreign company : interest, royalty or technical fees chargeable to tax under sections 115A to 115BBE, or capital gain arising on transactions on securities, if income tax payable in respect of these income under normal provisions (other than provisions governing MAT applicable from the assessment year 2016-17; and
 - h. Royalty in respect of patent chargeable to tax under section 115BBF.

The above incomes are not subject to minimum alternate tax.

11. Depreciation (other than because of revaluation of assets) debited to profit and loss account.
 12. Amount withdrawn from revaluation reserve credited to profit and loss account to the extent it does not exceed the amount of depreciation on account of revaluation of assets.
 13. Amount of loss brought forward or unabsorbed depreciation, whichever is less, as per books of account.
 14. Amount of profit eligible for deduction under sections 80HHC, 80HHE and 80HHF.
 15. Profit of sick industrial unit.
 16. The amount of deferred tax, if any such amount is credited to the profit and loss account
- 16A. Amount of income / loss in the case of units referred to in section 47 (xvii).

13.8 SOME OTHER RELEVANT PROVISIONS

1. Where the profit and loss account has been prepared in accordance with Part II and III of Schedule VI to the companies Act and which has been scrutinized and certified by the statutory auditors and relevant authorities, the Assessing officer has no power to scrutinize net profit in profit and loss account except to the extent provided in Explanation to 115J [Apollo Tyres Ltd. v CIT (2002) ITR 273 (SC)].
2. Provision for Gratuity on the basis of actuarial calculations is an ascertained liability – CIT v Inox Leisure Ltd. [2013] 213Taxmann 160(Guj.).
3. Provision for Bonus computed on the basis of the Payment of Bonus Act, 1965 is an ascertained liability.
4. Provision towards leave encashment of employee is ascertained liability.
5. Provision for reduction in ship repair bills, provision for obsolescence of materials, provision for future losses, provision for liquidated damages payable for delay in handing over the ship and provision for leave encashment are ascertained and hence fall outside the purview of explanation to section 115JA.
6. Depreciation debited to profit and loss account shall be added back. However, depreciation (not being depreciation which arises because of revaluation of assets) shall be deducted.
7. Current year's depreciation which has not been charged to profit and loss account but has been disclosed in notes appended to accounts would be deducted from net profit in determining Book Profit for purpose of section 115JB.
8. Amount transferred to reserve account by debiting profit and loss account shall be added back to convert net profit into book profit .This rule is applicable even if reserve is created under a statutory requirement.
9. Capital profit arising on transfer of a capital asset is part of book profit. If capital profit is not credited to profit and loss account, it is against the requirement of Accounting Standard AS-13 and the requirements of Schedule VI of Companies Act.
10. Capital profit credited to profit and loss account is part of book profit, even if it is exempt under section 54EC.
11. For purpose of computing Book Profits no adjustment can be made by way of reduction of interest on borrowed capital, which is not debited in profit and loss account.
12. No addition for the purpose of computation of total income of the assessee under section 115JB can be made with regard to share of loss from a firm which is debited to profit and loss account.
13. Loss of sale of car/ truck debited to profit and loss account cannot be added back.

14. Amount disallowable under section 14A can be added back while computing book profit, if it is debited to the profit and loss account.
15. Provisions of section 115JB do not prescribe any restriction on number of years that are required to be considered for allowing deduction of brought forward loss or unabsorbed depreciation, whichever is lower.

Tax Credit in respect of tax paid on deemed income of certain Companies or Tax Credit in respect of Minimum Alternative Tax (MAT) on certain Companies:

When MAT is paid by a company for the assessment year 2006-07 or any subsequent assessment year (u/s 115JB) a credit will be allowed to it in subsequent years as under:

- The tax credit shall be the difference between the tax paid under MAT and the tax payable on the total income computed under other provisions of the Act. Suppose tax payable on total income is Rs 20000/- and tax has been paid under MAT Rs. 50000/-. The tax credit will be allowed Rs. $(50000-20000) = \text{Rs. } 30000/-$.
- The tax credit will be allowed to be carried forward for a maximum of ten assessment years succeeding the assessment year in which the credit becomes allowable. Suppose credit is allowable in the A.Y. 2009-10; it can be carried forward and set off up to the A.Y. 2019-20. (Now from assessment year 2018-19 the carry forward of MAT credit increased to 15 years from 10 years).
- The tax credit will be allowed in the year in which the tax payable on total income is more than the tax payable under MAT under section 115JB.
- The set off will be allowed to the extent of an amount equal to the difference between the tax payable on the total income and the tax payable under MAT under section 115JB. Suppose brought forward credit is Rs. 40000. The tax payable on total income is Rs. 100000/- and the tax payable under MAT under section 115JB is Rs. 80000/-. Rs. 20000/- can be set off this year and the company will pay Rs. 80000/-.
- No interest shall be payable on tax credit.
- Where as a result of assessment, reassessment, rectification of mistake, settlement appeal or revision, the amount of tax payable is reduced or increased; the amount of tax credit shall also be increased or reduced accordingly.
- Where a private company or unlisted public company is converted into a limited liability partnership, the benefit of tax credit shall not be available to the successor limited liability partnership.

ILLUSTRATIONS

Numerical 1:

From the following information compute the tax liability of X & Co. keeping in view the provisions of MAT u/s 115JB for the assessment year 2018-19

1. **Profit and loss account**

To Expenses relating to business	4,50,000	By Long Term Capital Gains	1,00,000
To Income Tax Paid	20,000	By Sale	7,00,000
To General Reserve	40,000	By Deferred tax	1,00,000
To Provision for contingent liability	40,000		
To Provision for Diminution in the value of asset	50,000		
To Proposed Dividends			
To Balance c/d	50,000		
	2,50,000		
	9,00,000		9,00,000

2. B/F loss as per books of account Rs. 1, 00,000.
3. B/F depreciation as per books of account Rs. 80,000.
4. B/F loss under the head capital gains (Computed as per Income Tax Act) Rs. 60,000.
5. B/F unabsorbed depreciation Rs. 3, 00,000 for the assessment year 2017-18.

Solution:1. **Computation of tax on total income for A.Y. 2018-19**

Profit as per P & L A/c		Rs. 2, 50,000
Add:		
Income tax paid	Rs. 20,000	
General reserve	Rs. 40,000	
Provision for contingent liability	Rs.40, 000	
Provision for diminution in value of asset	Rs. 50,000	
Proposed dividends	Rs. 50,000	Rs. 2, 00,000
		Rs. 4, 50,000

Less:

Income taxable under the heads capital gains	Rs. 1, 00,000	
Deferred Tax	Rs. 1, 00,000	Rs. 2, 00,000
Business Income		Rs. 2, 50,000

Statement of total income

Business income		Rs. 2, 50,000
Less: B/F unabsorbed depreciation		Rs. 2, 50,000
Income		Nil
Capital Gains		Rs. 1, 00,000
Less: B/F Capital loss		Rs. 50,000
B/F unabsorbed depreciation		Rs. 50,000
		Nil
Tax on total income		NIL

II. Computation of Book Profit and tax payable u/s 115JB or Minimum Alternate Tax

Income as per P & L A/c		Rs. 2, 50,000
Add: Disallowed Items		
Income tax paid	Rs. 20,000	
General Reserve	Rs. 40,000	
Provision for contingent liability	Rs.40, 000	
Provision for diminution in value of asset	Rs. 50,000	
Proposed dividends	Rs. 50,000	Rs. 2, 50,000
		Rs. 4, 50,000
Less: Deferred Tax	Rs. 1, 00,000	
B/F loss as per books of account or		
B/F depreciation as per books of account		
(Whichever is less)	Rs. 80,000	Rs. 1, 80,000
Book profit		Rs. 2, 70,000
Tax on book profit @18.5%		Rs. 49,950

Add: Surcharge	Nil
	Rs. 49,950
Add: Education cess	Rs. 1,499
	Rs. 51,449

Tax payable. Tax on total income is Nil or tax on book profit Rs. 51,450 (rounded off Rs. 51,450), whichever is more. Hence, tax payable Rs. 51,450.

Note. Total income does not exceed Rs one crore, hence, surcharge is not applicable.

Numerical-2

From the following information compute the tax payable by Z & Co. keeping in view the provisions of MAT u/s 115JB for the assessment year 2018-19.

1. Profit and loss account

Expense related to sales	Rs.23, 20,000	
Security transaction tax	Rs. 5,000	
(Paid relating to long term capital gain)		
Depreciation	Rs. 1, 50,000	
Proposed Dividend	Rs. 2, 50,000	
Income tax	Rs. 1, 00,000	
Net Profit	Rs. 4, 00,000	
	Rs. 32, 25,000	
Sale		Rs. 30, 00,000
Long term capital gain {exempt u/s 10(38)}		Rs. 2, 00,000
Interest on Govt. Securities		Rs. 25,000
		Rs. 32, 25,000

2. The company revalued its assets from Rs. 300,000 to Rs. 6, 00,000 and provided depreciation on Rs. 6, 00,000 @ 25%. The depreciation allowable under the Income tax Act is Rs. 80,000.

3. B/F loss as per books of account Rs. 2, 00,000.

4. B/F depreciation as per books of account Rs. 50,000.

5. B/F unabsorbed depreciation Rs. 1, 00,000.

Solution:

Computation of Total Income and Tax Payable for the assessment year 2018-19

Profit as per P& L account			Rs.
4, 00,000			
Add: Expenses disallowed			
Security transaction tax paid	Rs. 5,000		
Excess depreciation (Rs. 1, 50,000-Rs. 80,000)	Rs. 70,000		
Proposed dividend	Rs. 2, 50,000		
Income Tax	Rs. 1, 00,000	Rs. 4, 25,000	
			Rs. 8, 25,000
Less: LTCG {exempt u/s 10(38)}			Rs. 2, 00,000
Interest on securities (taxable under the head of income, other sources)	Rs. 25,000		
Business Income			Rs. 6, 00,000
Less: B/F unabsorbed depreciation			Rs. 1, 00,000
Add:			
Income from other sources:			
Income from securities		Rs. 25,000	
Gross Total Income		Rs. 5, 25,000	
Deduction			Nil
Tax on Rs. 5, 25,000 @ 25 percent			Rs. 1, 31,250
Add: Surcharge			Nil
Add: Education cess (Rs. 1, 31,250* 3%)		Rs. 3938	
	(a)		Rs. 1,351,88

Computation of Book Profit and Tax Payable u/s 115JB**For the assessment year 2018-19**

Profit as per P&L A/c		Rs. 4, 00,000
Add: Disallowed items:		
Depreciation considered later	Rs. 1, 50,000	
Proposed dividend	Rs. 2, 50,000	

Income tax	Rs. 1, 00,000	Rs.5, 00,000
		Rs. 9, 00,000
Less: Depreciation on Rs. 3, 00,000 @ 25%	Rs. 75,000	
B/F loss or depreciation, whichever is lower	Rs. 50,000	Rs.1, 25,000
		Rs. 7, 75,000
Tax on Rs. 7, 75,000 @ 18.5%		Rs. 1, 43,375
Add: Surcharge		
NIL		
		Rs. 1, 43,375
Add: Education cess @ 3%		Rs. 4,301
	(b)	Rs. 1,47,676

Tax payable (a) or (b), whichever is more. Hence, tax payable Rs. 1, 47,680 (rounded off).

Notes:

1. LTCG (exempt u/s 10(38) is liable to MAT.
2. STT is deducted in computing book profit for MAT.
3. Total income does not exceed Rs. 1 crore; hence, surcharge is not payable.
4. Assuming Z& Co. as domestic company whose turnover does not exceeds 50 crores , therefore income tax charged at 25 % of taxable income .

Numerical 3:

The book profits of a company in the previous year 2017-18 computed in accordance with section 115JB of the Income Tax Act is Rs. 12, 00,000. Its total income under the Income – tax Act for the same period is computed at Rs. 3, 50,000. Is the company liable to pay ‘Minimum Alternate Tax’? If yes, how much has to be paid?

Solution:

Computation of Tax Payable

For the assessment Year 2018-19

Total Income Rs. 3, 50,000:

Tax @ 25%	Rs. 87,500
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Add: Surcharge

NIL

Rs. 87,500

Add: Education cess @ 3%

Rs. 2625

(a)

Rs. 90,125

Book Profit Rs. 12, 00,000:

Tax @ 18.5%

Rs. 2, 22,000

Add: Surcharge

NIL

Rs. 2, 22,000

Add: Education cess@ 3%

Rs. 6,660

Rs. 2, 28,000

Tax payable (a) or (b), whichever is more.

Company is liable to pay MAT Rs. 2, 28,000.

Note: Total turnover does not exceed 50 crores, hence tax @ 25 percent is charged and hence surcharge is also not payable.

Numerical 4:

X Co. Ltd has provided the following information for the year ended 31.03.2018:

1. Total income computed as per provisions of the Income Tax Act	Rs. 20, 00,000
2. Profit as per profit and loss account	Rs.50, 00,000
3. (A) Items debited to Profit and loss account	
a. Provision for Income tax	Rs. 6,50,000
b. Dividend Distribution tax	Rs. 40,000
c. Provisions for deferred tax	Rs. 60,000
d. Securities transaction tax	Rs. 1,00,000
e. Provisions on gratuity on actuarial valuation	Rs. 1,50,000
f. Dividend declared	Rs. 2,50,000
g. Expenditure to earn agricultural income	Rs. 1,00,000
h. Depreciation	Rs. 4,50,000

(This includes depreciation of Rs. 2, 00,000 on revaluation of assets)

(B) Items credited to P &L account:

a. Transfer from special reserve	Rs. 2,00,000
b. Agricultural income Rs.4,00,000	
c. Long term capital gains exempt u/s 10(38)	Rs. 2,00,000
4. Brought forward business loss as per books of account	Rs. 8, 00,000
5. Brought forward depreciation as per books of account	Rs. 7, 00,000

Solution:**Computation of Book Profit u/s 115JB**

Net profit as per P&L account		Rs.50, 00,000
Add: Provision for income tax	Rs. 6, 50,000	
Dividend distribution tax	Rs. 40,000	
Provision for deferred tax	Rs. 60,000	
Dividend declared	Rs. 2, 50,000	
Expenditure to earn agricultural income	Rs. 1, 00,000	
Depreciation	Rs. 4, 50,000	Rs. 15, 50,000
Less: Transfer from special reserve	Rs. 2, 00,000	
Agricultural income (exempt)	Rs. 4, 00,000	
LTTCG exempt u/s 10 (38) (liable to MAT)		
Depreciation Rs.(4,50,000 – 2,00,000)	Rs. 2, 50,000	Rs. 8, 50,000
		Rs. 57, 00,000
Less: B/f business loss or depreciation as per books of account, Whichever is less		Rs. 7, 00,000
	Book Profit	Rs. 50, 00,000

Computation of Tax Payable

(a) Tax on book profit Rs.50,00,000 @ 18.5%	Rs. 9,25,000
Add: Education cess @ 3 %	Rs. 27,750
	Rs. 9, 52,750
(b) Tax on total income Rs. 20,00,000 @ 25%	Rs. 5,00,000
Add: Education cess @ 3 %	Rs. 15,000
	Rs. 5, 15,000

Tax Payable (a) or (b), whichever is more

Tax credit to be credited forward Rs. (9, 52,750-5, 15,000) =Rs. **4, 37,750**

Numerical- 5:

From the following information compute tax payable by Z ltd for the A.Y. 2018-19.

1. Total income of the company for the P.Y.2017-18 Rs. 6,00,000
2. Book profit under section 115JB of the company for the P.Y. 2017-18 Rs.8,00,000
3. Carried forward credit under section 115JAA from the A.Y. 2017-18 Rs. 1,50,000

Solution:

Tax on total income of Rs. 6, 00,000 @25%		Rs. 1, 50,000
Add: Education cess @ 3 percent		Rs. 4,500
		(a) Rs154,500
Tax on book profit of Rs. 8, 00,000 @ 19.055%	(b)	Rs. 1, 52,440
MAT credit set-off (a-b)	(c)	Rs. 2060
Tax payable (a-c)		Rs. 1, 52,440
MAT Credit carried forward for the A.Y. 2018-19 (Rs. 1, 50,000-Rs. 2060)		Rs. 1, 47,940.



Check Your Progress-A

Q1. The business income of the assessee before claiming depreciation for the financial year 2017-18 is Rs. 15, 00,000. The book profit of the company as per provisions of section 115JB is Rs. 8, 00,000. The other details are as under:

- i. Current year depreciation Rs.2,80,000

ii.	Brought forward business loss	Rs. 8,00,000
iii.	Brought forward unabsorbed depreciation	Rs. 5,20,000

Compute the tax payable by the company for the assessment year 2018-19.

Q 2. The net profit as per the profit and loss account of R.ltd, a resident company, for the year ended 31.03.2018 is Rs 190 lacs arrived at after making the following adjustments:

- i. Depreciation on assets Rs. 100 lacs.
- ii. Reserve for currency exchange fluctuations Rs. 50 lacs.
- iii. Provision for tax Rs. 40 lacs.
- iv. Proposed dividend Rs. 120 lacs.

The following further information are also provided by company:

- a. Net profit includes Rs, 10 lacs received from a subsidiary company.
- b. Provision for tax includes Rs. 16 lacs of tax payable on distribution of profit and of Rs. 2 lacs of interest payable on income tax.
- c. Depreciation includes Rs. 40 lacs towards revaluation of assets.
- d. Amount of Rs. 50 lacs credited to profit and loss account was drawn from revaluation account.
- e. Balance of profit and loss account shown in balance sheet at the asset side as at 31.03.2017 was Rs. 30 lacs representing unabsorbed depreciation.

Compute the income of the company for the year ended 31.03.2018 liable to tax under MAT.

Q3. The accounts of R ltd. a domestic company prepared in accordance with the provisions of Part II and Part III of Schedule VI to the Companies Act, show the following position:

Profit before depreciation	Rs. 80 lacs
Less: Depreciation of the current year	Rs. 10 lacs
Net Profit	Rs. 70 lacs

The previous year of the company is the financial year ending 31.03.2018? The profit of Rs. 80 lacs includes Rs. 10 lacs qualifying for deduction under section 80-IA.

The profit computed in accordance with the provisions of the Income Tax Act is as under:

Profit before depreciation	Rs. 70 lacs
Less: Depreciation as per Income tax rules	Rs. 60 lacs
Balance	Rs. 60 lacs

The company is eligible to carry forward the following amounts from the assessment year 2017-18:

Unabsorbed Depreciation	Rs. 40 lacs
Business loss	Rs. 10 lacs

You are required to examine

- a. The application of section 115JB; and
- b. The eligibility for tax credit in the subsequent years.

Q4. From the assessment year 2018-19, a company has correctly worked out its book profit as per section 115JB as Rs. 12, 45,600. The total income computed as per the provisions is Rs. 2, 87,450. It desires to know how much has to be shown in the final accounts of the company as provision for taxation.

Q5. Following are the incomes of a domestic company for the year ended on 31.03.2018:

i. Business Profit	Rs. 4,20,000
ii. Dividend from an Indian public sector company(gross)	Rs. 10,000
iii. Dividend from an Indian Company whose 80 % income is agricultural income (Gross)	Rs. 9000
iv. Income from Mutual Fund(Gross)	Rs. 5000
v. Royalty received from a foreign concern for providing Technical knowledge	Rs. 16000
vi. Fee from an Indian company for technical advice	Rs. 12000
vii. Dividend from a foreign company	Rs. 8000
viii. Company has donated to National Rural Development Fund during the previous year	Rs. 8,800

Compute the total income of the company for the assessment year 2018-19. Find out the gross tax liability if the book profit of the company is Rs. 7, 00,000 u/s 115JB.

Q6. What are the positive adjustments made to the Net profit to arrive at Book profit?

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Q7. What are the negative adjustments made to convert the Net profit into Book profit?

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Q8. What are the powers of an assessing officer while computing the income under section 115 JB?

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Q9. What are the adjustments made to the net profit in respect of the following to arrive at the Book profit?

- a. Depreciation debited to profit & loss account.
- b. Amount withdrawn from reserves or provisions, if such amount is credited to the profit and loss account.
- c. Amount of income or loss in the case of units referred to in section 47 (xvii).
- d. Amounts carried to any reserves by whatever name called.
- e. The amount of deferred tax, if any such amount is credited to the profit and loss account.
- f. Income tax paid or payable and the provisions thereof.

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Q10. What do we mean by Tax Credit in respect of Minimum Alternate Tax?

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13.9 CASE LAWS

1. Held in the case of **Fascel Ltd.v. ITO [2008]117TTJ (Ahd.)891.**, Loss (before depreciation) as per the books of account of the assessee has to be considered, irrespective of the fact whether the same is allowable (or not) under section 79.
2. In the same case law, **Fascel Ltd.v. ITO [2008]117TTJ (Ahd.)891**, it was held that in arriving at book profit, lower of amount of brought forward loss or unabsorbed depreciation which is appearing in the books of account of assessee has to be allowed, irrespective of the fact whether or not the same is allowable under other provisions of the Income –tax Act.
3. It was held in the case, **Usha Marin Industries Ltd. v. CIT [2003] 81 TTJ (Cal.) 518**, provision for liability to pay wealth tax cannot be added back to net profit for computing book profit.
4. Prior period expense is not an item that can be deducted from profit in terms of any clauses covered by Explanation to section 115JA and, therefore the same cannot be allowed as deduction in MAT assessment as per case law – **Sree Bhagwathy Textiles Ltd. v. CIT [2011] 199 Taxman 14 (Ker.)**.
5. For purpose of computing book profits no adjustment can be made by way of reduction of interest on borrowed capital, which is not debited in profit and loss account—**CIT v. Avery Cycle Industries [2004] 89 ITD 497 (Chd.)**
6. In the case of **Syndicate Bank v.CIT [2006] 7 SOT 51 (Bang.)**, it was held that where entire income by way of interest on zero coupon bonds has not accrued to the assessee during relevant previous year, notional income by way of interest on zero coupon bonds is not liable to be included while computing book profits as per section 115JB.

13.9.1 MAT TAX RATE AT A GLIMPSE

CASES	TAX RATE	SURCHARGE	EDUCATION CESS	SHEC	EFFECTIVE TAX
Domestic companies with total income not exceeding 1 crore	18.5%	NIL	2%	1%	19.055%
Domestic companies with total income between 1 crore and 10 crore	18.5%	7 %	2%	1%	20.389%
Other Domestic companies	18.5%	12%	2%	1%	21.342%
Foreign companies with total income not exceeding 1 crore	18.5%	NIL	2%	1%	19.06%
Foreign companies with total income between 1 crore and	18.5%	2%	2%	1%	19.44%

10 crore					
Other foreign companies	18.5%	5%	2%	1%	20.01%

13.10 SUMMARY

Under the provisions of Minimum Alternate Tax Act, as per section 115JB:

- Every company domestic or foreign is required to pay MAT.
- The rule was made to ensure that no tax payer with substantial economic income gets to avoid significant tax liability on account of various exclusions, deductions and credits.
- It is a tax levied under Income Tax Act of India, 1961.
- The payment of Minimum Alternate Tax is only to be done by companies and this taxation concept is not applicable to individuals, HUF, partnership firms etc.
- The rules pertaining to section 115JA are applicable to foreign companies that derive profits as a result of operations in India.
- Under the Income Tax Act, 1961, all companies are liable to pay advance tax under section 115 JB of the Income Tax Act.
- The MAT credit can be understood as the difference between the tax calculated under general provisions of the Income Tax Act and that calculated under the MAT provisions of the Act.
- The MAT credit can be carried forward and set off for 10 consecutive assessment years succeeding the year in which the tax credit first accrued.(carry forward for 15 years is applicable from A.Y. 2018-19).
- All companies that are liable to pay MAT have to furnish a MAT report as prescribed in Form 29B. This report is to be submitted along with the ROI filed.
- The liability of the company is 18.5 per cent (+SC+EC+SHEC) of “book profit”.
- “Book Profit” as required for the computation of tax liability under minimum alternate tax is arrived after making specified adjustments to net profit as per profit and loss account.
- Tax on Domestic company under normal provisions :
 - a. When the turnover does not exceeds 50 crores, tax payable by the company is 25 percent of taxable income
 - b. If the turnover exceeds 50 crores, tax payable by the company is 30 percent of taxable income.



13.11 GLOSSARY

Domestic Company: A company that conducts its affairs in its home country. A domestic corporation is often taxed differently than a foreign corporation.

Foreign Company: A foreign company is any company or body corporate incorporated outside India which –a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and b) conducts any business activity in India in any other manner.

Financial Year: Financial year is the period between 1st April and 31st March in which we earn income.

Assessment Year: Assessment Year is the following year in which the income is assessed and taxed.

Provisions: Set aside an amount in an organization's accounts for a known liability.

Tax credit: A tax credit is an amount of money a tax payer is able to subtract from taxes owed to the government.

Long Term Capital Gain: A long term capital gain or loss is a gain or loss from a qualifying investment owned for longer than 12 months before it is sold. Long term Capital Gain arises if assets like shares and securities are held by the assessee for a period exceeding 12 months or 36 months in case of other assets.

Positive Adjustments: The adjustments to be added (if debited to the profit and loss account) to the Net profit as per normal provisions to arrive at the Book profit.

Negative Adjustments: The adjustments to be reduced from the Net profit as per the normal provisions.



13.12 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress –A

Answer1: Tax payable Rs. 1, 52,440 and unabsorbed depreciation to be carried forward Rs. 1, 00,000.

Answer2: Income liable to tax under MAT Rs. 3, 90, 00,000.

Answer3: Tax payable Rs. 11, 43,300. Tax credit as per the provisions of section 115JB shall be Rs. 11, 43,300.

Answer4: Tax payable under normal provisions Rs.74020. Tax payable under provisions of 115JB Rs. 2, 37,350. Tax credit of Rs. 1, 48,530 can be carried forward.

Answer5: Tax Payable: Rs. 1, 33,385/- (assumed turnover does not exceeds 50 crores), assume deduction regarding donation to N.R.D.F. has not been made in computing income. Hence deduct it.



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- Ahuja, Dr. Girish and Gupta, Dr. Ravi, *DIRECT TAXES Law & Practice* including *TAX PLANNING*, 26th Edition, Publication House- New Delhi; Bharat Law House Pvt. Ltd.
- Jain, Dr. R.K., *Income Tax Planning and Management*, SBPD publications.



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1. Student's Guide to *INCOME TAX* by "Dr. Vinod K. Singhania and Dr. Monica Singhania".
2. *Direct Taxes Ready Reckoner* by Dr. Vinod Singhania and Dr. Kapil Sighania.



13.15 TERMINAL QUESTIONS

- Q1.** What are the additions and subtractions to be made to the Net profit to arrive at Book Profit?
- Q2.** Explain how and when tax credit is allowed in respect of MAT paid by a company?

Corporate Tax Planning

MS 401



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MS 401

School of Management Studies and Commerce
Corporate Tax Planning



Block III Tax Planning in Functional Management

Block IV Tax Management

Corporate Tax Planning



Block – III

Block Title- Tax Planning in Functional Management

Block – IV

Block Title- Tax Management

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The provisions as applied in this SILM are only indicative. Therefore, these provisions do not correspond to the current or relevant Assessment Years, rather the Assessment Year used is only indicative and the learners are advised to make suitable changes corresponding to the particular Assessment Year being attempted. Learners are also advised to refer to <https://www.incometaxindia.gov.in/pages/tax-laws-rules.aspx> for the Assessment Year being followed.

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Course Name: Corporate Tax Planning

Course Code-MS 401

Course Objective: This course aims at making students conversant with the concept of the corporate tax planning and Indian tax laws, as also their implications for corporate management.

Block I Basics of Tax Planning and Management

Unit I Nature and Scope of Tax Planning and Management

Unit II Income from Salary

Unit III Tax Planning-Salary

Unit IV Income from House Property and Tax Planning

Unit V Profits and Gains from Business or Profession

Unit VI Tax Planning and Profits and Gains from Business or Profession

Block II Tax Planning and Assessment of Individual and Firms

Unit VII Income from Capital Gains and Tax Planning

Unit VIII Income from Other Sources and Tax Planning

Unit IX Assessment of Individuals and Firms

Unit X Set off and Carry Forward of Losses and Clubbing of Income

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Block III Tax Planning in Functional Management

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Block IV Tax Management

Unit XIX Special Tax Provisions

Unit XX Tax Planning in respect of amalgamation or de-merger of companies

Unit XXI Corporate failure and contraction

Unit XXII Tax implication of foreign collaboration agreements

Unit XXIII Tax Management

Unit XXIV Non-Resident Taxation and Tax Management

Suggested Readings:

1. E.A. Srinivas, Corporate Tax Planning, Tata McGraw Hill.
2. Vinod K. Singhania, Taxmann's Direct Taxes Planning and Management.
3. V.S. Sundaram, Commentaries on the Law of Income- Tax in India, Law Publishers, Allahabad.
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Block III
Tax Planning in Functional Management

UNIT 14 TAX PLANNING AND CORPORATE STRATEGIES

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14.2 Objectives

14.3 Concept of Tax Planning

14.4 Tax Planning, Tax Avoidance and Tax Evasion

14.5 Corporate Tax Planning

14.6 Objectives of tax planning in framing corporate strategies

14.7 Tax planning for corporate planning

14.8 Importance of corporate tax planning

14.9 Summary

14.10 Glossary

14.11 Answer to Check Your Progress

14.12 Reference/ Bibliography

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14.14 Terminal & Model Questions

14.1 INTRODUCTION

In this unit, you will study about tax planning and its significance in devising different corporate strategies.

14.2 OBJECTIVES

After reading this unit you will be able to:

- Understand corporate tax planning, tax evasion and tax avoidance.
- Understand objectives and importance of corporate tax planning.

14.3 CONCEPT OF TAX PLANNING

Tax Planning is undertaken to minimize tax liability through the best use of all available allowances, deductions, exclusions, exemptions, etc., to reduce income and/or capital gains. Tax planning is defined as an arrangement of one's financial and business affairs by taking legitimately in full benefit of all deductions, exemptions, allowances and rebates so that tax liability reduces to minimum.

The Hon'ble Supreme Court in *McDowell & Co. v. CTO* (1985) 154 ITR 148 has observed that “*tax planning maybe legitimate provided it is within the framework of the law. Colorable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid payment of tax by resorting to dubious methods.*”

All transactions in respect of tax planning must be in accordance with the true spirit of statute and should be correct in form and substance. Various judicial pronouncements have laid down the principle that substance and form of the transactions shall be seen in totality to determine the net effect of a particular transaction. The form and substance of a transaction is real test of any tax-planning device. The form of transaction refers to transaction, as it appears superficially and the real intention behind such transaction may remain concealed. Substance of a transaction refers to lifting the veil of legal documents and ascertaining the true intention of parties behind the transaction.

14.4 TAX PLANNING, TAX AVOIDANCE AND TAX EVASION

In India the tax laws are complicated because of various deductions, exemptions, relief and rebates. Therefore, the taxpayers generally plan their affairs so as to attract the least incidence of tax. However, the complexity of taxes makes the practice of avoidance a worldwide phenomenon and leads to a continuing battle in this regard between the taxpayer and the tax collector. The taxpayer and the tax collector have different perceptions regarding this. The taxpayer spares no efforts in maximizing his profits and attracting the least incidence. The tax collector, on the other hand, tries to break the plans whose sole objective is to save taxes.

In the context of saving tax, there are three commonly used practices, namely

(a) Tax Evasion; (b) Tax Avoidance ;(c) Tax Planning.

(a) Tax Evasion

It refers to a situation where a person tries to reduce his/her tax liability by deliberately reducing the reported revenue or by inflating the expenditure showing the income lower than what the actual income is and resorting to various types of deliberate manipulations.

An assessee guilty of tax evasion is punishable under the relevant laws in the country. Tax evasion may involve stating an untrue statement knowingly, submitting misleading documents, suppression of facts, not maintaining proper accounts of income earned (if

required under the law) omission of material facts in assessments. An assessee who dishonestly claims the benefit under the statute by making false statements, would be guilty of tax evasion. Tax evasion is a method of evading tax liability by dishonest means like suppression, showing lower incomes, conscious violation of rules, inflation of expenses etc. A tax evader has to pay not only penalty but he also incurs the risk of being prosecuted.

Tax evasion can never be construed as tax planning because it amounts to breaking of law whereas tax planning is devised within the legal framework by availing of what the legislature provides. Tax planning ensures not only accrual of tax benefits within the four corners of law but it also ensures that tax obligations are properly discharged so as to avoid penal provisions.

(b) Tax Avoidance

The line of demarcation between tax planning and tax avoidance is very thin and blurred. There could be elements of deceit involved in tax avoidance. It is usually done by taking full advantage of loopholes adjusting the affairs in such a manner that there is no infringement of taxation laws and least taxes are attracted. Earlier tax avoidance was considered completely legitimate, but at present it may be illegitimate in certain situations.

In the judgement of the Supreme Court in McDowell's case 1985 (154 ITR 148) SC, tax avoidance has been considered as heinous as tax evasion and a crime against society. Most of the amendments are now aimed at curbing practice of tax avoidance. In this case, Supreme Court observed – *“We think time has come for us to depart from Westminster principle.....tax planning may be legitimate provided it is within the framework of law. Colorable devices cannot be part of tax planning and it is wrong to encourage and entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay honestly without resorting to subterfuges.”*

The type of cases that come under ‘Tax avoidance’ are those where the tax payer has apparently circumvented the law (without giving rise to an offence) by using a scheme, arrangement or device though of a complex nature with the main or sole purpose of deferring, reducing or completely avoid the tax payable under the law.

Sometimes, the avoidance is accomplished by shifting the liability for tax to other person not at arm's length in whose hands the tax payable is reduced or eliminated. According to G.S.A. Wheat Craft, “tax avoidance is the act of dodging tax without actually breaking the law”. It is a method of reducing incidence of tax by taking advantages of certain loopholes of tax laws. The Royal Commission on Taxation for Canada has explained the concept of tax avoidance as under :

“For our purposes the expression “Tax Avoidance” will be used to describe every attempt by legal means to prevent or reduce tax liability which would otherwise be incurred, by taking advantage of some provisions or lack of provisions of law. It excludes fraud, concealment or other illegal measures”.

(c) Tax Planning

Tax Planning means arranging the financial activities in such a way that maximum tax benefits are enjoyed by making use of all beneficial provisions in the tax laws which entitle the assessee to get certain rebates and reliefs. Thus, tax planning implies compliance with the taxation provisions in such a manner that full advantage is taken of all tax exemptions, deductions, concessions, rebates and reliefs permissible under the Income Tax Act so that the incidence of tax is the least.

Tax planning can neither be equated to tax evasion nor to tax avoidance. It is the scientific planning of the assessee's operations to minimize, postpone or defer the tax liability by availing various incentives, concessions, allowances, rebates and reliefs provided for in the tax laws. They are meant to be availed of and they have certain clear objectives to achieve. Tax planning is regarded as a method of intelligent application of expert knowledge of planning a person's affairs with a view of securing consciously provided tax benefits on the basis of the national priorities in consonance with the interests of the State and the public. Flexibility should be considered as the most practical feature in a tax system. While planning a scheme relating to tax affairs, tax planner need to assure that tax planning device does not lose its efficiency due to changes in law. It would be a short-sighted perspective to think of a planning device that is in conformity with the law as it exists, but gets nullified by a subsequent change in law specially where the change is of a retrospective nature. Hence, the tax plan has to be flexible in nature and the planner has to comprehend about the future scenario too while devising a plan to save tax.

***Check Your Progress-A***

Q1. State the difference between tax avoidance and tax planning.

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Q2. State the difference between tax evasion and tax planning.

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14.5 CORPORATE TAX PLANNING

Corporate tax planning is a means of reducing tax liabilities on a registered company. The common ways to do this includes taking deductions on business transport, health insurance of employees, office expenses, retirement planning, child care, charitable contributions etc. Through the various tax deductions and exemptions provided under the Income Tax Act, a company can substantially reduce its tax burden in a legal way. Once again, tax planning should not be confused with tax avoidance and all the planning should be done within the framework of law.

Increasing profits for a company results in higher tax liabilities. As such, it becomes imperative for them to devote enough time on tax planning to reduce the liabilities. With proper tax planning, the direct tax and indirect tax burden is reduced at times of inflation. It also assists in proper planning of expenses, capital budget and sales and marketing costs, among others. A good tax planning results out of:

Disclosing correct information to relevant IT departments.

Not being ignorant of applicable tax laws as well as court judgements regarding the same.

Legal tax planning should be done which is under the purview of law.

Planning must be done with business objectives in mind and should be flexible enough to incorporate possible changes in the future.

14.6 OBJECTIVES OF TAX PLANNING IN FRAMING CORPORATE STRATEGIES

Tax planning, is honest and rightful approach to the attainment of maximum benefits of the taxation laws within their framework. Therefore, the objectives of tax planning cannot be regarded as violating any concept of the taxation laws and subject to reprehension of reducing the inflow of revenue to the Government's coffers, so long as the tax planning measures are in conformity with the statute laws and the judicial expositions thereof.

The basic objectives of tax planning are:

- (a) Reduction of tax liability
- (b) Minimization of litigation
- (c) Productive investment
- (d) Healthy growth of economy
- (e) Economic stability

14.6.1 REDUCTION OF TAX LIABILITY

A tax payer can derive the maximum savings by arranging his affairs in accordance with the requirements of law, as contained in the fiscal statutes. In many cases, a taxpayer may suffer heavy taxation amounts not on account of the rates of tax administered by the Act, but, because of his/her lack of awareness of the legal requirements. Since every taxpayer wishes to retain a maximum part of his earnings, rather than parting with it and facing the resource crunch, it would be to his/her benefit to plan his/her tax affairs properly and avail the deductions and exemption admissible under the Act (s). He/She can succeed in doing so by being aware of the implications of the various business/other transactions and the various concessions for which he is eligible.

14.6.2 MINIMIZATION OF LITIGATION

A general visualization of the tax administration scenario depicts a tug-of-war between the tax payers and tax collectors with the tax payers on one hand trying their maximum to pay the least tax and on the other hand, the tax collectors attempting to extract the maximum amount of tax from them. This may at times result in protracted litigations between the two. It is in this context that a good tax planning is very beneficial. Where a proper tax planning is adopted by the tax payer in conformity with the provisions of the taxation laws, the incidence of litigation is minimized. This saves him/her from the hardships and inconveniences caused by the unnecessary litigations, which at times may stretch upto the levels of High/Supreme Court.

14.6.3 PRODUCTIVE INVESTMENT

Channelization, of taxable income to the various investment schemes is one of the prime objectives of tax planning as it is aimed to attain twin-objectives of : (i) harnessing the resources for socially productive projects, and, (ii) relieving the tax payer from the burden of taxation, converting the earnings into means of further earnings. Legal awareness of the avenues so provided by the Government negates the need of avoidance/evasion of tax and lend authenticity to the investments made.

14.6.4 HEALTHY GROWTH OF ECONOMY

The growth of a nation's economy is synonymous with the growth and prosperity of its citizens. In this context, a saving of earnings by legally sanctioned devices fosters the growth of both. Tax-planning measures are aimed at generating white money having a free flow and generation without reservations for the overall progress of the nation. On the other hand, savings by dubious means lead to generation of black money, the evils of which are obvious. Tax planning thus assumes a great significance in this context.

14.6.5 ECONOMIC STABILITY

In the context of the case, *M.V.Valliapanv. ITO, (1988) 170 ITR 238 (Mad.)*, by a proper tax planning, a smooth flow without any recriminations of taxes ensured is between the tax payer and the tax administrator. This results in economic stability by way of: (i) availing of avenues

for productive investments by the tax payers and, (ii) harnessing of resources for national projects aimed at general prosperity of the national economy and (iii) reaping of benefits even by those not liable to pay tax on their incomes.

14.7 TAX PLANNING FOR CORPORATE PLANNING

The tax planning exercise ranges from devising a model for specific transaction as well as for systematic corporate planning. These are:

- (a) Short-range and long-range tax planning.
- (b) Permissive tax planning.
- (c) Purposive tax planning.

14.7.1 SHORT-RANGE PLANNING & LONG-RANGE PLANNING

Short-range planning refers to year to year planning to achieve some specific or limited objective. For example, an individual assessee whose income is likely to register unusual growth in particular year as compared to the preceding year, may plan to subscribe to the PPF/NSC's within the prescribed limits in order to enjoy substantive tax relief. By investing in such a way, he/she is not making permanent commitment but is substantially saving in the tax. It is one of the examples of short-range planning. Long-range planning on the other hand, involves entering into activities, which may not pay-off immediately. For example, when an assessee transfers his/her equity shares to his/her minor son he/she knows that the Income from the shares will be clubbed with his own income. But clubbing would also cease after minor attains majority.

14.7.2 PERMISSIVE TAX PLANNING

Permissive tax planning is tax planning under the expressed provisions of tax laws. Tax laws of our country offer many exemptions and incentives.

14.7.3 PURPOSIVE TAX PLANNING

Planning taxes with a particular objective in mind is known as purposive tax planning. Purposive tax planning is based on the measures which circumvent the law. The permissive tax planning has the express sanction of the Statute while the purposive tax planning does not carry such sanction. For example, under Sections 60 to 65 of the Income-tax Act, 1961 the income of the other persons is clubbed in the income of the assessee. If the assessee is in a position to plan in such a way that these provisions do not get attracted, such a plan would

work in favor of the tax payer because it would increase his disposable resources. Such a tax plan could be termed as 'Purposive Tax Planning'.



Check Your Progress-B

Q1. An individual saving in PPF is doing which type of tax planning?

Q2. If the company does tax planning as per the legal framework, it is doing which type of tax planning?

14.8 IMPORTANCE OF CORPORATE TAX PLANNING

Tax planning is considered very important on account of the following factors:

- Tax planning exercise is more reliable since the Companies Act, 2013 and other allied laws narrow down the scope for tax evasion and tax avoidance techniques, driving a taxpayer to a situation where he/she will be subjected to severe penal consequences in such cases.
- Presently, companies are supposed to promote those activities and programmes, which are of public interest and good for a civilized society. In order to encourage these, the Government has provided them with incentives in the tax laws. Hence a planner has to be well versed with the law concerning incentives.
- With increase in profits, the quantum of corporate tax also increases and it necessitates the devotion of adequate time on tax planning.
- Tax planning enables a company to bear the burden of both direct and indirect taxation during inflation. It enables companies to make proper expense planning, capital budget planning, sales promotion planning etc.
- Capital formation helps in replacing the technologically obsolete and outdated plant and machinery and enables the carrying on of manufacturing operation with a new and more sophisticated system and the need for capital formation in the corporate sector cannot be ignored. However, heavy taxation reduces the inflow of corporate funds which could otherwise be used for capital formation, repairs, renewals,

modernization or replacement of plant and machinery. Proper implementation of tax planning techniques assist companies in taking rational decisions related to aforementioned activities thereby helping them in saving tax.

- In these days of credit squeeze and dear money conditions, even a rupee of tax decently saved may be taken as an interest-free loan from the Government, which perhaps, an assessee need not repay.

14.9 SUMMARY

Tax Planning is undertaken to minimize tax liability through the best use of all available allowances, deductions, exclusions, exemptions, etc., to reduce income and/or capital gains. Tax planning is defined as an arrangement of one's financial and business affairs by taking legitimately in full benefit of all deductions, exemptions, and allowances and rebates so that tax liability reduces to minimum. The line of demarcation between tax planning and tax avoidance is very thin and blurred. There could be elements of deceit involved in tax avoidance. It is usually done by taking full advantage of loopholes adjusting the affairs in such a manner that there is no infringement of taxation laws and least taxes are attracted. Earlier tax avoidance was considered completely legitimate, but at present it may be illegitimate in certain situations. Tax evasion can never be construed as tax planning because it amounts to breaking of law whereas tax planning is devised within the legal framework by availing of what the legislature provides. Tax planning ensures not only accrual of tax benefits within the four corners of law but it also ensures that tax obligations are properly discharged so as to avoid penal provisions. Corporate tax planning is a means of reducing tax liabilities on a registered company. The common ways to do this includes taking deductions on business transport, health insurance of employees, office expenses, retirement planning, child care, charitable contributions etc. The basic objectives of tax planning are reduction of tax liability, minimization of litigation, productive investment, healthy growth of economy and economic stability. The tax planning exercise ranges short-range and long-range tax planning to permissive tax planning to purposive tax planning. It is very important for companies to do tax planning so that they can devise successful strategies.



14.10 GLOSSARY

Tax Planning - Tax planning is defined as an arrangement of one's financial and business affairs by taking legitimately in full benefit of all deductions, exemptions, allowances and rebates so that tax liability reduces to minimum.

Tax Evasion-It refers to a situation where a person tries to reduce his/her tax liability by deliberately reducing the reported revenue or by inflating the expenditure showing the income lower than what the actual income is and resorting to various types of deliberate manipulations.

Tax Avoidance- It is usually done by taking full advantage of loopholes adjusting the affairs in such a manner that there is no infringement of taxation laws and least taxes are attracted.



14.11 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress –B

Q1. Ans. Short term tax planning

Q2. Ans. Permissive tax planning



14.12 REFERENCES

- Singhania, Monica &Singhania, Vinod K. Corporate Tax Planning & Business Tax Procedures with Case Studies, Taxmann, 2016.
- http://220.227.161.86/18890sm_dtl_finalnew_cp14.pdf, www.icai.org/?page_id=5777, accessed in May, 2017.
- www.icsi.edu, accessed in May, 2017.



14.13 SUGGESTED READINGS

1. Singhanian, Monica &Singhanian, Vinod K. Corporate Tax Planning & Business Tax Procedures with Case Studies, Taxmann, 2016.
2. Gupta, Ravi &Ahuja, Girish. Simplified approach to Corporate Tax Planning & Management, Wolters &Kluwers, 2017.



14.14 TERMINAL QUESTIONS

- Q1. “Tax evasion, tax avoidance and tax planning are synonymous terms.”
Discuss the statement.
- Q2. Discuss the objectives of corporate tax planning.
- Q3. Explain the importance of tax planning in framing corporate strategies.

UNIT 15 TAX PLANNING AND MANAGERIAL DECISIONS

15.1 Introduction

15.2 Objectives

15.3 Areas of Tax Planning

15.4 Setting up and commencement of business

15.5 Form of the organisation

15.6 Locational aspects

15.7 Nature of Business

15.8 Tax Planning relating to corporate restructuring

15.9 Tax Planning relating to financial management decisions

15.10 Tax Planning for Indian collaborators

15.11 Tax Planning for employees

15.12 Organization of Tax Planning cells

15.13 Summary

15.14 Glossary

15.15 Answer to Check Your Progress

15.16 Reference/ Bibliography

15.17 Suggested Readings

15.18 Terminal & Model Questions

15.1 INTRODUCTION

In the last unit, you studied about tax planning and its significance in devising different corporate strategies. In this unit, we will study several aspects of tax planning and managerial decisions.

15.2 OBJECTIVES

After reading this unit you will be able to:

- Understand corporate tax planning for managerial decision making
- Understand different areas where tax planning could be incorporated by the manager

15.3 AREAS OF TAX PLANNING

Managers need to look at several aspects of tax planning while taking decisions. Some of the important areas of tax planning in the context of Income Tax Act, 1961 are as under:

- (a) Setting up and commencement of a business
- (b) Form of organization/ownership pattern;
- (c) Locational aspects;
- (d) Nature of business.
- (e) Tax planning in respect of corporate restructuring;
- (f) Tax planning in respect of financial management;
- (g) Tax planning for Indian Collaborators
- (h) Tax planning in respect of employees;

Managers can take advantage of these and make their decisions more effective and efficient.

15.4 SETTING UP AND COMMENCEMENT OF BUSINESS

Setting up a business within the scope of the Income Tax Act is a particular point to be considered for the purpose of tax planning strategy. It is different from the commencement of business. The company may be incurring certain expenditure of revenue nature during the intervening period after setting up and before the commencement of business (production). It is provided in the tax laws that the general expenses prior to the date of setting up are inadmissible but those incurred from the date of setting up and before the commencement of the business may be allowed as deduction for tax purposes provided they are of revenue nature and are incurred wholly and exclusively for the purpose of business.

All the activities which make up the business need not be started simultaneously in order that the business may commence. The business would commence when the activity which is first in point of time and which must necessarily precede all other activities is started.

15.5 FORM OF THE ORGANISATION

The first aspect of setting up of new business entity is deciding the form of organization/ownership pattern. The selection of particular form of organization depends not only on the magnitude of financial requirements and owner's liability, but also on the tax considerations. In the case of a company, the law interferes with the corporate planning process from the moment it comes into existence. At times, tax laws affect even the periods prior to the existence of a company and it can also extend upto the point of time when the company ceases to exist. For example, a director of a private limited company in liquidation, has to keep in view the provisions of Sections 178 and 179 of the Income Tax Act, 1961 dealing with misfeasance etc. Normally, depending upon the level of operation, expected profitability need for external financing and expected requirements of technical expertise, a suitable form can be chosen. But in view of the continuity of business, the benefits arising out of limited liability, organized accounting and the overall long-term tax benefits flowing to the company form of organization, the corporate enterprise may be regarded as an effective instrument of tax planning. The company being a separate legal entity, confers certain valuable benefits in the matter of tax planning to its shareholders and the persons connected with the management of the company.

Tax liability is an important consideration guiding the choice of a legal form of business organization.

The important tax privileges and advantages to a company over the other forms can be summarized as under:

- I. The provisions relating to clubbing of income under Section 64 of the Income Tax Act, 1961 do not apply even if the business is carried on by family members through a company. This ultimately leads to reduction of tax liability on the part of the individual members. However, if spouse of an individual having a substantial interest in a company receives remuneration from the same company, such remuneration is added to the income of the individual unless the spouse is technically or professionally qualified. [Section 40A(2)(b) of the Income Tax Act, 1961].
- II. Companies are subjected to flat rate of tax, regardless of the quantum of their income. The domestic companies now pay tax @ 30% plus surcharge @ 7% (surcharge is applicable if their total income exceeds Rs.1 Crore but does not exceed Rs. 10 Crore, if it exceeds Rs. 10 Crore then surcharge @ 12%), if applicable and education cess @ 3%. The rate of tax for domestic company shall be 29% of the total income (plus SC + SHEC) if the total turnover or gross receipts of the company in the previous year 2015-16 does not exceed 5 crores rupees. This, however, may not seem to be an advantage in view of low slab rates applicable to sole proprietorships, but when we look at the total incidence of tax after taking into account the various deductions allowed to companies and the scheme of perquisites, the real owners of companies stand to benefit.
- III. In order to provide relief to newly setup domestic companies engaged solely in the business of manufacture or production of article or thing, a new section 115BA was

inserted to provide that the income tax payable in respect of the total income of a domestic company for any previous year relevant to the assessment year beginning on or after the 1st day of April, 2017 shall be computed @ 25% at the option of the company, if, -(a) the company has been setup and registered on or after 1st day of March, 2016 and is engaged in the business of manufacture or production of any article or thing and is not engaged in any other business;(b) the company while computing its total income has not claimed any benefit under section 10AA, benefit of accelerated depreciation, benefit of additional depreciation, investment allowance, expenditure on scientific research and any deduction in respect of certain income under Part-C of Chapter-VI-A other than the provisions of section 80JJAA; and(c) the option is furnished in the prescribed manner before the due date of furnishing of income.

- IV. There are certain special tax concessions, allowances and deductions given under the Income Tax Act, 1961 available to the company form of business enterprises such as deductions allowed under Section 33AC and Sections 36(1)(ix) and 35D of the Income Tax Act, 1961 etc.
- V. Incorporation of a company has the incidental advantage of attracting large capital since the shareholder, who has to contribute only a miniscule part of the capital requirement, is assured of limited liability and free transferability of his shares. Those shares in companies are treated as long-term capital assets qualifying for considerable leniency in taxation even if they are held by the assessee for a small time of 12 months. This has made investment in the shares of companies all the more attractive and helps the companies to generate the funds required for their development as well as furtherance of their objects.

A company includes one Person Company, small companies, dormant company, etc. A company is regarded as a separate legal entity. The minimum limit does not apply in its case. It is required to pay tax on every rupee of its income. Besides the usual income tax at the flat rate prescribed by the respective Finance Acts, whatever amount of tax is paid by a company is not deemed to have been paid on behalf of the shareholders. Therefore, no rebate is allowed to shareholders in this regard as is the practice in advanced countries.

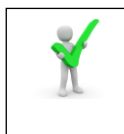
The relative tax burden of conducting business can be assessed by paying attention to the provisions of the Income-tax Act, 1961, Income-tax Rules, 1962 and various other notifications and circulars issued from time to time by the concerned authorities.

15.6 LOCATIONAL ASPECTS

Tax planning is relevant from location point of view. There are certain locations which are given special tax treatment. Some of them are as under:

- I. Full exemption under Section 10A for ten years in the case of a newly established industrial undertaking in free trade zones, etc. [Not allowed w.e.f. A.Y. 2012-13].

- II. Full exemption under Section 10AA for initial five years, 50% for subsequent five years and further deduction of 50% for a further period of five years in the case of a newly established units in special economic zones on or after 1.4.2005.
- III. Full exemption under Section 10B for 10 years in the case of a newly established 100% export-oriented undertaking. [Not allowed w.e.f. 2012-13].
- IV. Deduction under Section 80-IAB in respect of profits and gains by an undertaking or an enterprise engaged in the development of Special Economic Zone.
- V. Deduction under Section 80-IB in the case of profits and gains from certain industrial undertaking other than infrastructure development undertaking.
- VI. Deduction under Section 80-IC in case of certain undertaking or enterprises in certain special category States.
- VII. Deduction under Section 80-ID in respect of profits and gains from business of hotels and convention centers in specified area.
- VIII. Deduction under Section 80-IE in respect of certain undertakings in North-Eastern States.



Check Your Progress-A

State if the following statements are True or False:

- Q1.** The selection of particular form of organization depends not only on the magnitude of financial requirements and owner's liability, but also on the tax considerations.
- Q2.** Companies are subjected to flat rate of tax, regardless of the quantum of their income.
- Q3.** Incorporation of a company has the incidental advantage of attracting small capital since the shareholder, who has to contribute only a miniscule part of the capital requirement, is assured of unlimited liability and restricted transferability of his shares.
- Q4.** Full exemption is not given in the case of a newly established industrial undertaking in free trade zones.

15.7 NATURE OF BUSINESS

Tax planning is also relevant while deciding upon the nature of business. There are certain businesses which are granted special tax treatment. Some of them are as follows:

- I. Newly established units in special economic zones [Section 10AA].

- II. Tea Development Account, Coffee Development Account and Rubber Development Account [Section 33AB], Site restoration fund [Section 33ABA].
- III. Specified business eligible for deduction of Capital Expenditure [Section 35AD], Amortization of certain preliminary expenses [Section 35D], Expenditure on prospecting for certain minerals [Section 35E].
- IV. Special reserve created by a financial corporation under Section 36(1)(viii).
- V. Special provision for deduction in the case of business for prospecting for mineral oil [Sections 42 and 44BB], Special provisions for computing profits and gains of business on presumptive basis [Section 44AD], Special provisions in the case of business of plying, hiring or leasing goods carriages [Section 44AE], Special provisions in the case of shipping business in the case of non-residents [Section 44B], Special provisions in the case of business of operation of aircraft [Section 44BBA], Special provisions in the case of certain turnkey power projects [Section 44BBB], Special provisions in the case of royalty income of foreign companies [Section 44D], Special provisions in case of royalty income of non-residents [Section 44DA].
- VI. Certain income of offshore Banking Units and international Financial Service Centre [Section 80-LA].
- VII. Profit and gains of industrial undertakings or enterprises engaged in infrastructure development, etc. [Section 80-IA], Profits and gains of an undertaking or an enterprise engaged in development of Special Economic Zone. [Section 80-IAB], Profits and gains from certain industrial undertaking other than infrastructure development undertaking [Section 80-IB], Special provisions in respect of certain undertakings or enterprises in certain special category States [Section 80-IC], Deduction in respect of profits and gains from business of hotels and convention centers in specified area or a hotel at world heritage site. [Section 80-ID], Special provisions in respect of certain undertakings in North-Eastern States. [Section 80-IE].
- VIII. Profits and gains from the business of collecting and processing of bio-degradable waste [Section 80JJA], Employment of new workmen [Section 80JJAA].
- IX. Special tax rate under Sections 115A, 115AB, 115AC, 115AD, 115B, 115BB, 115BBD, 115BA and 115D.

15.8 TAX PLANNING RELATING TO CORPORATE RESTRUCTURING

The following suggestions could be useful for tax planning in respect of amalgamation merger, demerger, etc.

1. Since the unabsorbed losses and unabsorbed depreciation cannot be allowed to be carried forward or set off in the hands of the amalgamated company, except in the cases prescribed under Section 72A of the Act, it is suggested: (a) that the scheme of the amalgamation can be put off till such time the full benefit of set off is availed of by the amalgamating company; and

(b) that the loss carrying company should absorb or take over the business of the profit-making company. In other words, the profit-making company should merge itself with the loss incurring company. This would help in carrying forward the benefits of all unabsorbed losses and depreciation for set off against the profits derived from the business of the profit-making company.

2. To save from disallowance of the debts of the amalgamating company which subsequently become bad in the hands of the amalgamated company, the amalgamated company should plan to make suitable provision for the expected losses on account of bad debts at the time of fixing the consideration while taking over the business of the amalgamating company.

3. A company whose shares are not quoted on a recognized stock exchange may avail the benefit of amalgamation by amalgamating itself with another company whose shares are quoted on a recognized stock exchange. This would help shareholders of unlisted company to take the advantage of the quoted price of their shares in the stock exchange.

4. A company holding investments in immovable properties may avail the benefit of non-applicability of the provisions of the Urban Land Ceiling Act by amalgamating itself with an industrial company.

5. A loss incurring company and a profit-making company may merge in order to reduce the overall incidence of liabilities to tax under the Income Tax Act, 1961.

6. In case the conditions provided under Sections 2(1B) and 72A of the Act are not satisfied, it may be suggested that the profit making company should merge itself with the loss making company, so that the loss making company does not lose its existence and enjoys all other benefits.

7. Under Section 2(1B) of the Act, it is provided that for availing the benefits of amalgamation, at least 75% of the shareholders of the amalgamating company should become shareholders of the amalgamated company. In case more than 25% of the shareholders are not willing to become shareholders of the amalgamated company, it is proposed that the amalgamating company may persuade the other shareholders who may be willing, to purchase the shares in the amalgamated company to acquire the shares of the remaining shareholders so that the percentage of dissenting shareholders does not exceed 25%. Alternatively, the amalgamated company prior to, amalgamation, may purchase shares from such dissenting shareholders so as to make such dissenting shareholders to go below the specified percentage of 25%.

There is a recent trend of going in for reverse merger. It means that the profit-making company merges into the sick company thereby becoming eligible to carry forward of losses etc. without the aid of Section 72A of the Act. The profit making or healthy company extinct and lose its name and the surviving sick company retains its name. It is actually, device of bypassing merger under Section 72A of the Act and has become popular now a day. Invariably soon after the merger or after a year or so, the name of the company is changed to accord with that of

the profit-making amalgamating company in this way two birds are killed with one stone because: (1) Losses are carried forward, which would otherwise have not been possible; (2) Goodwill, which consists, in the name of the profit-making amalgamating company, is also retained.

The same route was followed, among others, by Kirloskar Pneumatics Ltd. where the company merged with Kirloskar Tractors Ltd., a sick unit and initially lost its name but after one year it changed its name as was prior to merger. However, it remains to be seen whether the Parliament/Judiciary views this kind of strategy as an exercise resulting in tax-avoidance or not? But, right now, this is not required in view of changes done in Section 2 (1B) and 72A of the Act.

15.9 TAX PLANNING RELATING TO FINANCIAL MANAGEMENT DECISIONS

When a company raises long term loans from financial institutions or by way of public issue of debentures or inviting deposits from the public, it should plan that the expenses incurred on such issues of debentures or expenses towards stamp duty, registration fees, and lawyer's fees should be incurred only after the date of the 'setting-up' of the business. The interest on loan paid before the commencement of production but after setting up of the business on the loans taken by the company for the acquisition of its plant and machinery and other assets, forms part of the actual cost of the asset and it should be capitalized in actual cost of asset. Thus, the company would be allowed to capitalize the expenditure and claim a higher depreciation and investment allowance.

The company should also plan the optimum use of the share capital and the borrowed funds. The borrowings should be utilized as far as possible for the acquisition and installation of assets like, buildings, plant and machinery so that interest could for the period after setting up of the acquired assets but before the commencement of production could be capitalized. The interest and higher amount of depreciation (due to capitalization of expense) may be claimed as revenue expenditure pertaining to the business of the company. The company should also plan to purchase the depreciable assets on credit terms and an agreed amount of interest can be paid on such credit purchases or the company may purchase these company assets on the basis of the hire purchase agreement enabling the company to claim the amount of interest paid as revenue business expenditure. The company would also be entitled to claim either the depreciation for use of the asset or may treat the hire charges as the rent for the asset in the normal course of business and claim deduction on revenue account.

The following table will help the finance manager framing suitable plans relating to capital structure:

	<i>Capital</i>	<i>Borrowings</i>
(a) Dividend/Interest	Not deductible	Fully deductible

(b) Cost of raising finance	1/5th allowed under Section 35D	Fully deductible in first year.
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Taking the same sources of finance, the comparison between pre-commencement period and post commencement period is as follows:

(a) (i) Dividend is not deductible either for pre-commencement period or in the post-commencement period in India.

(ii) Interest is capitalized for pre-commencement period, i.e. added to the cost of project' (cost of fixed assets) and its depreciation is calculated on capitalized value of assets. In post-commencement period, interest is fully deductible.

(b) (i) Cost of raising finance in case of capital is not deductible as revenue expenditure but amortized under Section 35D of the Act. If such expenditure is incurred after the commencement of the business. Section 35D is applicable, provided the expenditure is undertaken for expansion purposes in case of industrial undertaking.

(ii) Cost of borrowing funds in case of pre-commencement period is capitalized and in case of post commencement period, it is deductible fully in the year.

The above consideration goes a long way in suggesting the managements of corporate entities to adopt a suitable capital structure and selecting the appropriate financing sources by providing an optimum capital mix for the organization.

Other kind of decisions which can be taken considering tax include

- Make or buy,
- Own or lease,
- Retain or replace,
- Export or domestic sale,
- Shut down or continue,
- Expand or contract.



Check Your Progress-B

State if the following statements are True or False:

Q1. There are certain businesses which are granted special tax treatment like sole proprietorships.

Q2. A loss incurring company and a profit-making company may not merge in order to reduce the overall incidence of liabilities to tax under the Income Tax Act, 1961.

15.10 TAX PLANNING FOR INDIAN COLLABORATORS

While entering into an agreement for foreign collaboration, the Indian collaborator should take into consideration such aspects as will enable him to plan his tax affairs in a manner that ensures maximum after-tax profits and return on investment. In this context, the Indian collaborator may be advised to adopt the following steps for tax planning:

- Capitalization of installation expenses
- Treating purchase of spares as revenue expenditure
- Treating plans and drawings, etc. as “Plant” for availing of full value as depreciation.

15.11 TAX PLANNING FOR EMPLOYEES

The employees should keep the following aspects in view while planning their salary package:

- (i) The employee should opt for division of salary into basic pay and allowances and should not opt for the consolidated salary. This will minimize his tax incidence considerably as some of the allowances are exempt from tax upto a certain extent for e.g. conveyance allowance is exempt upto Rs.1600 p.m.
- (ii) Under the terms of employment, dearness allowance should form part of the retirement benefits. This will not only increase the employee’s retirement benefits but also reduce his tax incidence in respect of HRA, gratuity, commuted pension, employer's contribution to RPF, etc.
- (iii) Any commission payable as per the terms of employment should be based on turnover so as to form part of salary. This will also reduce the tax incidence in respect of HRA, commuted pension, interest credited to RPF, etc.
- (iv) If the employee is allowed the use of more than one car for his private purposes, the horse power of any such car should not exceed 1.6 litre cubic capacity as otherwise he shall be deemed to have been provided with one car of 1.6 cubic litre capacity which would lead to higher valuation of such perquisite.
- (v) The employer's contribution to RPF should be 12% of salary as it is exempt upto this limit.
- (vi) The employee should opt for re-imbursement of expenses on medical treatment (on free medical facility) in place of medical allowance because such allowance is taxable whereas the reimbursement is not taxable upto the extent of Rs. 15,000. The same thing holds good for entertainment allowance.

(vii) Perquisites should be preferred to taxable allowances. This shall help not only in lower valuation of perquisite like rent free house but the employee will also be free from falling into the category of specified employees.

(viii) It may be noted that if furniture is provided without rent free accommodation, it will not be taxable in the hands of non-specified employees.

(ix) An employee who resigns before completing five years of continuous service in an organization, should ensure that the new organization he joins maintains EPF so that the accumulated balance of the provident fund could be transferred to the new organization to claim exemption thereon.

(x) On retirement, the employee should opt for commuted pension to the maximum permissible limit as it is exempt from tax within certain limits.

(xi) Leave encashment should preferably be done on termination of employment by superannuation or otherwise as it will then be exempt from tax within certain limits.

In addition to the above, the employees should also plan for taking full advantage of the relevant provisions under Section 80C to 80U of the Income Tax Act.

15.12 ORGANIZATION OF TAX PLANNING CELLS

Some companies can afford to have separate tax planning departments while others cannot. The need for having tax planning department does not depend upon the amount of tax liability of the company. In fact, in certain cases, companies having effective tax planning cells can plan their transactions with a view to attract the least incidence of tax organization of such a cell can be justified on the following grounds :

- Complexity and volume of work: Where the volume of tax work to be handled is large and highly complex, then it is required to appoint a special tax expert along with the required staff.
- Separate Documentation: Documentation is an indispensable ingredient of tax planning. An assessee has to keep reliable, complete and updated documentation for all the relevant tax files so that the documentary evidence can be made available at a short notice whenever it is required. In absence, thereof, an assessee may lose a case for want of proper documentary evidence. The company has to maintain proper account books, records, vouchers, bills, correspondence and agreements, etc. as a part of tax planning. In the case of new industrial undertaking it is better to keep separate accounts for the same.
- Data Collection: The staff concerned with taxation has to collect and keep on collecting data relating to latest circulars, case laws, rules and provisions, and other government notifications to keep abreast of the current developments. This could also guide them in any particular area, when such guidance is needed. The composition of organization of such data bank may vary from one organization to another. However,

keeping in view the general areas of operation of the company, it may, be advisable to arrange the data in the order of subject sequence. This would able easy availability of information at the relevant time.

- **Integration:** Tax planner should be consulted by all the departments of the company to know the impact of taxation on their decisions. It would be necessary to integrate and properly link all the departments of the company with the tax planning department. Any project or blue print may have a tax angle. This has to be identified early enough to facilitate better tax compliance and availing of the several incentives. The department has to deal with all taxes(State, Central and Local Self Governments).
- **Constant Monitoring:** In order to obtain the intended tax benefits, persons connected with tax management should ensure compliance of all the pre-requisites, like procedures, rules etc. Besides, there should be constant monitoring, so that all the tax obligations are discharged and penal consequences avoided.
- **Developing Tax Effective Alternatives:** A managerial decision could be assumed to have been well taken only if all the pros and cons are considered. A tax planner could guide important decisions, by considering varieties of alternatives and choices.
- **Take advantage of variance allowances and deductions:** A tax manager has to keep track of the provisions relating to various allowances, deductions, exemptions, and rebates so as to initiate tax planning measures.

15.13 SUMMARY

Tax planning is an important aspect of managerial decision making. It includes taking decisions with respect to setting up and commencement of a business, form of organization/ownership pattern, locational aspects, nature of business, tax planning in respect of corporate restructuring, tax planning in respect of financial management, tax planning for Indian Collaborators and tax planning in respect of employees. To aid managers in effective tax planning, organization of tax planning cells could be done by the companies.

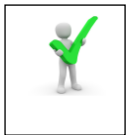


15.14 GLOSSARY

Complexity and volume of work: Where the volume of tax work to be handled is large and highly complex, then it is required to appoint a special tax expert along with the required staff.

Separate Documentation: Documentation is an indispensable ingredient of tax planning. An assessee has to keep reliable, complete and updated documentation for all the relevant tax files so that the documentary evidence can be made available at a short notice whenever it is required. In absence, thereof, an assessee may lose a case for want of proper documentary evidence.

Data Collection: The staff concerned with taxation has to collect and keep on collecting data relating to latest circulars, case laws, rules and provisions, and other government notifications to keep abreast of the current developments



15.15 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress –A

- Q1. Ans. True
Q2. Ans. True
Q3. Ans. False
Q4. Ans. False

Check Your Progress –B

- Q1. Ans.False
Q2. Ans.False



15.16 REFERENCES

- Singhania, Monica &Singhania, Vinod K. Corporate Tax Planning & Business Tax Procedures with Case Studies, Taxmann, 2016.

- http://220.227.161.86/18890sm_dtl_finalnew_cp14.pdf, www.icai.org/?page_id=5777, accessed in May, 2017.
- www.icsi.edu, accessed in May, 2017.



15.17 SUGGESTED READINGS

1. Singhania, Monica & Singhania, Vinod K. Corporate Tax Planning & Business Tax Procedures with Case Studies, Taxmann, 2016.
2. Gupta, Ravi & Ahuja, Girish. Simplified approach to Corporate Tax Planning & Management, Wolters & Kluwers, 2017.



15.18 TERMINAL QUESTIONS

- Q1. Discuss how managers can take advantage of tax planning while taking financial management decisions.
- Q2. Discuss the managerial decisions with respect to tax planning involving organization and form of the business.
- Q3. Explain the advantages of tax planning while restructuring the organization.

UNIT 16 CORPORATE TAX PLANNING IN INDIA

16.1 Introduction

16.2 Objectives

16.3 What is Tax Management?

16.4 Meaning and Importance of Tax Planning

16.5 Meaning of Tax Evasion and Avoidance

16.6 Meaning of a company

16.7 Kinds of companies

16.8 Provisions regarding taxation of companies In India

16.9 Summary

16.10 Glossary

16.11 Answers to check your progress

16.12 References

16.13 Suggested Readings

16.14 Terminal Questions

16.1 INTRODUCTION

The basic purpose of a business organisation is to earn profit. All businesses share the same purpose irrespective of their forms and size. All the activities and decisions of business management of a company are focussed on twin objectives of maximisation of profits and maximisation of wealth of shareholders. However, while discharging their obligations towards its stakeholders *vis -a-vis* consumers, suppliers, human resources, shareholders, financial institutions, creditors and other interested parties, the company has to comply with legal and regulatory provisions related to them which may have an impact on its profits. Therefore, the companies as taxpayers obviously pursue the quest for tax shelters. When such tax shelters are legitimately used to reduce tax liability it is referred as tax planning and management. But when the tax liability is illegally reduced using unfair means and manipulations it is termed as tax evasion or avoidance. The management of a company is expected to undertake tax planning and manage its taxes in such a manner that all legitimate

benefits are availed by the company and at the same time do away with tax evasion and avoidance. Let us explain this in detail.

16.2 OBJECTIVES

After discussing this unit, you will be able to:

- Understand the meaning of tax planning and management.
- Differentiate between tax planning and tax evasion and avoidance.
- Explain various kinds of companies.
- Discuss the provisions regarding taxation and tax incidence of companies.
- Compute book profit and tax liability under normal / MAT provisions.
- Explain dividend tax provisions.

16.3 WHAT IS TAX MANAGEMENT?

Tax management means complying the provisions of the Act e.g. filing of returns within the stipulated time in accordance with appropriate updated provisions of the finance Act, complying the obligations in respect of timely Tax deduction at source (TDS), advance tax and self-assessment, payment of interest, assessment proceedings, rectification and revision thereof and appeals , penalty, prosecution etc. The main objective of an effective tax management system is efficient and effective compliance with law and it obviously results in avoiding penalty and prosecution.

16.4 MEANING AND IMPORTANCE OF TAX PLANNING

Tax planning aims at reducing the tax liability to its minimum by complying the tax laws on the one hand and taking legitimate benefit of its provisions in respect of exemptions deductions, allowances, rebates on the other. Tax planning is an arrangement in advance on the part of company by which company ensures to comply with tax laws and to all its obligations and transactions. However, care must be taken that the transactions must not be of any colourable form i.e. transactions should not be such in which law is followed strictly in words but not in its true spirit. On the contrary the spirit behind the law is marred by these transactions. It is future oriented and includes tax management. Main features of tax planning are :

- It is mostly future oriented.
- It aims to get maximum legitimate benefits of tax laws.
- It ensures the compliance of tax laws not only in words but not in its true spirit.
- There is no intention to deceit the legal provisions.

16.5 MEANING OF TAX EVASION AND AVOIDANCE

Tax evasion refers to all the methods by which tax liability is illegally avoided. It may include various unfair means or methods attempted for tax omission which may lead to punishment and prosecutions.

Tax avoidance is generally referred to a legal way of escaping the tax liability which takes into account the loopholes in the laws. It is considered similar to tax hedging.

Main features of tax avoidance are :

- It seeks to reduce or negate the tax liability.
- It takes legally permissible way and has legal sanction.
- There is no mala fide intention.

Example: A Ghaziabad based company diversify its operations by launching a new computer parts manufacturing company in Uttarakhand. However, in order to get the benefit of section 80-IB, if the company starts the manufacturing in the existing factory and hire a premises to show the manufacturing being takes place in Uttarakhand ,and thereby claims the benefit, it is resorting to unfair means to get illegitimate benefit by false statement and it is an example of tax evasion which may lead to punishment and prosecution.

Taxation of a company is mainly dependent on its residential status. Company Tax payer may either be resident in India or non resident. Indian income is always taxable in India irrespective of residential status of the assessee. But foreign income is taxable in the hands of resident in India . Foreign income is not taxable in the hands of non resident in India. According to section 6(3) an Indian company is always resident in India. A foreign company may be a resident in India or non resident. There are certain provisions specifically made for different type of companies which may impact their tax liabilities. Therefore, type of company and its residential status both play an important role in determining its tax liability. Let us discuss it in detail.

16.6 MEANING OF A COMPANY

Section 2(17) defines the company as :

- a. Any Indian company; or
- b. Anybody corporate incorporated under the laws of a foreign company; or
- c. Any institution, association or a body which is assessed or was assessable/assessed as a company for any assessment year commencing on or before April, 1970; or
- d. Any institution, association or a body whether incorporated or not and whether Indian or non Indian, which is declared by the general or special order of the Central Board of Direct Taxes to be a company.

A company means an Indian company formed and registered under the Companies Act, 1956.

16.7 KINDS OF COMPANIES

Domestic company

Domestic company means an Indian company or any other company, which in respect of its income liable to tax under the act has made prescribed arrangements for the declaration and payment of dividends within India in accordance with section 194.

Hence a **Domestic company** is a company which is

- (i) an Indian company and
- (ii) If it is any other company which in respect of its income liable to tax under the Act, has made prescribed arrangements for the declaration and payment of dividends within India out of such income.

Under section 194 the requirement for a company other than the Indian company, for making prescribed arrangements, are :

- i. Maintenance of share register for all shareholders regularly for relevant AYs
- ii. General meeting should be held in any place in India for passing of accounts and declaration of dividend and
- iii. Dividend should be payable within India.

Foreign company

Foreign company is a company which is not a domestic company.

Industrial company

Industrial company means :

- a. a company which is mainly engaged in the business of generation and distribution of electricity or any other form of power or in the construction of ships or in the manufacture or processing of goods or in mining, even if its total income from such activities is less than 51% of its total income ;and
- b. A company which even though not mainly so engaged, derives in any year 51% or more of its income from such activities,

Company in which the public are substantially interested

Under section 2(18) a company is deemed as a Company in which the public are substantially interested in the following cases :

1. A company owned by GOI or RBI with not less than 40% shares in terms of value.
2. Section 25 companies which are registered for the purpose for promotion of arts, commerce, science, religion, charity, and prohibiting any dividends to its members.
3. A company having no share capital.
4. Nidhi or mutual benefit society.
5. Company owned by a cooperative society.
6. Listed companies as on the last date of previous year in a recognised stock exchange in India.

7. Public limited company owned by government shares carrying 50% of voting power (40% in case of industrial company) and / or a widely held subsidiary company .

It must be remembered that under the Income-tax Act, 1961 a public company under the Companies Act, 1956 need not necessarily be deemed a company in which the public are substantially interested. It will depend on the nature and extent of shareholding on the basis of which, it may be considered as one in which the public are not substantially interested under the Income-tax Act, 1961 .

Investment Company

Investment company means a company whose gross total income mainly consists of income chargeable under heads - income from House property, Capital gains and Income from other sources.

Widely held company

A company in which the public is substantially interested is known as widely – held company.

Closely Held Company

A company in which the public is not substantially interested is known as widely – held company.

16.8 PROVISIONS REGARDING TAXATION OF COMPANIES IN INDIA

16.8.1 RESIDENTIAL STATUS AND INCIDENCE OF TAX

Residential status: The concept of residential status has been laid down in section 6 of Income tax Act, 1961. Tax payers may be of two types i.e. resident in India and non-resident. While individuals /HUF may be resident (i. resident or ii. Not ordinary resident) but the company may be either resident in India or non-resident .

According to section 6(3) an Indian company is always resident in India. A foreign company may be a resident or non-resident as per rules as under :

- Upto the AY 2016-17 , A foreign company is resident in India only if , during the previous year, the control and management of its affairs are situated wholly in India. However, a foreign company is treated as non-resident if, during the relevant previous years, the control and management of its affairs are either wholly or partly situated out of India.
- From AY 2016-17, A foreign company will be resident in India if , its place of effective management (POEM) during the relevant previous years is in India.

Here, control and management refers to “head and brains” which directs the affairs of a company and POEM means a place where key management and

commercial decisions for the conduct of the business of the company are in substance made. It should be noted that control referred in this section is not the place of day to day control of business but usually is the place of central control where the board meetings are held.

Incidence of tax

Residential status along with the place and time of accrual or receipt of income is an important factor that determines the tax liability of a taxpayer. Therefore, the residential status and tax liability is interrelated. For this the income has been classified in two categories i.e (i) Indian Income and (ii) Foreign Income, Let us first understand their meaning.

(i) **Indian Income** : According to section 5 any of the following three is Indian income :

1. If income is received (or deemed to be received in) in India during the previous year and at the same time it accrues (or arises or is deemed to be accrue or arise) in India during the previous year,
2. If income is received (or deemed to be received in) in India during the previous year but it accrues (or arises) outside India during the previous year,
3. If income is received outside India during the previous year but it accrues (or arises or is deemed to accrue or arise) in India during the previous year,

(ii) **Foreign Income** : Foreign income refers to an income for which following two conditions are essential :

1. income is not received (or not deemed to be received in) in India and
2. Income does not accrue (or arise or is not deemed to accrue or arise) in India ,

From the above it is clear that;

1. Indian income is always taxable in India irrespective of residential status
2. Foreign income is taxable only in the hands of resident in India
3. Foreign income is not taxable in the hands of non resident in India

Distinction between receipt of income and accrual of income:

Receipt of Income means when it is actually received by the recipient or it reaches the assessee whereas it accrues or arise when the right to receive the income vested with the assessee . As regards tax incidence, income received in India is taxable in all cases irrespective of the residential status of assessee. Similarly, income accruing in India is chargeable in all cases irrespective of the residential status of assessee. It is not necessary that the income should be received in India. Income deemed to be received in India in the previous years is chargeable to tax. Therefore receipt is not the only criteria for chargeability to tax. If any income is not chargeable on receipt basis it can be taxed on accrual basis. It is also not necessary that the income should be received in cash, it may be received in cash or kind.

According to section 9 the following income is deemed to accrue or arise in India though it may accrue or arise outside India:

1. Income from business connections in India.
2. Income from any property, asset or source of income in India.
3. Capital gain on transfer of capital asset situated in India/
4. Income from salary of services rendered in India.
5. Income from salary (not being prerequisite /allowance) if services is rendered outside India (provided the employer is GOI and employee is Indian citizen).
6. Dividend paid by Indian company.
7. Interest, royalty or technical fees received from GOI.
8. Interest, royalty or technical fees received from a resident (except when the payments pertains to business carried on by the payer outside India)
9. Interest, royalty or technical fees received from a non-resident if the payments pertains to business carried on by the payer in India.

16.8.2 COMPUTATION OF INCOME

Computation of Income :

The step wise process of computation of Income is as under :

Computation of Income

1	Income from different heads	xxx
2	Add income from other persons to the income of the company under section 60 and 61	xxx
3	Adjust current and brought forward losses as per section 70 to 80	xxx
4	Gross Total Income 1+2 -3	xxx
5	Less deductions under section 80C to 80 U	xxx
6	Net Income 4-5	xxx

In order to find whether tax liability under normal provisions is more or less than the tax liability under MAT , computation of income under both alternatives has to be computed. Computation of income under normal provisions has already been discussed above. Under MAT provisions Book profit has to be computed .

Book profits

Book profits means net profit as per profit and loss a/c which has been adjusted as under :

1. **ADD :** (Amount to be added back if earlier debited to profit and loss a/c)
 1. Income tax paid or payable and provisions
 2. Amount carried for any reserve

3. Provisions made for liabilities
 4. Provisions for losses of subsidiary companies
 5. Dividend paid or proposed
 6. Expenditure related to certain incomes
 7. Depreciation
2. **DEDUCT** : (Amounts to be deducted from net profits)
1. Amount withdrawn from reserves and provisions
 2. Income exempt from tax
 3. Depreciation amount withdrawn from revaluation reserve credited to P/L a/c
 4. Amount of loss brought forward or unabsorbed depreciation whichever is less
 5. Profit of sick industrial unit
 6. Deferred tax credited to P/L a/c
 7. Income/ loss in case of units referred to under section 47(xvii)

16.8.3 COMPUTATION OF TAX LIABILITY

The step wise process of computation of Income tax liability is as under :

:

Step	Under normal conditions	Step	Under MAT Provision
1	Compute taxable income under normal provisions	8	Compute book profits
2	Compute tax @30%(40% in case of a foreign company)	9	Compute tax @18.5% of book profits
3	Add surcharge @7% if net income is in the range of 1-10crore and @12% if it exceeds 10 crore (In case of foreign company @ 2% and 5% respectively)	10	Add surcharge
4	Add (2+3)	11	Add (9+10)
5	Add education cess @2% and secondary and higher education @1%	12	Add education cess @2% and secondary and higher education @1%
6	Deduct tax rebate or tax credit	13	Find out(11+12)
7	Find out (4+5-6)		

Tax liability :

1. If Tax computed at step 7 is more than or equal to step 13 , MAT provisions will not be applicable and tax liability will be determined under normal provisions.
2. If Tax computed at step 7 is less than to step 13 , MAT provisions will be applicable.

16.8.4 SET OFF AND CARRY FORWARD OF LOSSES

Provisions regarding Set off and Carry forward of losses are important to reduce tax liability. Following are the rules in respect of Set off and Carry forward of losses:

Rules in respect of Set off of losses:

- a. Set off within same head of income:
 - Speculative business losses against speculative income only.
 - Specified business losses (i.e. section 35 AD) from Specified business gains only.
 - Long term capital loss against long term gains only.
 - Loss from race horses against gains from same activity.
- b. Set off against income of other heads :
 - A loss cannot be set off against winning from lotteries, gambling and betting etc.
 - Speculative business losses cannot be set off against any other income.
 - Losses under 'capital gains' head cannot be set off against any other head.
 - Business losses cannot be set off against income from salary head.

Rules in respect of Carry forward of losses :

- Loss from house property can be carried forward and set off up to 8 years.
- Speculative business loss can be carried forward and set off up to 4 years.
- Loss from business specified under section 35 AD can be carried forward and set off without any time limit.
- Unabsorbed depreciation can be carried forward and set off without any time limit. In the subsequent years it can be set off against any income except salary.
- Long term capital losses can be carried forward and set off only in the subsequent year.
- Short term capital losses can be carried forward and set off up to 8 years.
- Loss of a discontinued business cannot be set off.
- losses from race horses can be carried forward and set off up to 4 years.

16.8.5 PROVISIONS REGARDING MINIMUM ALTERNATE TAX (MAT)

As explained earlier Tax liability of a company is computed (i) under normal provisions and (ii) under section 115 JB which is referred to as Minimum alternate Tax (MAT). If tax computed under former i.e. normal tax provisions, is less than tax computed under latter (MAT), the provisions of Minimum alternate Tax (MAT) will be applicable in the following manner :

- a. Book profit of the company is assumed as taxable income
- b. Tax liability will be calculated @18.5% (add surcharge education cess secondary and higher education cess)
- c. Company is liable to pay the MAT thus calculated.
- d. The extra tax over and above the tax computed under normal provisions is tax credit which can be set off against future tax liability subject to few conditions as under :
 - Tax credit will be available only in the year in which tax is computed.
 - Tax credit will be available only in the year in which tax is computed.
 - MAT will not be applicable to the following incomes :
 - i. Income from any business/services in SEZs (31.3.2005-1.4.2011)
 - ii. Income of a shipping company (after 31.3.2004)
 - iii. Income arises and accrues from life insurance business (After 31.3.2000)

This can be explained from the following example :

Example : 1

The following are the information extracted from the records of a company :

Sales	56,00,000
Amount withdrawn :	
(a) From general reserve	4,00,000
(b) From revaluation reserve	<u>3,00,000</u>
Total (A)	63,00,000

Less expenses :

1. Depreciation (normal)	12,00,000
2. Depreciation (On account of revaluation)	5,00,000
3. Salary and wages	10,00,000
4. Income tax	4,00,000
5. Outstanding custom duty not paid yet	1,00,000
6. Tax Consultation fee paid	50,000
7. Other expenses	1,50,000
8. Proposed dividend	1,00,000
Total (B)	35,00,000

Net profit (A)-(B) 28,00,000

Company wants to claim:

- i. Deduction under section 80-IB 30% of Rs.31,50,000 or 9,45,000.
- ii. Depreciation under section 32 (Rs.9,00,000)
- iii. Unabsorbed loss brought from previous year is Rs.29,50,000
Long term Capital gains are Rs.1,00,000 and unabsorbed depreciation is 1,00,000.

You are required to compute tax liability and tax credit under section 115JB.

Solution :

A. Under Normal Provision :

Net profit as per P & L a/c	28,00,000
Add :	
Depreciation (12,00,000+5,00,000-9,00,000)	8,00,000
Income tax	4,00,000
Custom Duty not yet paid	1,00,000
Proposed dividend	<u>1,00,000</u>
Total	42,00,000
Less :	
Amount withdrawn from reserves 4,00,000+3,00,000)	7,00,000
Unabsorbed loss	<u>29,50,000</u>
Business Income	5,50,000
Add Long term capital gains	<u>1,00,000</u>
Gross Total Income	6,50,000
Less Deduction u/s -IB (30% of 5,50,000)	<u>1,65,000</u>
Net Income	4,85,000

Tax liability on above (20% of 1,00,000 +
30% of 3,85,000 + 3% of tax as cess) **1,39,565**

B. Under MAT Provisions :

Net profit	28,00,000
Add :	
Depreciation (12,00,000+5,00,000)	17,00,000
Income tax	4,00,000
Proposed Dividend	1,00,000
Less :	
Withdrawal from reserve	4,00,000
Unabsorbed depreciation	1,00,000
Depreciation Normal	12,00,000
Withdrawal from revaluation reserve to the extent it does not exceed extra Depreciation	3,00,000

Book profit 20,00,000

Tax liability (19.055% of book profit) 3,81,100

Tax credit under section 115 JB Rs. 2,41,535.

Since tax liability by MAT is higher, therefore the company will pay Rs. 3,81,100 and the tax credit will be $3,81,100 - 1,39,565 = 2,41,535$ under section 115 JB.

Meaning of Dividend

A dividend is that part of residual disposable income of a company which is paid to shareholders. Definition of deemed dividend is given in Section 2(22) .

- a. any distribution entailing the release of company's assets
- b. any distribution of debenture, debenture stock and bonus to preference shareholders
- c. Distribution on liquidation of company
- d. Distribution on reduction of capital
- e. Any payment of loan or advance by closely held company to a shareholder holding substantial interest provided the loan should not have been made in the ordinary course of business and money lending should not be a substantial part of the company 's business.

In the first four cases (a to d) the recipient shareholder of the dividend is not chargeable to tax but the company will pay the dividend tax according to section 115-O but in the last case (e), the recipient shareholder of the dividend and not the company, will pay the dividend tax .

16.8.6 DIVIDEND TAX

Dividend declared, distributed or paid on or after June 1, 1997 but before April 1, 2002 or after March 31, 2003 is subject to dividend tax. The levy of additional tax is in addition to normal tax payable by a company. This additional tax cannot be avoided even if tax liability of a domestic company , computed under the provisions of the Act is nil.

Tax on dividend paid by a domestic company shall be taken as the final tax payment in respect of the amount declared, distributed or paid as dividend. The company or the shareholders cannot claim any deduction from taxable income in respect dividend tax levied under section 115-O. Moreover, no deduction is available from tax on dividend under any provision. However, by virtue of section 10(34), dividend income (in respect of which dividend tax is applicable under section 115-O) is exempt in the hands of recipient shareholders. (subject to exception under section 115BBDA from AY 2017-18)

Rates of Dividend tax :The rates of dividend tax has been changing . From April 1, 2015 the amount of dividend tax would be as follows:

Dividend tax as a % of dividend – 17.64706

Surcharge as a % of dividend tax – 12

Education cess as a % of dividend tax – 3

Total dividend tax – 20.35765

Example 2

ABC Limited a company in which the public are substantially interested furnishes the following particulars for the previous year ending March 31, 2016.

Business income	16,20,000
Dividend from Indian company	6,00,000
Dividend from a foreign company	12,00,000
Royalty from Foreign Government for use of patents	5,00,000
Royalty from an Indian company for transfer of technical knowhow	3,00,000
Short term gain from sale of unlisted shares	30,000
Short term loss on sale of land	24,000
Long term gain on sale of building (sale proceed:Rs. 3,00,,000 ;Indexed cost: Rs.2,24,800)	75,200
Long term loss on sale of listed preference shares (sale proceed:Rs. 56,000 ;Indexed cost: Rs.1,06,000)	60,000
Short term gain from sale of machine (sale proceed:Rs. 4,00,000 ;cost of acquisition Rs. 2,80,000)	1,20,000
Brought forward business loss	10,00,000
Unabsorbed depreciation	2,00,000

Determine the tax liability of the company for assessment year 2016-17 on the assumption that dividend distribution for the year 2016-17 is Rs.8,40,000(date of distribution May10,2016)

Solution :

Computation of income and tax liability

Business Income	17,20,000
Less : Brought forward business loss and unabsorbed depreciation	<u>12,00,000</u> 5,20,000
Capital gains :	
Short term capital gain on sale of shares	30,000
Less: short term loss on sale of land	<u>24,000</u> 6,000

Long term capital gains (LTCG):

Sale of building	75,200	
Sale of Shares		<u>(-60,000)</u> 15,200

Short term gain on sale of machine

(deemed as short term by virtue of section 50)1,20,000

Income from other sources :

Dividend	12,00,000	
Royalty	8,00,000	<u>20,00,000</u>
Gross Total Income	<u>26,61,200</u>	
Less Deduction		nil
Net Income	<u>26,61,200</u>	

Computation of Tax Liability

Income tax on Rs.26,46,000=(26,61,200

-15200)@30% + tax on Rs.15,200 @ 20% 7,96, 840

Add surcharge NIL

Add education cess @2% 15,937

Add secondary and higher education cess 7,968

Tax Liability 8,20,745

Besides, ABC Limited will has to pay Rs. 1,71,004 (i.e 8,40,000 @ 20.35765) as dividend tax on May10,2016.

Some steps to minimise tax incidence under section 115 JB :

While undertaking tax planning a few things should be kept in view to minimise tax incidence under section 115JB:

1. Depreciation may be charged , as far as possible, on the basis of written down value method.
2. If any change is made in the method of charging depreciation Extra depreciation may be debited to P/L a/c .
3. Depreciation can be charged in books of accounts at higher rate than what is specified in company Act.
4. Profit or loss on sale of a fixed asset should be credited to P/L a/c as far as possible , the depreciable asset should be possibly sold at profit to offset the loss on account of sale of another asset while on computing tax liability under section 115JB.
5. Writing off goodwill may be an appropriate way to reduce book profits.
6. Similarly, for accounting purposes amortisation of the expenditure on acquisition of patent rights, copyrights, , preliminary expenses and expenses of prospecting etc. , for

certain minerals may also be made to reduce the impact of section 115JB on computation of tax incidence .

7. Income tax refund should be credited to income tax reserve account for being adjusted against income tax paid/ payable and surplus /deficiency at the end should be transferred to P/L account because unadjusted refund will increase net profit and thereby enhance tax liability.
8. Accounting standards laid down in AS -9 for recognising any revenue to P/L account must be followed in order to make certain the point of time of their identification .
9. Any tax, penalty, fine or interest paid or payable under Income tax/ wealth tax/gift tax /companies (profits) surtax Act , any tax or duty not allowed as deduction for calculating taxable income, securities transaction tax and fringe benefit tax etc. debited to P/L a/c , do not require any adjustment and are not added to net profit to compute book profits under 115JB.
10. Arrears of depreciation which could not be provided in earlier years may be provided in current years.
11. Software expenses may be debited to P/L a/c as these expenses are in the nature of revenue expenditure and not of capital nature.



Check Your Progress-A

Q1. Indicate TRUE or FALSE :

- i. Tax avoidance has legal sanction.
- ii. A private company can never be a company in which the public is substantially interested.
- iii. An Indian company is always resident in India.
- iv. As regards tax incidence, income received in India is taxable in all cases irrespective of the residential status of assessee.
- v. Investment company means a company whose gross total income mainly consists of business income .
- vi. The company or the shareholders cannot claim any deduction from taxable income in respect dividend tax levied under section 115-O.
- vii. To reduce book profit goodwill may be written off .
- viii. If tax computed under normal tax provisions , is less than tax computed under latter (MAT) , the provisions of Minimum alternate Tax (MAT) will be applicable.

16.9 SUMMARY

All the activities and decisions of business management of a company are focussed on twin objectives of maximisation of profits and maximisation of wealth of shareholders. Therefore, the companies as taxpayers obviously pursue the quest for tax shelters. When such tax shelters are legitimately used to reduce tax liability it is referred as tax planning and management. Tax management means complying the provisions of the Act e.g. filing of returns within the stipulated time in accordance with appropriate updated provisions of the finance Act, complying the obligations in respect of timely Tax deduction at source (TDS), advance tax and self assessment, payment of interest, assessment proceedings, rectification and revision thereof and appeals, penalty, prosecution etc. whereas Tax planning aims at reducing the tax liability to its minimum by complying the tax laws on the one hand and taking legitimate benefit of its provisions in respect of exemptions deductions, allowances, rebates on the other. When the tax liability is illegally reduced using unfair means and manipulations it is termed as tax evasion or avoidance. **Tax evasion** simply refers to all the methods by which tax liability is illegally avoided i.e. unfair means or methods attempted for tax omission which may lead to punishment and prosecutions whereas **Tax avoidance** is generally referred to a legal way of escaping the tax liability using the loopholes in the laws.

Taxation of a company is mainly dependent on its residential status. Company Tax payer may either be resident in India or non resident. Indian income is always taxable in India irrespective of residential status of the assessee. But foreign income is taxable in the hands of resident in India. Foreign income is not taxable in the hands of non resident in India. According to section 6(3) an Indian company is always resident in India. A foreign company may be a resident in India or non resident. There are certain provisions specifically made for different type of companies which may impact their tax liabilities. Therefore, type of company and its residential status both play an important role in determining its tax liability. A company may be an industrial company, Investment Company, holding or subsidiary company, widely held or closely held company. Widely held company is a company in which the public is substantially interested whereas in a Closely Held company is company in which the public is not substantially interested. It must be remembered that under the Income-tax Act, 1961 a public company under the Companies Act, 1956 need not necessarily be deemed a company in which the public are substantially interested. It will depend on the nature and extent of shareholding on the basis of which, it may be considered as one in which the public are not substantially interested under the Income-tax Act, 1961.

From AY 2016-17, a foreign company will be resident in India if, its place of effective management (POEM) during the relevant previous years is in India. As regards tax incidence, income received in India is taxable in all cases irrespective of the residential status of assessee. Similarly, income accruing in India is chargeable in all cases irrespective of the residential status of assessee. It is not necessary that the income should be received in India. Income deemed to be received in India in the previous years is chargeable to tax.

Tax liability of a company is computed (i) under normal provisions and (ii) under section 115 JB which is referred to as Minimum alternate Tax (MAT). If tax computed under former i.e.

normal tax provisions, is less than tax computed under latter (MAT), the provisions of Minimum alternate Tax (MAT) will be applicable i.e. i. Book profit of the company is assumed as taxable income ii. Tax liability will be calculated @18.5% (add surcharge+ education cess+ secondary and higher education cess) and Company is liable to pay the MAT thus calculated. The extra tax over and above the tax computed under normal provisions is tax credit which can be set off against future tax liability subject to certain conditions.

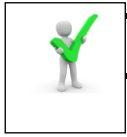
A dividend is that part of residual disposable income of a company which is paid to shareholders. Definition of deemed dividend is given in Section 2(22). Dividend declared, distributed or paid on or after June 1, 1997 but before April 1, 2002 or after March 31, 2003 is subject to dividend tax. This additional tax is paid by a domestic company as the final tax payment and the company or the shareholders cannot claim any deduction from taxable income in respect dividend tax levied under section 115-O. From April 1, 2015 the amount of dividend tax would be 20.35765% (17.64706+ Surcharge @12% of dividend tax and Education cess as a 3% of dividend tax).

For tax planning the management of company may consider all possible propositions to reduce book profit and, thereby, minimising the tax liability to that extent. All permissible allowances should be utilised and Losses can be set off and carried forward as per provisions.



16.10 GLOSSARY

- TDS** - Tax deduction at source
- POEM** - Place of Effective Management
- MAT** – Minimum Alternate Tax
- GTI**- Gross Total Income
- LTCG** - Long Term Capital Gains
- GOI**- Government of India
- AY**- Assessment Year
- HUF**- Hindu Undivided Family
- SEZ** – Special Economic Zone.



16.11 ANSWERS TO CHECK YOUR PROGRESS

Check your Progress- A

1. True
2. True
3. True
4. True
5. False
6. True
7. True
8. True



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16.13 SUGGESTED READINGS

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16.14 TERMINAL QUESTIONS

- Q1. What is tax planning? Differentiate between tax planning and management.
- Q2. What is tax evasion ? Explain with an example.
- Q3. Differentiate between tax evasion and tax avoidance.
- Q4. Explain the relationship between residential status and tax liability.
- Q5. What is the difference between Indian income and foreign income?
- Q6. Explain in which cases a company is regarded as a company in which the public are substantially interested?
- Q7. What is book profit? Explain how book profit is computed?
- Q8. Explain how tax liability of companies is calculated?
- Q9. Explain the provisions of Income tax Act regarding MAT ?
- Q10. Define dividend. What are the rules regarding dividend tax ?
- Q11. What are the broad propositions which should be kept in view to minimise tax incidence under section 115JB?

UNIT 17 TAX PLANNING AND FINANCIAL DECISIONS

17.1 Introduction

17.2 Objectives

17.3 Capital structure decisions

17.4 Lease vs. buy or make vs. buy decisions

17.5 Distribution of dividends

17.6 Tax treatment of dividends

17.7 Bonus shares

17.8 Summary

17.9 Glossary

17.10 Answer to Check Your Progress

17.11 Reference / Bibliography

17.12 Suggested Readings

17.13 Terminal & Model Questions

17.1 INTRODUCTION

As you already aware that corporate tax planning involves systematic planning of a company's operations in such a way as to attract a minimum liability to tax or deferment of tax liability for the subsequent periods through getting the benefit of available exemptions, concessions, incentives, rebates & reliefs, Allowances and deductions provided for in law. However, tax planning implies legal and legitimate tax benefits only and any colourable devices cannot be part of tax planning. Tax planning and financial decisions are interrelated. Financial management decisions comprised of decisions regarding finance, investment and dividends. Financial decisions should be taken in the light of basic objective of maximisation of wealth of shareholders. Since corporate tax payments involve cash outflows and would obviously result in the reduction of profits and wealth of shareholders. Therefore scope of the function of finance manager extends to analyse the tax implications of various decisions and minimise the cash outflows in the form of taxes.

There are several financial decisions which may have an impact on taxation of the company. Some of the such important decisions are as under :

1. Capital structure decisions involving raising of long term finances in equity and debt
2. Lease or buy decisions
3. Distribution of dividends

Let us discuss them in detail:

17.2 OBJECTIVES

After discussing this unit you will be able to:

- Understand the meaning of financial decisions.
- Explain meaning of Optimum Capital Structure.
- Discuss the tax implication of Capital structure decisions.
- Understand the meaning and tax implications of lease vs. buying or make vs, buying decisions.
- Understand the meaning and tax implications of dividend, deemed dividend and bonus shares.

17.3 CAPITAL STRUCTURE DECISIONS

A company can raise funds from short term as well as long term sources. While short term sources mainly comprise current liabilities and provisions, long term sources constitute capital, reserves and long term loans.

Capital structure generally implies long term sources and the proportion of debt and equity in the total capital of the company. The increase in the debt in the capital structure implies greater amount of interest payments then before. Higher proportion of debt increases the fixed charge commitment of the company as well as the commitment for timely repayment. Debt involves both type of risks i.e. business risk and financial risk. Business risk is mainly influenced by fixed costs whereas the financial risk is associated with debt equity mix. A company with low level of business risk may have higher proportion of debt in their capital structure. However, if business risk is higher, higher proportion of debt becomes more risky. For the purposes of tax , the debt interest can be set against profits providing a cost advantage. Under income tax law interest paid on debt is deductible from income and reduces tax liability whereas the dividend payable on equity and preference share capital are not deductible and thereby increases cost of equity capital. Normally cost of equity is higher than cost of debt but debt capital also carries financial risk. Certainly debt has tax advantage over equity and higher debt component in capital mixture can increase earning per share(EPS)

available to shareholders provided earning before interest and taxes (EBIT) is at higher level . But debt capital also carries financial risk. If EBIT levels are at lower level then its tax advantage is also reduced. Debt funds are also preferred to retain control of existing shareholders in the company.

Thus, capital structure of a company is an important consideration while making finance decisions which is again dependent on factors like risk, cost, return, and tax etc. A tax planner has to balance all these factors and seek to arrive at an optimum capital structure for maximisation of profits and wealth of shareholders of the company. Therefore, planning the optimum capital structure is one of the basic function of finance manager and on his decisions there is considerable impact of corporate taxation.

Optimum capital structure refers to a combination or mix of debt and equity of a company that can provide maximum value to its shareholders by minimising the overall cost of capital. Earnings per share (EPS) is an important measure for it. Additionally, benefits in terms of profitability and value of the firm must also be considered. If returns are greater than cost of debt capital , it may lead to a sound capital structure specially for those companies which have demonstrated stable and better profit earning capacity for several years in the market.

Let us discuss Capital structure decisions involving raising of long term finances in equity and debt in detail with the help of an illustration:

Since Capital structure refers to the composition of different types of capital i.e. equity, preference and long term debt in the overall capital of the company. Choice among different sources of finance is dependent on tax structure. For example raising finance through borrowings has tax advantage as the interest is charged before taxes and therefore debt capital is preferred over equity for increasing the earning on equity. Under section 36(1)(iii) interest paid on borrowed capital is allowed as deduction but dividend is not deductible and dividend distribution is subject to dividend tax. Cost of raising finance is deductible in the year in which it is incurred whereas the cost of issue of share is allowed as deduction in five years under section 35 D.

Illustration :1

XYZ Ltd. Is considering an expansion programme with an investment of Rs. 5 crore and evaluating the following financing alternatives :

Alternative 1 : 100% by equity

Alternative 2 : 40% by equity; 40% by Debentures(4%); and 20% by Long term debt @ 18%

Alternative 3 : 20% by equity; 30% by Debentures(4%); and 50% by Long term debt @ 18%

Expected rate of return on investment before tax is 25% .The rate of dividend of the company is 20% and the date of declaration of dividend is 30th June.

Solution :

Cost /Returns	Alternative 1	Alternative 2	Alternative 3
---------------	---------------	---------------	---------------

	Equity100%	Equity 40%; 4%Debentures40%; Long term debt @18% 20%	Equity 40%; 4%Debentures40% ; Long term debt @18% 20%
EBIT	1,25,00,000	1,25,00,000	1,25,00,000
Interest	-	4,60,0000	6,60,0000
Earning before Tax (EBT)	1,25,00,000	7,90,0000	5,90,0000
Tax @30% plus surcharge (7%) and education cess (3%)	41,32,875	24,41,100	18,23,100
Return on equity share capital before dividend tax	83,67,125	54,58,900	40.76.900
Return on equity share capital	16.73%	27.29%	40.77%

The company should prefer the third alternative as it provide highest return(40.77%) on equity. It is also clear that the return is lowest when new financing is entirely done by equity and no debentures/ debt is used in the capital structure. In this case tax amount is highest. Tax planner has to strike proper balance between cost, return and risk.

In case when tax rate are falling ,or even remaining constant , increasing the debt equity ratio or increasing the financial leverage is generally preferred . This can be explained by the following illustration :

Illustration : 2

Equity (10%) Dividend : Alternatives - 60% or 50% or 40%

Tax rate are likely to be 35%, 30% and 25% in the next three years .

Average cost of debt is 12%.

Solution :

Effect of tax rates and debt equity ratio on the cost of financing

(a) When tax rate is 35%

Particulars	Gross cost	Alternative 1		Alternative 2		Alternative 3	
		Equity	Debt	Equity	Debt	Equity	Debt
Equity	10	60	6.0	50	5.0	40	4.0
Debt	12	40	4.8	50	6.0	60	7.2

Total Cost			10.8		11.0		11.2
Tax saved	35% on debt cost		1.68		2.10		2.52
Net Cost			9.12		8.90		8.68

(b) When tax rate is 30%

Particulars	Gross cost	Alternative 1		Alternative 2		Alternative 3	
Equity	10	60	6.0	50	5.0	40	4.0
Debt	12	40	4.8	50	6.0	60	7.2
Total Cost			10.8		11.0		11.2
Tax saved	30% on debt cost		1.44		1.80		2.16
Net Cost			9.36		9.20		9.04

(c) When tax rate is 25%

Particulars	Gross cost	Alternative 1		Alternative 2		Alternative 3	
Equity	10	60	6.0	50	5.0	40	4.0
Debt	12	40	4.8	50	6.0	60	7.2
Total Cost			10.8		11.0		11.2
Tax saved	25% on debt cost		1.20		1.50		1.80
Net Cost			9.60		9.50		9.40

17.4 LEASE VS. BUY OR MAKE VS. BUY DECISIONS

Lease or buy or make or buy decisions are important managerial decisions involving i. determining the effective tax savings of given alternatives and ii. Deciding the better choice out of them leading to maximisation of shareholders wealth.

1. Lease or buy decision

What is a lease ?

Leasing is an innovative technique which provide the facility of possessing and operating an asset without owning it. Under this technique periodical rental payments are made without incurring any initial capital investment and successive capital outflows thereafter. Thus , huge amount of capital outlays are substituted by instalments of rents paid periodically under a contract made between lessor and lessee in which the lessee acquire the asset in consideration of specific amount to be paid to lessor for specified period. Thus the lessee acquire the asset without buying it and just make agreed periodical payments as rentals . The lessee gets the exclusive rights to use the asset for a specified period but the title of ownership remains with the lessor. These lease rentals when paid are shown as business expenditure in the statement of affairs of the lessee company.

Tax implications :

Leasing is advantageous to lessee for being an easy method of financing capital asset with heavy costs without any risk of its obsolescence. Though it is considered costly method of financing in comparison to other methods, it however , benefits both the parties as under :

- **Tax benefit to lessee :** For computing total income lease rentals are fully deductible.
- **Tax benefit to lessor :**the lessor can claim the depreciation allowance but Lease rentals are included in taxable income.

Illustration :3

X Limited is considering to install a plant which can either directly be purchased or can be acquired on a lease basis . The following particulars is given by the company :

Buying alternative	Leasing alternative
Initial cost 10,00,000	Annual rentals Rs.3,00,000 for five years
Residual value 3,20,000	Residual Value Rs.1,80,000

Depreciation is 20% on written down value .Cost of capital is 10%. The time gap between the claiming of tax allowances and receiving the benefit is one year. Assume tax rate as 40%.

You are required to evaluate the alternatives and recommend the better option.

Solution :

Alternative 1 : Buying

Tax saving under scheme of depreciation :

year	Cost or WDV	Depreciation @ 20%	Corporate tax savings @40%
1	10,00,000	2,00,000	80,000
2	8,00,000	1,60,000	64,000
3	6,40,000	1,28,000	51,200
4	5,12,000	1,02,400	40,960

5	4,09,600		
Less residual value	3,20,000		
	89,600	89,600	35,840

Calculation of Net present value (NPV)

Year	Cost	Tax relief	Net cash inflow	PV factor 10%	PV
0	(10,00,000)		(10,00,000)		(10,00,000)
1				.909	
2		80,000	80,000	.826	66080
3		64,000	64,000	.751	48,064
4		51,200	51,200	.683	34,970
5	3,20,000	40,960	3,60,960	.621	2,24,157
6		35840	35840	.564	20214
				NPV	(6,06,515)

Alternative 2 : Buying

Calculation of Net present value (NPV)

year	Lease Rentals	Tax relief	Net cash inflow	PV factor 10%	PV
0	(3,00,000)		(3,00,000)		(3,00,000)
1	(3,00,000)		(3,00,000)	.909	(2,72,700)
2	(3,00,000)	1,20,000	(1,80,000)	.826	(1,48,680)
3	(3,00,000)	1,20,000	(1,80,000)	.751	(1,35,180)
4	(3,00,000)	1,20,000	(1,80,000)	.683	(1,22,940)
5	1,80,000	1,20,000	3,00,000	.621	1,86,300
6	Residual value 1,80,000	72,000	48,000 (1,20,000-72,000)	.564	27,072
				NPV	766128

Evaluation : From the above analysis it is clear that the NPV of discounted cash flows is higher in case of leasing alternative i.e. Rs. 7,66,180 as compared to buying alternative which is only Rs.6,06,515.

Decision : The company should purchase the plant than acquiring it on lease basis.

2. Make or buy decision

The decision to make or buy is dependent on several factors i.e. the variable and fixed cost involved in manufacturing and purchase price, the labour problem, the installed capacity, the reliance on suppliers etc. There are many tax considerations too. If the decision is related to the establishment of new unit of manufacture, then there is a need to consider the several tax incentives available under section 10A, 10B, 32, 80 IB, 80 IC . if manufacturing is done for a long time and the manufacturing plant or machinery is to be sold , then tax implication of section 50 may also be considered.

17.5 DISTRIBUTION OF DIVIDENDS

Dividend decisions are also important financial decisions which attract the consideration of financial manager for maximisation of shareholders wealth. A Dividend refers to a share of profit of a company divided among its shareholders in proportion to their shareholding. Dividend are periodic cash payment made from the distributable profits of the company. Therefore, the payment of dividend also implies cash outflows which reduce the cash resources of the company. Dividend payable to preference shareholders is fixed but in case of equity shareholders is is dependent on the discretion of company's Board of directors. Dividend policy determines how much amount of distributable profit is distributed among shareholders and how much is kept as retained earning for the requirements of the company. Besides considering the tax implication of dividend on shareholders wealth, a finance manager also has to keep in mind that distribution of dividend in certain cases attract individual tax liability and also non payment or less payment of dividend may lead to selling of shares which again attract capital gains tax liability on individuals.

Meaning of Dividend

A dividend is that part of residual disposable income of a company which is paid to shareholders. According to Section 2(22) the following payments or distribution by a company to its shareholders are treated as deemed dividend to the extent of its accumulated profits :

- a. any distribution entailing the release of company's assets
- b. any distribution of debenture, debenture stock and bonus to preference shareholders
- c. Distribution on liquidation of company
- d. Distribution on reduction of capital
- e. Any payment of loan or advance by closely held company to a shareholder holding substantial interest provided the loan should not have been made in the ordinary course of business and money lending should not be a substantial part of the company's business.

Tax Implications:

In the first four cases (a to d) the recipient shareholder of the dividend is not chargeable to tax but the company will pay the dividend tax according to section 115-O but in the last case (e), the recipient shareholder of the dividend and not the company, will pay the dividend tax.

Distribution of Accumulated Profits

According to sub clause (a) of section 2(22), any distribution by a company of its accumulated profits (whether capitalised or not) is dividend if it entails release of the assets by the company.

It is therefore clear that:

- (i). dividend must be distributed from accumulated profits (not from capital) and**
- (ii). It must result in release of assets by the company.**

What is the meaning of Accumulated Profits?

Accumulated profits include all profits (Accumulated or current) up to the date of distribution or payment in the case of a company which is not in liquidation. But in the case of a company in liquidation it includes all profit up to the date of liquidation. Accumulated profits are computed on the basis of commercial profits.

Deemed dividend

The following payments or distribution by a company to its shareholders are treated as deemed dividend :

1. Issue of bonus shares to preference shareholders

If a company distributes ordinary or equity bonus by capitalising its profits then there is no release of assets and consequently, bonus shares are not taxable as dividends. In case of issue of bonus shares to preference shareholders, it amounts to distribution of dividend according to sub clause (b) of section 2(22).

2. Debentures ,debenture stock or debenture certificates

In addition to preference share dividend as mentioned above, according to sub clause (b) of section 2(22) Distribution of debentures, debenture stock or deposit certificate with or without interest by a company to its shareholders are treated as dividend to the extent of accumulated profits (whether capitalised or not)of the company.

3. Distribution on liquidation of company

Under sub clause (c) of section 2(22) any distribution made by a company to its shareholders on its liquidation is treated as dividend to the extent to which such distribution is attributable to the accumulated profits, whether capitalised or not, of the company immediately before the liquidation. But the following will not be treated as dividends:

- (i) Any distribution in respect of preference shares issued in full consideration and
- (ii) Any distribution from capitalised profits of the company representing bonus shares allotted to equity shareholders after 31 March 1964 but before April 1, 1965.

4. Distribution on reduction of capital

According to section 2(22)(d) any distribution by a company to its shareholders on the reduction in the capital is treated as dividend to the extent company possesses accumulated profits (whether capitalised or not). However any distribution in respect of preference shares issued for full consideration is not treated as dividend. Reorganisation of capital splitting up capital of the company into two companies without the reduction of capital in aggregate is not treated dividend.

5. Distribution of dividend by advance and loans

If loans and advances is given by a closely held company to a registered shareholder holding 10% or more shares in the company, such loans and advances is treated as dividend to the extent of accumulated profits (including capitalised profits).

17.6 TAX TREATMENT OF DIVIDENDS

1. Dividend from a domestic company:

According to section 10(34) dividend declared, distributed and paid by a domestic company after May 31, 1997 but before April 1, 2002, or after March 31, 2003, is not taxable in the hands of shareholders of a company. Under section 115-O the company has to pay dividend tax on such dividends subject to following exceptions :

(i) **Deemed dividend** : If a loan or advance is given during June 1, 1997 and March 31, 2002 or after March 31, 2003, which is deemed as dividend under section 2(22) (e), then such loan and advance is taxable under section 56 as dividends in the hands of recipient.

(ii) **Tax on certain dividends** : From Assessment year 2016-17, Under section 115BBDA aggregate dividend income from a domestic company in excess of Rs.10 Lakh to a resident individual/HUF/ firm is chargeable to tax at the rate of 10%.[except deemed dividend under section 2(22)(e)].

2. Dividend from a company other than a domestic company :

Dividend received from a company other than a domestic company is chargeable to tax in the hands of recipients.

3. **Relief for mitigation of cascading effect of dividend distribution Tax** : According to section 115 O (IA) when a holding company has received dividend from its subsidiary company and the holding company declares the dividend to its shareholders in the same financial year, a relief is allowed to the holding company in respect of dividend received from its subsidiary company out of the dividend

declared, distributed and paid by the holding company to its shareholders provided the subsidiary company is a domestic company and it has paid tax on the amount of dividend paid to holding company or if the subsidiary company is a foreign subsidiary, the dividend paid by it to Indian holding company is taxable in the hands of holding company under section 115 BBD when is not taxable in the home country of Y limited.

This can be explained with the help of the following example :

Example :4

A Limited, a Delhi based manufacturing Indian company has declared a dividend of RS. 4 lakh during financial year 2016-17. For the same financial year company's income from business is Rs.30 Lakhs. The company holds 51% shareholding in X limited, a domestic subsidiary and Y limited a foreign subsidiary. During the financial year the company has received Rs.25,000 from X Limited and RS. 50,000 dividend from Y Limited respectively. Assuming that X Limited has paid dividend tax on the dividend paid to A Limited and A limited has to pay tax on dividend paid by Y limited, find out Income tax and dividend tax liability of A Limited. Does it make any difference if dividend income from foreign subsidiary company Y limited is taxable in the home country of Y limited.

Solution :

Computation of Taxable Income and Tax liability of A Limited (Holding company)

Particulars	Amount Rs.
Business Income	30,00,000
Dividend received from Indian subsidiary (exempt under section 10(34))	NIL
Dividend received from Foreign subsidiary	
Taxable Income	50,000
Tax on Taxable Income	30,50,000
15% on Dividend from Y Limited +	
30% on balance Rs. 30,00,000)	7,500
Add Education cess @ 3%	9,00,000
Tax Liability	27,725
	9,27,730

Computation of Dividend Tax liability of A Limited (Holding company)

Particulars	Amount Rs.
Dividend declared by A Limited	4,00,000
Less Dividend received from X limited on which tax is paid by X limited u/s 115 O	25,000

Less Dividend received from Y limited on which tax is payable by A limited u/s 115 BBD	50,000
Net Dividend	3,25,000
Dividend Tax @17.64706% of 3,75,000	57,353
Add surcharge@12 % +	6,882
Education cess @ 3%	1,721
Dividend Tax liability	65,956

If dividend income from foreign subsidiary company Y limited is taxable in the home country of Y limited, the business income tax, tax liability and dividend tax liability will be calculated as under :

Computation of Taxable Income and Tax liability of A Limited (Holding company)

Particulars	Amount Rs.
Business Income	30,00,000
Dividend received from Indian subsidiary (exempt under section 10(34))	NIL
Dividend received from Foreign subsidiary	
Taxable Income	NIL
Tax on Taxable Income	30,00,000
@30% on balance Rs. 30,00,000)	9,00,000
Add Education cess @ 3%	27,000
Tax Liability	9,27,000

Computation of Dividend Tax liability of A Limited (Holding company)

Particulars	Amount Rs.
Dividend declared by A Limited	4,00,000
Less Dividend received from X limited on which tax is paid by X limited u/s 115 O	25,000
Less Dividend received from Y limited on which tax is not payable by A limited u/s 115 BBD	NIL
Net Dividend	3,75,000
Dividend Tax @17.64706% of 3,75,000	66,176
Add surcharge@12 % +	7941
Education cess @ 3%	1985
Dividend Tax liability	76102



Check Your Progress-A

Q1. Fill in the gaps :

- i. According to section dividend declared, distributed and paid by a domestic company is not taxable in the hands of shareholders of a company.
- ii. Dividend must be distributed from
- iii. Planning the optimum capital structure is one of the basic function of
- iv. A relief is allowed to the holding company in respect of dividend received from its subsidiary company under.....
- v. Payments or distribution by a company to its shareholders are treated as deemed dividend under
- vi. If the subsidiary company is a foreign subsidiary , the dividend paid by it to Indian holding company is taxable in the hands of holding companywhen is not taxable in the home country of Y limited.
- vii. At the time of sale of bonus shares the issuing company does not attract any tax liability but the shareholder is chargeable to tax for capital gains on bonus share. As the bonus shares are received without any payment ,for this, cost of acquisition will be zero under section
- viii. If a company capitalise its profits by the distribution of ordinary and equity shares as bonus then there isby the company to its shareholders.
- ix. According to section 2(22)(d) any distribution by a company to its shareholders on the reduction in the capital is treated as..... to the extent company possesses accumulated profits.
- x. At the time of redemption of bonus shares or at liquidation of company the issue of bonus share will be deemed as dividend distribution up-to the amount of

Q2. Indicate whether TRUE or FALSE

- i. Tax planning and financial decisions are interrelated.
- ii. Business risk is mainly influenced by fixed costs whereas the financial risk is associated with debt equity mix.

- iii. Debt funds are also preferred to retain control of existing shareholders in the company.
- iv. A company with high level of business risk may have higher proportion of debt in their capital structure.
- v. If bonus shares are issued to preference shareholders, then it amounts to distribution of dividend and therefore bonus shares are taxable in this case.
- vi. In computing total income lease rentals are fully deductible for lessee.
- vii. Lease rentals when paid are shown as business expenditure in the statement of affairs of the lessee company.
- viii. Bonus shares are taxable as dividend if issued to equity shareholders.
- ix. Bonus shares are taxable in the hands of shareholders at the time of sale of such shares under capital gains.
- x. From Assessment year 2016-17, Under section 115BBDA aggregate dividend income from a domestic company in excess of Rs.20 Lakh to a resident individual/HUF/ firm is chargeable to tax at the rate of 10%.

17.7 BONUS SHARES

Bonus shares are not taxable as dividend if issued to equity shareholders:

If a company capitalise its profits by the distribution of ordinary and equity shares as bonus then there is no release of assets by the company to its shareholders and therefore bonus shares are not taxable as dividend in the hands of either the issuing company or shareholder at the time of issue of bonus share. At the time of sale of bonus shares the issuing company does not attract any tax liability but the shareholder is chargeable to tax for capital gains on bonus share. For this, cost of acquisition will be zero as the bonus shares are received without any payment. (Section 55). If original shares and bonus shares are acquired before April 1, 1981 the cost of acquisition for bonus shares would be fair market value on April 1, 1981 but if original shares are acquired before April 1, 1981 and bonus shares are allotted after April 1, 1981, the cost of acquisition will be actual cost or fair market value whichever is more for original shares and zero for bonus shares. In case both of these shares acquired after April 1, 1981, the cost of acquisition will be actual cost for original shares and zero for bonus shares. Holding period will be determined from date of allotment. At the time of redemption of bonus shares or at liquidation of company the issue of bonus share will be deemed as dividend distribution up-to the amount of accumulated profit and the company is liable to pay the dividend distribution tax on it. However, the shareholder will be exempt from tax to the extent of deemed dividend and the balance will be treated as capital gain.

Bonus shares are taxable as dividend if issued to preference shareholders:

If bonus shares are issued to preference shareholders, then it amounts to distribution of dividend and therefore bonus shares are taxable in the hands of shareholders at the time of

sale of such shares under capital gains. The issuing company does not attract any tax liability except at the time of issue of these shares after May 31, 1997 but not during 2002-03.

Let us understand this with the help of the following example.

Example: 5

A is the shareholder of XY Limited. He has given the following information to you to find out his capital gains. Assume security transaction tax is not applicable. Fair market value of shares of XY Limited on April 1, 1981 is Rs. 70.

- i. On 30.6.1980, he purchased 100 equity shares of XY Limited @ Rs. 50 per share on which he paid brokerage @ 1%.
- ii. On 30.5.1984, he was allotted 50 bonus shares.
- iii. On 15.3.2016, he sold 100 original shares @ Rs. 150 per share on which he paid brokerage @ 1%.
- iv. On 30.3.2016, he sold 50 Bonus shares @ Rs. 150 per share on which he paid brokerage @ 2%.

Solution :

Computation of income from capital gains on sale of original / bonus shares

Particulars	Amount Rs.
Sale proceed of 100 original shares 100x 50	5000
Less indexed cost of acquisition : 70x100x1081/ 100	(-)75,670
Less brokerage 1% of 5000	(-)50
Long term capital gains	(-)70720
Sale proceed of 50 bonus shares 100x 150	15,000
Less cost of acquisition	NIL
Less brokerage 2% of 15000	300
Long term capital gains	14,700
Total Income from capital gains	(-)56,020

17.8 SUMMARY

Tax planning and financial decisions are interrelated. Financial management decisions comprised of decisions regarding finance, investment and dividends. Financial decisions should be taken in the light of basic objective of maximisation of wealth of shareholders. Since corporate tax payments involve cash outflows and would obviously result in the reduction of profits and wealth of shareholders. There are several financial decisions which may have an impact on taxation of the company. Some of the such important decisions are : Capital structure decisions involving raising of long term finances in equity and debt, Lease or buy decisions and distribution of dividends.

Optimum capital structure refers to a combination or mix of debt and equity of a company that can provide maximum value to its shareholders by minimising the overall cost of capital. Capital structure generally implies long term sources and the proportion of debt and equity in the total capital of the company. Higher proportion of debt increases the fixed charge commitment of the company as well as the commitment for timely repayment. Debt involves both type of risks i.e. business risk and financial risk. Business risk is mainly influenced by fixed costs whereas the financial risk is associated with debt equity mix. A company with low level of business risk may have higher proportion of debt in their capital structure. However, if business risk is higher, higher proportion of debt becomes more risky. Under income tax law interest paid on debt is deductible from income and reduces tax liability whereas the dividend payable on equity and preference share capital are not deductible and thereby increases cost of equity capital. Cost of raising finance is deductible in the year in which it is incurred whereas the cost of issue of share is allowed as deduction in five years under section 35 D.

Lease or buy or make or buy decisions are important managerial decisions. Leasing is an innovative technique which provide the facility of possessing and operating an asset without owning it. The lessee just make agreed periodical payments as rentals . These lease rentals when paid are shown as business expenditure in the statement of affairs of the lessee company and are fully deductible for computing total income. The lessor can also claim the depreciation allowance but Lease rentals are included in its taxable income. Leasing is, therefore, advantageous to lessee for being an easy method of financing capital asset with heavy costs without any risk of its obsolescence. Though it is considered costly method of financing in comparison to other methods, it however , benefits both the parties.

Dividend decisions are also important financial decisions. According to sub clause (a) of section 2(22) , any distribution by a company of its accumulated profits (whether capitalised or not) is dividend if it entails release of the assets by the company. Certain payments or distribution by a company to its shareholders are treated as deemed dividend. According to section 10(34) dividend declared, distributed and paid by a domestic company after May 31, 1997 but before April 1, 2002, or after March31, 2003, is not taxable in the hands of shareholders of a company.

Under section 115-O the company has to pay dividend tax on such dividends. Dividend received from a company other than a domestic company is chargeable to tax in the hands of recipients. Bonus shares are not taxable as dividend if issued to equity shareholders but are taxable as dividend if issued to preference shareholder.

If a company capitalise its profits by the distribution of ordinary and equity shares as bonus then there is no release of assets by the company to its shareholders and therefore bonus shares are not taxable as dividend in the hands of either the issuing company or shareholder at the time of issue of bonus share. At the time of sale of bonus shares the issuing company does not attract any tax liability but the shareholder is chargeable to tax for capital gains on bonus share. For this, cost of acquisition will be zero as the bonus shares are received without any payment. (Section 55). Holding period will be determined from date of allotment. At the time of redemption of bonus shares or at liquidation of company the issue of bonus share will be deemed as dividend distribution up-to the amount of accumulated profit and the company is liable to pay the dividend distribution tax on it. However, the shareholder will be exempt from tax to the extent of deemed dividend and the balance will be treated as capital gain. If bonus shares are issued to preference shareholders, then it amounts to distribution of dividend and therefore bonus shares are taxable in the hands of shareholders at the time of sale of such shares under capital gains. The issuing company does not attract any tax liability except at the time of issue of these shares after May31, 1997 but not during 2002-03.



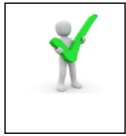
17.9 GLOSSARY

Capital structure : refers to the composition of different types of capital i.e. equity, preference and long term debt in the overall capital of the company.

Optimum capital structure : refers to a combination or mix of debt and equity of a company that can provide maximum value to its shareholders by minimising the overall cost of capital.

Leasing : is an innovative technique which provides the facility of possessing and operating an asset without owning it.

Dividend : refers to a share of profit of a company divided among its shareholders in proportion to their shareholding.



17.10 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress –A

Q1.

- i. 10(34)
- ii. accumulated profits
- iii. finance manager
- iv. section 115 O (IA)
- v. section 22 (e)
- vi. under section 115 BBD
- vii. Section 55
- viii. no release of assets
- ix. dividend
- x. accumulated profit.

Q2.

- i. True
- ii. True
- iii. True
- iv. False
- v. True
- vi. True
- vii. True
- viii. False
- ix. True
- x. False



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17.12 SUGGESTED READINGS

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2. Vinod K. Singhanian, Taxmann's Direct Taxes Planning and Management.
3. V.S. Sundaram, Commentaries on the Law of Income- Tax in India, Law Publishers, Allahabad.
4. A.C. Sampath Iyengar, Law of Income Tax, Bharat Publishing House, Allahabad.
5. Taxman, The Tax and Corporate Law Weekly.
6. Bhagwati Prasad, Direct Taxes Laws Practice, Wishwa Prakashan



17.13 TERMINAL QUESTIONS

- Q1. What do you mean by capital structure? What is the role of finance manager to build an optimum capital structure?
- Q2. Explain the Tax implications of capital structure decisions with the help of a suitable example.
- Q3. What do you understand by lease? Discuss the tax benefits of leasing? Give suitable example.
- Q4. Discuss with the help of an example, the tax implication of make or buy decisions.
- Q5. Define dividend. What are treated deemed dividend under section 2(22)?
- Q6. Explain tax treatment of dividends.
- Q7. What do you mean by dividend distribution tax ? Explain with suitable example the relief provided under section 115 O (IA) in respect of mitigation of cascading effect of dividend distribution tax.
- Q8. Explain with example the taxability of bonus shares in the hands of issuing company and shareholder.

UNIT 18 TAX PLANNING FOR NEW BUSINESS

18.1 Introduction

18.2 Objectives

18.3 Organisational form of new business

18.4 Location of new business

18.5 Nature of new business

18.6 Acquisition of assets for new business

18.7 Summary

18.8 Glossary

18.9 Answer to Check Your Progress

18.10 References

18.11 Suggested Readings

18.12 Terminal Questions

18.1 INTRODUCTION

As you already aware that corporate tax planning involves systematic planning of a company's operations in such a way as to attract a minimum liability to tax or deferment of tax liability for future years. The tax payer can plan to take the benefits of all available allowances, incentives, exemptions, and deductions, various concessions, rebates & reliefs, specifically provided for new businesses in law. However, tax planning is not about taking illegitimate or illegal benefits. Tax planning must not comprise any colourable act or devices . It refers to the legal and legitimate tax benefits only.

Tax planning is more relevant for new businesses. Encouraged by emerging opportunities in the modern business environment there has been increased trend of new start ups in various parts of the country on a daily basis. The globalisation, privatisation and liberalisation of economies has fuelled and accelerated this process by facilitating conducive business environment. The new industrial policy , new licensing policy , Export Import (EXIM) policy and Foreign trade policy(FTP) along with the monetary and fiscal measures of the government, new businesses are increasingly coming across various sectors and regions. The advent and access to emerging new technologies and new market potential has also attracted new entrepreneurs to invest in various sectors. However, despite huge potential , new

businesses are also prone to possible failures and closure due to variety of factors. While starting up new businesses one is more concerned about their cost structure, likely profitability in future and sustainability which is influenced to a great extent by their tax liabilities. Since the income of new businesses is mainly chargeable to tax under the head, Business and Profession, capital gains and income from other sources, the new entrepreneur or management takes into account allowable business expenditures in computing taxable business income, the exemptions, deductions, the special incentives available for particular locations, nature and organisational forms of business to minimise the overall tax liability. The entrepreneur has to find and undertake tax planning in areas where he can reduce the tax liability. He seeks to get maximum advantage of the various allowances, deductions and other tax concessions given under the law. Therefore, appropriate decisions may be taken by the management of new businesses for tax planning purpose in the following areas:

- Form of New Business
- Nature of New business
- Location of new business
- Acquisition of assets for New business

18.2 OBJECTIVES

After discussing this unit you will be able to:

- Understand the meaning and objectives of new business.
- Discuss the basic features of each form of organisation on the basis of their tax implications
- Explain the tax benefits of organisational form of new business
- Explain the tax benefits of Location of new business
- Explain the tax benefits of Nature of new business

18.3 ORGANISATIONAL FORM OF NEW BUSINESS

A new business may be commenced on sole proprietorship or it can choose any other organisational form i.e. firm, HUF, LLP or a company. Every form has its specific characteristics, likely benefits and limitations. The choice of the organisational form is itself dependent on many factors which may include both types of factors i.e. tax related factors and other factors. While the former include tax concessions, exemptions and allowances available to a particular form of organisation the latter may include nature, size and scale of business, capital investment requirements of new business and resource availability for it e.g. land, labour, capital, management skills and technology, its target market potential and size and many other considerations. Organisational form itself does not remain static over the years. It can be changed as and when required as per compliance of provisions laid down in the laws. However, such changes may attract possible tax liability in the hands of both

parties i.e. seller and purchaser of business such as capital gains arising out of given sale. Business losses can be set off and unabsorbed losses may be carried forward as per provisions of the Act. Therefore, appropriate decisions must be taken to determine the organisational form of new business in order to avoid frequent changes and resultant tax liability. The new business can be organised in any of the following main forms of business organisation:

1. Sole proprietorship
2. Hindu undivided Family
3. Partnership firms
4. Limited liability partnership
5. Company
6. Cooperative society

Let us discuss the basic features of each form of organisation on the basis of their tax implications in detail :

1. Sole proprietorship

Under sole propriety concern the entire business income is included in gross total income along with other income chargeable in other heads. No allowance or relief is available in respect of business income. For example reasonable amount of remuneration paid to managing director in case of a private company is allowable as business expenditure but under sole proprietorship the remuneration for services rendered by the proprietor is not allowable. However loss and other allowances can be set off against his other income. If there is a change in the form of organisation later by its conversion to LLP or firm or company , it attracts the tax liability in terms of capital gains.

2. Hindu undivided Family

HUF is a an organisational form of business where business is carried on by the members of the family on behalf of the family The income of the family is computed and taxed in the hands of the family at the rates applicable to it. Business expenses are normally allowable. Share of member in family income is exempt under section 10(2). Therefore, HUF has double advantage as far as tax benefit is concerned. The family gets the same treatment as company does in respect of business income and additionally members share of family income is exempt from tax in the hands of the members.

3. Partnership firm

In partnership form of organisation, the liability of partners is unlimited. Partners are jointly and severally liable and any change in partners may effect the very survival of the firm. In computing taxable income of the firm deduction in respect of interest and remuneration is allowed. Like LLPs the entire income of the firm is taxable at the rate of 30%plus Surcharge of 12% (if the income exceeds 1 crore). , education cess@2% and secondary and higher

education cess @1%, but the share of members in the income of firm is fully exempt from tax.

4. Limited liability partnership

Limited liability partnership (LLP) is a form of organisation that contains some features of both company and a firm. This form has limited liability feature of a company on the one hand and at the same time has the feature of flexibility of a partnership. It has perpetual succession like a company and unlike partnership firm, any change in the partners of LLP have no effect on the rights and duties of partners. Moreover, the liability of partners of LLP is limited to their share of contribution and the liability of LLP to the outsiders is limited to the extent of its assets. While computing taxable income of LLP, interest on capital (up to 12%) and remuneration paid to partners is allowable subject to fulfilling the conditions under section 184 and 40 (b) as deductions. Thereafter, the total income of LLP is taxable like a firm (maximum tax rate is 30% plus surcharge and cess) but the partner's share is exempt from tax. The deducted amount of Interest on capital and remuneration paid to Partners by LLP is again added to their business income and taxable to that extent.

5. Company

With potential of attracting large amount of funds from public and financial institutions, company form of organisation is appropriate for comparatively larger projects requiring huge capital investment and serving for large markets. However, for tax purpose, several options are available as to specific kind of company form of organisation which will determine its tax liability. The company may be a domestic or foreign company; closely held or widely held company or a company in which public are substantially interested because in the income tax act certain restriction i.e. restriction on carry forward of losses (under section 79); advances and loans to shareholders to be treated as deemed dividend under section 2(22) etc. has been imposed on the companies in which public are not substantially interested. The domestic companies are liable to pay tax @ 15% plus surcharge @ 12% and cess @3% on dividend declared, distributed and paid under section 2(22)(e). However, according to section 10(34) dividend declared, distributed and paid by a domestic company after May 31, 1997 but before April 1, 2002, or after March 31, 2003, is not taxable in the hands of shareholders of a company.

6. Cooperative society

A cooperative society attracts substantial benefits under the provisions of the Income Tax Act, 1963. Under section 80 P the income of cooperative society is exempt from tax subject to conditions specified therein. Cooperative banks (primary agricultural cooperative societies and primary cooperative agriculture and rural banks) enjoy certain tax benefit than commercial banks who are not treated at par with cooperative banks. Moreover, a cooperative society can claim deduction of the amount paid to its members as remuneration for services rendered by them, commission payable of them and interest on deposits or loan.

Example : 1

From the following information undertake a comparative study of tax incidence on sole proprietorship , firm and a private company :

1. There are two equal partners A and B in the firm and there are two shareholders and directors in the public limited company.
2. Both partners in the firm and both directors in the company are drawing maximum permissible equal salary.
3. They are entitled to simple interest @ 12% on Rs. 10,00,000 of capital contributed by them.
4. There is no other income .

Table 1**Tax incidence on sole proprietorship**

Total Income	Share of each individual	Tax liability of A	Tax Liability of B	Total tax liability	Total tax as % of income
4,00,000	2,00,000	nil	nil	nil	nil
8,00,000	4,00,000	10,300	10,300	20,600	2.575
12,00,000	6,00,000	46,350	46,350	92,700	7.725
20,00,000	10,00,000	1,28,750	1,28,750	2,57,500	12.875

Table 2**Tax incidence on firm and partners**

Total Income before interest and salary	Interest	salary	Tax able income	Tax Liability of firm	tax liability of partners A &B	Total tax as % of income
4,00,000	1,20,000	2,52,000	28,000	8,652	nil	nil
8,00,000	1,20,000	4,98,000	1,82,000	56,238	1, 860	7.262
12,00,000	1,20,000	7,38,000	3,42,000	1,05,678	36,880	11.879
20,00,000	1,20,000	12,18,000	6,62,000	2,04,560	1,21,120	16.284

Table 3**Tax incidence on Private limited company and Directors**

Total Income	Salary to Director	Taxable income	Tax Liability	Taxable income	Tax Liabil	Total tax of	Total tax as
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before salary	s		of the company	of A	ity of A	company and A&B (5+6 x2)	% of income
1	2	3	4	5	6	7	8
4,00,000	3,30,000	70,000	21,630	1,15,000	nil	21,630	5.407
8,00,000	5,70,000	2,30,000	71,070	2,85,000	nil	71,070	8.884
12,00,000	8,10,000	3,90,000	1,20,510	4,05,000	15,970	1, 52,450	12.704
20,00,000	12,90,000	7,10,000	2,19,390	6,45,000	55,620	3,30,630	16.532

Analysis of results and conclusion :

1. Tax incidence in case of sole proprietorship is lowest as compared to firm and company.
2. Tax incidence in case of Private limited company is highest as compared to sole proprietorship and firm.
3. Tax incidence in case of firm is lower than Private limited company .
4. Therefore, tax incidence for smaller proprietorship and firm is lower.

18.4 LOCATION OF NEW BUSINESS

Location of a business is not only effected by economic and statutory restrictions imposed upon them by the government but also determined to a great extent on the tax concessions and incentives available to different business entities. These legal provisions providing specific concessions play an important role in deciding the location of a business.

The following are some of the important incentives, concessions, deductions or allowances on the basis of location of new businesses :

1. Newly established undertakings in free trade zone (FTZ) : Under section 10 A

100% Of profit is deductible for 10 years commencing from the initial assessment year for the provision of infrastructural facility; incentive also covers telecommunication services, industrial parks, power generation, transmission and distribution, renovation and modernisation, undertakings set up for reconstruction of a power unit, cross country natural gas distribution network for deduction extending different periods and in specific percentage)

2. Newly established Units in Special Economic Zones (SEZs) - Under section 10 AA

If an assessee satisfies the following conditions, then he can claim a deduction from gross total income in respect of profits and gains derived from such business provided that the

deduction is claimed in return of income submitted before due date, the books of accounts are duly audited and submit Audit Report in Form No.56F along with the return of income:

- (i) An Assessee is an entrepreneur according to section 2 of the Special Economic Zones Act, 2005. Entrepreneur means a person who has been granted a letter of approval by the Development Commissioner to set a unit in a Special Economic Zone.
- (ii) The Unit in SEZ who begins to manufacture or produce articles or things or provide any services during the previous year relevant to any assessment year commencing on or after the 1st day of April 2006.
- (iii) It should not be formed by the transfer of old machinery or plant to a new business and by the splitting up, or the reconstruction, of a business already in existence.
- (iv) The assessee has income from export of articles or thing or from services from such unit.

Quantum and period of deduction :

1 Amount of deduction which depends upon the quantum of profits derived from exports , is calculated as under –

(Profit of business of the undertaking X export turnover) ÷ Total turnover of the business)

1. Quantum and period of deduction: For first five years 100% of the profit and gains derived from such business for 5 consecutive assessment years relevant to previous years in which the unit begins followed by 50% of the profit and gains in the next five years . A deduction of 50 % of profits will be allowed from 11th year to 15th year provided in the previous year an equivalent amount is credited from profit and loss account to Special economic zone reinvestment allowance reserve account or special reserve account, which will be utilised for business purposes other than distribution of dividend , until acquiring new plant and machinery that must be put in use before the expiry of 3 years from the date of creation of such reserve account . If new plant and machinery is not acquired within three years as referred above, or in case of misutilisation of special reserve account the deduction would be taken back in the year in which such misutilisation is done and in the subsequent year following three years respectively.

3. Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings (Section 80-IB)

Industrial undertakings deriving profit and gains from (i) Business of an industrial undertaking (ii) operation of ship (iii) hotels (iv) Scientific research (v) Production of mineral oil (vi) Developing and building housing projects. (vii) Cold Chain facility for agriculture produce.. (viii) Multiplex theaters. (ix) Convention Centre (x) Hospital in Rural area. (xi) Hospital anywhere in India, can claim a Deduction under Section 80-IB .

If a new industrial undertaking is mainly engaged in the business of construction of ships or in the manufacture or processing of goods or in mining, is allowed to claim deduction under this section, satisfying the following conditions:

1. It is not formed by splitting up, or the reconstruction, of a business already in existence.
2. It is not formed by the transfer to a new business of machinery or plant previously used for any purpose. But, old plant and machinery, not exceeding 20% of the total value of plant and machinery of the new industrial undertaking, can be transferred to the new industrial undertaking,
3. It manufactures or produces any article or thing, not being any article or thing specified in the list in the Eleventh Schedule, or operates one or more cold storage plant or plants, in any part of India. However, this does not apply to a small scale industrial undertaking or an industrial undertaking located in an industrially backward state.
4. The undertaking employs ten or more workers if the manufacturing process is carried with the aid of power or employs twenty or more workers if the manufacturing process is carried without the aid of power.
5. Manufacture or production should begin: (i) for small scale industries during April 1, 1991 – March 31, 2002; (ii) for industrial undertaking in a backward state during April 1, 1994 – March 31, 2004; (in case of J & K during April 1, 1993 – March 31, 2012;) cold chain facility during April 1, 1999 – March 31, 2004;
6. The deduction is claimed in return of income submitted before due date and the books of accounts are duly audited.

4. Special provisions in respect of certain undertakings or enterprises in certain special category states (Section 80-IC)

A deduction can be claimed in return of income submitted before due date provided that the books of accounts are duly audited in case the income of an assessee includes any profits and gains derived by an undertaking or an enterprise :

- (1) which has begun or begins to manufacture or produce specified articles or things in specified area and undertakes substantial expansion during the period beginning—
 - (i) on the 23rd day of December, 2002 and ending before the 1st day of April, 2012, in any specified areas, in the State of Sikkim; or
 - (ii) on the 7th day of January, 2003 and ending before the 1st day of April, 2012, in any specified areas, in the State of Himachal Pradesh or the State of Uttaranchal; or
 - (iii) on the 24th day of December, 1997 and ending before the 1st day of April, 2007, in any specified areas, in any of the North-Eastern States;
- (2) which has begun or begins to manufacture or produce any specified article or thing, in specified area and undertakes substantial expansion during the period beginning –

(i) on the 23rd day of December, 2002 and ending before the 1st day of April, 2012, in the State of Sikkim; or

(ii) on the 7th day of January, 2003 and ending before the 1st day of April, 2012, in the State of Himachal Pradesh or the State of Uttaranchal; or

(iii) on the 24th day of December, 1997 and ending before the 1st day of April, 2007, in any of the North Eastern States.

(3) it is not formed by splitting up, or the reconstruction, of a business already in existence; (excluding an undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking within the specified period;

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

Meaning of Specified area : In this respect, the Specified area refers to any Export Processing Zone or Integral Infrastructure Development Centre or Industrial Growth Centre or Industrial Park or Theme Park, as notified by the Board in accordance with the scheme framed and notified by the central government.

Quantum and period of deduction: 100% of such profits and gains for ten assessment years commencing with the initial assessment year; (ii) In the case of Himachal Pradesh and Uttaranchal 100% of such profits and gains for five assessment years commencing with the initial assessment year and thereafter, 30% of the profits and gains (25% in case of a non corporate assessee) for the next 5 years.

18.5 NATURE OF NEW BUSINESS

One of the major consideration in tax planning about new business is the Choice of the nature of business with reference to special benefits available to the particular kind of industries under the taxation laws. Some of these benefits are of substantial nature and become an important deciding factor of the nature of business.

The following are the incentives , concessions , deductions or allowances on the basis of nature of new businesses :

1. **Newly established industrial undertaking in free trade zone and SEZ**
:Amount of deduction will depend upon the quantum of profits derived from exports. Under section 10 A the deduction would be given for 10 consecutive assessment years from the previous year of beginning of manufacturing or production in case of FTZ. Under section 10 AA, in case of new units in SEZ deduction will be : for first five years 100% of the profit and gains derived from such business for 5 consecutive assessment years relevant to previous years in which the unit begins production followed by 50% of the profit and gains in the next five years . A deduction of 50 % of profits will be allowed from 11th year to 15th year provided in the previous year an equivalent amount is credited from

profit and loss account to Special economic zone reinvestment allowance reserve account or special reserve account, which will be utilised for business purposes other than distribution of dividend, until acquiring new plant and machinery that must be put in use before the expiry of 3 years from the date of creation of such reserve account.

2. Eligible start ups : Under section 80 IAC

A company or LLP incorporated after March, 31,2016 but before April1, 2019 and engaged in eligible business i.e. innovation, development, deployment or commercialisation of new products, processes, or services and the annual business turnover of the company or LLP does not exceed 25 crore in any of the previous year during 2016-17 to 2020-21 can claim deduction in return of income submitted before due date provided that the books of accounts are duly audited and audit report is duly uploaded with return of income.

Quantum and period of deduction :(1) 100% of such profits and gains deductible in any three consecutive assessment years out of five years at the option of the assessee.

3. **Enterprises engaged in Tea/coffee/Rubber Development :** According to section 33AB, if an assessee deposits any amount in a special account with NABARD as specified by the Tea Board /coffee Board /Rubber Board within 6 months from the end of previous year or the due date of furnishing of return whichever is earlier, he can claim a deduction equivalent to the sum deposited in special account or 40% of such business income before deduction and adjustment of brought forward losses. The deposited Amount can be only be withdrawn for the purpose specified in the scheme.
4. **Telecommunication services :** According to section 35ABB deduction is available for any payment actually made for obtaining licence for operating telecommunication services which is of capital nature. The deduction is allowed in equal instalments during the period from the beginning of payment till the end of license.
5. **Expenditure on Specified business :** According to section 35AD 100% of capital expenditure exclusively incurred in specified business before commencement of operations will be allowed as deduction in the previous year during which the capital expenditure is incurred. Weighted deduction of 150% is also allowed for some specified business operations commenced after April. 2012. Specified business include (i) cold chain or warehousing facility, cross country pipeline distribution network of natural gas, crude or petroleum, building and operating 2 star or above category hotel, 100 bed hospital, housing project, fertiliser production, bee keeping and honey production, pipeline for iron ore transportation, developing, maintaining or operating any infrastructural facility (road, bridge or a rail system, highway project including housing and other activities, water supply, water treatment, irrigation, sanitation, sewerage or solid waste management systems, port, airport, inland waterway, inland port or navigational channel in the sea) with notified date of commencement of business.

6. Computing business profits and gains for eligible businesses on presumptive basis : Provision under section 44 AD applies to any business whose total turnover or gross receipts does not exceed an amount of one crore (Two crore from AY 2017-18) , except the business of brokering, hiring, or leasing goods carriages provided that the assessee is a resident individual, HUF or a partnership firm and not a LLP and who has not claimed deduction under any of the section 10A,10AA,10B,10BA or any deduction under chapter VI A.

Quantum and period of deduction : This section provides relief to small businesses from maintaining books of accounts and reduces the burden of compliance. A sum equal to 8% of the gross receipts and total turnover in the previous year shall be the presumptive profit and gains of the assessee chargeable to tax. The assessee has the option to claim a sum higher than 8% of the gross receipts and total turnover. If the assessee claims and declare lower profits and gains than the presumptive/ deemed profit and gains, then he is required to maintain accounts , get them audited and furnish audit report as required in section 44B. If an assessee declares his income for any of the previous year at 8% of the total turnover but declares income lower than this in any of the five consecutive assessment years subsequent to that previous year , he is not entitled to get the benefit under section 44AD.

If the assessee however does not opt for presumptive basis of profit and gains and taxation the provision of section 44AA and 44 AB requiring books of accounts to be maintained and audited ,will be applicable.

Example -2 :

AB is a firm engaged in wholesale trading whose annual turnover for 2015-16 is Rs. 50 lakh. The firm opt for presumptive basis of profit and gains and taxation under section 44AD. The firm claims the following deductions:

	Rs
Salary and interest to partners	80,000
Operating Business expenses	5,00,000
Depreciation	2,00,000
Deduction under section 80 G	2,500

Determine the net taxable income of the firm .

Solution :

	Rs
Income from business (8% of Rs.50 lakh on presumptive basis)	. 4,00,000
Less Expenses allowed :	
1. Partners salary and interest	80,000
2. Operating Expenses	NIL
3. Depreciation	NIL
Total allowed expenses	Rs. 80,000
Gross Total Income (GTI)	Rs. 3,20,000
Less Deduction under Sec.80G	Rs. 2,500

Taxable Income (TI)

Rs. **3,15,000****Notes :**

1. Other expenses except partners salary and interest are not deductible .
2. Depreciation is not deductible.
3. If the firm declares lower income than 8% of total turnover in any of the assessment year 2017-18 to 2021-22, then the firm is not eligible to get the benefits of section 44AD.
4. The firm at its option can declare higher profits than 8% of the total turnover.
7. Establishment of hotels and convention centre in NCR : Under section 80ID
8. Housing projects : Under section 80IBA9.
9. Skill Development : Under section 35CCD

18.6 ACQUISITION OF ASSETS FOR NEW BUSINESS

New businesses need to invest huge amounts in acquisition of assets for successful start ups. In addition to depreciation, Investment allowance for new plant and machinery and additional investment allowance for backward states is given under section 32AC and 35AD respectively which are discussed as under:

1. **Investment allowance for plant and machinery:** Under section 32AC this allowance is available for acquisition of new plant and machinery which does not include old and used plant and machinery, residential accommodation, office premises or guest houses computers and vehicles. It will not be allowed for the plant and machinery in which actual cost is already allowed as depreciation allowance . This investment allowance is given in addition to depreciation allowance. Under section 32 AC(1A) the amount of allowance is 15% of actual cost and given in respect of plant and machinery purchased and installed after April 1, 2014 and before April 1, 2017. The allowance will be given for Assessment year 2015-16, 2016-17 and 2017-18. If the purchased plant is sold or transferred within 5 years since its installation , the given allowance will be included in assessee's income. Thus, it is clear that it has to be retained for five years from its installation to get the full benefit of allowance .
2. **Additional Investment allowance :** In addition to investment allowance an additional deduction is available under section 35AD for undertakings set up in the notified backward areas of Bihar, Andhra Pradesh, Bihar and Telangana or west Bengal equivalent to 15 % of actual cost of new assets acquired and installed after March 31, 2015 but before April 1, 2020.



Check Your Progress-A

1. Fill in the gaps :

- i. Advances and loans to shareholders is to be treated as under section 2(22)
- ii. Under section 80 P the income of is exempt from tax subject to conditions specified therein.
- iii. In partnership form of organisation, the liability of partners is
- iv. The liability of partners of LLP is to their share of contribution.

2. Indicate TRUE/FALSE :

- i. Tax planning refers to the legal and legitimate tax benefits only.
- ii. Under section 32 AC(1A) Investment allowance is given in addition to depreciation allowance.
- iii. A cooperative society can claim deduction of the amount paid to its members as remuneration.
- iv. In case of Newly established Units in Special Economic Zones (SEZs) 50% of profit is deductible for 10 years out of 15 years beginning from the year in which SEZ is notified.

18.7 SUMMARY

Corporate tax planning involves systematic planning of a company's operations in such a way as to attract a minimum liability to tax or deferment of tax liability for future years. The tax payer can plan to take the benefits of all available allowances, incentives, exemptions, and deductions, various concessions, rebates & reliefs, specifically provided for new businesses in law. Tax planning is more relevant for new businesses. Encouraged by emerging opportunities in the modern business environment there has been increased trend of new start ups in various parts of the country on a daily basis. New business While starting up new businesses one is more concerned about their cost structure, likely profitability in future and sustainability which is influenced to a great extent by their tax liabilities. Since the income of new businesses is mainly chargeable to tax under the head, Business and Profession, capital gains and income from other sources, the new entrepreneur or

management takes into account allowable business expenditures in computing taxable business income, the exemptions, deductions, the special incentives available for particular locations, nature and organisational forms of business to minimise the overall tax liability. A new business may be commenced on sole proprietorship or it can choose any other organisational form i.e. firm, HUF, LLP or a company. Every form has its specific characteristics, likely benefits and limitations. The choice of the organisational form is itself dependent on many factors which may include both types of factors i.e. tax related factors and other factors. Under sole proprietorship the entire business income is included in gross total income along with other income chargeable in other heads. No allowance or relief is available in respect of business income. In computing taxable income of the firm deduction in respect of interest and remuneration is allowed. The domestic companies are liable to pay tax @ 15% plus surcharge @ 12% and cess @3% on dividend declared, distributed and paid under section 2(22)(e). However, according to section 10(34) dividend declared, distributed and paid by a domestic company after May 31, 1997 but before April 1, 2002, or after March 31, 2003, is not taxable in the hands of shareholders of a company. Limited liability partnership (LLP) is a form of organisation that contains some features of both company and a firm. The liability of partners of LLP is limited to their share of contribution and the liability of LLP to the outsiders is limited to the extent of its assets. The total income of LLP is taxable like a firm (maximum tax rate is 30% plus surcharge and cess) but the partner's share is exempt from tax. The deducted amount of Interest on capital and remuneration paid to Partners by LLP is again added to their business income and taxable to that extent. Under section 80 P the income of cooperative society is exempt from tax subject to conditions specified therein. Moreover, a cooperative society can claim deduction of the amount paid to its members as remuneration for services rendered by them, commission payable of them and interest on deposits or loan. Legal provisions providing specific concessions play an important role in deciding the location of a business. Some of the important incentives, concessions, deductions or allowances on the basis of location of new businesses are given in section 10A, 10AA, 80IB, 80IC. One of the major considerations in tax planning about new business is the choice of the nature of business with reference to special benefits available to the particular kind of industries under the taxation laws which include section 10A, 80IAC, 33AB, 35AAB, 35AD, 44AD, 35CCD, 80IBA, 80ID etc. In addition to depreciation, Investment allowance for new plant and machinery and additional investment allowance for backward states is given under section 32AC and 35AD respectively.



18.8 GLOSSARY

Hindu undivided Family (HUF) : is a an organisational form of business where business is carried on by the members of the family on behalf of the family.

Limited liability partnership (LLP): is a form of organisation that contains some features of both company and a firm.



18.9 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress –A

1.
 - i. Deemed dividend
 - ii. Cooperative society
 - iii. Unlimited
 - iv. limited
2.
 - i. True
 - ii. True
 - iii. True
 - iv. False



18.10 REFERENCES

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18.11 SUGGESTED READINGS

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4. A.C. Sampath Iyengar, Law of Income Tax, Bharat Publishing House, Allahabad.
5. Taxman, The Tax and Corporate Law Weekly.
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18.12 TERMINAL QUESTIONS

- Q1. Explain how location of business is significant factor in tax planning? Discuss the provision for deductions in respect of certain undertakings or enterprises in certain special category states under Section 80-IC.
- Q2. Discuss the deduction available to new undertakings established in FTZs or SEZs.
- Q3. State various provisions of Income tax Act, 1961 available to tax payers on the basis of location of their business ?
- Q4. Explain with example how organisational form of new business effect the tax incidence ?
- Q5. Describe the basic characteristic of Limited liability partnership (LLP) ?
- Q6. Explain how LLP is a better alternative form of organisation as compared to firms for the purpose of tax?
- Q7. What is Investment allowance? Explain the provision of investment allowance under section 32AC for acquisition of plant and machinery .

Q8. Explain the provision under section 80 IAB in respect of Industrial undertakings or enterprises other than those engaged in the development of Special Economic Zone (SEZ) .

Q9. What are eligible start ups? What is the quantum and period of benefit available under section 80 IAC ?

Q10. Explain the provision under section 10 IA in respect of Industrial undertakings or enterprises engaged in infrastructure development?

Block IV
Tax Management

UNIT 19 SPECIAL TAX PROVISIONS

19.1 Introduction

19.2 Objectives

19.3 Special tax provisions

19.4 Tax provisions relating to Free Trade Zone

19.5 Tax incentives to exporters

19.6 Tax provisions relating to Infrastructure sector

19.7 Tax provisions relating to Backward areas

19.8 Summary

19.9 Glossary

19.10 Answers to Check Your Progress

19.11 Reference / Bibliography

19.12 Suggested Readings

19.13 Terminal & Model Questions

19.1 INTRODUCTION

Tax management is largely dependent on the business environment and specific benefits offered by an economy. Indian economy is an emerging economy. However, there have been several deficiencies of infrastructure, lack of indigenous technology and equipment's, higher costs arising out of heavy tax incidence etc. which over the years adversely effected the competitiveness of Indian industry. In order to boost economic growth various measures has been taken particularly since the adoption of new economic policy in 1991. Trade policy was substantially liberalised to promote exports and make them internationally competitive. As a complementary to the scheme of export oriented units (EOUs) scheme (1981) which provides nationwide locational options such as land, skills, raw materials and industrial base, the scheme of special economic Zones (SEZs) introduced in EXIM policy 2000 and later by the enactment of SEZ Act, 2005 has offered several tax incentives in addition to providing quality infrastructure complemented with fiscal support with minimum regulations. The announcement of a new Foreign Trade Policy for a five year period of 2004-09, replacing the hitherto nomenclature of EXIM Policy by Foreign Trade Policy (FTP) is another step in this direction. Special focus initiatives for five key sectors i.e. Agriculture, Handicrafts,

Handlooms, Gems and Jewellery and footwear sectors, introduced in the foreign trade policy, 2004-09, facilitated duty free imports of specified items. 100% FDI was permitted in free trade zones under new scheme of FTWZ s scheme. FTP also has announced a number of incentives for EOUs and further simplified the procedures. The foreign trade policy, 2015-20, which aims to double Indian exports by 2020 from the present 3%, has extended the benefits under the Merchandise Export from India Scheme (MEIS) and Service Export from India Scheme (SEIS) to all units located in SEZ and also reduce the Specific Export Obligation under Export Credit Guarantee Scheme (ECGS) for domestic capital goods manufacturing industry to 75% from the present 90%. Realising the role of infrastructure in growth and development, efforts have been made to channelize investments in infrastructure by providing various incentives. Digital infrastructure has its unique role in modern global economy driven by information and communication technologies. Recently, **Digital India campaign** was launched to step up digital infrastructure and promote digital literacy resulting in reducing time lag in procedural matters and ensuring transparency. By the introduction of GST the concept of **one nation one tax** is set to be realised which would lead to significant reduction in inventory costs, logistics and manufacturing costs on the one hand and ensure lower tax incidence, less tax evasion, higher tax revenue and cheaper goods and services through competitive manufacturing and nationwide market for goods and services etc., on the other. In view of the slow growth of manufacturing sector, there is a need to revamp the manufacturing in India. The flagship programme of **Make in India** was launched with the aim of making India a global manufacturing hub with better infrastructure, skilled manpower through *Kaushal vikas* and enhanced FDI and improved technology. Entrepreneurship could be promoted by ease of doing business. Online submission of application, documents, online monitoring consultation and coordination, the online complaint addressing etc. are also necessary besides monetary and fiscal incentives. The government has launched the programmes such as **Start Up India** and **Stand up India** to encourage young entrepreneurs to participate in Indian growth story. India is a vast country with diverse regional and developmental variations. There is an urgent need to accelerate the development of backward states and areas. To ensure balanced regional development special provisions have been announced for the development of backward regions located in different parts of the country. In each of these broad areas specific tax provisions in the form of exemptions, concessions, deductions and allowances have been introduced. Tax holiday for specified period has been permitted to small scale industries in backward regions subject to satisfying specified conditions. In this unit the special tax provisions and incentives would be discussed by which new enterprises can be benefited while undertaking tax planning and management.

19.2 OBJECTIVES

After discussing this unit you will be able to:

- What is special economic zone (SEZ) ?
- Define SEZ, FTZ and various special provisions made for SEZs.

- Describe the provisions made for export sector.
- Explain the Tax provisions relating to Infrastructure sector.
- Explain the Tax provisions relating to Backward areas.

19.3 SPECIAL TAX PROVISIONS

Special tax provisions may be studied in the following broad categories :

- Tax provisions relating to Free trade Zone
- Tax incentives to exporters
- Tax provisions relating to Infrastructure sector
- Tax provisions relating to Backward areas

19.4 TAX PROVISIONS RELATING TO FREE TRADE ZONE

What is special economic zone (SEZ) ?

SEZ is a specified geographical region in which globally competitive and hasslefree environment is provided for production designed to export through exemptions from various tariff, quota and tax and other regulations. The units operating in SEZ are deemed as outside the country's custom territory and enjoy full flexibility of operations. The highly attractive package fiscal incentives given to the SEZ and its units include exemption from custom duties, central excise, central sales tax (now CGST), service tax, security transaction tax, 100 % tax holiday for first five years followed by 50% profits in the next five years and remaining 50% ploughed back profit in the next five years and 100% income tax exemption for 10 years for SEZ developers, Duty free import of capital goods and also accessing them from Domestic tariff area (DTA), free warehousing Zones etc. Foreign-investment based businesses can also be established in SEZs for the manufacturing of goods, the provisioning of services, and other activities including processing, assembling, trading, repairing and reconditioning.

SEZs also include free trade zones, export processing zones, free zones, industrial parks or industrial estates, free economic zones and urban enterprise zones. SEZ imply a qualitative improvement of the EPZs as SEZ is an integrated township than the EPZ which is only an industrial enclave. It deals with infrastructural deficiencies of a particular zone in the short run rather than going for expensive nationwide infrastructural deficiencies. Besides tax incentives it simplifies procedures, attracts foreign investments and gives big push to exports.

What is a free-trade zone (FTZ)?

A free-trade zone (FTZ) is a specific type of special economic zone which is generally referred to a geographic area where goods may be brought, handled, manufactured or reconfigured, and reexported.

Recent changes in the Special Economic Zones (Amendment) Rules, 2013.

The key changes are as under:

1. An SEZ may now house various types of business activities within a single sector if they are of similar products or services);
 2. The minimum area requirements for multi-product SEZs is now reduced from 1000 hectares to 500 hectares, or from 100 hectares to 50 hectares for sector-specific SEZs and SEZs with one or more services;
 3. The minimum area requirement for setting up an IT or ITes SEZ is now subject to the minimum built up processing area conditions of its respective state/city;
 4. There is now a minimum area requirement of 10 hectares for SEZs proposed to be set up exclusively for electronic hardware and software (including ITes), bio-technology, handicrafts, gems and jewellery, non-conventional energy and agro-based food processing;
 5. Benefits (fiscal incentives) are now available for additions/inclusions to pre-existing structures; and
 6. A Unit may now opt out of a SEZ by transferring its assets & liabilities to another person by way of transfer of ownership, including a sale of the SEZ Unit.
- 1. Deduction in respect of profit and gains by an undertaking and enterprise engaged in development of special economic zone (Section 80-IA B)**

According to Section 80-IA(13), any undertaking which develops notified SEZ on or after 1.4.2005, will not be eligible to claim deduction u/s 80-IA. Now, those undertaking, which develops SEZ, notified on or after 1.4.2005 under the special economic zones Act, 2005 will be eligible to claim deduction under the new Section 80-IAB provided that the assessee's gross total income include income from any business engaged in the development of SEZ, the deduction is claimed in return of income submitted before due date and the books of accounts are duly audited.

Quantum of deduction: The deduction shall be allowed of an amount equal to 100% the profit and gains derived from such business and can be claimed at option of the assessee for any 10 consecutive assessment years, out of 15 years beginning from the year in which a SEZ has been notified by the central government.

2. Special provision in respect of new undertaking in special economic zone (section 10A)

If an industrial undertaking begin manufacture or production in free trade zone or electronic hardware technology park or software technology park or SEZ and the sale proceed of exported articles or things or software is brought in India in convertible foreign exchange within 6 months in the previous year, a deduction can be claimed provided that the deduction is claimed in return of income submitted before due date, the books of accounts are duly audited and submit Audit Report certifying the deduction is correctly claimed in Form No.56F along with the return of income.

Quantum and period of deduction :

1. Amount of deduction which depends upon the quantum of profits derived from exports , is calculated as under –

(Profit of business of the undertaking X export turnover) ÷ Total turnover of the business)

2. If an undertaking which was initially located in FTZ or EPZ is located in SEZ by virtue of conversion of such FTZ or EPZ in SEZ, the deduction will be available for 10 consecutive years from the previous year in which manufacturing begins in such FTZ or EPZ.
3. Quantum and period of deduction: For first five years 100% of the profit and gains derived from such business for 5 consecutive assessment years relevant to previous years in which the unit begins followed by 50% of the profit and gains in the next five years . A deduction of 50 % of profits will be allowed from 11th year to 15th year provided in the previous year an equivalent amount is credited from profit and loss account to Special economic zone reinvestment allowance reserve account or special reserve account, which will be utilised for business purposes other than distribution of dividend , until acquiring new plant and machinery that must be put in use before the expiry of 3 years from the date of creation of such reserve account . If new plant and machinery is not acquired within three years as referred above, or in case of misutilisation of special reserve account the deduction would be taken back in the year in which such misutilisation is done and in the subsequent year following three years respectively.
3. **Special provision in respect of newly established units in special economic zone (Section 10AA)**

If an assessee satisfies the following conditions, then he can claim a deduction from gross total income in respect of profits and gains derived from such business provided that the deduction is claimed in return of income submitted before due date, the books of accounts are duly audited and submit Audit Report in Form No.56F along with the return of income:

- (i) An Assessee is an entrepreneur according to section 2 of the Special Economic Zones Act, 2005. Entrepreneur means a person who has been granted a letter of approval by the Development Commissioner to set a unit in a Special Economic Zone.
- (ii) The Unit in SEZ who begins to manufacture or produce articles or things or provide any services during the previous year relevant to any assessment year commencing on or after the 1st day of April 2006.
- (iii) it should not be formed by the transfer of old machinery or plant to a new business and by the splitting up, or the reconstruction, of a business already in existence.
- (iv) The assessee has income from export of articles or thing or from services from such unit.

Quantum and period of deduction :

1 Amount of deduction which depends upon the quantum of profits derived from exports , is calculated as under –

(Profit of business of the undertaking X export turnover) ÷ Total turnover of the business)

1. Quantum and period of deduction: For first five years 100% of the profit and gains derived from such business for 5 consecutive assessment years relevant to previous years in which the unit begins followed by 50% of the profit and gains in the next five years . A deduction of 50 % of profits will be allowed from 11th year to 15th year provided in the previous year an equivalent amount is credited from profit and loss account to Special economic zone reinvestment allowance reserve account or special reserve account, which will be utilised for business purposes other than distribution of dividend , until acquiring new plant and machinery that must be put in use before the expiry of 3 years from the date of creation of such reserve account . If new plant and machinery is not acquired within three years as referred above, or in case of misutilisation of special reserve account the deduction would be taken back in the year in which such misutilisation is done and in the subsequent year following three years respectively.

19.5 TAX INCENTIVES TO EXPORTERS

In the new economic policy government has adopted various measures for export promotion. Apart from Foreign Trade Policy (FTP), which aimed to double the exports by the year 2020 , various incentives are given in Income Tax Act, 1961. These measures and provisions are discussed as under :

Salient features of Foreign Trade Policy (FTP) (2015-2020)

The following are the key features of Foreign Trade Policy (2015-2020):

1. Two new schemes have been introduced for exports of merchandise and services namely (i) Merchandise Exports from India Scheme (MEIS); (ii) Service Exports from India Scheme (SEIS).
 - (i) **Merchandise Exports from India Scheme (MEIS)** : Under this comprehensive scheme all the erstwhile Schemes viz., Focus Product Scheme (FPS), Market Linked Focus Product Scheme (MLFPS), Focus Market Scheme (FMS), Agri. Infrastructure Incentive Scrip (AIIS), and Vishesh Krishi and Gram Udyog Yojana (VKGUI) offering separate duty credit scrips with varying conditions] have been merged to provide rewards to exporters for offsetting infrastructural inefficiencies and associated costs involved in export of goods/products, which are produced/manufactured in India, especially those having high export intensity, employment potential and thereby

enhancing India's export competitiveness. Under MEIS, exports of notified goods to notified markets will be eligible for rewards in the form of duty credit scrips @ 2% / 3% / 5% of FOB value of notified goods exported to notified markets. Incentives available under MEIS have now been extended to units located in SEZs. However, those already availing direct tax benefits/exemption i.e. EOUs / EHTPs / BTPs/ STPs, Supplies made from DTA units to SEZ units, Exports through trans-shipmen, Deemed Exports, SEZ/EOU/EHTP/BPT/FTWZ products exported through DTA units among others shall be ineligible.

(ii) **Service Exports from India Scheme (SEIS)** :In FTP 2015-20, the Served from India Scheme ('SFIS') has now been recast into the Service Exports from India Scheme ('SEIS') to encourage export of notified Services from India. Under SEIS, Service providers of notified services will be eligible for rewards in the form of duty credit scrips. The rates of reward under SEIS are 3% and 5% on the net foreign exchange earned from notified services. List of ineligible services are related to the Financial Sector, Services where foreign exchange is earned through contract/regular employment abroad, Service providers in Telecom Sector, Foreign exchange earnings for services provided by Airlines and Shipping Lines plying from one foreign country to another, where the routes are not touching India, Payments received from services received from EEFC Account, etc.. The minimum net free foreign exchange earnings threshold limit is fixed to be eligible for Duty Credit Scrip (i) For Individual Service Providers and Sole Proprietorship - \$ 10,000/- and (ii) Other Service Providers-\$ 15,000/-

2. The benefits under MEIS and SEIS has been extended to SEZ units as well.
3. Scrips issued under Exports from India Schemes can be used for the payment of Customs duty, Excise duty and Service tax.
4. New criteria for export performance for recognition of status holder have been prescribed in terms of US dollar earnings instead of Rupees Earning.
5. The facility of self certification has been granted to the status holders in specified situations. Category of Status holders on the basis of their export performance will be counted on the basis of FOB value of export proceeds realized during current and previous two FY. The amended categories are : One Star Export House 3 crore; Two Star Export House 25 crore; Three Star Export House 100 crore ;Four Star Export house 500 crore ;Five Star Export House 2000 crore .
6. Status holders shall be entitled to export freely exportable items on free of cost basis for export promotion subject to an annual limit of Rs. 10 Lakhs or 2% of average annual export realization during preceding three licensing years whichever is higher.
7. Reduced Export Obligation (up to 75%)for Capital goods procured domestically

8. Online filing of documents/ applications , inter-ministerial consultations: Simplification of procedures/processes, digitisation and e-governance
9. EOUs, EHTPs, STPs have been allowed to share infrastructural facilities among themselves
10. Inter unit transfer of goods and services have been allowed among EOUs, EHTPs, STPs, and BTPs.
11. EOUs have been allowed facility to set up Warehouses near the port of export.
12. 100% EOU units have been allowed facility of supply of spares/ components up to 2% of the value of the manufactured articles to a buyer in domestic market for the purpose of after sale service.
13. Goods falling in the category of handloom products, books / periodicals, leather footwear, toys and customized fashion garments, having FOB value up to Rs.25000 per consignment (finalized using eCommerce platform) shall be eligible for benefits under FTP .
14. Export of such goods under Courier Regulations shall be allowed manually at specified ports.

Special provisions in case of non residents

1. According to sections 115 F if a non resident Indian transfers specific assets as long term capital assets such as shares in an Indian company, debentures , deposits in Indian public limited company or central government securities (original assets) as long term assets and the tax payer invests the whole or any part of such net consideration within 6 months of such transfer in shares of an Indian company or debentures or deposits of Indian public limited company or central government securities (new assets), the assessee is entitled for exemption which will be calculated by using the formula as under :

(Amount invested in long term assets x Capital gains/ Net sale consideration)

2. Some special provisions relating to non resident Indians are also given in section 115C to 115- I which are applicable if income derived is from (i) a foreign exchange assets and (ii) long term gain on sale or transfer of foreign exchange assets. Foreign exchange assets means specified assets which are acquired or bought or subscribed in convertible foreign exchange in shares in an Indian company, debentures , deposits in Indian public limited company or central government securities. While calculating the LTCG on sale or transfer of such assets , the benefit of indexation and deduction under section 80C to 80 U are not permissible. However, the non resident is entitled to get exemption under section 115 F provided the sale consideration is invested in new assets.

19.6 TAX PROVISIONS RELATING TO INFRASTRUCTURE SECTOR

What is infrastructure ?

Infrastructure generally refers to all basic services including health and education, water supply and irrigation, transport communication and connectivity, energy , power and electricity, ports, etc. According to A.O.Hirschman, **“infrastructure is usually defined as comprising those basic services without which primary, secondary and tertiary productive activities cannot function.”**

For the purpose of taxation within the meaning of infrastructure ,section 80IA include infrastructural facility , telecommunication services, industrial parks, power generation, transmission, and distribution, reconstruction of power unit, natural gas distribution. **Infrastructural facility is comprised of (a) a road including toll road, a bridge or a rail system; (b) a highway project including housing or other activities being an internal part of the highway project; (c) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system; (d) a port, airport, inland waterway or inland port.**

1. Deduction in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development (Section 80-IA)

If an Indian company satisfies the following conditions, then it will be allowed a deduction from gross total income in respect of profits and gains derived from such business:

(1) Infrastructure facility: The enterprise is carrying on the business of operating any infrastructure facility .

(2)Agreement : The enterprise enters into an agreement with the Central or State Government or a local authority or any other statutory body for (i) developing, (ii) operating and maintaining, (iii) developing, operating and maintaining, a new infrastructure facility and transfer such infrastructure facility after the period stipulated in the agreement to such Government or authority or body concerned;

(3) Period of start of operations :It starts operating and maintaining the infrastructure facility on or after 1st April, 1995 but before 1st April, 2017 .

Quantum and period of deduction :100% of profits for 10 consecutive years beginning with initial financial year and within a period of 15 year from initial financial year.

Special reserve account :In case of housing and other development activities deduction shall be allowed only when (i)Such profits are transferred to a special reserve account and (ii)Such profits are utilised for highway project, excluding housing and other activities, before the expiry of three years following the year in which the amount was transferred to the reserve account. The amount remaining unutilised shall be chargeable to tax as income of the year in which it was transferred to the reserve account.

Other cases covered by the deduction under section 80-IA

(1) Telecommunication services: If a new undertaking is engaged in providing telecommunication services (basic or cellular including radio-paging, domestic satellite service or network of trunking and electronic data interchange services) at any time after 31.3.1995 but before 31.3.2005, then the deduction can be claimed in return of income submitted before due date provided that the books of accounts are duly audited. The deduction is allowed subject to satisfying the following conditions : (i) It should not be formed by the splitting up, or the reconstruction, of a business already in existence; (b) it should not be formed by the transfer of old machinery or plant to a new business .

Quantum and period of deduction :(1) First five assessment years - 100% of such profits.
(2) Next five assessment years - In case of companies 30% of such profits. In case of other assessees 25% of such profits.

(2) Industrial park:If a new undertaking is engaged in developing, operating or maintaining a special economic zone during April 2007 and March 2011 and operates an industrial park (notified by the Central Government) during 31.3.1997 and 31.3.2005 then the deduction can be claimed in return of income submitted before due date provided that the books of accounts are duly audited .

Quantum and period of deduction :100% of profits for 10 consecutive years beginning with initial financial year and within a period of 15 year from initial financial year.

(3) Generation and distribution of power:If a new undertaking (a) is set-up in any part of India for the generation or generation and distribution of power if it begins to generate power at any time during the period 1 April, 1993 and 31st March 2017. (b) starts transmission or distribution during the period beginning on the 1 April, 1999 and 31st March 2017. (c) undertakes substantial renovation and modernization of the existing network of transmission or distribution lines at any time during the period from 1 April, 2004 and 31st March, 2017, then the deduction can be claimed in return of income submitted before due date provided that the books of accounts are duly audited and it should not be formed by the transfer of old machinery or plant to a new business and by the splitting up, or the reconstruction, of a business already in existence.

Quantum and period of deduction:100% of profits for 10 consecutive years beginning with initial financial year and within a period of 15 year from initial financial year.

(4) Re-construction or revival of a power generating plant

If an undertaking owned by an Indian Company and set up before 30.11.2005 with majority equity participation by public sector companies for re-construction or revival of a power generating plant and is notified by the Central Government before 31.12.2005 and begins to generate or transmit or distribute power before 31.3.2011 then the deduction can be claimed in return of income submitted before due date provided that the books of accounts are duly audited .

Quantum and period of deduction: 100% of profits for 10 consecutive years beginning with initial financial year and within a period of 15 year from initial financial year. If the undertaking is engaged in infrastructure facility then deduction can be claimed in any ten consecutive assessment years out of twenty years .

(5). Laying and operating cross country natural Gas distribution network: If an undertaking owned by an Indian Company engaged in Laying and operating cross country natural Gas distribution network with the availability of 1/3rd of pipeline capacity as common carrier is certified by central government and starts its operations after April 1, 2007 , then the deduction can be claimed in return of income submitted before due date provided that the books of accounts are duly audited and it should not be formed by the transfer of old machinery or plant to a new business and by the splitting up, or the reconstruction, of a business already in existence.

Quantum and period of deduction: 100% of profits for 10 consecutive years beginning with initial financial year and within a period of 15 year from initial financial year.



Check Your Progress-A

Q1. Indicate TRUE or FALSE :

- i. SEZ Act, was passed in 2005.
- ii. Quantum and period of deduction for industrial park is 100% of profits for 10 consecutive years beginning with initial financial year and within a period of 15 year from initial financial year.
- iii. Section 80-IA B is related to enterprises engaged in development of special economic zone.
- iv. Infrastructural facility include telecommunication services, industrial parks, power generation, transmission, and distribution and hotels.
- v. Some special provisions relating to non resident Indians are also given in section 115C to 115- I.

19.7 TAX PROVISIONS RELATING TO BACKWARD AREAS

1. Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings (Section 80-IB)

Industrial undertakings deriving profit and gains from (i) Business of an industrial undertaking (ii) operation of ship (iii) hotels (iv) Scientific research (v) Production of mineral

oil (vi) Developing and building housing projects. (vii) Cold Chain facility for agriculture produce.. (viii) Multiplex theatres. (ix) Convention Centre (x) Hospital in Rural area. (xi) Hospital anywhere in India, can claim a Deduction under Section 80-IB .

If a new industrial undertaking is mainly engaged in the business of construction of ships or in the manufacture or processing of goods or in mining, is allowed to claim deduction under this section, satisfying the following conditions:

1. It is not formed by splitting up, or the reconstruction, of a business already in existence.
2. It is not formed by the transfer to a new business of machinery or plant previously used for any purpose. But, old plant and machinery, not exceeding 20% of the total value of plant and machinery of the new industrial undertaking, can be transferred to the new industrial undertaking,
3. It manufactures or produces any article or thing, not being any article or thing specified in the list in the Eleventh Schedule, or operates one or more cold storage plant or plants, in any part of India. However, this does not applicable to a small scale industrial undertaking or an industrial undertaking located in an industrially backward state.
4. The undertaking employs ten or more workers if the manufacturing process is carried with the aid of power or employs twenty or more workers if the manufacturing process is carried without the aid of power.
5. Manufacture or production should begin: (i) for small scale industries during April 1, 1991 – March 31, 2002; (ii) for industrial undertaking in a backward state during April 1, 1994 – March 31, 2004; (in case of J & K during April 1, 1993 – March 31, 2012;) cold chain facility during April 1, 1999 – March 31, 2004;
6. The deduction is claimed in return of income submitted before due date and the books of accounts are duly audited.

2. Special provisions in respect of certain undertakings or enterprises in certain special category states (Section 80-IC)

A deduction can be claimed in return of income submitted before due date provided that the books of accounts are duly audited in case the income of an assessee includes any profits and gains derived by an undertaking or an enterprise:

- (1) which has begun or begins to manufacture or produce specified articles or things in specified area and undertakes substantial expansion during the period beginning—
 - (i) on the 23rd day of December, 2002 and ending before the 1st day of April, 2012, in any specified areas, in the State of Sikkim; or
 - (ii) on the 7th day of January, 2003 and ending before the 1st day of April, 2012, in any specified areas, in the State of Himachal Pradesh or the State of Uttaranchal; or
 - (iii) on the 24th day of December, 1997 and ending before the 1st day of April, 2007, in any specified areas, in any of the North-Eastern States;

(2) which has begun or begins to manufacture or produce any specified article or thing, in specified area and undertakes substantial expansion during the period beginning –

(i) on the 23rd day of December, 2002 and ending before the 1st day of April, 2012, in the State of Sikkim; or

(ii) on the 7th day of January, 2003 and ending before the 1st day of April, 2012, in the State of Himachal Pradesh or the State of Uttaranchal; or

(iii) on the 24th day of December, 1997 and ending before the 1st day of April, 2007, in any of the NorthEastern States.

(3) it is not formed by splitting up, or the reconstruction, of a business already in existence; (excluding an undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking within the specified period;

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

Meaning of Specified area: In this respect, the Specified area refers to any Export Processing Zone or Integral Infrastructure Development Centre or Industrial Growth Centre or Industrial Park or Theme Park, as notified by the Board in accordance with the scheme framed and notified by the central government.

Quantum and period of deduction: 100% of such profits and gains for ten assessment years commencing with the initial assessment year; (ii) In the case of Himanchal Pradesh and Uttaranchal 100% of such profits and gains for five assessment years commencing with the initial assessment year and thereafter, 30% of the profits and gains (25% in case of a non corporate assessee) for the next 5 years.

19.8 SUMMARY

Tax management is largely dependent on the business environment and specific benefits offered by an economy. However, there have been several deficiencies of infrastructure, lack of indigenous technology and equipment's, higher costs arising out of heavy tax incidence etc. Various special tax provisions have been made in Income tax Act, 1961 and other economic laws to promote exports, develop infrastructure, and balanced regional development. Special tax provisions may be studied in the following broad categories i.e. Tax provisions relating to Free trade Zone, Tax incentives to exporters, Tax provisions relating to Infrastructure sector and Tax provisions relating to Backward areas. The scheme of special economic Zones (SEZs) introduced in EXIM policy 2000. SEZ is a specified geographical region in which globally competitive and hassle free environment is provided for production designed to export through exemptions from various tariff, quota and tax and other regulations. The units operating in SEZ are deemed as outside the country's custom territory and enjoy full flexibility of operations. Recently many changes has been made by bringing

the Special Economic Zones (Amendment) Rules, 2013. In Foreign Trade Policy (2015-2020) two new schemes have been introduced for exports of merchandise and services namely (i) Merchandise Exports from India Scheme (MEIS); (ii) Service Exports from India Scheme (SEIS). Section 80-IA B Income tax Act provides deduction for enterprise engaged in development of special economic zone, section 10A and 10AA provides for newly established undertakings in SEZ subject to satisfying certain conditions. Special provisions in case of non residents are provided in sections 115 F. Some special provisions relating to non resident Indians are also given in section 115C to 115- I. Infrastructural facility is comprised of (a) a road including toll road, a bridge or a rail system; (b) a highway project including housing or other activities being an internal part of the highway project; (c) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system; (d) a port, airport, inland waterway or inland port. Deduction in respect of profits and gains from industrial undertakings or enterprise engaged in infrastructure development is made available in section 80-IA. To ensure balanced regional development special provisions has been announced for the development of backward regions located in different parts of the country. In each of these broad areas specific tax provisions in the form of exemptions, concessions, deductions and allowances have been introduced. Tax holiday for specified period has been permitted to small scale industries in backward regions subject to satisfying specified conditions. Tax provisions relating to Backward areas is provided by allowing deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings under section 80-IB and Special provisions in respect of certain undertakings or enterprises in certain special category states under Section 80-IC .



19.9 GLOSSARY

Foreign exchange assets: It means specified assets which are acquired or bought or subscribed in convertible foreign exchange in shares in an Indian company, debentures, deposits in Indian public limited company or central government securities.

Free-trade zone (FTZ) : is a specific type of special economic zone which is generally referred to a geographic area where goods may be landed, handled, manufactured or reconfigured, and re exported.

Special economic zone SEZ is a specified geographical region in which globally competitive and hassle free environment is provided for production designed to export through exemptions from various tariff, quota and tax and other regulations .



19.10 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress –A

1. i. True
- ii. True
- iii. True
- iv. False
- v. True



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5. Taxman, The Tax and Corporate Law Weekly.
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19.13 TERMINAL QUESTIONS

- Q1. What are the special tax provisions ?
- Q2. Explain what are the Tax incentives given to exporters in new economic policies.
- Q3. What are the benefits available in respect of profit and gains of an undertaking or enterprise engaged in development of special economic zone?
- Q4. What is special economic zone (SEZ)? Explain various special provisions made for SEZs.
- Q5. What do you understand by Infrastructure? Explain various Tax provisions available to Infrastructure sector.
- Q6. What are the key features of Foreign Trade Policy (2015-2020)?
- Q7. What is Special reserve account and explain how it can be utilised?
- Q8. What is the meaning of (i) Original assets, (ii) New assets and (iii) specified assets as explained in section 115F ?
- Q9. Explain the provision for deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings.
- Q10. Explain Special provisions in respect of certain undertakings or enterprises in certain special category states.

UNIT 20 TAX PLANNING IN RESPECT OF AMALGAMATION OR DE-MERGER OF COMPANIES

20.1 Introduction

20.2 Objectives

20.3 Amalgamation

20.4 Demerger

20.5 Special Provisions for computation of Cost of Acquisition

20.6 Transfer of capital Asset in case of Amalgamation and Demerger

20.7 Treatment of Preliminary Expenses and Amortization of Expenditure

20.8 Summary

20.9 Glossary

20.10 Answer to Check Your Progress

20.11 Reference/ Bibliography

20.12 Suggested Readings

20.13 Terminal & Model Questions

20.1 INTRODUCTION

In the previous unit, you learnt the Special tax provisions given under the Income Tax Act. Now in this unit you would be learning the provisions relating to Amalgamation and Demerger as specified under the Income Tax Act. Amalgamation and demerger are the two min dimensions of corporate restructuring and as such companies rearrange their identity. Therefore, provisions and rules regarding Amalgamation and Demerger has been provided separately and specifically in the Act. In this unit you will be given an insight about these provisions in detail.

20.2 OBJECTIVES

After reading this unit, you will be able to –

- Understand the provisions relating to the Amalgamation
- State the provisions relating to demerger.

- Understand as when the transfer of capital asset is not treated as transfer for capital gain tax purposes in case of Amalgamation or demerger.

20.3 AMALGAMATION

The term 'amalgamation' is derived from the word "amalgam" means to unite, to come together as one, or to blend, and, from this root, the accounting terminology of 'Amalgamation' is derived.

According to Halsbury Laws of England, "Amalgamation is a blending of two or more existing undertaking into one undertaking, the shareholders of each blending company becoming substantially the shareholders in the company which is to carry on the blended undertaking. There may be amalgamation either by the transfer of two or more undertakings to a new company, or by the transfer of one or more undertakings to an existing company." Thus, when two or more companies merge into one company and the shareholders of each merged company becomes substantially the shareholder in the newly formed company. Thus, the companies are voluntarily liquidated and new company is established that takeover the business of the existing companies.

Income Tax Act defines amalgamation in Section 2 (1B). For the point of view of Income tax "amalgamation", in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that;

- (i) All the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;
- (ii) All the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;
- (iii) A shareholder holding not less than three-fourths in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation,

otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first-mentioned company.

Transactions not treated as amalgamation

Section 2(1B) has specifically explained that under the following cases shall not be treated as amalgamation;

- a) the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company. Thus, it means that when the asset of one company which is merged is sold to another company and accordingly, merger is the outcome of the transaction of sale, in such condition, transaction shall not be treated as amalgamation.
- b) the distribution of such property to the other company after the winding up of the first-mentioned company. When the company is liquidated and the liquidator distributes the property to another company, then such transaction shall not be treated as amalgamation.

20.4 DEMERGER

Demerger [Section 2 (19AA)]

"Demerger", in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956 (1 of 1956), by a demerged company of its one or more undertakings to any resulting company in such a manner that;

- (i) all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;
- (ii) all the liabilities relating to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;
- (iii) the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;
- (iv) 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];
- (v) the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein

immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become share-holders of the resulting company or companies by virtue of the demerger,

- (vi) the transfer of the undertaking is on a going concern basis;
- (vii) the demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

Here, "undertaking" shall include any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

Further, the liabilities referred to in sub-clause (ii), shall include;

- a) the liabilities which arise out of the activities or operations of the undertaking;
- b) the specific loans or borrowings (including debentures) raised, incurred and utilised solely for the activities or operations of the undertaking; and
- c) in cases, other than those referred to in clause (a) or clause (b), so much of the amounts of general or multipurpose borrowings, if any, of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of such demerged company immediately before the demerger.

Further, for determining the value of the property referred to in sub-clause (iii), any change in the value of assets consequent to their revaluation shall be ignored.

For the purposes of this section, the splitting up or the reconstruction of any authority or a body constituted or established under a Central, State or Provincial Act, or a local authority or a public sector company, into separate authorities or bodies or local authorities or companies, as the case may be, shall be deemed to be a demerger if such split up or reconstruction fulfils such conditions as may be notified in the Official Gazette, by the Central Government.

For the purposes of this clause, the reconstruction or splitting up of a company, which ceased to be a public sector company as a result of transfer of its shares by the Central Government, into separate companies, shall be deemed to be a demerger, if such reconstruction or splitting up has been made to give effect to any condition attached to the said transfer of shares and also fulfils such other conditions as may be notified by the Central Government in the Official Gazette;

(19AAA) A "demerged company" means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company;

Section 35 in respect to amalgamation

Where, in a scheme of amalgamation, the amalgamating company sells or otherwise transfers the rights to the amalgamated company (being an Indian company), any asset which is in respect to capital expenditure on scientific research, then the provisions of this section shall,

as far as may be, apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not so sold or otherwise transferred the rights.

Section 35 A in respect to amalgamation and demerger

Where, in a scheme of amalgamation, the amalgamating company sells or otherwise transfers the patent rights or copyrights to the amalgamated company (being an Indian company), the provisions of sub-sections (3) and (4) shall not apply in the case of the amalgamating company; and the provisions of this section shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not so sold or otherwise transferred the rights. [Section 35A(6)]

Further, the section also explain for the transfer of patents and copyrights in case of demerger that in a scheme of demerger, the demerged company sells or otherwise transfers the rights to the resulting company (being an Indian company), the provisions of sub-sections (3) and (4) shall not apply in the case of the demerged company; and the provisions of this section shall, as far as may be, apply to the resulting company as they would have applied to the demerged company, if the latter had not sold or otherwise transferred the rights.

Reference Sub section 3 and 4 of Section 35 A

(3) Where the rights either come to an end without being subsequently revived or are sold in their entirety and the proceeds of the sale (so far as they consist of capital sums) are less than the cost of acquisition thereof remaining unallowed, a deduction equal to such cost remaining unallowed or, as the case may be, such cost remaining unallowed as reduced by the proceeds of the sale, shall be allowed in respect of the previous year in which the rights come to an end, or, as the case may be, are sold.

(4) Where the whole or any part of the rights is sold and the proceeds of the sale (so far as they consist of capital sums) exceed the amount of the cost of acquisition thereof remaining unallowed, so much of the excess as does not exceed the difference between the cost of acquisition of the rights and the amount of such cost remaining unallowed shall be chargeable to income-tax as income of the business of the previous year in which the whole or any part of the rights is sold.

Expenditure on know-how[Section 35 AB(3)]

Where there is a transfer of an undertaking under a scheme of amalgamation or demerger and the amalgamating or the demerged company is entitled to a deduction under this section, then, the amalgamated company or the resulting company, shall be entitled to claim

deduction under this section in respect of such undertaking to the same extent and in respect of the residual period as it would have been allowable to the amalgamating company or the demerged company, as the case may be, had such amalgamation or demerger not taken place.

Here, "know-how" means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil well or other sources of mineral deposits (including the searching for, discovery or testing of deposits or the winning of access thereto).

Expenditure for obtaining license to operate telecommunication services[35ABB]

Any capital expenditure incurred for acquiring any right to operate telecommunication services either before the commencement of the business to operate telecommunication services or thereafter at any time during any previous year and for which payment has actually been made to obtain a license, a deduction equal to the appropriate fraction of the amount of such expenditure shall be allowed for each of the relevant previous years.

Where, in a scheme of amalgamation, the amalgamating company sells or otherwise transfers the licence to the amalgamated company (being an Indian company), then the deduction will not be applicable under section 35ABB to the amalgamating company. However, the provisions of this section shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not transferred the licence.

The provisions relating to the transfer of license shall not be applicable when in the scheme of demerger, to the demerged company and the provisions of the section allowing deduction of such expenditure arisen or obtaining the licence shall be applicable to the resulting company (being an Indian company) as they would have applied to the demerged company if the latter had not transferred the licence.

Amortization of expenditure in case of amalgamation or demerger [Section 35 DD]

Where an assessee, being an Indian company, incurs any expenditure, on or after the 1st day of April, 1999, wholly and exclusively for the purposes of amalgamation or demerger of an undertaking, the assessee shall be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the five successive previous years beginning with the previous year in which the amalgamation or demerger takes place. However, no deduction shall be allowed in respect of the expenditure mentioned under any other provision of this Act.

Deduction for expenditure on prospecting, etc., for certain minerals 35E

An assessee, being an Indian company or a person (other than a company) who is resident in India, is engaged in any operations relating to prospecting for, or extraction or production of, any mineral and incurs, after the 31st day of March, 1970, any expenditure the assessee shall be allowed for each one of the relevant previous years a deduction of an amount equal to one-

tenth of the amount of such expenditure. In this section, the following points have also been mentioned under sub-section 7 which states that the undertaking of an Indian company which is entitled to the deduction is transferred, before the expiry of the period of ten years to another Indian company in a scheme of amalgamation then no deduction shall be admissible in the case of the amalgamating company for the previous year in which the amalgamation takes place; and the provisions of this section shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamating company if the amalgamation had not taken place. Further, as per sub-section 7A where the undertaking of an Indian company which is entitled to the deduction is transferred, before the expiry of the period of ten years specified in sub-section (1), to another Indian company in a scheme of demerger then no deduction shall be admissible in the case of the demerged company for the previous year in which the demerger takes place; and the provisions of this section shall, as far as may be, apply to the resulting company as they would have applied to the demerged company, if the demerger had not taken place.

Actual cost in case of amalgamation or demerger [Section 43(1) Explanation 7 and 7A]

"Actual cost" means the actual cost of the assets to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority. When a capital asset is transferred by the amalgamating company to the amalgamated company and the amalgamated company is an Indian company, the actual cost of the transferred capital asset to the amalgamated company shall be taken to be the same as it would have been if the amalgamating company had continued to hold the capital asset for the purposes of its own business. As per section 7A, in a demerger, any capital asset is transferred by the demerged company to the resulting company and the resulting company is an Indian company, the actual cost of the transferred capital asset to the resulting company shall be taken to be the same as it would have been if the demerged company had continued to hold the capital asset for the purpose of its own business. However, such actual cost shall not exceed the written down value of such capital asset in the hands of the demerged company.

Written down value of the block of assets transferred in the scheme of amalgamation or demerger[Section 43(6)]

Where in any previous year, any block of assets is transferred, by the amalgamating company to the amalgamated company in a scheme of amalgamation, and the amalgamated company is an Indian company, then the actual cost of the block of assets in the case of the transferee-company or the amalgamated company, as the case may be, shall be the written down value of the block of assets as in the case of the transferor-company or the amalgamating company

for the immediately preceding previous year as reduced by the amount of depreciation actually allowed in relation to the said preceding previous year.[Explanation 2 (Section 43(6))]

In case of demerged company, in any previous year explanation 2A states that any asset forming part of a block of assets is transferred by a demerged company to the resulting company, then, the written down value of the block of assets of the demerged company for the immediately preceding previous year shall be reduced by the written down value of the assets transferred to the resulting company pursuant to the demerger.

When any asset forming part of a block of assets is transferred by a demerged company to the resulting company, then the written down value of the block of assets in the case of the resulting company shall be the written down value of the transferred assets of the demerged company immediately before the demerger. [Explanation 2B.]

Explanation 5 of Section 43(6) states that where in a previous year, any asset forming part of a block of assets is transferred by a recognized stock exchange in India to a company under a scheme for corporatization approved by the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the written down value of the block of assets in the case of such company shall be the written down value of the transferred assets immediately before such transfer.



Check Your Progress-A

Q1. What is Amalgamation under the Income Tax Act?

Q2. What do you mean by Demerger?

Q3. Which of the following is/are transaction not treated as amalgamation ?

- a) the acquisition of the property of one company by another company pursuant to

the purchase of such property by the other company.

- b) the distribution of such property to the other company after the winding up of the first-mentioned company.
- c) Both a and b

Ans-c

Q4. Under which Section deduction for expenditure on prospecting, etc., for certain minerals in given?

- a) Section 35
- b) Section 72
- c) Section 43
- d) All the above

Ans-a

Q5. All the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the..... by virtue of the demerger;

- a) resulting company
- b) company before the demerger
- c) Director of the company
- d) None of the above

Ans-a

20.5 SPECIAL PROVISION FOR COMPUTATION OF COST OF ACQUISITION

Special provision for computation of cost of acquisition of certain assets. [Section 43C]

Where an asset [not being an asset referred to in sub-section (2) of section 45] which becomes the property of an amalgamated company under a scheme of amalgamation, is sold after the 29th day of February, 1988, by the amalgamated company as stock-in-trade of the business carried on by it, the cost of acquisition of the said asset to the amalgamated company in computing the profits and gains from the sale of such asset shall be the cost of acquisition of the said asset to the amalgamating company, as increased by the cost, if any, of any improvement made thereto, and the expenditure, if any, incurred, wholly and exclusively in connection with such transfer by the amalgamating company.

Reference Section 45 (2)

The profits or gains arising from the transfer by way of conversion by the owner of a capital asset into, or its treatment by him as stock-in-trade of a business carried on by him shall be

chargeable to income-tax as his income of the previous year in which such stock-in-trade is sold or otherwise transferred by him and, for the purposes of section 48, the fair market value of the asset on the date of such conversion or treatment shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset.

20.6 TRANSFER OF CAPITAL ASSET IN CASE OF AMALGAMATION AND DEMERGER

Transfer of capital asset is not treated as transfer for capital gain tax purposes in case of Amalgamation or demerger

The following transfers are not treated as ‘transfer’ in case of Amalgamation or demerger for tax purposes;

- a) Any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company; [Section 47(vi)]
- b) any transfer, in a scheme of amalgamation, of a capital asset being a share or shares held in an Indian company, by the amalgamating foreign company to the amalgamated foreign company, if at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company, and such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated; [Section 47(via)]
- c) any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company except where the shareholder himself is the amalgamated company, and the amalgamated company is an Indian company; [section 47 (vii)]

As per section 48[(viab) any transfer, in a scheme of amalgamation, of a capital asset, being a share of a foreign company, which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the amalgamating foreign company to the amalgamated foreign company, if—

- (A) at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and
 - (B) such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated;]
- (vib) any transfer, in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company;

(vic) any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company, if—

(a) the shareholders holding not less than three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and

(b) such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated:

Provided that the provisions of sections 391 to 394 of the Companies Act, 1956 (1 of 1956) shall not apply in case of demergers referred to in this clause;

The following shall not be treated as transfer in case of demerger;(Section 47(vic))

a) any transfer, in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company.

b) any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company, if the shareholders holding not less than three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated:

Provided that the provisions of sections 391 to 394 of the Companies Act, 1956 (1 of 1956) shall not apply in case of demergers referred to in this clause;

c) any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking; [47(vic)]

Provisions relating to carry forward and set off of accumulated loss and unabsorbed depreciation allowance in amalgamation or demerger, etc. [Section 72 A]

The provision section 72 A is relation to carry forward and set off of accumulated loss and unabsorbed depreciation in case of amalgamation. By this section company may take the advantage of reducing their tax liability by set off in the same year or carrying forward the accumulated losses and depreciation in the subsequent year. However, the following conditions should be fulfilled, there should be the amalgamation between;

a) a company owning an industrial undertaking or a ship or a hotel with another company; or

b) a banking company referred to in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949) with a specified bank; or

c) one or more public sector company or companies engaged in the business of operation of aircraft with one or more public sector company or companies engaged in similar business.

The accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, allowance for unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected, and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

Further, the amalgamating company;

- a) has been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years;
- b) has held continuously as on the date of the amalgamation at least three-fourths of the book value of fixed assets held by it two years prior to the date of amalgamation;
- c) holds continuously for a minimum period of five years from the date of amalgamation at least three-fourths of the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation;
- d) continues the business of the amalgamating company for a minimum period of five years from the date of amalgamation;
- e) fulfils such other conditions as may be prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.

If the above conditions are not satisfied then that part of carry forward of loss and unabsorbed depreciation which is utilized by the amalgamated company shall be treated as the income in the year in which the above conditions are not fulfilled.

Provisions relating to carry forward and set off of accumulated loss and unabsorbed depreciation allowance in case of demerger, etc.

In the case of a demerger, the accumulated loss and the allowance for unabsorbed depreciation of the demerged company shall be carried forward and set off

- (a) where such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company;
- (b) where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

The Central Government may, for the purposes of this Act, by notification in the Official Gazette, specify such conditions as it considers necessary to ensure that the demerger is for genuine business purposes.

(6) Where there has been reorganisation of business, whereby, a firm is succeeded by a company fulfilling the conditions laid down in clause (xiii) of section 47 or a proprietary concern is succeeded by a company fulfilling the conditions laid down in clause (xiv) of section 47, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor firm or the proprietary concern, as the case may be, shall be deemed to be the loss or allowance for depreciation of the successor company for the purpose of previous year in which business reorganisation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly :

Provided that if any of the conditions laid down in the proviso to clause (xiii) or the proviso to clause (xiv) to section 47 are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor company, shall be deemed to be the income of the company chargeable to tax in the year in which such conditions are not complied with.

(6A) Where there has been reorganisation of business whereby a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to clause (xiiib) of section 47, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance for depreciation of the successor limited liability partnership for the purpose of the previous year in which business reorganisation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly :

Provided that if any of the conditions laid down in the proviso to clause (xiiib) of section 47 are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor limited liability partnership, shall be deemed to be the income of the limited liability partnership chargeable to tax in the year in which such conditions are not complied with.

The following explanation is given for the terms used for carry forward and set off of accumulated loss and unabsorbed depreciation allowance in amalgamation or demerger, etc.

(a) "accumulated loss" means so much of the loss of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, under the head "Profits and Gains of Business or Profession" (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of section 72 if the reorganisation of business or conversion or amalgamation or demerger had not taken place;

(aa) "industrial undertaking" means any undertaking which is engaged in—

- (i) the manufacture or processing of goods; or
 - (ii) the manufacture of computer software; or
 - (iii) the business of generation or distribution of electricity or any other form of power; or
 - (iiia) the business of providing telecommunication services, whether basic or cellular, including radio paging, domestic satellite service, network of trunking, broadband network and internet services; or
 - (iv) mining; or
 - (v) the construction of ships, aircrafts or rail systems;
- (b) "unabsorbed depreciation" means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the reorganisation of business or conversion or amalgamation or demerger had not taken place;
- (c) "specified bank" means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955) or a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959) or a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970) or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980).

20.7 TREATMENT OF PRELIMINARY EXPENSES AND AMORTIZATION OF EXPENDITURE

Treatment of preliminary expenses [Sec. 35D(5)]

When an amalgamating company merges with an amalgamated company under a scheme of amalgamation, the amount of preliminary expenses of the amalgamating company to the extent not yet written off shall be allowed as deduction to the amalgamated company in the same manner as would have been allowed to the amalgamating company. However, the advantage of this section will not be availed if the undertaking of an Indian company is transferred to another Indian company in a scheme of amalgamation within the 5 year period of amortisation (period of ten years if expenditure is incurred upto March 31,1998) then the deduction in respect of previous year in which the amalgamation takes place and the following previous year within the 5 year (period of ten years if expenditure is incurred upto

March 31,1998) shall be allowed to the amalgamated company and not to the amalgamating company. Similarly, in the case of demerger where the resulting company shall be able to claim amortisation of preliminary expenses as if demerger had not taken place.

Amortization of expenditure in case of amalgamation or demerger[Section35DD]

If an assessee, being an Indian company, incurs any expenditure (on or after the 1st day of April, 1999) wholly and exclusively for the purposes of amalgamation or demerger of an undertaking, the assessee shall be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the five successive previous years beginning with the previous year in which the amalgamation or demerger takes place.

20.8 SUMMARY

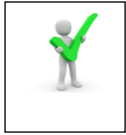
In this unit you learnt about the provision regarding amalgamation and demerger. You learnt that from the point of view of Income tax "amalgamation", in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company. You also learnt the provisions regarding transfer of capital asset in case of amalgamation and demerger. Further, you also learnt that "demerged company" means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company. You came to know that how preliminary expenses and amortization of expenses shall be treated. In the next unit, you will be learning about corporate failure and contraction.



20.9 GLOSSARY

Amalgamation-When two or more companies merge into one company and the shareholders of each merged company becomes substantially the shareholder in the newly formed company. The companies are voluntarily liquidated and new company is established that takeover the business of the existing companies.

Demerger- Demerger in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956 (1 of 1956), by a demerged company of its one or more undertakings to any resulting company.



20.10 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress –A

- 3. c
- 4. a
- 5. a



20.11 REFERENCES

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- Singhanian Dr. Vinod K., SinghanianKapil and Singhanian Monica, Direct Taxes Planning and Management, Taxmann's
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- <https://www.incometaxindia.gov.in/pages/tax-laws-rules.aspx>



20.12 SUGGESTED READINGS

1. Mehrotra H.C. and Goyal S.P. , Income Tax : Law and Accounts, SahityaBhawan Publications
2. Singhania Dr. Vinod K., SinghaniaKapil and Singhania Monica, Direct Taxes Planning and Management, Taxmann's
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20.13 TERMINAL QUESTIONS

- Q1. What do you mean by amalgamation? What are the transactions which are not treated as Amalgamation?
- Q2. What do you mean by demerger? State the transfer which shall not be treated as transfer for demerger.
- Q3. Explain the consequences in case of the amalgamation under section 35.
- Q4. Write short notes on
- a) "Actual Cost in a scheme of Amalgamation and Transfer".
 - b) Section 35DD

UNIT 21 CORPORATE FAILURES AND CONTRACTION

21.1 Introduction

21.2 Objectives

21.3 Corporate failures and contraction

21.4 Business restructuring

21.5 Restructuring through slump sale

21.6 Conversion of firm/proprietorship to company

21.7 Other cases of capital restructuring subject to capital gains tax

21.8 Summary

21.9 Glossary

21.10 Answer to Check Your Progress

21.11 Reference / Bibliography

21.12 Suggested Readings

21.13 Terminal & Model Questions

21.1 INTRODUCTION

Globalisation and liberalisation have not only provided immense opportunities for international business but also exposed companies to tremendous amount of competition in an environment of free competition. This has lead to growing cases of corporate failure and contraction. In order to avoid future losses and survive in competition , the companies tends to redesign their structures and follow reconstruction strategies.

21.2 OBJECTIVES

After discussing this unit you will be able to:

- Understand the meaning and strategies of restructuring.
- Explain meaning and tax benefits in case of amalgamation and demerger.

- Explain provisions for restructuring through slump sale .
- Discuss the tax implication of conversion of sole proprietorship / firm to limited liability company.
- Understand other methods of restructuring and their tax implications.

21.3 CORPORATE FAILURES AND CONTRACTION

In modern competitive and volatile business environment business failure has become a common phenomenon. Economic recession or downturn is a major reason for business failures. Besides, reasons like managerial , locational, product related, ownership and control, labour processes etc. may also be responsible for it e.g. companies may face situations like increasing operational risk by variability of earnings, overriding cost structure, increasing financial risk or portfolio risk, product failure, change in technologies, or a sharp dip in market share etc. which create issues of declining shareholders value and that finally may result in business failure. Many companies resort to several strategies for their survival whereas some others may want to improve their efficiency and effectiveness. Therefore, restructuring may be both reactive and proactive.

Obviously, restructuring comprises both expansion and contraction strategies. Whereas **expansion strategies** include mergers and consolidations, joint ventures, acquisitions , etc. **contraction strategies** include , sell offs, spin offs, equity carve outs, abandonment of assets, and liquidation etc. Apart from it ownership and control strategies may also be undertaken.

In contraction business pursues a smaller target market be it a subset of one currently served or a different market. Contraction is aimed at profitable, smaller and underserved market. Restructuring by contraction culminates in smaller, better and faster processes.

21.4 BUSINESS RESTRUCTURING

Restructuring means rearrangement and business restructuring refers to the rearrangement of corporate structure by which business is redefined to build core competency and to increase shareholders worth.

Restructuring is basically undertaken for the following motives:

1. To get competitive advantage
2. To establish synergy and convergence through consolidation
3. To establish forward and backward linkages
4. Technology transfer
5. To get tax exemptions and benefits
6. Redefining business strategies
7. To get economies of scale

There are several strategies for business restructuring which comprise merger including amalgamation and absorption, capital reduction, redemption of shares, conversion of debentures into shares, buy back of shares, demerger and spin off, slump sale of business, conversion of sole proprietary business and partnership firms into company, conversion of a private company or an unlisted company into a limited liability partnership (LLP) etc.

Let us discuss some of the major types of restructuring in detail :

1. Amalgamation

Meaning :

For tax purposes amalgamation refers to merger of one existing company with another existing company and merger of two or more existing companies to form a third company. The former type of merger is specifically called absorption and the latter is referred to as Amalgamation.

Conditions of Amalgamation :

According to section 2(1B) of Income Tax Act, 1961 merger takes place in such a manner that :

- a. All the properties of the amalgamating company or companies before the amalgamation, become the properties of the amalgamated company by virtue of the amalgamation;
- b. All the liabilities of the amalgamating company or companies immediately before the amalgamation, becomes the liabilities of the amalgamated company by virtue of the amalgamation ; and
- c. Shareholders holding not less than 75% in value of the shares in the amalgamating company or company (other than shares already held therein immediately before the amalgamation by, or by a nominee, for the amalgamated company or its subsidiary) become shareholders of amalgamated company.

Examples :

- A limited merges with B Limited by which A Limited (Amalgamated company) goes into liquidation and B Limited (Amalgamating company) takes over the assets and liabilities of A Limited.
- A limited and B Limited merges with AB Limited by which both A Limited and B Limited (Amalgamated companies) go into liquidation and an existing company AB Limited (Amalgamating company) takes over the assets and liabilities of A Limited and B Limited.
- A limited and B Limited both merges with a newly formed company AB Limited by which both A Limited and B Limited (Amalgamated companies) go into liquidation and the new company AB Limited (Amalgamating company) takes over the assets and liabilities of A Limited and B Limited.

Transactions not deemed as amalgamation :

However, within the meaning of section 2 (IB) , even though there exists a merger, for Income tax purposes there is no amalgamation in the following two cases:

- a. Where the property of the company which merges is sold to another company and the merger is a result of transfer of sale;
- b. Where the company which merges is wound up in liquidation and the liquidator distributes its property to the other company.

Exemptions Available under the income Tax Act, 1961 :

i. Capital gains:

- **Exemption for Amalgamating company :** Under section 47 (vi) capital gains arising out of transfer of assets by the amalgamating company to the Indian amalgamated company is exempt from tax .
- **Exemption for shareholders of Amalgamating company :** Under section 47 (vii) capital gains arising out of transfer of assets by the amalgamating company to the Indian amalgamated company is exempt from tax if :
 - a. The transfer is made in consideration of the allotment to him of shares in amalgamated company except where the shareholders itself is an amalgamated company; and
 - b. The amalgamated company is an Indian company
- **Exemption for transfer of shares held in Indian company by Amalgamating foreign company :** Under section 47 (via) in case of transfer of shares in an Indian company held by a foreign company to another foreign company is exempt from tax if , at least 25% of the amalgamated foreign company continue to remain the shareholders of the amalgamated company and such transfer is tax free in the country of incorporation of amalgamating company.

- ii. **Carry forward and set-off of accumulated loss and unabsorbed depreciation :** Under section 72(A) in case of amalgamation of a company, owning an industrial undertaking or a ship or a hotel with another company or the amalgamation of a banking company with a specified bank (SBI or its subsidiary bank or a new bank constituted under section 3 of Banking companies Act 1970), then the accumulated loss and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or allowance for depreciation of amalgamated company for the previous year in which the amalgamation was effected and other provisions of the Act shall apply accordingly.

Conditions for Allowance :

- a. **For amalgamating company**

- i. The amalgamating company should have been engaged in business in which the accumulated loss occurred or depreciation remain unabsorbed, for 3 or more years.
- ii. The amalgamating company was held continuously as on the date of amalgamation at least three fourth of the book value of the fixed assets held by it , two years prior to the date of amalgamation.

b. For amalgamated company

- i. The amalgamated company holds continuously for a minimum period of five years from the date of amalgamation at least 75% in the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation.
- ii. The amalgamated company continues the business of amalgamating company for a minimum period of five years from the date of amalgamation
- iii. The amalgamated company fulfils such other conditions as may be prescribed to ensure the revival of the business of amalgamated company or to ensure that the amalgamation is for genuine business interest.

Example 1 :

A Limited which has the following accumulated loss of Rs.10,00,000 and Unabsorbed depreciation of Rs. 6,00,000 wants to amalgamate with B Limited . Both companies are evaluating the proposal .

The following alternatives may be considered by the companies :

- a. Merger of A Limited into B
- b. Merger of B Limited into A
- c. Merger of A Limited and B Limited into a new company

The above merger alternatives again may be subject to three situations as mentioned below :

Situation 1: If the merger is not an amalgamation within the meaning of section 2 (1B)

Situation 2 : If the merger is an amalgamation but it does not fulfil the provisions of section 72 A.

Situation 3 : If the merger fulfils both the conditions of section 2 (1B) and section 72.

	Possibility of carry forward and set off of loss/dep. Under Alternatives		
	a	b	c

Merger Situations		Merger of A Limited into B	Merger of B Limited into A	Merger of A Limited and B Limited into a new company
1	If the merger is not an amalgamation within the meaning of section 2 (1B)	Not possible	Possible	Not Possible
2	Situation 2 : If the merger is an amalgamation but it does not fulfil the provisions of section 72 A.	Not possible	Possible	Not Possible
3	Situation 3 : If the merger fulfils both the conditions of section 2 (1B) and section 72.	Possible	possible	possible

Conclusions :

1. If the conditions of section 72 A are fulfilled , any of the three alternative could be adopted.
2. Merger of B limited into A Limited is better alternative since in this case B Limited would go into liquidation and A Limited would be in existence and thereby would be able to carry forward and set off of loss/ depreciation even if the merger does not fulfil the conditions of section 2(1B). This is also called the reverse merger.

Other benefits available to amalgamated company : Amalgamated company is also entitled to carry forward and set off the following unabsorbed expenditures of the amalgamating company:

- i. Capital expenditure on scientific research (section 35 D)
- ii. Expenditure of amalgamation (section 35 DD)
- iii. Expenditure for obtaining license to operate telecommunication services (section 35 ABB)

- iv. Preliminary expenses (35D)
- v. Expenditure on prospecting of minerals (section 35 E)

2. Demerger

Demerger is primarily aimed to enable companies to undertake business restructuring in a tax neutral form.

Meaning of Demerger

Section 2 (19AA) defines demerger as the transfer by the demerged company of one or more of its undertakings to any resulting company in such a manner that :

- a. All the property and liabilities of the undertaking which is being transferred by the demerged company become the property and liabilities of the resulting company;
- b. Property and liabilities of the undertaking being transferred at their book values immediately before the demerger;
- c. In consideration of demerger , the resulting company issues shares to the shareholders of the demerged company on a proportionate basis except where the resulting company itself is the shareholder of the demerged company;
- d. Shareholders not less than the 75% in value of shares in demerged company(other than the shares already held therein) becomes shareholders of the resulting company
- e. Transfer of the undertaking on a going concern basis;
- f. The merger is in accordance with the conditions if any notified by central government u/s 72A(5).

Exemptions and benefits :

- i. Transfer of assets and issue of shares to the shareholders will be free of capital gains tax under section 2 (19AA);
- ii. Issue of shares directly to the shareholder pursuant to the demerger of an undertaking will not constitute deemed dividend tax under section 2 (22);
- iii. Transfer of shares in an Indian company pursuant to the demerger of a foreign company is exempt from tax if (a) at least 75% shares in the demerged foreign company continue to be shareholders in the resulting company and (b) such transfer is free from capital gains tax in the foreign company.
- iv. Accumulated losses and depreciation related to the undertaking being transferred in a scheme of demerger is allowed to be carried forward and set off in the hands of resulting company.

21.5 RESTRUCTURING THROUGH SLUMP SALE

What is Slump sale ?

According to section 2(42C) “Slump sale means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sale.”

Conditions of slump sale

On the basis of above definition , Slump sale must have to satisfy the following essential conditions :

1. There must be two persons i.e. transferor and transferee,
2. Transferor must own one or more undertakings,
3. Transfer must take place by way of sale,
4. Transfer must be made for lump sum consideration without values being assigned to the individual assets and liabilities in such sale.

For example :

- if an asset or liability is valued with sole purpose of payment of stamp duty, registration fees or other such taxes it should not be regarded as assignments.
- If transfer is effected by allotment of shares in the acquiring company and not by monetary consideration ,in that case too, it may be considered as slump sale, provided other conditions are fulfilled.

Undertaking means any part of undertaking, or a unit, or division of an undertaking or a business activity taken as a whole , but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

Chargeability to tax :

According to section 50 B any amount arising from slump sale effected in the previous year shall be chargeable to tax as long term capital gains and shall be deemed to be the income of the previous year in which the transfer took place. For the purpose of tax , net worth of the capital assets transferred by way of such sale will be the cost of acquisition and improvement. Net assets would be worked out by deducting the value of liabilities of the undertaking appearing in books of accounts from the value of aggregate amount. (Net worth = Aggregate value of assets- value of liabilities). The aggregate value of assets will be worked out as under :

Written down value of block of assets = Depreciated value of block of assets on the first day of previous year + assets acquired during the previous year – sale value for assets during the previous year - scrap value of assets. If such net worth comes out to be negative it will be deemed as zero.

For computation of LTCG from the value of slump sale the depreciation allowable for (i) previous year 1987-88 and (ii) from 1988-89 to the previous year of slump sale has to be deducted.

While computing LTCG , no benefit of indexation will be given.

This can be explained by the following example :

Example 2 :

A limited who commenced a manufacturing plant in 1980, has given the following information :

1. Depreciated value of block of assets on 31.03.2015 after charging 15% depreciation p.a) :10,00,000;
2. Purchase of another plant on June 15,2015 for Rs. 5,00,000 (depreciation rate being 15%)
3. Sold one plant for Rs. 6,00,000 on December 15,2015. (depreciation rate being 15%)
4. A Limited sold the manufacturing plant by slump sale for Rs. 6,00,000; Expenses of transfer are Rs. 1,50,000;
5. Actual cost of assets acquired during 1986-87 was 5,50,000, depreciation claimed is Rs. 50,000 and depreciation that would have been allowable if the assets is the only asset in the relevant block of assets is Rs. 80,000.

Computation of Long term capital gain of A Limited on slump sale

Particulars	Amount Rs.
Depreciated value of block of assets on 31.03.2015	10,00,000
Add : Actual cost acquired during previous year 2015-16	5,00,000
Less : sale value of plant sold during previous year 2015-16 (It should not be more than 15 Lakh)	6,00,000
Balance	9,00,000
Less : Value of plant transferred by way of slump sale (Actual cost – Depreciation for 1988-89 + Depreciation allowable from 1989-90 to 2015-16) 5,50,000-50,000-80,000	4,20,000
Written down value of block of assets on March 31, 2016	4,80,000
Less depreciation for previous year 2015-16 @ 15% On Rs. 4,80,000	72,000
Depreciable value of assets on April 1, 2016	4,08,000
Computation of LTCG	
Sale proceed of plant	6,00,000
Less : Actual cost (Indexation not allowed) –Dep.	4,20,000
Expenses of transfer	1,50,000
Long term capital gain (LTCG)	2,70,000

Dear learner, you might have understood how Long term capital gain (LTCG) is worked out in case of slump sale which is chargeable for tax. The assessee is required to furnish the return of income along with a certificate from chartered accountant in form 3CEA that the net worth has been correctly worked out.

If the transfer is on a going concern basis, even though no specific exemption is provisioned, the firm shall not be taxable since there can be no indication of a sale of any specific item comprised therein.

In case of slump sale, accumulated loss/ depreciation will be carried forward and set off by the transferor whereas in case of amalgamation/ demerger, the transferee can carry forward the losses / depreciation of the transferor under section 72A.

21.6 CONVERSION OF FIRM/PROPRIETORSHIP TO COMPANY

For tax purposes transfer of any capital assets as a result of conversion of firm/proprietorship to company is free from chargeability of capital gains tax in the hands of firm/proprietary concern and the accumulated loss and the unabsorbed depreciation of the converted concern is allowed to be carry forward and set off by the successor company provided the conditions laid down under section 47(xiii) and 47(xiv) for such conversion are fulfilled.

Following are the conditions for i. Conversion of sole proprietorship to company ii. Conversion of firm to company

a. Conversion of sole proprietorship to company: under section 47(xiv)

b. Where a sole proprietary concern is converted into a company and as a result of such conversion the sole proprietary concern transfer any capital tangible or intangible asset to a company, such transfer is free from capital gain tax under section 47(xiv) provided the following conditions are fulfilled.

- i. all the assets and liabilities of the sole propriety concern immediately before its succession should become the assets and liabilities of the company;
- ii. the shareholding of sole proprietor in the company is not less than 50% of the total voting power in the company and his shareholding continues to remain so for a period of five years from the date of succession;
- iii. the sole proprietor does not receive any consideration or benefit (whether directly or indirectly) other than the shares allotted to him by the company under section 47(xiv)

c. Conversion of Partnership firm to company : under section 47(xiii)

Where a firm is converted into a company and as a result of such conversion the firm transfer any capital tangible or intangible asset to a company, such transfer is free from capital gain tax under section 47(xiii) provided the following conditions are fulfilled :

- i. all the assets and liabilities of the firm immediately before its succession should become the assets and liabilities of the company;
- ii. all the partners of the firm immediately before its succession become the shareholders of the company in the same proportion in which their capital accounts stood before such succession;

- iii. the partners of the firm do not receive any consideration or benefit (whether directly or indirectly) other than the shares allotted to them by the company;
- iv. the partner's aggregate shareholding in the company is not less than 50% of the total voting power in the company and their shareholding should continue to remain so for a period of five years from the date of succession; under section 47(xiii).

Other Exemptions and benefits :

In addition of non chargeability of capital gains tax , the successor company is allowed to carry forward and set off of losses and unabsorbed depreciation in case of reorganisation of business as under :

- i. Carry forward of loss and unabsorbed depreciation of the converted concern and
- ii. Set off of loss and unabsorbed depreciation of the converted concern.

The provisions mentioned above can be explained by the following example:

Example 3 :

A and B are the equal partners of a firm whose Balance sheet is as under :

Balance Sheet of firm A and B as on 31st March, 2016

Capital and liabilities	Amount	Assets	Amount
Capital		Building	4,00,000
A	2,00,000	Plant	1,60,000
B	4,00,000	Stock in trade	80,000
Creditors	1,00,000	Debtors	1,00,000
Bills payable	1,00,000	Accounts receivable	40,000
		Cash and Bank	20,000
Total	8,00,000	Total	8,00,000

Both the partners A and B decided to convert the firm in a Limited liability company which was incorporated on April 1, 2016. The company took over the building , plant and Stock at Rs. 8,00,000 , Rs. 3,20,000 and Rs. 1,00,000 respectively and all the liabilities of the firm .

You are required to capital gains and business income of the firm and advise about the chargeability of tax. Assume that the building is acquired on April 1, 1999.

Computation of Net consideration and allotment of shares to partners A and B in the new company :

Building	8,00,000
Plant	3,20,000
Stock in trade	1,00,000
Debtors	1,00,000
Accounts Receivable	40,000
Cash and Bank	20,000
Total	13,80,000
Less liabilities : 1. Creditors	1,00,000
2. Bills payable	1,00,000
	2,00,000
Net consideration (To be allotted to A and B equally)	11,80,000

Computation of capital gains and business income :

Assets	Cost of acquisition	Agreed consideration	capital gains / business income
Building	4,00,000	8,00,000	4,00,000 (LTCG)
Plant	1,60,000	3,20,000	1,60,000 (STCG)
Stock in trade	80,000	1,00,000	20,000 (business income)

Note :

1. Since this is a case of “transfer” by virtue of section 47(iii), therefore the firm is not chargeable for capital gains of Rs. 5,60,000.(LTCG Rs.4,00,000+STCG Rs. 1,60,000).
2. The firm is liable to pay tax on business income of Rs. 20,000.
3. The shares allotted to A and B in the new company are 50% and their shareholding must continue for five years from the date of conversion. If any one of them transfers within the stipulated time shares resulting in reducing their shareholdings less than 50%, then the capital gains of Rs, 5,60,000 will be chargeable to tax in the hands of new company.



Check Your Progress-A

1. Fill in the gaps :

- i.defines demerger as the transfer by the demerged company of one or more of its undertakings to any resulting company.
- ii. The assessee is required to furnish the return of income along with a certificate from chartered accountant inthat the net worth has been correctly worked out in case of slump sale.
- iii. Buy Back of shares by a company is allowed under Section 77A, of.....
- iv.the accumulated loss and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or allowance for depreciation of amalgamated company for the previous year in which the amalgamation was effected.
- v. According to any amount arising from slump sale effected in the previous year shall be chargeable to tax as long term capital gains and shall be deemed to be the income of the previous year in which the transfer took place.
- vi. In case of a sole proprietary concern is converted into a company and transfer of any tangible or intangible capital asset from the sole proprietary concern to a company takes place, such transfer is free from capital gain tax
- vii. While computing LTCG , no benefit of indexation will be given in case of
- viii. Under section 10(34 A) the income arising to the shareholders in respect of buy back of shares by the domestic company is

B. Indicate whether TRUE or FALSE.

- i. Business restructuring refers to the rearrangement of corporate structure.
- ii. For the purpose of tax , net worth of the capital assets transferred by way of slump sale will be the cost of acquisition and improvement.
- iii. For tax purposes amalgamation is same as merger.
- iv. In case of demerger, property and liabilities of the undertaking being transferred should be taken at their market values.
- v. Expansion strategies include mergers and consolidations, joint ventures, acquisitions.
- vi. Amalgamated company is also entitled to carry forward and set off the Expenditure of amalgamation (section 35 DD) of the amalgamating company.
- vii. Capital expenditure on scientific research (section 35 D) is allowed to be carried forward and set off by the amalgamating company.

- viii. Where a firm is converted into a company and as a result of such conversion the firm transfer any capital tangible or intangible asset to a company , such transfer is free from capital gain tax.
- ix. For tax purposes amalgamation refers to merger of one existing company with another existing company and merger of two or more existing companies to form a third company.
- x. Restructuring may be both reactive and proactive.

21.7 OTHER CASES OF CAPITAL RESTRUCTURING SUBJECT TO CAPITAL GAINS TAX

In a scheme of structuring , there may be some transactions , which are not regarded as transfer and hence are subject to capital gains tax. In the following cases any transfer of capital assets will attract capital gains tax :

(1) Buy Back of shares

Purchasing its own shares from its shareholders by a company is called Buy Back of shares which is allowed under Section 77A, of company Act 1956. According to section 2(22) of Income Tax Act, 1961 dividend does not include any payment made by a company on purchase of its own shares . **Section 46 A provides that in such case , the cost of the shares/securities shall be deemed to be the capital gains arising to such shareholders or the holders of any specified securities in the year in which such shares or other securities were purchased by the company.**

Often companies resort to buy back of unlisted shares instead of payment of dividend to its shareholders specially if the capital gains arising to shareholders are either not chargeable to tax or are chargeable at lower rates. **Under section 10(34 A) the income arising to the shareholders in respect of buy back of shares by the domestic company is exempt but the domestic company is liable to pay additional income tax i.e. 20% (plus surcharge , education cess and secondary and higher education cess) on distributed income (i.e the excess of consideration paid by company at buy back of shares over the sum received by the company at the time of issue of such shares).** The company is liable to pay such additional tax under section 115 Q even though no income may be payable by it in respect of total income computed under the provisions of the Act.

- (2) **Redemption of preference shares :** When preference shares of a company is redeemed by a company by paying the preference shareholders the value of the shares in exchange of preference shares held by them, it is deemed as buy back of preference shares by the company and will attract capital gains tax.
- (3) **Conversion of debentures into shares :** If bonds or debentures, debenture stock or debenture stock of a company in any form is converted into shares or debentures of

that company, the transaction is not regarded as transfer under section 47(x) and will attract capital gains tax.

21.8 SUMMARY

Restructuring means rearrangement and business restructuring refers to the rearrangement of corporate structure by which business is redefined. There are several strategies for business restructuring which comprise merger including amalgamation and absorption, capital reduction, redemption of shares, conversion of debentures into shares, buy back of shares, demerger and spin off, slump sale of business, conversion of sole proprietary business and partnership firms into company, conversion of a private company or an unlisted company into a limited liability partnership (LLP) etc.

Amalgamation refers to merger of one existing company with another existing company and merger of two or more existing companies to form a third company. Under section 47 capital gains arising out of transfer of assets by the amalgamating company to the Indian amalgamated company and capital gains arising out of transfer of assets by the amalgamating company to the Indian amalgamated company is exempt from tax subject to satisfying certain conditions. Under section 72A, the accumulated loss and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or allowance for depreciation of amalgamated company for the previous year in which the amalgamation was effected. Demerger is the transfer by the demerged company of one or more of its undertakings to any resulting company in which all the properties and liabilities of the undertaking which is being transferred by the demerged company become the property and liabilities of the resulting company a Shareholders not less than the 75% in value of shares in demerged company (other than the shares already held therein) becomes shareholders of the resulting company. Exemptions and benefits include transfer of assets and issue of shares to the shareholders will be free of capital gains tax and accumulated losses and depreciation related to the undertaking being transferred is allowed to be carried forward and set off in the hands of resulting company. Slump sale means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sale. Any amount arising from slump sale effected in the previous year shall be chargeable to tax as capital gains and shall be deemed to be the income of the previous year in which the transfer took place. Transfer is also free from capital gain tax subject to certain conditions in case of restructuring through conversion of firm/proprietorship to company. According to section 50 B any amount arising from slump sale effected in the previous year shall be chargeable to tax as long term capital gains and shall be deemed to be the income of the previous year in which the transfer took place. For the purpose of tax, net worth of the capital assets transferred by way of such sale will be the cost of acquisition and improvement. Net assets would be worked out by deducting the value of liabilities of the undertaking appearing in books of accounts from the value of aggregate amount. (Net worth = Aggregate value of assets - value of liabilities). The aggregate value of assets will be :

Written down value of block of assets = Depreciated value of block of assets on the first day of previous year + assets acquired during the previous year – sale value for assets during the previous year - scrap value of assets. If such net worth comes out to be negative it will be deemed as zero.

For computation of LTCG from the value of slump sale the depreciation allowable for (i) previous year 1987-88 and (ii) from 1988-89 to the previous year of slump sale has to be deducted.

While computing LTCG, no benefit of indexation will be given. The assessee is required to furnish the return of income along with a certificate from chartered accountant that the net worth has been correctly worked out.

Similarly, carry forward of loss and unabsorbed depreciation is also allowable in case of reorganisation of business subject to satisfying certain conditions laid down in the Act. It has to be noted that in case of slump sale, accumulated loss/ depreciation will be carried forward and set off by the transferor whereas in case of amalgamation/ demerger, the transferee can carry forward the losses / depreciation of the transferor under section 72A.

Purchasing its own shares from its shareholders by a company is called Buy Back of shares which is allowed under Section 77A, of company Act 1956. Often companies resort to buy back of unlisted shares instead of payment of dividend to its shareholders specially if the capital gains arising to shareholders are either not chargeable to tax or are chargeable at lower rates. Under section 10(34 A) the income arising to the shareholders in respect of buy back of shares by the domestic company is exempt but the domestic company is liable to pay additional income tax i.e. 20% (plus surcharge, education cess and secondary and higher education cess) on distributed income (i.e. the excess of consideration paid by company at buy back of shares over the sum received by the company at the time of issue of such shares). When preference shares of a company is redeemed by a company by paying the preference shareholders the value of the shares in exchange of preference shares held by them, it is deemed as buy back of preference shares by the company and will attract capital gains tax. Similarly, If bonds or debentures, debenture stock or debenture stock of a company in any form is converted into shares or debentures of that company, the transaction is not regarded as transfer under section 47(x) and will attract capital gains tax.



21.9 GLOSSARY

Amalgamation: refers to merger of one existing company with another existing company and merger of two or more existing companies to form a third company.

Demerger : is primarily aimed to enable companies to undertake business restructuring in a tax neutral form.

Slump sale : means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sale.

Buy Back of shares : is Purchasing its own shares from its shareholders by a company.



21.10 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress –A

1.
 - i. Section 2 (19AA)
 - ii. form 3CEA
 - iii. Company Act 1956
 - iv. Under section 72A
 - ii. section 50 B
 - iii. under section 47(xiv)
 - iv. Slump sale
 - v. Exempt.

2.
 - i. True
 - ii. True
 - iii. True
 - iv. False
 - v. True
 - vi. True
 - vii. True

- viii. True
- ix. True
- x. True



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21.12 SUGGESTED READINGS

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2. Vinod K. Singhania, Taxmann's Direct Taxes Planning and Management.
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4. A.C. Sampath Iyengar, Law of Income Tax, Bharat Publishing House, Allahabad.
5. Taxman, The Tax and Corporate Law Weekly.
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21.13 TERMINAL QUESTIONS

- Q1. What do you understand by the term 'reconstruction' ? Explain its various causes and objectives.
- Q2. What is the meaning of amalgamation? Discuss the exemptions and other benefits available to amalgamating and amalgamated companies under income Tax Act , 1961.
- Q3. Explain provisions in respect of any transfer to be free from capital gain tax or for getting allowance of set off and carry forward of loss/ depreciation in case of conversion of firm/proprietorship to company.
- Q4. What is Slump sale ? Discuss the essential conditions to be satisfied for it? Explain the chargeability of amount arising from slump sale .
- Q5. Explain with the help of an example how depreciated value of assets and capital gain is computed in case of transfer by way of slump sale .
- Q6. Define demerger ? What are the exemption and benefits available in case of demerger ?
- Q7. What is Buy Back of shares? Explain the provisions in respect of Buy Back of shares by the companies.
- Q8. Explain the provisions in respect of redemption of preference shares and Conversion of debentures into shares .

UNIT 22 TAX IMPLICATION OF FOREIGN COLLABORATION AGREEMENTS

22.1 Introduction

22.2 Objectives

22.3 Meaning and objectives of foreign collaboration

22.4 Residential status and Tax liability of foreign collaborators

22.5 Taxability of different kinds of Income

22.6 Assessment of foreign collaborators

22.7 Deduction of Tax at source from Non-resident income

22.8 Summary

22.9 Glossary

22.10 Answer to Check Your Progress

22.11 Reference / Bibliography

22.12 Suggested Readings

22.13 Terminal & Model Questions

22.1 INTRODUCTION

In the modern age of free markets lead by liberalisation privatisation, and globalisation (LPG), the markets and economies all over the world are fast integrating. The emergence and expansion of Multinational corporations and their interdependence have triggered emerging forms of business strategies i.e mergers and acquisitions, consolidation. Today, Survival and growth of manufacturing and service sectors is again dependent on the transfer of technology which is mainly possible by the foreign collaboration agreements. In order to promote exports and boost economic growth, government of India has offered many fiscal incentives particularly for non resident Indians. They have to take full advantage of these incentives and exemptions and other tax provisions particularly those which are laid down in the Income Tax Act, 1961. For this they are required to take precautions and extra care in accordance with various tax provisions in this respect. Efficient tax Planning and Tax management is essential for successful growth of foreign collaborations as it facilitates to reduce the tax burden on foreign collaborators and enhance their products attractiveness as

well as their willingness for technology transfer to the domestic manufacturers and traders. In this unit , the tax implications of these foreign collaboration will be discussed in detail.

22.2 OBJECTIVES

After discussing this unit you will be able to:

- Understand the meaning and objectives of foreign collaborations.
- Explain the residential status and tax liability of foreign collaborators.
- Discuss the meaning and taxability of different kinds of income of foreign collaborators and their implications.
- Understand the assessment of foreign collaborators.

22.3 MEANING AND OBJECTIVES OF FOREIGN COLLABORATION

Meaning of foreign collaboration : Foreign Collaboration is a strategic alliance between firms of two or more countries with the goal of providing mutual benefit for each firm.

Objectives of foreign collaboration:

1. Gain technological advancement at relatively low cost
2. Low cost market access
3. Strengthen competitive advantage or core competencies
4. Technology sharing and transfer
5. Gain mutual insights into business practices and strategies .

Types of collaborations :

1. Joint ventures
2. Outsourcing agreements
3. Product licensing
4. Providing Technical services
5. Transfer of know how.

22.4 RESIDENTIAL STATUS AND TAX LIABILITY OF FOREIGN COLLABORATORS

Income tax Act impose tax liability based on residential status of assessee. Residential status is determined by section 6 of Income tax Act, 1961 which classifies it in three categories namely i. Resident ii. Not ordinarily Resident and iii. Non Resident.

Foreign collaborations are generally non resident in India.

- They are generally incorporated outside India and they could be regarded as non resident within the meaning of section 6(3) because in case of foreign companies the whole of control and management of affairs of such company is situated outside India and the place of carrying on business and having transactions and operations being immaterial for the purpose.
- Foreign collaborators are generally not brought between individuals but there is no prohibition in law for doing so.
- If foreign collaborator is an individual, his residential status will be determined under section 6(1) on the basis of number of days of his stay in India.
- If foreign collaborator is a partnership firm or an association of person, it would be regarded as being resident in India in every case where even the negligible portion of control and management of affairs of the firm or association of person is situated in India.
- If whole of control and management of affairs of a partnership firm or an association of person is situated outside India, the claim of the status of being non resident in India will have to be claimed for the purpose of income tax, under Income Tax act, 1961.

22.5 TAXABILITY OF DIFFERENT KINDS OF INCOME

Chargeability of non resident's Income : According to section 5(2) the total income of any previous year of any person who is non resident must be taken to include all income from whatever source derived which is :

- Is received or deemed to be received in India in such year by or on behalf of the non resident; or
- Accrues or arise or is deemed to be accrue or arise to the non resident in India during the previous year.

This must be noted that place of actual accrual is essential to be determined for the purpose of inclusion or exclusion in the total income of the non resident assessee.

Exemptions from income tax and tax liability of non residents :

- Non residents are entitled to concessional rates of tax in respect of their income chargeable to tax in India.
- Interest on non-resident non - repatriable deposits as well as non resident Rupee deposit in the banks in India would be exempt under section 10(4) subject to limits and conditions specified therein.
- Concessional rates of income tax is available to non resident Indians in respect of their investment income through foreign exchange remittances including capital gains under section 115 C read with 115 D, 115 E and 115 H.
- Since an assessee can change his residential status by changing the place of control and management of business, it provides opportunities to the foreign collaborator that by

changing status of residence from non resident to resident would allow him set off losses outside India with income earned in India.

- According to section 145 of Income Tax Act, 1961 determination of liability to tax in India also depends on choice of accounting system i.e. cash or mercantile system followed by assessee. A foreign collaborator has the option of changing the accounting system to determine the chargeability of income but once he determined the method of accounting system, it cannot be changed without sufficient reasons.
- Tax liability of a non resident is also determined by forms of business organisation i.e. a joint venture in the form of a company, partnership firm, association of persons or body of individuals such as society or a trust or HUF.

Meaning and taxability of different kinds of Income is explained as under:

1. Interest Income

What is interest ?

Interest means , according to section 2(28A),

- interest payable in any manner in respect of any money borrowed or debt incurred(including a deposit, claim or other similar right or obligation)
- It includes any service fee or other charge in respect of any money borrowed or debt incurred or in respect of any credit facility which has not been utilised.
- Interest also include any service fee or other charges in respect of loans, debts, deposits etc. as well as commitment charges or non utilised portion of credit facilities.

Taxability of Interest

According to Section 9(1) interest income by way of interest payable by government or by a person who is resident or by a person who is a non-resident, shall be income deemed to accrue or arise in India subject to following exceptions:

1. Interest payable by a resident or non resident in respect of any debt incurred or any money borrowed and used for the purpose of a business or profession carried on by him outside India ;
2. Interest payable by a resident in respect of any debt incurred or any money borrowed and used for the purpose of making or earning any income from any source outside India.

2. Royalty :

What is Royalty ?

Royalty means any consideration including any lump sum consideration (but excluding any consideration which would be the income of the recipient chargeable under the head 'capital gains') for the following :

- (i) transfer of all or any rights (including the granting of a licence) in respect of a patent, invention , model, design, secret formula or process, or trade mark or similar property;
- (ii) the imparting of any information concerning the working of or use of patent, invention, model, design, secret formula or trade mark or similar property;
- (iii) the use of patent, invention, model, design, secret formula or trade mark or similar property;
- (iv) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;
- (v) the imparting of any information concerning technical, industrial ,commercial or scientific knowledge, experience or skill;
- (vi) the transfer of all or any rights including the granting of a licence in respect of any copyright, literary, artistic, or scientific, work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting but not including consideration for the sale, distribution or exhibition of cinematographic films; or
- (vii) the rendering of any service in connection with the activities referred to in (i) to(v)above.

Taxability of Royalty

According to section 9(1)(vi) income by way of royalty is deemed as accruing or arising in India in the following three cases :

- (i) Royalty payable by the central government or any state government must be deemed to accrue in India regardless of who is the payee and what is the amount of royalty and also irrespective of the purpose of payment;
- (ii) Royalty payable by any resident taxpayer to any person, whether resident or non resident, would be deemed to accrue in India in every case except where the payment is relatable to business or profession carried on by the resident outside India or for the purpose of making or earning any income from any other source in India; and
- (iii) Royalty payable by even a non-resident would be deemed to accrue in India in cases where the payment is relatable to any business or profession carried on by the non resident in India or to any other sources of the non resident's income in India.

However, the receipt of capital nature arising out of total change in ownership of technical knowhow provided by the foreign collaborator to Indian taxpayers would be chargeable as capital gains. But , if ownership of such assets still belongs to foreign collaborators , income is deemed as royalty and the non resident is liable to tax under this provision.

Rate of tax : Under section 115 A , royalty income is taxable at the rate of 25% if it is received in pursuance of an agreement made after 31st March, 1976 subject to the following provisions :

- (i)The recipient of royalty should be a foreign company or a non corporatenon resident,
- (ii)The royalty may be received from the government or an Indian concern.
- (iii)The royalty should be received in pursuance of an agreement made by foreign company with the government or the Indian concern after 31st march, 1976.
- (iv)Where the agreement is with an Indian concern, it should be approved by the central government.
- (v)Where the agreement relates to a matter included in the industrial policy (prevailing at that time) of the central government , the agreement should be in accordance with that policy.
- (vi) The conditions (iv)and (v) shall not apply where the royalty is received in consideration for the transfer to an Indian concern, all or any right in respect of copyright in any book, or for the transfer to a person resident in India, any computer software.
- (viii) In computing the royalty income , no deduction shall be allowed under section 28 to 44C and section 57.

3. Fees for technical services :

What is the meaning of Fees for technical services?

According to section 9(1)(vii),Fees for technical services meansany consideration (including lump sum consideration) for the rendering of any a managerial service, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or the like project undertaken by the recipient. It does not include any income of the recipient chargeable under the head salaries .

Taxability of fees for technical services?

Fees for technical services is taxable on similar lines as royalty.Under section 115A , fees for technical services received by non corporatenon resident or foreign company is taxable @25%, if the agreement is entered into on or after 31st March,1976. No deduction is allowable under section 28 to 44C and section 57 in respect of any expenditure or allowance , for the purpose of computing the afore side income.

Income by way of interest, royalty, or fee for technical services which is deemed to accrue or arise in India by virtue of clause (v)(vi)and (vii)of section 9(1), shall be included in the total income of the non resident whether or not :

- (i)the non resident has a residence or place of business or business transaction in India; or
- (ii)the non resident has rendered services in India.

It must be remembered that income from interest, royalty or fees for technical services utilised in India would be deemed to accrue or arise in India in case of a non resident and would be included in his total income whether or not such services were rendered in India.

4. Transfer of know how :

What is transfer of know how?

Transfer of know how refers to a manufacturing technique . It is also called an intangible asset .It not only grants the licensor right to use the invention but also provides the supply of technical know how.Know how may be taken as comprehending , according to a judgement in Madras High court in FennerWoodroff& co. vs. CIT (1976) , the knowledge and experience gained by a manufacturer during the long number of years in which they had been manufacturing on the formulae , the engineering drawings and specifications, mechanical details or processes , and general knowledge that is associated with the production and development which is in the exclusive knowledge of trade.

Taxability of transfer of know how?

The following criteria has been laid down by House of Lords in Moriarty vs. Evans Medical supply Ltd. (1959) to decide whether the transaction involving dealing in know how would constitute income of a capital or revenue nature :

1. If the assessee sells its know how and realises the price for the same , the money for realised for providing the know how is of capital nature. Being an income of capital nature it would be outside the purview of tax under section 9(1)(vi) as royalty. It is liable to tax under the head capital gains. If the transfer takes in India , the non resident collaborator would be liable to capital gains tax in respect of transfer of know how but not otherwise e.g. when the transfer does not take place in India.
2. If the assessee who owns the know how continue to own it and allows the other person the right to use the know how of other person, it would be a revenue receipt liable to tax.

5. Export of goods from India by non residents

According to clause (b) of the explanation to section 9(1)(i)no income in case of a non resident should be regarded as being deemed to accrue or arise to him in India through or operations which are confined to the purchase of goods in India for the purpose of export. Here the non resident may have an agency or office in India who does nothing but to purchase the goods for their export. However, his income outside India from such exports traceable to business connection in India is exempt subject to the following :

- No part of goods purchased is sold in India .

- No part of sale proceed for the goods exported is received directly or indirectly , in cash or in kind, in India by or on behalf of the non resident.
A non resident can get advantages of this exemption through taking precautions as mentioned above with proper tax planning and management.

Tax treatment of payments made for expenses

While computing business income of the assessee certain expenditure are admissible for deduction and certain others are disallowed under section 37(1) read with section 28 of the Income Tax Act, 1961. The tax implication of disallowance of certain expenditure results in an addition of the real income of the assessee to the extent of such disallowance and consequent income tax and interest liability on such enhanced income. While entering into foreign collaboration agreements , the Indian taxpayer is required to be careful about the collaboration agreement which could be suitably modified that such disallowance is not attracted.

In this respect, the following considerations may be taken :

1. While setting up a new business the expenditure on the acquisition of capital assets including their installation and other expenditures are incurred before the setting up of business. Such expenditure do not qualify for any allowance or deduction in computing the taxable income of the taxpayer in India. In order to be entitled for claims of deduction such expenses have to be capitalised to claim depreciation allowance and investment allowance.
2. Under section 37(1) an expenditure would be admissible for obtaining an allowance if :
 - Expenditure is of revenue nature
 - It has been incurred wholly and exclusively for the purpose of business or profession and
 - Has been incurred during the previous year the income of which is assessable to tax in India.
3. Whether an expenditure is of revenue or capital nature is not of an universal application but depends on the circumstance of the case. The following broad criteria may be followed :
 - Capital expenditure is for initial outlay or for bringing into existence an asset or advantage of an enduring benefit to the business that is being carried on or for the extension of the business that is going on or for substantial replacement of a business asset. However , the amount paid for acquiring an asset into various small amounts or periodic instalments would not cease the capital nature of an asset.
 - Revenue expenditure is for the purpose of acquiring an assets or for working out an asset or for running the business with a view to producing profit. Revenue expenditure is of recurring nature and is incurred during the course of business or manufacture.

Drafting of agreement and termination of agreement

On the basis of above discussion , this is now clear that the Indian taxpayers could best take the advantage of tax provisions if the collaboration agreement is carefully written and all precautions are taken in its drafting in respect of existing tax system, provisions and procedures. Therefore , Drafting of an agreement is of prime importance . Liability of Indian tax payer to make payment under the Agreement ceases once the agreement is terminated or disapproved by GOI or RBI or assessee is directed to terminate the agreement for money paid/payable after the date of termination.

22.6 ASSESSMENT OF FOREIGN COLLABORATORS

Assessment of foreign collaborators:

Special provisions is contained in Income Tax Act, 1961 for making assessment on representative assesses of non resident foreign collaborators.

What is representative assessee?

“**Representative assessee**” means the agent of a non resident in respect of the income of non resident which is deemed to accrue or arise to him in India under section 9(1)of the Income Tax, 1961. Here the term ‘Agent’ include any person who has been deemed as an agent of the non resident foreign collaborator by an assessing officer under section 163. Agent include :

- Any person in India who is employed by or on behalf of the non resident or
- Any person who has any business connection with non resident or
- Any person in India from or through whom the non resident is in receipt of any income whether directly or indirectly or
- Any person in India who is a trustee of the non resident or
- Any person in India, whether resident or non resident, who has acquired by means of transfer , a capital asset in India

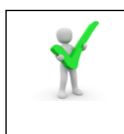
Rights and liabilities of representative assessee:

Rights: A representative assessee has following rights :

- **Recovery of tax paid** :According to section he can recover the amount paid by him from the person/s on whose behalf the payment (tax, interest, fine and/or penalty) is made by him in his representative capacity.
- **Retain the money in possession** :He is also entitled to retain the money that may be in his possession or may come to him in his representative capacity an equal amount of payment of tax or other sum made by him.
- **Right to agitate the assessment** : He can challenge the arbitrary or unreasonable assessment in the court of law by a writ petition or other appellate proceedings.

Liabilities: A representative assessee has following liabilities :

- **Liable to be assessed in his representative capacity:**He is treated by an assessing officer as an agent of non resident person and imposes on him the various liability to income tax on behalf of the non resident.
- **Liable to tax to be levied and recovery of tax :**He is not liable to be assessed in his own name but he is liable for tax determined on assessment which shall be levied upon and recovered from him in the like manner and to the same extent as it would be levied upon and recoverable from the non resident for whom he is representative assessee.



Check Your Progress-A

1. Indicate whether TRUE or FALSE.

- i. Residential status is determined by section 6 of Income tax Act, 1961.
- ii. Foreign collaborations are generally resident in India.
- iii. Fees for technical services is taxable on similar lines as royalty.
- iv. Interest also include any service fee or other charges in respect of loans, debts, deposits etc. as well as commitment charges or non utilised portion of credit facilities.
- v. Under section 115 A , royalty income is taxable at the rate of 35%

22.7 DEDUCTION OF TAX AT SOURCE FROM NON-RESIDENT INCOME

Deduction of Tax at source from Non-resident income is recovered by the person who makes the payment or from whom the non resident collaborator is entitled to receive payment under provisions of section 192 to 266 B of Income tax Act. These provisions are discussed as under :

1. **TDS from the head ‘salaries’:** If the non resident renders technical services in the capacity of an employee to the Indian enterprise and such payment is liable to tax under the head salaries, the TDS for tax payable on such income should be deducted before making such payment of remuneration or crediting the amount thereof to the account of non resident under section 192.
2. **TDS from other payments :**Section 195(1) provides that any person who is responsible for paying to a non resident any interest or any other sum (not being salaries) chargeable to Income Tax Act, 1961 must, at the time of crediting of such

income to the account of payee or at the time of making the payment thereof in cash or by the issue of cheque or draft or any mode, whichever is earlier, deduct income tax payable thereon at the rates in force. In case, person responsible for such payment to non resident considers that the whole of the payment payable to non resident may not be assessable in the hands of recipient, he may apply to the assessing officer for general or special order. Sub section 2 of section 195 provides for appropriate proportion of TDS in which the payment to the non resident becomes taxable in India.

3. **Disallowance of certain expenditures** :Section 40(a)(i) provides for disallowance of any interest, royalty, fees for technical services or other sum chargeable under this Act which is payable (a)outside India; (b) in India to a non resident, not being a company or to a foreign company, on which tax is deductible but has not been deducted or after deduction has not been paid during the previous year or in the subsequent year before the expiry of the time prescribed under section 200 (1).
4. **Payments made after prescribed time**: However if such deduction is made in previous/ subsequent years but paid in subsequent years after prescribed time will be allowed as deduction in previous year in which tax is paid.

22.8 SUMMARY

In the modern era of Globalisation and integration of markets, Multinational corporations are entering into new forms of collaboration to get the advantage of sharing of technology and transfer of know how which ultimately contributes in the growth of economy. Foreign collaborations are generally non resident in India. Special provisions and exemptions have been provided in the Income tax Act, 1961. According to section 5(2) the total income of any previous year of any person who is non resident must be taken to include all income from whatever source derived. Income from interest, royalty or fees for technical services utilised in India would be deemed to accrue or arise in India in case of a non resident and would be included in his total income whether or not such services were rendered in India.

While computing business income of the assessee certain expenditure are admissible for deduction and certain others are disallowed under section 37(1) read with section 28 of the Income Tax Act, 1961. The tax implication of disallowance of certain expenditure results in an addition of the real income of the assessee to the extent of such disallowance and consequent income tax and interest liability on such enhanced income. While entering into foreign collaboration agreements, the Indian taxpayer is required to be careful about the collaboration agreement which could be suitably modified that such disallowance is not attracted.

Non resident foreign collaborators are assessed through representative assesses who is treated by an assessing officer as an agent of non resident person and imposes on him the various liability to income tax on behalf of the non resident. Deduction of Tax at source from Non-resident income is recovered by the person who makes the payment or from whom the non resident collaborator is entitled to receive payment under provisions of section 192 to 266 B

of Income tax Act. Collaboration agreement should be carefully written and all precautions must be taken in its drafting in respect of existing tax system, provisions and procedures. Indian taxpayer may discontinue his liability under the agreement through termination of the collaboration agreement for transactions after such termination.



22.9 GLOSSARY

Transfer of know how - refers to a manufacturing which not only grants the licensor right to use the invention but also provides the supply of technical know how.

Fees for technical services: means any consideration (including lump sum consideration) for the rendering of any a managerial service, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or the like project undertaken by the recipient.

Representative assessee: means the agent of a non resident in respect of the income of non resident which is deemed to accrue or arise to him in India under section 9(1) of the Income Tax, 1961.



22.10 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress –A

1. i. True
- ii. False
- iii. True
- iv. True
- v. False



22.11 REFERENCES

- Singhania V.K. and Singhania Monica : Corporate tax planning & business tax procedures with case studies.
- ICAI , New Delhi : Foreign collaborations (Chapter 17) pp1-17.



22.12 SUGGESTED READINGS

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4. A.C. Sampath Iyengar, Law of Income Tax, Bharat Publishing House, Allahabad.
5. Taxman, The Tax and Corporate Law Weekly.
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22.13 TERMINAL QUESTIONS

- Q1. What do you understand by the term 'foreign collaborations' ? Explain its various objectives.
- Q2. Discuss various provisions of Income tax Act regarding residential status and tax liability of foreign collaborators.
- Q3. Explain provisions in respect of non-residents income by way of interest, royalty, or fee for technical services.
- Q4. What is the meaning of technical know-how? What is the criteria of taxability of technical know-how?

UNIT 23 TAX MANAGEMENT

23.1 Introduction

23.2 Objectives

23.3 Assessment and Its Types

23.4 Procedural Aspects of Assessment

23.5 Appeal and Revision

23.6 Summary

23.7 Glossary

23.8 Reference / Bibliography

23.9 Suggested Readings

23.10 Terminal & Model Questions

23.1 INTRODUCTION

Before taking advantage of various exemptions, rebates and deductions under various sections, it is compulsory to follow the conditions one which have been mentioned in the respective section. To follow the conditions of that particular section is called Tax-management. If these conditions are not followed by the assessee, the advantage of rebate etc cannot be taken and in this situation tax-planning is not possible. The tax management is the first step towards tax planning that means tax-planning is not possible without tax management as it includes the compliance of legal formalities.

23.2 OBJECTIVES

After reading this unit you will be able to:

- Understand the term assessment, re-assessment and rectification of mistakes.
- Understand about the provisions regarding the filing of return of income.
- Understand about the term appeal and revision.
- Understand the types and powers of appellate authorities.

23.3 ASSESSMENT AND ITS TYPES

23.3.1 MEANING OF ASSESSMENT

As per section 2(8), assessment includes re-assessment for income escaping assessment. So, assessment includes the determination of total income and tax payable. It can be of following types: (1) Self-Assessment (2) Regular Assessment (3) Best Judgement Assessment (4) Re-Assessment.

1. Self-Assessment [Sec. 140A] - If on the basis of return an assessee finds that some amount is payable as tax after adjusting (i) tax deducted and collected at source, (ii) tax paid in advance, (iii) double taxation relief u/s 90 90A, 91, or (iv) tax credit u/s 115JAA, he shall deposit it with a challan for self-assessment before filing the return.

Such assessment is known as self-assessment because in this case the assessee computes his total income, tax payable on it and deposits the tax and interest himself. If any assessee fails to pay the whole or any part of such tax or interest or both (in accordance with the above provisions), he shall be deemed to be an assessee in default in respect of the tax or interest or both remaining unpaid, and all the provisions of this Act shall apply accordingly.

Computation of Interest on Self-assessment - The advance tax paid or, tax deducted or collected at source/any relief allowed (u/s 90) on account of tax paid in a country outside India or, any relief allowed (u/s 90A) on account of tax paid in specified territory outside India or, any deduction allowed (u/s 91) on account of tax paid in a country outside India or, any tax credit allowed to be set-off (u/s 115JAA) regarding Minimum Alternative Tax paid by a company will be deducted from the amount of tax on the total income declared in return for getting the amount on which interest payable u/s 234A and u/s 234B.

Notes: (1) When a belated return is filed or return not filed, interest is levied u/s 234A.

(2) When assessee fails to pay advance tax, interest is levied u/s 234B.

2. Regular Assessment [Sec. 143] - Regular assessment can be done in the following ways:

(a) *Assessment on the basis of Return of Income* [Sec. 143(1)]: This assessment is also called Summary Assessment. The Income-tax Officer can assess the tax on the basis of return of income submitted by the assessee without calling him. For the enquiry, the assessee is not called. Important point regarding it are given below:

(i) On the basis of the Return of Income, if there is any balance amount of tax and interest thereon, a notice will be issued to the assessee, if any.

(ii) If more amount of tax than due has been deposited on the basis of Return of

Income, a refund will be sent.

Adjustments: Before calculating additional tax to be submitted by the assessee or refund to be paid to the assessee, some adjustments are done, e.g., (i) Carry forward losses, deductions or rebate, if not demanded in Return of Income (ii) Correction in mathematical errors and unabsorbed loss.

(b) Assessment on the basis of Evidence [Sec 143(3)]: This assessment is also called Scrutiny Assessment. On the basis of Return of Income, if the Assessing Officer feels to get certain information about the verification and facts, he can issue a notice u/s 143(2) to the assessee. Under this notice, the assessee is asked to present himself or through his authorised agent on a prescribed date in the office of Assessing Officer to produce all the evidence for verification of income shown in Return of Income.

3. Best Judgement Assessment [Sec. 144] – This method of assessment is also called Ex-parte Assessment. When return of income is not submitted by the assessee, or the assessee does not follow the instruction issued by notice, or does not produce required accounts or produces incomplete facts, the Assessing Officer (AO), on the basis of available materials, can assess the tax. While doing such type of assessment he keeps in mind honesty in judgement and interest of the assessee. It is known as Best Judgement Assessment. So, this assessment is based on the decision of the Assessing Officer and his own discretion estimates. But, if the assessee feels that wrong judgement has been issued and he has been assessed wrongly, the assessee has a remedy that he can file an appeal against the order of Assessing Officer before Deputy Commissioner (Appeal) or Commissioner (Appeal) to the High Court. This assessment can be of two types:

(a) Compulsory Best Judgement Assessment: This assessment can be done by the Assessing Officer in the following conditions like, if the assessee does not submit the return of income u/s 139(1) voluntarily; If an assessee does not file his return of income u/s 139(4) or revised return u/s 139(5); If the assessee after getting order from the AO, does not get his accounts audited or does not submit audit report; if the assessee after the issue of notice u/s 143(2) remains absent.

(b) Discretionary Best Judgement Assessment: This assessment can be done by the Assessing Officer in the conditions, when assessing officer is not satisfied by the accounts of assessee or the assessee has not followed any regular system of accounting u/s 145(2). The consequences of this assessment may be a penalty imposed on the assessee u/s 271 or refund of tax can be cancelled or the registration of the firm may be cancelled with the prior permission of Deputy Commissioner of Income-tax.

4. Re-Assessment [Sec. 147] - This assessment is also called Income Escaping Assessment. If the Assessing Officer thinks (on some basis), that certain incomes have been left out in assessment of the assessee, the Assessing Officer u/s 148 to 153 can assess the tax on such escaped incomes (after re-assess those incomes). According to Act, Assessing

Officer can again calculate the amount of loss, depreciation, rebate and income for the purpose of re-assessment. Re-assessment can be done under the following conditions:

- (a) If the assessee does not submit the return of income, whereas his income is more than the taxable limit.
- (b) The assessee has submitted the return of income, but he has shown (i) less income in the return, or (ii) shown more deductions and rebates for which he is not entitled.
- (c) The assessment has been done, but the taxable income has been assessed less or the calculation of tax on income has been done at lower rates.
- (d) Where the assessee has failed to furnish a report in respect of any international transactions which he was so required u/s 92E.

Procedure of Re-Assessment - Before assessment of tax, the Assessing Officer will issue a notice on the assessee to submit a return of income for the relevant assessment year within specified period [Sec. 148]. The Assessing Officer will also mention the reasons for re-assessment in the notice which is issued in a prescribed time limit.

23.3.2 RECTIFICATION OF MISTAKES [SEC. 154]

If, any Assessing Officer feels that after assessment there is any mistake in his order or decision, then this mistake or error can be rectified within 4 years after the year of error or mistake.

Rectification by Officer Issuing Order:

- The Assessing Officer who has issued the order can revise the assessment. Here Assessing Officer means concerned officer working on the post, not the particular person. If an officer is transferred from that particular post, in this case, revision can be made by another officer who has joined on that post.

- Amendment in the notice issued by an Assessing Officer can be revised.
- Decrease or increase refund of tax which has been accepted or approved.

The concerned Income-tax Officer can rectify his mistake in the following circumstances:

- (i) On receipt of an application by the assessee,
- (ii) On finding out mistake, he himself can rectify it by his own sweet Will,
- (iii) If the order is passed by Deputy Commissioner (Appeal), the rectification mistake can be made by Deputy Commissioner (Appeal) or Commissioner (Appeal), on the mistake indicated by the Assessing Officer.

Notice of Rectification and Opportunity of Hearing:

- On account of rectification of error, the liability of the assessee increases, it is the duty of concerned officer to give information to the assessee.
- The concerned officer should give sufficient chance to hear the assessee.
- After that any order regarding rectification may be issued.
- But if the liability of the assessee decreases, due to rectification of error, the concerned Assessing Officer shall return the money of refund.

Notice of Demand [Sec. 156] - If the Assessing Officer finds that any amount in the form of tax, interest, fine or penalty or other sum is due on the assessee under Income-tax Act, the Assessing shall send a demand notice on prescribed form, in which the amount payable shall indicated.

*Check Your Progress-A*

Q1. How an assessee can compute the amount of interest which is payable u/s 234A and u/s 234B?

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Q2. Define ex-parte assessment.

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Q3. Write short notes on re-assessment.

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Q4. What are the provisions of Income-tax Act, 1961 in respect of rectification of mistakes?

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23.4 PROCEDURAL ASPECTS OF ASSESSMENT

It is a system under which the assessee has to go under a certain process so that he may be imposed the liability of tax. Following two steps are covered under this procedure of assessment i.e., (a) Submission of Return of Income by the assessee relating to the income of previous year, and (b) Determination of tax by Income-tax Officer in the assessment year relating to the previous year. The process of assessment goes on continuously until his income is assessed and tax is levied and a notice of demand is sent. For understand this concept, we must referred to the following points -

1. Return of Income [Sec. 139] – Return of income means a statement furnished by an assessee regarding his total income. This includes the information of assessee about his Gross Total Income, Deduction u/s 80, Taxable income, particulars of tax, particulars of rebate etc.

2. Filing of return [Sec. 139(1)] - Following persons will require to file Return of Income:

(i) A company or a firm, or

(ii) A local authority whose total income exceeds the maximum limit which is not chargeable to income-tax, or

(iii) Resident person to file Return of Income in certain cases (even though otherwise not required) -

- An ordinarily resident holds, as a beneficial owner or otherwise, any asset (including any financial interest) located outside India or has signing authority in any account located outside India, or

- Is a beneficiary of any asset (including any financial interest in any entity) located outside India shall furnish, on or before the due date, a return in respect of his income or loss for the previous year in such form and verified.

- A person other than a company or firm, if his total income or, the total income of any person in respect of which he is assessable under the income-tax act, during the previous year (without giving effect to provisions of sections 10A, 10B, 10BA or Chapter VI-A) exceeds the maximum amount which is not chargeable to income-tax.

Thus, every person, being an individual/HUF/AOP/BOI, whether incorporated or not, or an artificial juridical person, if his total income in respect of which he is assessable under this Act during the previous year, exceeded the exemption limit, shall, on or before the due date, furnish a return of his income in the prescribed form and verified in the prescribed manner.

3. Due date of filing return of income – The date of submission of return of income to various types of assessee is as under:

(i) In case of Company Assessee – 30th September of assessment year.

(ii) In case of any assessee other than company assessee:

- If the assessee is a working partner in a firm whose accounts are required to be audited under any law - 30th September of assessment year

- If audit of assessee's account is done under any law - 30th September of assessment year

- In any other case (excluding above) – 31st July of assessment year.

(iii) If an assessee who is required to furnish a report of Chartered Accountant under section 92E relating to international transactions - 30th November of assessment year.

4. Filing of return through employer [Sec. 139(1)] – The assessee whose salary is taxable under the head 'income from salary' may file his return of income through his employer at his option. The employer shall furnish all the return received from the employees on or before due date under a scheme as prescribed by Board by notification in the Official Gazette. The return shall be deemed as if furnished u/s 139(1).

5. Exemption from furnishing a return of income [Sec. 139(1C)] - The Central government may, by notification in the Official Gazette, exempt any person or class of persons from the requirement of furnishing a return of income under such conditions as may be specified in that notification.

6. Return of loss [Sec. 139(3)] – It is not mandatory to file return as the assessee does not have taxable income. But, if the assessee does not file the return of loss during prescribed time, he will not get any benefit to carry forward of loss.

7. Late filing of return of income [Sec. 139(4)] - Any person, who has not furnished a return within the time allowed u/s 139(1) may furnish a return for any previous year at any time before the end of the relevant assessment year or before the completion of the assessment, whichever is earlier.

8. Return of income of charitable or religious trusts [Sec. 139(4A)] – If the total income of charitable or religious trusts is more than the tax-free limit, return of income has to be submitted in prescribed manner and in prescribed time limit (31st October).

9. Return of political parties [Sec. 139(4B)] - If the total income of any political party is more than the tax-free limit, return of income has to be submitted in prescribed manner and in prescribed time limit (31st October), if that political party want to get the benefit of exemption u/s 13A, otherwise the due date of filing of return will be 31st July.

10. Revised Return [Sec. 139(5)] - If a person having filed his return within the due date discovers some mistake or any omission therein, he may file a revised return before the expiry of one year from the end of the Assessment Year or completion of assessment whichever is earlier.

11. Defective Return [Sec. 139(9)] - Return suffering from specified defects like tax credit is claimed without attaching the proof of payment, tax computation statement is not attached with the return etc are treated as defective return. The Assessing Officer is required to intimate the defects in the return to the assessee and allow him 15 days time to remove such defects. The time-limit may be extended on the request of the assessee. If the defect is not rectified within the time limit allowed, the return is treated as invalid.

12. Forms for income tax return - The forms to be used for filing the return of income for the current financial year are mentioned below:-

Form No.	Description/ Who Can Use?
ITR 1 (SAHAJ)	For Individual having income from salary, pension, income from one house property (excluding loss brought forward from Previous Year), income from other sources (excluding winning from lottery or income from horse races).
ITR 2	For Individual/HUF having income from income from salary, pension, income from house property, income from capital gains/other sources or agricultural income is more than Rs.5000. This form should not be used by an Individual/HUF whose income includes income from business or profession.
ITR 2A	For Individual/HUF that has income from more than one house property but does not have any income from business or profession/capital gains or agricultural income is more than Rs.5000 and who do not hold foreign assets.
ITR 3	For Individual/HUF being partners in firms and not carrying out business or profession under any proprietorship.
ITR 4	For Individuals/HUF having income from a proprietary business or profession.
ITR 4S (SUGAM)	For Individuals/HUF/Partnership Firm having income from presumptive business.
ITR 5	For persons other than,- (i) individual, (ii) HUF, (iii) company and

	(iv) person filing ITR-7.
ITR 6	For Companies other than companies claiming exemption under Section 11 (Charitable trust or religious).
ITR 7	For persons including companies required to furnish return under Section 139(4A) or Section 139(4B) or Section 139(4C) or Section 139(4D).
ITR V	Where the data for the return of income in Form ITR-1, ITR-2, ITR-3, ITR-4, ITR-5, ITR-6, ITR-7 is transmitted electronically without linked your Aadhar number or using digital signature.

13. Return by whom to be verified [Sec. 140] - The return of income furnished u/s 139 or u/s 115WD shall be verified by the following:

(a) In the case of an Individual –

(i) by the individual himself;

(ii) where he is absent from India, by himself or by some person duly authorised by him;

(iii) by any person duly authorised by him (In case a person is duly authorised to verify, a valid power of attorney must be attached with the return).

(b) In the case of a Hindu Undivided Family; by the Karta and if Karta is out of India or mentally incapacitated, then by any other adult member of such family.

(c) In the case of a Company; by the managing director thereof or by any director thereof. But if the company is non-resident in India, the return may be verified by a person, who holds a valid power of attorney from such company to do so, which shall be attached to the return.

(d) In the case of a Firm; by the managing partner thereof or by any partner thereof.

(e) In the case of a Limited Liability Partnership (LLP); by the designated partner thereof or in his absence by any partner thereof.

(f) In the case of a Local Authority; by the principal officer thereof.

(g) In the case of a Political Party; by the chief executive officer thereof.

(h) In the case of any other Association; by any member of the association or the principal officer thereof.

(i) In the case of any Other Person; by that person or by some other person acting on his behalf.

14. Electronic Filing of Return [Sec. 139D] - The Board (CBDT) may make rules regarding E-filing of Return:

- (a) The class or classes of persons who shall be required to furnish the return electronic form;
- (b) The form and the manner in which the return in electronic form may be furnished;
- (c) The documents, statements, receipts, certificates or audited reports which may not be furnished along with the return in electronic form but shall be produced before the Assessing Officer on demand;
- (d) Company assesseees and all firms of which audit is mandatory, will have to file return electronically. Similarly, if the individual have any foreign assets or his total income exceeds Rs. 5 Lakh. Other assesseees/conditions may file return on electronically or paper.

The e-filing can be done with or without digital signature:

(i) Furnishing the return electronically through digital signature - If the returns are filed using digital signature, then no further action is required from the tax payers.

(ii) Furnishing the return electronically without digital signature - If the returns are filed without using digital signature, then the tax payers have to file ITR-V with the department within 120 days of e-filing or he can use the electronic verification code (EVC).

(iii) Furnishing the return through an e-intermediary - For enabling specified classes of tax payers in preparing and furnishing income tax returns, the Board has notified the 'Tax Return Preparer Scheme' under which specially trained and authorized Tax Return Preparers will provide assistance to tax payers in this regard. The tax payer can e-file the returns through an e-intermediary also who will e-file and assist him in filing of ITR-V within 15 days.

15. Compulsory Return [Sec. 142(1)(i)] – Where any person is assessable either in respect of his income or income of any other person and he has not furnished the return of income on or before the due date of furnishing the return u/s 139(1), the Assessing Officer may serve a notice on such person requiring him to furnish the return. Such return should be furnished within the time allowed in the notice. Such person remains liable to pay interest u/s 234A for late furnishing of return from the due date of furnishing the return till the return is furnished.

16. Permanent Account Number (PAN) - According to section 139(A), Permanent Account Number is compulsorily mentioned in return of income. This number is allotted by Income-tax Department. Whenever the assessee wants to contact with the Income-tax Department, he should mention or refer his PAN number for reference. PAN number includes new types of series. Under new category, PAN number is allotted on laminated card which is in 10 words or Alphanumeric numbers.

Mandatory of Permanent Account Number - PAN is compulsory to mention in the following transactions:

- (i) For opening an account in any Bank/Post Office,
- (ii) Term deposit Rs.50,000 or more in any Bank,
- (iii) Sale-purchase of immovable property worth Rs.5,00,000 or more,
- (iv) Contract of sale-purchase of securities of more than Rs.1,00,000,
- (v) Payment of more than Rs.25,000 at a time in connection with foreign tour.

Allotment of Permanent Account Number (PAN) - The Income-tax Department allots Permanent Account Number to the following assesseees:

- (i) Assesseees whose income is more than exempted limit and who submits an application before Assessment Officer before 31st May in assessment year, or
- (ii) Assesseees who are engaged in business or profession and the total turnover of previous year is expected by more than Rs.5,00,000, or
- (iii) If he is forced to file return of income u/s 139(4A), *e.g.*, charitable and religious trust and to whom no PAN has been allotted and have applied for the allotment of PAN to the Assessment Officer,
- (iv) Being an employer, he is required to file return of fringe benefits under *section* 115WD.

Other points relating to PAN -

- (i) The assesseees who get PAN, use this number in every return of income, in every challan for the payment of tax, in other documents and papers, which are submitted to Income-tax Officers.
- (ii) If a person is liable to pay income-tax on behalf of any other person, a separate PAN is to be allotted to him.
- (iii) If the address or the name of business or profession is changed of PAN holders, its information should be given to Assessing Officer.
- (iv) For the allotment of PAN, an application on prescribed Form No. 49A (in case of resident) or Form No. 49AA (in case of non-resident) shall be given.



Check Your Progress-B

Q1. In what case, ITR-1 can be used?

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Q2. “Defective return is no return”. Discuss.

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Q3. State the uses of Permanent Account Number.

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Q4. In what conditions, a revised return can be filled?

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23.5 APPEAL AND REVISION

23.5.1 APPEAL

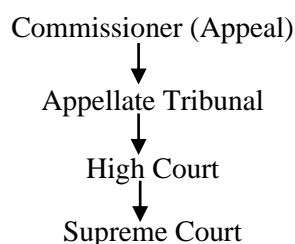
Appeal is a statutory and fundamental right of an assessee. Generally, the order of Assessing Officer regarding assessment of an assessee is final. But, it is not essential for the assessee to be satisfied fully with this order. So, there are two options available to an assessee under the Act who is not satisfied with the order of Assessing Officer. i.e., Appeal and Revision.

“Under such conditions, in order to safeguard the interest of the assessee, certain rights have been given to the assessee. Appeal is one of these rights. The assessee can file appeals at

different levels and get justice done to him, whereas if the assessee, does not like to file an appeal, he may give an application for revision”.

So, an appeal is a complaint to a superior court of an injustice, done by an inferior one. A person who files an appeal *i.e.*, the aggrieved party (assessee) is called as the ‘*appellant*’ and the other party (assessing officer) against whom appeal is filed is called the ‘*respondent*’. Hence, the assessee has the first right to file an appeal.

Appellate Authority – From the point of view of appeal, the Appellate Authorities may be put in the following order:



1. Appeal to the Commissioner (Appeal) [Sec. 246] – It is the first appeal by the assessee against the order of Assessing Officer.

Appealable Orders [Sec. 246(A)] - According to section 246(A), the assessee or the tax deductor can file an appeal to Commissioner (Appeal) against the orders of Assessing Officer in the following cases:

- (i) If information u/s 143(1) has been given to the assessee and the assessee disagrees with this tax liability.
- (ii) Any order u/s 143(3) or 144, when assessee has an objection about the amount of income or amount of tax or residential status.
- (iii) Order u/s 147 or 150 of assessment or re-assessment or re-calculation of tax.
- (iv) Any order against valuation of fringe benefits.
- (v) Assessment on change of ownership of business and profession u/s 170(2) or (3).
- (vi) Order of rectification of mistake u/s 154 or 155 on account of that tax liability is increasing.
- (vii) Order u/s 201 under which a person is treated as defaulter, not to deduct tax at source or after deduction not to deposit the tax.
- (viii) Order concerning levying interest on depositing advance tax.
- (ix) Order imposing penalty under not to pay the amount of tax u/s 221 or not to fulfil the matter given in notice u/s 271 or not to keep books of accounts u/s 271A or default in the audit of accounts u/s 271B or default in relation to allotment of Permanent Account Number u/s 272B or default in connection with Tax Deducted Account Number u/s 272BB or default in filing return of income u/s 271F etc.

Appeal by person denying liability to deduct tax [Sec. 248] – As per section 248, if under an agreement or arrangement, the tax deductible on any income, other than interest u/s 195, is to be borne by the person who pays the income, but such person has deducted tax and paid it to the credit of Central Government. If such person claims that no tax was required to be deducted on such income, he may appeal to the Commissioner (Appeal) for a declaration that no tax was deductible on such income.

Procedure for Filing Appeal [Sec. 249] - The appeal is to be filed in Form no. 35 (including notice and statement of facts) which will be verified in the prescribed manner (person who is authorized to sign the return of income under section 140) accompanied by a fee as under:

- (i) Where assessed income in a case to which appeal relates is Rs.1,00,000 or less - Rs.250
- (ii) Where assessed income in a case to which appeal relates exceeds Rs.1,00,000 but does not exceed Rs.2,00,000 – Rs.500
- (iii) Where assessed income in a case to which appeal relates exceeds Rs.2,00,000 – Rs.1,000
- (iv) Where the subject-matter of appeal relates to any matter other than specified in clauses (i), (ii) and (iii) – Rs.250.

This fee should be credited in a branch of the authorised Bank after obtaining a challan from the Assessing Officer and a copy of challan sent to the Commissioner of Income-tax (Appeal).

Time-limit for Filing Appeal [Sec. 249(2)] - The appeal should be filed within a period of 30 days of:

- (a) the date of service of notice of demand relating to assessment or penalty if the appeal relates to assessment or penalty; or
- (b) the date of payment of tax, if it relates to any tax deducted under section 195(1) in respect of payment to non-resident in certain cases.

Condonation of delay in filing appeal [Sec. 249(3)] - The Commissioner (Appeal) may admit an appeal after the expiration of the prescribed period, if he is satisfied that the appellant had sufficient cause for not presenting it within that period. If the Commissioner (Appeal) refuses to admit appeal after the prescribed period, then the assessee has a right to file an appeal against such order.

Amount of tax payable before filing appeal [Sec. 249(4)] - No appeal shall be admitted unless at the time of filing of the appeal:

(i) where a return has been filed by the assessee, the assessee has paid the tax due on the income returned by him; or

(ii) where no return has been filed by the assessee, the assessee has paid an amount equal to the amount of advance tax which was payable by him i.e., tax which is payable on income assessed under section 144 or 147.

However, in the case mentioned under clause (ii) above, on an application made by the appellant in this behalf, the Commissioner (Appeal) may, for any good and sufficient reason to be recorded in writing, exempt him from the payment of such tax.

Powers of the Commissioner (Appeals) [Sec. 251] - The Commissioner (Appeal) shall have the following powers in disposing of an appeal:

(i) He can confirm, cancel or reduce or increase the tax of assessment or penalty against which an appeal has been filed.

(ii) He can again send the case for re-assessment with necessary instructions to the Assessing Officer.

(iii) He can give his decisions on his discretion regarding appeal in other matters.

2. Appeal to the Appellate Tribunal [Sec. 252] – Appellate Tribunal is formed by the Central Government under section 252 having its main office in Mumbai and its sub-offices are at Mumbai, Kolkata, Delhi and Chennai. The Central Government may appoint the members of Tribunal in as much as number as it can think. The Assessee as well as the Assessing Officer can file an appeal in Tribunal. The members are of two types i.e., Judicial member (Central Government appoints the judicial member as Chairman of Appellate Tribunal) and Accountant member.

(a) *Judicial Member* - Any person can be a judicial member who, (i) has been at least on a civil judicial post for 10 years, (ii) has been on the post of Grade I of Central Govt. service for at least 3 years, or (iii) has done practice as Advocates for the last 10 years.

(b) *Accountant Member* – Any person, who (i) has done practice of Chartered Accountant for at least 10 years, or (ii) has been a member of Grade A of Indian Income-tax service and has done work on the post of Income-tax Commissioner for at least 3 years or equivalent to it on a higher post.

Fee for appeal in Tribunal - The prescribed fee as mentioned below, has to be deposited by the assessee at the time of filing appeal to the Appellate Tribunal:

(i) If the total income of assessee is upto Rs.1,00,000 – Rs.500

(ii) If the total income of assessed by Assessing Officer is more than Rs.1,00,000 but less than Rs.2,00,000 – Rs.1500

(iii) If the total income of assessee is more than Rs.2,00,000, 1% of total income upto a maximum of Rs.10,000.

(iv) Where the subject-matter of appeal relates to any matter other than specified in clauses (i), (ii) and (iii) – Rs.250.

(v) No fee is charged, if appeal is filed by Income-tax Commissioner or Income-tax Officer.

Procedure of Appellate Tribunal [Sec. 255] – The procedure of appellate tribunal is as follows:

(i) The Chairman of Tribunal divides the Tribunal into several benches, and each bench uses the powers of tribunal separately. In every bench there is at least one judicial member and one accountant member.

(ii) The opposite party can file within 30 days of receiving such notice, on this Memorandum attention will be given just like an appeal. On receiving any appeal on prescribed form, a notice is served to assessee or Assessing Officer, as the case may be.

(iii) The Chairman or anyone member on being authorised by the Central Govt. after hearing the case, if the assessed income of the assessee is not more than Rs.5,00,000, can give his own decision. It will be one man Judicial Committee.

(iv) A special bench may be constituted for special type of appeal in which 3 or more than 3 may be the members.

(v) If there is any difference of opinion amongst the members of the bench, the decision will be taken on majority basis. If equal votes are there in any decision, the matter will be handed over to the Chairman. The Chairman will take the decision after consulting original members and the members appointed afterward.

(vi) Appellate Tribunal after hearing both the parties issue the order as it thinks proper.

(vii) The Tribunal has right to rectify the mistake of the records within the four years from the date of its order.

(viii) The copy of the order of the Tribunal shall be sent to the assessee and Commissioner both.

(ix) If there is no question of legality in the order of Tribunal, its order or decision shall be final.

Orders of Appellate Tribunal [Sec. 254] -

(i) The Appellate Tribunal may, after giving both the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit.

(ii) The appellate Tribunal may, at any time within 6 months from the end of the month in which the order was passed amend its previous order to rectify any mistake which is apparent from the record and the mistake is brought to its notice by the assessee or by the Assessing Officer. But, if the amendment has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee, the assessee shall be given a notice of its intention to do so and he shall be given a reasonable opportunity of being heard before any order is so amended by the Tribunal. But any application filed by the assessee in this section on or after 1-10-1998, shall be accompanied by a fee of Rs.50.

(iii) In every appeal, the Tribunal, if possible, may hear and decide such appeal within 4 years from the end of the financial year in which such appeal is filed. But, if a stay order is made in any appeal proceedings, the Appellate Tribunal shall disposed off the appeal within a period of 180 days from the date of such stay order. If such appeal is not so disposed off within 180 days, the Tribunal may, on an application made by the assessee and it is proved that the delay in disposing of the appeal is not attributable to the assessee, extend the period of stay and the aggregate period of stay shall, in no case, exceed 365 days. If, such appeal is not so disposed off within the period of 365 days, the order of stay shall stand vacated after the expiry of such period or periods even if the delay in disposing of the appeal is not attributable to the assessee.

(iv) The cost of any appeal to the Appellate Tribunal shall be at the discretion of that Tribunal.

(v) The Appellate Tribunal shall send a copy of any orders passed to the assessee and to the Principal Commissioner or Commissioner.

(vi) The order passed by the Tribunal is final so far as facts are concerned.

3. Appeal to the High Court [Sec. 260(A)] – The main provisions regarding Appeal to High Court are as follows:

(i) An appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal, if the High Court is satisfied that the case involves a substantial question of law.

(ii) The High Court may admit an appeal after the expiry of 120 days, if it is satisfied that there was sufficient cause for not filing the same within that period.

(iii) If the applicant is the assessee, then the appeal shall be done on Form no. 37 with a fee of Rs.200 deposited with the application.

(iv) If the Tribunal, on the basis of application received does not agree to refer the case to High Court, after preparing the statement, then assessee or Commissioner within 6 months of receiving such orders may apply to High Court. In such conditions, High Court may order the Tribunal to prepare the statement for sending it to the High Court.

(v) If Tribunal rejects the application of the assessee, the applicant, within 30 days of rejection of order by Tribunal, can withdraw his application. In case of withdrawal of

application, the fee deposited by the assessee Rs.200 shall be refunded.

(vi) The hearing of appeal is done by at least two judges of the Bench and decisions are taken on majority basis. Whatever decision is given by High Court on the point of law, the reasons are also mentioned on which the decision is based.

(vii) High Court, while giving its decision, will disclose the grounds on which it has taken decision.

(viii) High Court will send a certified copy of its decision to Tribunal and Tribunal can modify his order accordingly.

(ix) From 1-10-1998 or after it, in the matter of appeal in Appellate Tribunal, direct appeal to High Court can be made for every order. In this connection, the appeal should be made within 120 days from the date of order sent to appellant and, if appeal is made by the assessee, a fee of Rs.10,000 is to be deposited. If appeal is routed by Commissioner, no fee is payable.

4. Appeal to the Supreme Court [Sec. 261] – The main provisions regarding Appeal to Supreme Court are as follows:

(i) If any party is dissatisfied by the decision given by High Court, he can file an appeal against that order to Supreme Court, provided High Court certifies that the matter is appealable to Supreme Court.

(ii) If on account of this appeal, Supreme Court makes some changes in the decision of High Court, then Appellate Tribunal, on the basis of decision of Court will make revision in his earlier orders.

(iii) Expenses of appeal shall be decided by the Supreme Court.

(iv) After hearing both the parties, the Supreme Court will decide whether the question arisen is as per law or not, after this it will give its decision.

(v) A copy of decision of Supreme Court shall be given to Appellate Tribunal.

23.5.2 REVISION

As we know that, if the assessee is not satisfied with the order of Assessing Officer, he has two options. First is 'Appeal' and second is 'Revision'. If any assessee do not like to file appeal or the time limit of appeal has been expired, then the assessee may give an application for revision to Commissioner of Income-tax under section 264.

The Income-tax Commissioner can think about revision on the order of Assessing Officer under the following circumstances:

(i) *Revision of Orders Prejudicial to Revenue* [Sec. 263] - If any order given by any

Assessing Officer is prejudicial to revenue in the eyes of Commissioner, he can rethink on such orders. Under this section, Commissioner can ask the record of any proceedings and investigate the matter. If he feel that the order of Assessing Officer wrong, and harmful to the Govt. revenue, then, by giving an opportunity to the assessee of hearing, he can issue the orders according to the circumstances. In that case, he can increase the assessment, revise it or cancel it and order to assess it from the very beginning.

(ii) *Revision of orders* [Sec. 264] - Commissioner may revise such orders which are in favour of the assessee. Those orders which are not covered under section 263, they may be re-considered for revision either on application of the assessee or the Commissioner can himself re-consider. The assessee will have to pay fees of Rs.500 for this revision.

Note: *No Revision under the following circumstances:*

- The Commissioner cannot rethink of such orders, for which two years have elapsed and the time of appeal has not expired.
- If the order is under consideration in appeal to Commissioner (Appeal).
- If appeal has been done against the order to Commissioner (Appeal) or Appellate Tribunal.



Check Your Progress-C

Q1. What do you understand by the term ‘appeal’?

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Q2. What is the procedure for filing an appeal by the assessee?

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Q3. What is appellate tribunal?

Q4. Under which circumstances matters cannot be revised?

23.6 SUMMARY

As per section 2(8), assessment includes re-assessment for income escaping assessment. So, assessment includes the determination of total income and tax payable. When an assessee deposits the amount before filing the return, which is related to his tax deducted and collected at source, or tax paid in advance through a challan, then this is known as self-assessment. Sometimes it is not essential for the assessee to be satisfied fully with the order of the Assessing Officer. So, the assessee can file appeals at different levels (Appellate authorities) and get justice done for him. On the other hand, if any assessee does not like to file an appeal or the time limit of appeal has expired, then the assessee may give an application for revision to the Commissioner of Income-tax under section 264.



23.7 GLOSSARY

Self-Assessment [Sec. 140A] - If on the basis of return an assessee finds that some amount is payable as tax after adjusting (i) tax deducted and collected at source, (ii) tax paid in advance, (iii) double taxation relief u/s 90, 90A, 91, or (iv) tax credit u/s 115JAA, he shall deposit it with a challan for self-assessment before filing the return.

Re-Assessment [Sec. 147] - This assessment is also called Income Escaping Assessment. If the Assessing Officer thinks (on some basis), that certain incomes have been left out in assessment of the assessee, the Assessing

Officer u/s 148 to 153 can assess the tax on such escaped incomes (after re-assess those incomes).

Rectification of Mistakes [Sec. 154] – If, any Assessing Officer feels that after assessment there is any mistake in his order or decision, then this mistake or error can be rectified within 4 years after the year of error or mistake.

Return of Income [Sec. 139] – Return of income means a statement furnished by an assessee regarding his total income. This includes the information of assessee about his Gross Total Income, Deduction u/s 80, Taxable income, particulars of tax, particulars of rebate etc.

Revised Return [Sec. 139(5)] - If a person having filed his return within the due date discovers some mistake or any omission therein, he may file a revised return before the expiry of one year from the end of the Assessment Year or completion of assessment whichever is earlier.

Permanent Account Number (PAN) - This number is allotted by Income-tax Department. Under new category, PAN number is allotted on laminated card which is in 10 words or Alphanumeric numbers. For the allotment of PAN, an application on prescribed Form No. 49A (in case of resident) or Form No. 49AA (in case of non-resident) shall be given.

Appeal - In order to safeguard the interest of the assessee, certain rights have been given to the assessee. Appeal is one of these rights. The assessee can file appeals at different levels and get justice done to him, whereas if the assessee, does not like to file an appeal, he may give an application for revision.



23.8 REFERENCES

- Singhania, V.K and Singhania, K. 2017. *Direct Taxes Law and Practice with Special Reference to Tax Planning*, 57th Edition. Taxmann Publications, New Delhi.

- Agarwal, B.K. and Agarwal, Rajeev. 2017. *Income Tax Law and Accounts*. Nirupam Sahitya Sadan, Agra.
- Pant, Kamal. 2017. *Procedure of E-Filing*. Laxmi Publications, New Delhi.



23.9 SUGGESTED READINGS

1. <http://www.taxmann.com>
2. CIT v. Raghuvir Singh (1988) 125 ITR 257 (P & H).



23.10 TERMINAL QUESTIONS

- Q1. What are the provisions of Income-tax Act, 1961 in respect of income escaping assessment?
- Q2. Explain Permanent Account Number (PAN).
- Q3. Discuss various ITR forms with their description.
- Q4. Describe briefly the procedure of an appeal to appellate tribunal.
- Q5. Who are appellate authorities? Discuss the main provisions regarding Appeal to Supreme Court.

UNIT 24 NON-RESIDENT TAXATION AND TAX MANAGEMENT

24.1 Introduction

24.2 Objectives

24.3 Tax Incidence on Non-Residents

24.4 Investment Income of a Non-Resident

24.5 Exempt Investment Income

24.6 Non-Resident's Income and Tax Liability

24.7 Double Taxation Relief and other Provisions for NRI

24.8 Tax Management of Non-Residents

24.9 Tax Planning in Respect of Non-Residents

24.10 Summary

24.11 Glossary

24.12 Answers to Check Your Progress

24.13 Reference / Bibliography

24.14 Suggested Readings

24.15 Terminal & Model Questions

24.1 INTRODUCTION

An individual is regarded as Resident of India if:

i. She/he stays in India for 182 days or more during a previous year,

OR

ii. She/he stays in India for 60 days or more during a previous year, and 365 days or more during the 4 years, preceding that previous year.

The short period of stay in India of "60" days, however gets extended to 182 days in following conditions (i.e., even though an Individual is in India for 365 days or more during preceding 4 previous years).

1. An Indian citizen who leaves India in any previous year for employment or as a member of the crew of an Indian Ship;
2. An Indian citizen or a person of Indian origin, who is abroad, comes on visit to India in any previous year

Further, in case of an individual being citizen of India and member of crew of foreign bound ship leaving India, the period or periods of stay in India, in respect of such voyage shall be determined in manner and subject to conditions as may be prescribed.

b. An Individual is regarded as 'Resident but not ordinarily Resident' if:

- i. She/he is a non-resident in India in 9 out of 10 previous years preceding the previous year;
OR
- ii. She/he has stayed in India for 729 days or less during 7 years preceding the previous year.

c. An Individual is regarded as 'Non-Resident' if:

He doesn't satisfy any of the conditions mentioned in (a) above.

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Further, in case of an individual being citizen of India and member of crew of foreign bound ship leaving India, the period or periods of stay in India, in respect of such voyage shall be determined in manner and subject to conditions as may be prescribed.

b. An Individual is regarded as 'Resident but not ordinarily Resident' if:

- i. He is a non-resident in India in 9 out of 10 previous years preceding the previous year;
OR
- ii. He has stayed in India for 729 days or less during 7 years preceding the previous year.

c. An Individual is regarded as 'Non-Resident' if:

He doesn't satisfy any of the conditions mentioned in (a) above.

24.2 OBJECTIVES

We have already learnt the tax assessment and management of an individual. In this unit we will learn:

- How to determine the residential status of an individual-resident, resident but not ordinarily resident and non-resident.
- Tax incidence of a non-resident

- Treatment of investment income of a non-resident.
- Special tax rate and surcharge applicable

24.3 TAX INCIDENCE ON NON-RESIDENT

- A. Resident & Ordinarily Resident – Global Income is taxable.
- B. Resident but not Ordinarily Resident – Income earned/ received in India; or income which accrues or arises or is deemed to accrue or arise in India or income arising abroad out of business controlled in India is taxable.
- C. Non-resident – Only income earned/received in India and income deemed to accrue or arise in India is taxable.

24.4 INVESTMENT INCOME OF A NON-RESIDENT

While computing the investment income of a non-resident Indian, no deduction in respect of any expenditure or allowance shall be allowed under any provision of the Act. Moreover, no deduction under sections 80C to 80U shall be allowed in respect of investment income.

Para 287.1-2b: Similarly, long term capital gain on sale or transfer of foreign exchange assets shall be calculated subject to following points:

- a. The benefit of indexation is not available.
- b. No deduction is permissible in respect of long term capital gain under section 80C to 80U.
- c. By investing sale consideration in another asset, the nonresident Indian can claim exemption under section 115F.

Para 287.1-3: Tax on Investment Income and Long Term Capital Gain: Non resident Indians are chargeable to tax on investment income and long term capital gain at the rate 20 percent and 10 percent respectively.

Note: Para 287.1-4: A non-resident assessee is not required to file the return of income u/s 139(1), where the tax deductible at source from his only income from foreign exchange assets or income by way of long term capital gain arising on the transfer of foreign assets or both has been deducted. On the other hand if the non-resident Indian has any other income in India then it is treated as separate block and accordingly tax is charged with other provisions of the act.

Para 287.1-5: Benefit available even after the assessee becomes resident: Under following circumstances the provisions shall continue to apply to a non resident in relation to such income for that assessment year (and for every subsequent assessment year) until the transfer or conversion into money of such assets:

- a. A non resident Indian during any previous year becomes assessable as resident in India in any subsequent year.
- b. Simultaneously he may furnish to the Assessing Officer along with his return of income, (for the assessment year in which he is so assessable) a declaration in writing in respect to the special provisions which shall continue to apply to him in relation to the investment income derived from any foreign exchange asset (debentures and deposit with an Indian public limited company and Central Government securities).

Mere transfer of such deposit (as long as the source of deposit was convertible foreign exchange) from one bank to other would not affect its identity and the assessee is entitled to concessional rate of tax on interest earned from such deposits.

Para 287.1-6: However a non resident Indian may choose that the special provisions should not apply to him. In cases where such an option is exercised by a non resident Indian , the whole of his total income including income from foreign exchange assets and long term capital gains arising on transfer of a foreign exchange asset is charged to tax under the general provisions of the Act.



Check Your Progress-A

Q1. State the conditions where an individual is regarded as Non-Resident?

Q2. What is the tax treatment of investment income of a Non-Resident?

Q3. Discuss the benefits available to a non –resident even after he/she becomes a resident?

24.5 EXEMPT INVESTMENT INCOME

A. Exempt Investment Income

Following types of investment income are exempt:

1. Interest on NRE account paid or credited to individual non-residents Indian who are permitted by RBI to maintain such account. Section 10(4)(ii) (Including person who may be ‘Resident’ in India as per Income Tax law, but are resident outside India under FEMA).
2. Interest, premium on redemption or any other payment on NRNR deposit and other securities, bonds, annuity certificates, savings certificates, notified under section 10(15)(i). NRNR deposit interest is exempt in the hands of non-resident while he remains non-resident as per the Income-tax Act.
3. Sec 10(15)(ii)(c) – In the case of an individual or a Hindu undivided family, interest on such Relief Bonds as the Central Government may, by notification in the Official Gazette, specify in this behalf.
4. Interest on ‘NRI Bonds 1988’ and ‘NRI Bonds (Second Series), issued by SBI purchased in foreign exchange, exemption continues even after person becomes resident. [Section 10(15)(iid)] However, no exemption under this clause will be available in the year of premature encashment.
5. Interest paid by a scheduled bank on RBI approved foreign currency deposit, FCNR & RFC A/c to Non-resident or Not Ordinarily Resident is exempt. [Section 10(15)(iv)(fa)].
6. Any interest received by a non-resident or a person who is not ordinarily resident in India on a deposit made on or after the 1-4-2005, in an Offshore Banking Unit referred in section 2(u) of the Special Economic Zones Act, 2005 is exempt u/s 10(15)(viii).
7. Any income by way of dividend referred to in section 115-O received by non-resident is exempt u/s. 10(34). Any income received in respect of the units of a

Mutual Fund specified u/s. 10(23D) or from the Administrator of the specified undertaking as defined; or from the specified company is exempt u/s. 10(35).

8. Any income by way of long-term capital gains on sale of equity shares on a recognised stock exchange or on repurchase of units of equity oriented funds on which Security Transaction Tax (STT) is paid is exempt u/s. 10(38).

9. Any income earned in India from the sale of crude oil by a foreign company is exempt u/s. 10(48), provided the following conditions are satisfied:

- The income earned by the foreign company is pursuant to an agreement with the Central Government or after taking approval of the Central Government.
- The foreign company and the agreement should be notified by the Central Government.

24.6 NON -RESIDENT'S INCOME AND TAX LIABILITY

INCOME TAX SLAB RATES

For any Non-Resident individual, tax rate is as under:

Net income Range	Income- tax rates	Surcharge	Education Cess	Secondary and Higher secondary education cess
Upto Rs. 2,50,000	Nil	Nil	Nil	Nil
Rs.2,50,000- Rs. 5,00,000	5 percent of (total income minus Rs.2,50,000)	Nil	2% of income tax	1 % of income tax
Rs.5,00,000 - Rs. 10,00,000	Rs. 12500 + 20% of (total income minus Rs. 5,00,000)	Nil	2% of income tax	1 % of income tax
Exceeds Rs. 10,00,000	Rs. 112500+ 30% of (total income minus Rs 10,00,000)	Nil	2% of income tax	1 % of income tax

Notes:

- 1. Rebate under section 87A-** A resident individual (whose net income does not exceed Rs.3,50,000) can avail rebate u/s 87A.It is deductible from income tax before calculating

education cess. The amount of rebate is 100 percent of income tax or Rs.2500, whichever is less.

2. Surcharge: Surcharge is 15 percent of income tax if net income exceeds Rs. 1 crore. It is subject to marginal relief (in case of a person having a net income of exceeding Rs. 1 crore, the amount payable as income tax and surcharge shall not exceed the total amount payable as income tax on total income of Rs. 1 crore by more than the amount of income that exceeds Rs 1 crore). Surcharge is 10 percent of the Income Tax, where taxable income is more than Rs. 50 lacs and upto Rs. 1 crore.

3. Education cess: It is 3 percent of income tax and surcharge.

4. Alternate minimum tax : Tax payable by a non – corporate assessee cannot be less than 18.5 percent (+SC+EC+SHEC) of “ adjusted total income” as per section 115JC.

Non Resident Company

A Company is said to be resident in India in any previous year, if it is an Indian company or during that year for which the residential status is being determined, the control and management of its affairs is situated wholly in India. In case the control and management of its affairs is located outside India, then the residential status of such company shall be that of a foreign company. In case of a *Non Resident individual and a foreign company* , the income which is received or is deemed to be received in India or income which accrues or arises or is deemed to accrue or arise in India , shall be liable to be taxed in India.

For any Non Resident company or Foreign Company, tax rates are as follows; Income tax:

- @50% of on so much of the taxable income as consist of (a) royalties received from Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern after 31st day of March 1961, but before the first day of April 1976; (b) fees for rendering technical services received from Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern after the 29th day of February , 1964 but before the 1st day of April 1976, and where such agreement has, in either case, been approved by the Central Government
- @ 40% of the balance.

Surcharge:

The amount of income tax as computed in accordance with above rates, and after being reduced by the amount of tax rebate shall be increased by a surcharge as under:

- At the rate of 2% of such income tax, provided that the taxable income exceeds Rs. 1 core. However, the amount of Income Tax and surcharge shall not increase the amount of income tax payable on a taxable income of Rs. 1 crore by more than the amount of increase in taxable income.

- At the rate of 5% of such income tax, provided that the taxable income exceeds Rs. 10 crores. However, the amount of Income Tax and Surcharge shall not exceed the amount of income tax payable of Rs. 10 crore by more than the amount of increase in taxable income.

Education cess: It is 3 percent of income tax and surcharge.

SALARY INCOME OF NON-RESIDENT DURING SHORT STAY IN INDIA

Any remuneration received by foreign citizen as an employee of a foreign enterprise for services rendered by him in India is exempt, provided the following conditions are fulfilled-

- a) The foreign enterprise is not engaged in any trade or business in India ;
- b) His stay in India does not exceed in the aggregate a period of 90 days in such previous year; and
- c) Such remuneration is not liable to be deducted from the income of the employer chargeable under the Income –tax Act {section 10(6) (vi)}.

BUSINESS INCOME OF NON –RESIDENT

A. Income from business of operation of ship taxable at 7.5% of the gross receipts from such business(sec 44B)

B. Income from business of providing services or facilities in connection with plant and machinery or hire used, or to be used, in the prospecting for , or extraction or production of , mineral oils including petroleum and natural gas is taxable at 10 % of gross receipt of such business , unless the assessee claims lower profits and gains by maintaining proper books of accounts and other documents., get the same audited and file the audit report along with return of income (Section 44BB).

C. Income from business of operation of aircraft is taxable at 5%of the Gross receipts from such business (section 44BBA).

D. Income of foreign company from business of civil construction or the business of erection of plant and machinery or testing or commissioning thereof, in connection with a turnkey power project approved by the central Government is chargeable at 10 % of the gross receipts from such business, unless the assessee claims lower profits or gains by maintaining proper books of accounts and other documents , get the same audited and file the audit report along with return of income . Such income tax return will be subject to scrutiny assessment (Section 44BBB).

E. In any other case, for computing the business income of non –resident , expenditure in the nature of head office expenses is allowable at least of the:

- a) Up to 5% of the adjusted income as specified in section ; or
- b) Actual expenditure attributable to business in India (Section 44C)

Section 9A has been inserted w.e.f. April 1, 2016 which states that:

- a) In the case of eligible investment fund, the fund management activity carried out through an eligible fund manager acting on behalf of such fund shall not constitute business connection in India of the said fund, and
- b) An eligible investment fund shall not be said to be resident in India for the purpose of section 6 merely because the eligible fund manager, undertaking fund management activities on its behalf, is situated in India.

In order to avail the above benefits, the offshore fund and the fund managers are required to fulfill several conditions like having minimum 25 members who are not connected; any member along with connected person shall not have not more than 10% participating interest of 10 or less members along with connected persons shall be less than 50% etc.

Actual cost of an asset brought into India by a Non-Resident

For the computation of business income, actual cost of any asset brought into India by non-resident would be computed as actual cost of acquisition to the non –resident as reduced by the notional depreciation as provided in the Income Tax Act , 1961 from the date of its acquisition as if the asset has been used in India,

Where an imported capital asset is acquired on deferred payments terms or out of the foreign loan the actual cost would be after taking into account the fluctuation in exchange rate. For this purpose, actual payment will be considered.



Check Your Progress-B

Q1. When a company is said to be a Non –Resident in India?

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Q2. Give a brief note on tax slab rates, surcharge, education cess and Rebate in case of a Non-Resident Individual.

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Q3. What is the rate of taxes on business Income of a Non-Resident Indian?

Q4. What are the provisions of Section 9A?

Q5. How the computation is done when an asset is brought in India by a Non-Resident Indian?

24.7 DOUBLE TAXATION RELIEF & OTHER PROVISIONS FOR NRI

Double Taxation Relief (section 90/9A)

All provisions learned above are subject to DTAA entered into with various countries or with any specified association in a specified territory outside India. The provision of the relevant tax treaty or domestic law provision whichever is beneficial to the tax payer would be applicable.

In order to claim treaty benefits the non-resident tax payer shall be required to provide certificate of his being a resident of country outside India (Tax Residency Certificate) as well as such other documents and information ‘as may be prescribed’

Other Provisions for NRI

A. ‘Section 115C:

- (i) “Non Resident Indian” means an individual, being a citizen of India or a person of Indian origin who is not a “resident”. A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grandparents , was born in undivided India,
- (ii) Investment Income means any income derived (other than dividends referred to in section 115-O) from a foreign exchange asset.
- (iii) Foreign Exchange Asset means any specified asset which the assessee has acquired or purchased with, or subscribed to, in convertible foreign exchange.
- (iv) Specified assets means, any of the following assets namely:
- Shares in Indian company,
 - Debentures or deposits with an Indian company, not being a private company.
 - Any security of the central government
 - Other notified assets (no such asset has yet been certified)

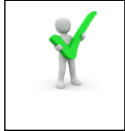
Section 115F-Exemption of Long –term Capital gains

Capital gain arise from transfer of foreign exchange asset, is exempt from the tax if the following conditions are satisfied:

- (i) The asset transferred must be a long term asset,
- (ii) Net consideration must be invested in certain specified assets,
- (iii) Investment to be made within 6 months of transfer
- (iv) If only a portion of the net consideration is reinvested , then proportionate exemption is allowed.
- (v) New asset must be held for atleast three years.

Section 115 I- NRI may opt out of Chapter XIIA

A non-resident Indian may elect not to be governed by the provisions of Chapter XIIA, for any assessment year by furnishing a written declaration to Assessing Officer with his return of income. If he does so, his total income for that assessment year shall be computed and tax on such total income shall be charged in accordance with the other provisions of this Act



Check Your Progress-C

Q1. Briefly state the provisions of Section 115C.

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Q2. How a Non-Resident Indian can opt out of Chapter XIA?

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Q3. What are the conditions where the capital gains from transfer of foreign exchange asset is exempted?

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ILLUSTRATIONS

TAX INCIDENCE IN BRIEF:

The following table highlights the tax incidence in brief:

Whether taxable or not

Incomes	Resident	Not Ordinarily Resident	Non-Resident
Income received in India whether accrued or	Yes	Yes	Yes

arisen in India or outside India			
Income deemed to be received in India whether accrued or arisen in India or outside India	Yes	Yes	Yes
Income accruing or arising in India whether received in India or Outside India	Yes	Yes	Yes
Income deemed to accrue or arise in India whether received in India or outside India	Yes	Yes	Yes
Income received and accrued or arisen outside India from a business controlled in or a profession set u in India	Yes	Yes	No
Income received and accrued or arisen outside India, from a business controlled outside or a profession set up outside India	Yes	No	No
Income received and accrued or arisen outside India from any other source	Yes	No	No
Income accrued or arisen and received outside India in earlier years but later remitted to India during the previous year	No	No	No

Example 1:

X ltd. and Y ltd. are registered in Pakistan and India respectively. All meetings of Board of Directors of X ltd. were held in India, whereas all Board of Directors meetings of Y ltd. were held in Pakistan, during the previous year 2017-18. Determine their residential status for the assessment year 2018-19.

Answer:

X ltd. is registered in Pakistan. Hence, it is a foreign company, but its whole management and control is situated in India. Hence, it is resident in India.

Y ltd. is registered in India. Hence, it is an Indian company. An Indian company is treated as resident in India, whether its management is situated in India or not.

Example 2:

The following are the incomes of Shri Ram Prasad for the previous year 2018-19

- a. Profit from business in Iran received in India Rs. 5000*

- b. *Income from House Property in Iran received in India Rs. 500*
- c. *Income from house property in Pakistan deposited in a bank there Rs. 1000*
- d. *Profits of business established in Pakistan deposited in a bank there(out of Rs. 20,000 a sum of Rs. 10,000 is brought into India)-this business is controlled from India-Rs. 20,000*
- e. *Accrued in India but received in England Rs. 2000*
- f. *Profit earned from business in Kanpur Rs. 6000*
- g. *Income from agriculture in England –it is all spent on the education of children in London Rs. 5000*
- h. *Past untaxed foreign income brought into India during the previous year Rs. 10,000*

From the following particulars ascertain the taxable income of Shri Ram Prasad for the previous year 2017-18, if Shri Ram Prasad is a Non-resident.

Answer:

Computation of Taxable Income (for the previous year 2017-18)

(a)	Profit from business in Iran received in India	
	Rs.5000	
(b)	Income from house property in Iran received in India	Rs. 500
(c)	Income from house property in Pakistan deposited in a bank there	Rs. -----
(d)	Profits of business established in Pakistan deposited in a bank there, the business being controlled from India	Rs. -----
(e)	Accrued in India but received in England	Rs. 2000
(f)	Profit earned from business in Kanpur	Rs. 6000
(g)	Income from agriculture in England	Rs. -----
(h)	Past untaxed foreign income brought into India During the previous year	Rs . -----
	Total Income	Rs.13,500

Example 3:

Particulars of Income of previous year 2017-18 of Mr. Sanjay Bansal are given below. Compute his taxable income for the assessment year 2018-19, if he is a Non- Resident.

- a) Loss from house property situated in Canada Rs. (20000)
- b) Income from house property in India (computed) Rs. 15000
- c) Income from business in India Rs. 40000
- d) Loss from business in Australia Rs. (25000)
- e) Income from business in Australia which is controlled from there Rs. 50000
- f) Interest on Indian debentures Rs. 8000
- g) Salary received in India Rs. 100000

Answer:

Computation of Taxable Income

(a)	Loss from House Property situated in Canada	Rs. -----
(b)	Income from House Property situated in India	Rs. 15000
(c)	Income from Business in India	Rs. 40000
(d)	Loss from business in Australia	Rs.-----
(e)	Interest on Indian Debentures	Rs. 8000
(f)	Salary received in India	Rs. 100000
	Taxable Income	Rs.1,63,000

Example 4:

Shri Ramesh , who was born and brought up in India ,went for further studies to U.K., on 1st March , 2016and came back to India on 1ST October ,2017 early in the morning .Find out the residential status for the assessment year 2018-19.

Answer:

Assessment Year 2018-19 or Previous Year 1.4.2017 to 31.3.2018.

Stay in India during the previous year 2017-18

$31+30+31+31+28+31=182$ days.(First basic condition satisfied). Hence, he is resident.

For determining whether he is ordinarily resident, we shall see his status during the preceding 10 years as under:

Previous Year 2016-17-He was non-resident because he was not in India at all during the previous year.

Previous year 2015-16- He was resident, as he left India on 1st March, 2016

Previous year 2008-09 to 2014-15- He was resident, as he was in India throughout.

He was not non-resident in India for 9 out of 10 years preceding the previous year 2014-15.

He has been in India for more than 729 days during the preceding 7 years. Therefore, he is Resident and Ordinarily Resident for the Assessment Year 2018-19.

Example 5:

X Chamber of Commerce is an association of traders of South India.

The following data is available:

(Situation 1)-Income derived from performing specific services for members (which is taxable) Rs.86, 000

(Situation 2)- Income derived from performing specific services for members (which is taxable) Rs.90, 000

Surplus from other activities (mutual concern activities, not taxable), (Situation 1-Rs. 50,000), (Situation 2-Rs. (1, 60,000)).

Answer:

TAXABLE INCOME

Particulars	Situation 1	Situation 2
Income derived from performing specific services for members (which is taxable) (a)	86,000	90,000
Surplus from other activities (mutual concern activities , not taxable) (b)	50,000	(1,60,000)
Taxable Income		
Income mentioned at(a)	86,000	90,000
Less: Loss from other activities but subject to maximum at 50 % of (a)		45,000
Net Income	86,000	45,000



Check Your Progress-D

Numerical 1:

Mr. X, who is a foreigner, comes to India on June 15, 2012. During the financial years 2012-13, 2013-14, 2014-15, 2015-16, 2016-17 and 2017-18 he stays in India for 120 days, 115 days, 15 days, 191 days, 54 days, and 80 days respectively. Determine his residential status for the A.Y. 2018-19

Numerical 2:

Heynes, a West Indian, came to India for the first time on 10.01.2014 and left for Australia on 15.09.2014. He again came to India on 1.5.2017 to leave for South Africa on 15.7.2017. Determine his status for the previous year 2017-18.

Numerical 3:

An Indian citizen and businessman Shri Anuj who resides in Bhopal, went to London for the first time for employment purpose on 8th August, 2017 and came back to India on 31st October, 2018. Shri Anuj has not been out of India in the past.

Determine the residential status of Shri Anuj for the assessment year 2018-19. If he has gone to London on leisure trip what will be your answer?

24.8 TAX MANAGEMENT OF NON RESIDENTS

Tax management can be especially tough for the Non Resident Indians. Not only they have to stay up to date with the taxation rules in their foreign country of residence but in India as well. An NRI is expected to do some things differently than other ordinary Indians, but first one must know how to determine one's residential status.

The following are some tips on saving money as an NRI:

- By opening an NRE (Non-Resident Rupee) account an NRI can save his/her foreign earnings in India and also avoid TDS deductions.
- She/he can enjoy tax exemptions on certain earnings such as Interest earned on Foreign Currency Non-Resident, Dividend income from Indian Public/Private Company, Indian Mutual Funds incomes, etc.
- She/he is allowed to deduct taxes from their home loan interest amount or education loan interest amount just like ordinary Indians.

Apart from the above, there are many other ways for NRIs to save taxes and make sound investments. For instance, one can invest in ELSS, tax-free bonds, etc.

INCOMES EXEMPT FROM INCOME TAX:

The following incomes of NRI are completely exempt from tax:

- a. Interest on Non-Resident (External) Account is fully exempt from Income Tax.
- b. Remuneration of Non Citizens is exempt from Income tax.
- c. Exemption of Long term capital gains regarding Residential house property (section 54).
- d. Exemption of Long term capital gains on capital asset on Investment in House Property (section 54F).
- e. Computation of capital gains in Real Estate transactions.
- f. Exemption of Long term capital gains on securities and lower tax on short term capital gains.
- g. Income of certain Venture Capital Undertakings- section 10(23FB).
- h. Income in Special Economic Zones, 100% EOU's etc.
- i. Interest from NSCS is completely exempt from income tax under section 10(4B).

DEDUCTIONS ALLOWED TO NON –RESIDENT INDIANS IN THE COMPUTATION OF TOTAL INCOME AND TAX PAYABLE

- i. Tax benefit regarding Life Insurance Premium, PPF contributions, NSCS, Tuition Fees etc.
- ii. Donations to certain Funds and Charitable Institutions.
- iii. Profits and Gains from New Industrial Undertakings of Infrastructural facility.
- iv. Five year tax holiday to Hospitals at certain locations section 80-IB.
- v. Tax holiday to enterprises providing Telecommunication Services, Industrial Parks, and New Hotels and having Commercial Production of Mineral Oil.

- vi. Five year tax holiday for New Industrial Undertakings in Industrially Backward Areas and Districts.
- vii. Deduction in respect of Medical Insurance premium section 80D.
- viii. Additional deduction for Health Insurance Premium paid of Parents section 80 D.
- ix. Deduction for repayment of loan for higher studies section 80E.
- x. Deduction in respect of certain undertakings in North Eastern States.
- xi. Other deductions such as depreciation to Non-Resident Indians.

PROCEDURE FOR THE FILING OF INCOME TAX RETURN, ASSESSMENT AND REFUNDS

- a) Income tax return to be voluntarily filed and tax paid on self assessment if an NRI has taxable income in India.
- b) The assessing officer can also require a Non-Resident Indian to file income tax return.
- c) NRI's can apply for refund of Income tax by filing income tax return.
- d) Income of NRI'S is generally accepted without scrutiny.
- e) Regular assessment is done by personal hearing and examination of papers by the Assessing Officer.
- f) In case of any income of an NRI escaped assessment, there is provision for Re-assessment or Additional assessment.
- g) Remedies by way of Appeal etc are available to Non-Resident Indian.
- h) There is provision for getting Permanent Account Number (PAN).
- i) Double Taxation Relief.
- j) There are provisions for rectification and settlement of cases.
- k) Deduction of Tax at source and payment of advance tax by NRI's.
- l) There are provisions regarding Penal Interest and penalty for delay in filing Income Tax Return or Payment of Tax.

24.9 TAX PLANNING IN RESPECT OF NON -RESIDENTS

Section 90-The Government of India has entered into comprehensive agreements for **avoidance of double taxation** with 57 countries. Besides, the Government of India has entered into agreements which cover limited areas of activity like aircraft and shipping business. This is known as Avoidance of Double Taxation Agreements.

Generally, there are two modes of granting relief under ADT agreements:

- a. Exemption method: a particular income is taxed in one of the two countries.
- b. Tax Credit Method: an income is taxable in both the countries in accordance with their respective tax laws.

By the Finance Act 2013, with effect from the assessment year 2013-14, the amended version provides that apart from submission of a tax residency certificate which is necessary for the assessee, the assessee shall also provide the following documents and information(in Form no. 10F) for claiming benefits under Double Taxation Avoidance Agreements:

1. Status (individual, company , firm , etc.) of the assessee;
2. Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others);
3. 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 specified territory;
4. Period for which the residential status is applicable ; and
5. Address of the assessee in the country or specified territory outside India, during the period for which the certificate is applicable.

However, the above information in Form No. 10F is not required if such information is available in tax residency certificate.

UNILATERAL RELIEF:

Section 91 provides for the grant of unilateral relief in case of resident tax payers on income which has suffered tax in India as well as in the country with which there is no ADT agreement. Relief is granted by allowing to the taxpayer a deduction from the tax liability of an amount equal to the tax calculated at the average Indian rate of tax or the amount of tax calculated at the rate of tax of the other country on the doubly taxed income, whichever is lower.

DOUBLE TAXATION RELIEF IN CASE OF SPECIFIED ASSOCIATIONS (sec 90A)

Sec 90A provides for the following:

There is a specified association in India which enters into an agreement with any specified association in a specified territory outside India for (a) grant of double taxation relief, for avoidance of double taxation; (b) exchange of information for the prevention of evasion or avoidance of income-tax; (c) recovery of income tax.

The Central Government may, by notification in the Official Gazette, make the necessary provisions for adopting and implementing such agreement.

24.10 SUMMARY

1. Assesseees are either (a) resident in India, or (b) non-resident in India. As far as resident individuals and Hindu Undivided Families are concerned, they can be further divided into two categories, (a) resident and ordinarily resident and (b) resident but not ordinarily resident.
2. It is not necessary that a person, who is resident in India, cannot become resident in any country for the same assessment year.
3. In case of a *Non Resident individual and a foreign company*, the income which is received or is deemed to be received in India or income which accrues or arises or is deemed to accrue or arise in India, shall be liable to be taxed in India.
4. While computing the investment income of a non-resident Indian, no deduction in respect of any expenditure or allowance shall be allowed under any provision of the Act. Moreover, no deduction under sections 80C to 80U shall be allowed in respect of investment income.
5. By opening an NRE (Non-Resident Rupee) account an NRI can save his/her foreign earnings in India and also avoid TDS deductions.
6. Section 91 provides for the grant of unilateral relief in case of resident tax payers on income which has suffered tax in India as well as in the country with which there is no ADT agreement.
7. She/he can enjoy tax exemptions on certain earnings such as Interest earned on Foreign Currency Non-Resident, Dividend income from Indian Public/Private Company, Indian Mutual Funds incomes, etc.
8. She/he is allowed to deduct taxes from their home loan interest amount or education loan interest amount just like ordinary Indians.
9. Section 90A provides for the double taxation relief in case of specified associations.
10. Capital gain arise from transfer of foreign exchange asset, is exempt from the tax.



24.11 GLOSSARY

DTAA-Double Taxation Avoidance Agreement

NRI- Non-Resident Indian

Relief- a financial or practical assistance, help or aid.

Citizen- an inhabitant of a country, especially one entitled to its privileges or franchises.

Official Gazette –is a periodical publication that records the business and proceedings of a government and has been authorized to publish public or legal notices.

Indian Rate: The Indian rate of tax means the rate determined by dividing the amount of Indian income tax after deduction of any relief due under the provisions of the Act, but before deduction of any relief due under sections 90 and 9, by the total income.

Foreign Rate: The rate of tax of the foreign country means income tax and super tax actually paid in that country in accordance with the corresponding laws in force thereafter deduction of all relief due , divided by the whole amount of the income as assessed in that country.



24.12 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress –D

Answer1: N.O.R.

Answer2 : N.R.

Answer3: (a) Non-resident. (b) Ordinarily resident.



24.13 REFERENCES

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24.14 SUGGESTED READINGS

1. Dr, Ahuja, Girish and Dr.Gupta Ravi,*Direct Taxes Law and Practice including TAX PLANNING*, Publication House: Bharat Law House Pvt Ltd., Delhi.
2. WEBSITE: <http://www.taxmann.com>
3. E-mail : sales @taxmann.com



24.15 TERMINAL QUESTIONS

- Q1.** What do you mean by Double Taxation Avoidance Agreement?
- Q2.** What is the procedure for filing the income tax return of an NRI?
- Q3.** Briefly explain the deductions allowed to an NRI on his/her income.
- Q4.** What do you mean by tax incidence on Non –Resident?
- Q5.** Can an NRI opt out of Chapter XII A?
- Q6.** Explain section 90.

Corporate Tax Planning MS 401



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