CHAPTER ONE

Basic concepts

Assessment year [Sec. 2(9)]

1. Assessment year means the period of twelve months starting from April 1 of every year and ending on March 31 of the next year. For instance, the assessment year 2009-10 which will commence on April 1, 2009, will end on March 31, 2010. The period of assessment year is fixed by statute.

Income of previous year [*see* para 2] of an assessee is taxed during the following assessment year at the rates prescribed for such assessment year by the relevant Finance Act.

Previous year [Sec. 3]

2. Income earned in a year is taxable in the next year. The year in which income is earned is known as previous year and the next year in which income is taxable is known as assessment year. In other words, it can be said that income earned during the previous year 2008-09 is taxable in the immediately following assessment year (*i.e.*, 2009-10) [*see* para 2.2 for exception to this rule].

2.1 ***Uniform previous year*** - From the assessment year 1989-90 onwards, all assessees are required to follow financial year (*i.e.*, April 1 to March 31) as the previous year. This uniform previous year has to be followed for all sources of income.

Provision illustrated - For the assessment year 2009-10, income earned by X Ltd. during the previous year 2008-09 (*i.e.*, April 1, 2008 to March 31, 2009) is chargeable to tax. It is, however, not necessary that X Ltd. should maintain books of account on the basis of financial year. It is not necessary that X Ltd. should close books of account on March 31 every year. X Ltd. may maintain books of account on the basis of any other year but for the purpose of income-tax, income of the previous year 2008-09 (*i.e.*, April 1, 2008 to March 31, 2009) is taxable for the assessment year 2009-10. If X Ltd. maintains books of account on the calendar year basis, taxable income shall be determined as follows—

Accounting year	Profits as per books of account	Chargeable heads of income	
		Business/Profession	Capital Gains
	Rs.	Rs.	Rs.
2007	60,000	18,000	42,000
2008	70,000	26,000	44,000
2009	90,000	21,000	69,000

Taxable income—

Assessment year	Previous year	Income Rs.
2008-09	2007-08	68,000 (42,000 + 26,000)
2009-10	2008-09	65,000 (44,000 + 21,000)

2.1-1 ***PREVIOUS YEAR IN THE CASE OF NEWLY SET-UP BUSINESS/PROFESSION*** - In the case a newly set-up business/profession or in the case of a new source of income, the previous year is determined as follows—

	First previous year	Second and subsequent previous years
Starting point	It commences on the date of setting up of the business/ profession or on the date when the new source of income comes into existence	April 1

	First previous year	*Second and subsequent previous years*
Ending point	Immediately following March 31	March 31 of the following year
Duration of previous year	12 months or less	12 months

On the basis of the above table, the following broad conclusions can be drawn —

1. The first previous year commences on the date of setting up of the business/profession (or, as the case may be, the date on which the source of income newly comes into existence) and ends on the immediately following March 31. Thus, in the case of a newly set-up business/profession or new source of income, the first previous year is a period of 12 months or less than 12 months. It can never exceed 12 months.

2. The second and subsequent previous years are always financial years. The second and subsequent previous years are always of 12 months each (*i.e.*, April to March).

2.1-1P1 *X joins an Indian company on December 18, 2008. Prior to December 18, 2008, he is not in employment. He does not have any other source of income. What are the previous years for the assessment years 2009-10 and 2010-11 ?*

SOLUTION : Previous years for the assessment years 2009-10 and 2010-11 will be as under :

Assessment year	*Previous year*
2009-10	December 18, 2008 to March 31, 2009
2009-10	April 1, 2009 to March 31, 2010

2.1-1P2 *The income of X comprises of only property income up till March 10, 2008. On March 10, 2008, he starts a new business of computer hardware. From the data given below, find out the taxable income of X for the assessment years 2007-08 to 2009-10.*

Property income : Rs. 42,000 every year

Business income : Rs. 69,000 from March 10, 2008 to March 31, 2009 (out of which Rs. 10,000 is for the period ending March 31, 2008)

SOLUTION :

Assessment year	Property income		Business income		Total
	Previous year	Income Rs.	Previous year	Income Rs.	Rs.
2007-08	2006-07	42,000	—	—	42,000
2008-09	2007-08	42,000	March 10, 2008 to March 31, 2008	10,000	52,000
2009-10	2008-09	42,000	2008-09	59,000	1,01,000

Note - For the assessment year 2008-09, the assessee has income from house property which can be said to be his existing source of income during the previous year. His new source of income comes into existence in the form of business income from March 10, 2008. Therefore, the assessee has two previous years for assessment year 2008-09. For the property income which is his existing source, the previous year is 2007-08. For the business income, which is his new source of income, the previous year is a period commencing from March 10, 2008 to March 31, 2008.

For computing taxable income for the assessment year 2008-09 (or any subsequent year), the income from both the previous years will be aggregated.

2.1-2 ***PREVIOUS YEAR AS DEFINED IN SECTION 3*** - Except in the case mentioned in para 2.1-1, previous year is the financial year immediately preceding the assessment year. For instance, for the assessment year 2009-10, the immediately preceding financial year (*i.e.*, 2008-09) is the previous year.

2.2 *When income of previous year is not taxable in the immediately following assessment year* - The rule that the income of the previous year is assessable as the income of immediately following

assessment year has certain exceptions which are given in paras 2.2-1 to 2.2-5. These exceptions have been incorporated in order to ensure smooth collection of income-tax from these taxpayers who may not be traceable if tax assessment procedure is postponed till the commencement of the normal assessment.

2.2-1 ***SHIPPING BUSINESS OF NON-RESIDENTS [SEC. 172]*** - Section 172 is applicable if the following conditions are satisfied —

[illegible]	There is a non-resident.
[illegible]	He owns a ship or ship is chartered by the non-resident.
[illegible]	The ship carries passengers, livestock, mail or goods shipped at a port in India.
[illegible]	The non-resident may (or may not) have an agent/representative in India.

If all the aforesaid conditions are satisfied, 7.5 per cent of amount paid (or payable) on account of such carriage (including demurrage charge or handling charge or similar amount) to the non-resident shall be deemed to be the income of the non-resident. For this purpose, the master of the ship shall submit a return of income before the departure of the ship from the Indian port (such return may be submitted within 30 days of the departure of the ship, if the Assessing Officer is satisfied that it will be difficult to submit the return before departure and if satisfactory arrangement for payment of tax has been made).* Unless the tax has been paid (or satisfactory arrangements have been made for payment thereof), a port clearance shall not be granted by the Collector of Customs. Under the abovenoted provisions of section 172, 7.5 per cent of amount of freight, fare, etc., is deemed as income of the non-resident taxpayer and tax is payable at the rate applicable to a foreign company. Income is, thus, taxable in the same year in which freight, fare, etc., is collected and not in the immediately following assessment year.

2.2-2 ***PERSONS LEAVING INDIA [SEC. 174]*** - Section 174 is applicable as follows —

1. It appears to the Assessing Officer that an individual may leave India during the current assessment year or shortly thereafter.

2. He has no present intention of returning to India.

3. The total income of such individual up to the probable date of his departure from India shall be chargeable to tax in that assessment year.

Provisions illustrated - X, a foreign citizen, is residing in India since 2003. While completing his assessment for the assessment year 2008-09, on February 14, 2009, the Assessing Officer comes to know that X will leave India on April 12, 2009 with no intention of returning. In this case, the Assessing Officer will make 3 assessments for the assessment year 2008-09 :

a. regular assessment for the previous year 2007-08 (*i.e.*, income of the period April 1, 2007 to March 31, 2008) ;

b. assessment for the income of the period April 1, 2008 to March 31, 2009 ; and

c. assessment for the income of the period April 1, 2009 to April 12, 2009.

The above three income assessments shall be completed separately. For the first assessment, tax shall be chargeable at the rates applicable for the assessment year 2008-09. For the second and third assessments, tax shall be chargeable at the rates applicable for the assessment year 2009-10 which are given in Part III of the First Schedule to the Finance Act, 2008.

2.2-3 ***BODIES FORMED FOR SHORT DURATION [SEC. 174A]*** - Section 174A is applicable as follows—

1. There is an association of persons or a body of individuals or an artificial juridical person, formed or established or incorporated for a particular event or purpose.

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*No order assessing the income and determining the sum of tax payable thereon under the aforesaid provisions shall be made under section 172(4) by the Assessing Officer after the expiry of 9 months from the end of the financial year in which the return is furnished. Where, however, return is furnished before April 1, 2008, the order assessing the income and determining the sum of tax payable thereon may be made at any time on or before the December 31, 2009. In other words, a longer time-limit of 21 months has been provided to complete all pending assessments under section 172.

2. It appears to the Assessing Officer that the abovementioned association, body, etc., is likely to be dissolved in the assessment year (*i.e.*, April to March) in which such association of persons or body of individuals or artificial juridical person was formed or established or incorporated or immediately after such assessment year.

3. The total income of such association or body or juridical person for the period from the expiry of the previous year for that assessment year up to the date of its dissolution shall be chargeable to tax in that assessment year.

Provisions illustrated - X Co. is an association of two individuals X and Y. It is formed on April 10, 2007 for the purpose of completing a contract given by a French company in India. It is likely to be dissolved on September, 10, 2008. While processing return submitted by the association for the assessment year 2008-09, the Assessing Officer comes to know on August 6, 2008 about the probable date of dissolution. In this case, the Assessing Officer will make two assessments for the assessment year 2008-09 :

a. regular assessment for the previous year 2007-08 (*i.e.*, income of the period April 10, 2007 to March 31, 2008); and

b. assessment for the income of the period April 1, 2008 to September 10, 2008.

The above two income assessments shall be completed separately. For the first assessment, tax shall be chargeable at the rates applicable for the assessment year 2008-09. For the second assessment, tax shall be chargeable at the rates applicable for the assessment year 2009-10 which is given in Part III of the First Schedule to Finance Act, 2008.

2.2-4 ***PERSON LIKELY TO TRANSFER PROPERTY TO AVOID TAX [SEC. 175]*** - The salient features of section 175 are given below —

1. It appears to the Assessing Officer during any current assessment year that a person is likely to charge, sell, transfer, dispose of (or otherwise part with) any of his asset.

2. Such asset may be movable or immovable.

3. The taxpayer is likely to part with the asset with a view to avoiding payment of any liability under the Income-tax Act.

4. The total income of such person from the first day of the assessment year to the date when proceeding is started under section 175 is taxable in that assessment year.

Provision illustrated - On December 19, 2008, the Assessing Officer comes to know that X Ltd. is likely to dispose of a house property during January 2009 with a view to avoiding payment of income-tax. A notice is issued by the Assessing Officer on December 28, 2008 to X Ltd. under section 175 to submit return of income of the period commencing on April 1, 2008 to December 28, 2008.

In this case, income from April 1, 2008 to December 28, 2008 is chargeable to tax in the assessment year 2008-09 and tax is calculated at the rate applicable for the assessment year 2009-10 given in Part III of the First Schedule to the Finance Act, 2008.

2.2-5 ***DISCONTINUED BUSINESS [SEC. 176]*** - The salient features of section 176 are as follows —

1. A business or profession is discontinued in any assessment year.

2. Income of the business/profession from April 1 of the assessment year (in which the business/profession is discontinued) to the date of discontinuation may be taxable in the assessment year in which the business/profession is discontinued.

3. The above income is taxable at the discretion of the Assessing Officer in the assessment year in which business is discontinued or it may be taxed in the normal assessment year (*i.e.*, assessment year immediately following the previous year).

4. If it is taxable in the assessment year in which the business/profession is discontinued, then it is chargeable to tax at the rate applicable to that assessment year.

It may be noted that in the first four exceptions discussed earlier (*i.e.*, shipping business of non-residents, persons leaving India, bodies formed for short duration and transfer of property) tax shall be charged in the previous year itself (it is mandatory on the part of the Assessing Officer). But in the case of discontinued business, it is at the discretion of the Assessing Officer.

Provisions illustrated - X discontinues his business on August 10, 2008. In this case, income will be taxable as follows —

a. for the assessment year 2008-09, income of the previous year 2007-08 will be taxable ; and

b. income of the period commencing on April 1, 2008 and ending on August 10, 2008 may be taxable at the discretion of the Assessing Officer in the assessment year 2008-09 at the rate applicable to the assessment year 2009-10 given in Part III of the First Schedule to the Finance Act, 2008 (or, on the other hand, the Assessing Officer may wait till the commencement of the normal assessment year and then income of the period : April 1, 2008 to August 10, 2008, shall be taxed in the assessment year 2009-10 at the rate applicable to the assessment year 2009-10 which will be given in Part I of the First Schedule to the Finance Act, 2009).

Person [Sec. 2(31)]

3. The term "person" includes :

a. an individual ;

b. a Hindu undivided family ;

c. a company ;

d. a firm ;

e. an association of persons or a body of individuals, whether incorporated or not ;

f. a local authority ; and

g. every artificial juridical person, not falling within any of the preceding categories.

These are seven categories of persons chargeable to tax under the Act. The aforesaid definition is inclusive, and not exclusive. Therefore, any person, not falling in the abovementioned categories, may still fall in the four corners of the term "person" and accordingly may be liable to tax under section 4.

3.1 ***An individual*** - Under the present Act, the word "individual" means only a natural person, *i.e.*, a human being. Deities and statutory corporations are assessable as "juridical person". "Individual" includes a minor or a person of unsound mind—*Shridhar Uday Narayan* v. *CIT* [1962] 45 ITR 577 (All.), or a group of individuals—*WTO* v. *C.K. Mammed Kayi* [1981] 129 ITR 307 (SC).

■ Trustees of a discretionary trust have to be assessed in status of "individual" and not in status of "association of persons"—*CIT* v. *Deepak Family Trust (No. 1)* [1994] 72 Taxman 406 (Guj.).

3.2 ***A Hindu undivided family*** - A Hindu undivided family consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters. Profits made by a joint Hindu family are chargeable to tax as income of the Hindu undivided family as a distinct entity or unit of assessment. Once a family is assessed as a Hindu undivided family, it will continue to be assessed as such till a finding of partition is given by the Assessing Officer under section 171.

■ For detailed discussion, *see* para 299 and problems 303-P1 to 303-P18.

3.3 ***A company*** - *See* para 333.

3.4 ***A firm*** - A firm is a taxable entity separate and distinct from its partners. For details, *see* para 314.

3.5 ***An association of persons (AOP) or a body of individuals (BOI)*** - "Association of persons" means an association in which two or more persons join in a common purpose or common action. The term "person" includes any company or association or body of individuals, whether incorporated or not. An association of persons may have companies, firms, joint families as its members—*M.M. Ipoh* v. *CIT* [1968] 67 ITR 106 (SC).

3.6 ***Local authority*** - Local authority is a separate unit of assessment. As per section 3(*31*) of the General Clauses Act, 1897, a local authority means a municipal committee, district board, body of port commissioners, or other authority legally entitled to or entrusted by the Government with the control and management of a municipal or local fund. The definition was examined by the Apex Court in various cases and the first important decision on the point was *Union of India* v. *R.C. Jain* AIR 1981 SC 951, indicating certain tests therein. The major tests which can be carved out from the above decision and subsequent decisions, are essentially, that (*i*) the authorities must have separate legal existence as corporate bodies and autonomous status; (*ii*) it must function in a defined area and

must ordinarily, wholly or partly, directly or indirectly be elected by the inhabitants of the area; (*iii*) it performs Governmental functions such as running market, providing civic amenities, etc.; (*iv*) it must have power to raise funds for the furtherance of its activities and the fulfilment of its projects by levying taxes/fees—this may be in addition to money provided by the Government and control and management of the fund must vest with the authority.

3.7 ***Every artificial juridical person*** - It covers not only deities— *Jogendra Nath Naskar* v. *CIT* [1969] 74 ITR 33 (SC) but also all artificial persons with a juridical personality such as a Bar Council— *Bar Council of Uttar Pradesh* v. *CIT* [1983] 143 ITR 584 (All.). Guru Granth Sahib is to be regarded as a juristic person—*Shiromani Gurudwara Prabandhak Committee, Asr.* v. *Som Nath Das* [2000] 160 CTR (SC) 61. This is residuary classification and, therefore, it does not cover those falling within any of the preceding classifications.

3.8 ***Profit motive is not essential*** - An *Explanation* is inserted in section 2(*31*) with effect from the assessment year 2002-03. It provides that an association of persons or a body of individuals or a local authority or an artificial juridical person shall be deemed to be a "person", whether or not, such person or body or authority or juridical person, is formed or established or incorporated with the object of deriving income, profits or gains.

Assessee [Sec. 2(7)]

4. Assessee means a person by whom any tax or any other sum of money (*i.e.*, penalty or interest) is payable under the Act. The term includes the following persons :

4.1 ***First category*** - A person (*i.e.*, an individual ; a Hindu undivided family; a company ; a firm ; an association of persons or body of individuals, whether incorporated or not ; a local authority ; and every artificial juridical person) by whom any tax or any other sum of money (including interest and penalty) is payable under the Act (irrespective of the fact whether any proceeding under the Act has been taken against him or not).

4.2 ***Second category*** - A person in respect of whom any proceeding under the Act has been taken (whether or not he is liable for any tax, interest or penalty). Proceeding may be taken :

a. either for the assessment of the amount of his income or of the loss sustained by him ; or

b. of the income (or loss) of any other person in respect of whom he is assessable ; or

c. of the amount of refund due to him or to such other person.

4.3 ***Third category*** - Every person who is deemed to be an assessee. For instance, a representative assessee is deemed to be an assessee by virtue of section 160(2).

4.4 ***Fourth category*** - Every person who is deemed to be an assessee in default under any provision of the Act. For instance, under section 201(1), any person who does not deduct tax at source, or after deducting fails to pay such tax, is deemed to be an assessee in default. Likewise, under section 218, if a person does not pay advance tax, then he shall be deemed to be an assessee in default.

Charge of income-tax [Sec. 4]

5. The following basic principles are followed while charging tax :

5.1 ***Annual tax*** - Income-tax is an annual tax on income.

5.2 ***Tax rate of assessment year*** - Income of previous year is chargeable in the next following assessment year at the tax rates applicable for the assessment year. This rule is, however, subject to some exceptions [*see* para 2.2].

5.3 ***Rates fixed by Finance Act*** - Tax rates are fixed by the annual Finance Act and not by the Income-tax Act. If, however, on the first day of April of the assessment year, the new Finance Bill has not been placed on the statute books, the provisions in force in the preceding assessment year or the provisions proposed in the Finance Bill before Parliament, whichever is more beneficial to the assessee, will apply until the new provisions become effective [*see* para 8.1].

5.4 ***Tax on person*** - Tax is charged on every person [*see* para 3].

5.5 ***Tax on total income*** - The tax is levied on the "total income" [*see* para 8] of every assessee computed in accordance with the provisions of the Act.

5.6 ***Provisions as on April 1 of the assessment year applicable for computing income for the assessment year*** - The legal position is summarized below—

■ *Rule one - For computing income* - Total income is calculated in accordance with the provisions of the Income-tax Act, as they stand on the first day of April of the assessment year.

Provisions illustrated - Consider the following cases—

1. For calculating taxable income for the assessment year 2009-10, the provisions of the Income-tax Act as on April 1, 2009 are applicable. If an amendment is made with effect from April 2, 2009, it is irrelevant for calculating income for the assessment year 2009-10. Likewise, the law existing during the previous year 2008-09 has no relevance for determining the total income for the assessment year 2009-10.

2. Suppose depreciation rate in respect of a particular asset is 20 per cent up to December 20, 2008. It has been increased to 30 per cent from December 21, 2008. It has been further increased to 35 per cent from April 10, 2009. In such a case, for calculating the taxable income for the assessment year 2009-10, the depreciation rate as on April 1, 2009 (*i.e.*, 30 per cent) would be applicable.

■ *Rule two - For other purposes* - The above rule is applicable only for the purpose of computing taxable income. To put it differently, it can be said that the provisions applicable on April 1 of the assessment year are relevant only for determining the taxable income for that assessment year. If, however, an amendment is made which is purely procedural (not for computing taxable income), then it is applicable from the date of the amendment.

Provisions illustrated - Consider the following cases—

1. Suppose an amendment is made with effect from April 10, 2008 to the effect that a salaried employee will submit the return of income in Form No. 102* (not in Form No. 98*). This is a procedural amendment. It does not affect computation of income. The rule stated in *Rule one* (*supra*) is not applicable. If a taxpayer wants to submit the return of income on or after April 10, 2008, then Form No. 102 would be applicable (irrespective of the assessment year for which the return is submitted). Conversely, if a taxpayer wants to submit the return of income on or before April 9, 2008, then Form No. 98 would be applicable (irrespective of the assessment year for which the return is submitted).

2. Suppose the Income-tax Act is amended with effect from September 8, 2003 to decrease the rate of interest for non-payment of tax from 1.25 per cent to 1 per cent per month. This is a procedural amendment. It does not affect computation of income. The rule stated in *Rule one* (*supra*) is not applicable. Suppose in a given case, the period of default for non-payment of tax is from August 1, 2003 till December 20, 2003, then interest at the higher rate of 1.25 per cent per month is applicable up to September 7, 2003 and the lower rate of 1 per cent is applicable from September 8, 2003.

Income [Sec. 2(24)]

6. The definition of the term "income" in section 2(*24*) is inclusive and not exclusive. Therefore, the term "income" not only includes those things which are included in section 2(*24*), but also includes such things which the term signifies according to its general and natural meaning. Before discussing the definition of income given under section 2(*24*) [*see* para 6.2] it is imperative to know meaning of "income" as generally understood.

6.1 ***Income as generally understood for tax purposes*** - Entry 82 of List I of the Seventh Schedule to the Constitution empowers Parliament to levy "taxes on income other than agricultural income". Entries in the Lists in the Seventh Schedule to the Constitution should not be read in a narrow or restricted sense—*Bhagwan Dass Jain* v. *Union of India* [1981] 5 Taxman 7 (SC). It, therefore, follows that in addition to receipts mentioned in section 2(*24*) (which does not define the term "income" but merely describes the various receipts as income), any other receipt is taxable under the Act, if it comes within the general and natural meaning of the term "income".

■ According to the *Shorter Oxford English Dictionary*, "income" means "that which comes in as the periodical product of one's work, business, lands, or investments (commonly expressed in terms of money); annual or periodical receipts accruing to a person or a corporation".

*Form Nos. 102 and 98 are used above only for illustration purposes.

In *CIT* v. *Shaw Wallace & Co.* 6 ITC 178 (PC), Sir George Lowndes defined "income" as follows :

"Income connotes a periodical monetary return 'coming in' with some sort of regularity, or expected regularity from definite sources. The source is not necessarily one which is expected to be continuously productive, but it must be one whose object is the production of a definite return, excluding anything in the nature of a mere windfall."

Anything which can be properly described as income is taxable under the Act, unless expressly exempted — *Gopal Saran Narain Singh* v. *CIT* [1935] 3 ITR 237 (PC). Income may not necessarily be recurring in nature, though it is generally of that character— *Kamakshya Narain Singh of Ramgarh* v. *CIT* [1943] 11 ITR 513 (PC).

Though there are different concepts of "income" for the purpose of taxation, income is broadly defined as the true increase in the amount of wealth which comes to a person during a stated period of time— *Comm. of Corporation and Taxation* v. *Filoon* 38 NE 2d 693, 700.

A study of the following judicial principles will be helpful to understand the concept of income.

6.1-1 ***REGULAR AND DEFINITE SOURCE*** - The term "income" connotes a periodical monetary return coming in with some sort of regularity— *CIT* v. *Shaw Wallace & Co.* 6 ITC 178 (PC). However, it must be read with reference to facts of each case— *Raghuvanshi Mills Ltd.* v. *CIT* [1952] 22 ITR 484 (SC).

6.1-2 ***DIFFERENT FORMS OF INCOME*** - Income may be received in cash or kind. When income is received in kind, its valuation is to be made according to the rules prescribed in the Income-tax Rules. If, however, there is no prescribed rule, valuation thereof is made on the basis of market value.

6.1-3 ***RECEIPT vs. ACCRUAL*** - Income arises either on receipt basis or on accrual basis. Income may accrue to a taxpayer without its actual receipt. Moreover, in some cases, income is deemed to accrue or arise to a person without its actual accrual or receipt [*see*, for instance, para 32]. Tax incidence arises either on "accrual" basis or on "receipt" basis [*see* para 29].

6.1-4 ***ILLEGAL INCOME*** - The income-tax law does not make any distinction between income accrued or arisen from a legal source and income tainted with illegality. By bringing the profits of an illegal business to tax, the State does not condone it or take part in crime, nor does it become a party to the illegality. The assessee might be prosecuted for the offence and yet be taxed upon profits arising out of its commission—*Mann* v. *Nash* [1932] 1 KB 752. However, any expense incurred by an assessee in carrying on such business is not deductible. *Explanation* to section 37(1) provides that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure. However, *Explanation* to section 37(1) is applicable only in case expenditure pertaining to illegal business and not in the case of business loss—***T.A. Quereshi*** v. ***CIT*** [2006] 157 Taxman 514 (SC).

6.1-5 ***DISPUTED TITLE*** - Income-tax assessment cannot be held up or postponed merely because of existence of a dispute regarding the title of income. The recipient is, therefore, chargeable to tax, though there may be rival claims to the source of the income—*Franklin* v. *IRC* [1930] 15 TC 464. A mere claim, on the other hand, by a person against the recipient of income is not sufficient to make income accrue to the claimant and render him liable for tax.

6.1-6 ***RELIEF OR REIMBURSEMENT OF EXPENSES NOT TREATED AS INCOME*** - Mere relief or reimbursement of expenses is not treated as income. For instance, reimbursement of actual travelling expenses for official purposes to an employee is not an income. Similarly, when the assessee is relieved of his obligation of a certain sum to a party by an order of court, the amount so relieved cannot be treated as income of the assessee.

6.1-7 ***DIVERSION OF INCOME BY OVERRIDING TITLE vs. APPLICATION OF INCOME*** - There is a thin dividing line between diversion of income and application of income.

▪ *Diversion of income* - Income is received by a person other than the person who is actually entitled for it. The recipient later on diverts the income under a pre-existing title to the person who is actually

entitled for it. It is diversion of income by overriding title. Income is not taxable in the hands of the person who first receives it. Tax is payable by the person to whom income is diverted by overriding title.

■ *Application of income* - Income is received by the person who is actually entitled for it. He is chargeable to tax. Post-tax income is utilised for different purposes (like payment of salary). It is application of income.

■ *How to find out whether it is diversion or application* - In order to decide whether a particular payment is a diversion of income or application of income, it has to be determined whether amount sought to be diverted reaches the assessee as his own income or not. To put it differently, it has to be seen whether the disbursement of income made by the assessee is a result of fulfilment of an obligation on him or whether income has been applied to discharge an obligation after it reaches the assessee. Where by an obligation income is diverted before it reaches the assessee, it is not taxable. Where, however, the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow and it is taxable. It is the first kind of payment which can truly be excused and not the second one. The second payment is merely an obligation to pay another portion of one's income, which has been received and is since applied. The first is the case in which the income never reaches the assessee, who even if he were to collect it, does so, not as part of his income, but for and on behalf of the person to whom it is payable—*CIT* v. *Sitaldas Tirathdas* [1961] 41 ITR 367 (SC).

Provisions illustrated - X and Y prepare an article for publication in Taxman, a tax and corporate law weekly magazine on the understanding that remuneration will be shared equally. The article is published in August 9, 2008 issue of Taxman. On September 10, 2008, X receives the entire remuneration of Rs. 9,000 (as per practice of the magazine, the remuneration is paid to the first author), a half of which is later on paid by X to Y. The payment of Rs.4,500 (being 50 per cent of Rs. 9,000) by X to Y is diversion of income by overriding title. The taxable income of X will be Rs.4,500 (payment of Rs.4,500 to Y will not be treated as income of X as it is diverted by an overriding title). Any expenditure or investment by X out of his income of Rs. 4,500 will be an "application of income".

6.1-8 ***SURPLUS FROM MUTUAL ACTIVITY*** - A person cannot make a taxable profit out of a transaction with himself—*Dublin Corporation* v. *M'Adam* 2 TC 387. Income must, therefore, come from outside. A surplus arising to a mutual concern cannot be regarded as income chargeable to tax. A body of individuals, raising contribution to a common fund for the mutual benefits of members, cannot be said to have earned an income when it finds that it has overcharged members and some portion of contribution raised may safely be refunded. The fact whether such body of individuals is incorporated or not, is wholly irrelevant, so long as there is a complete identity between the contributors as a class and the participants of the benefits and surplus as a class. In other words, all the participators in the surplus/benefits must be contributors to the common fund—*CIT* v. *Bankipur Club Ltd.* [1981] 6 Taxman 47 (Pat.). But that does not mean that each member should contribute to common fund or that each member should participate in surplus or get back from surplus precisely what he has paid; what is required is that members as a class should contribute to common fund and participators as a class must be able to participate in surplus—***U.P. State Nagariya Sahkari Bank Ltd.*** v. ***ITO*** [2007] 108 ITD 332 (Luck.).

Where the members of the assessee association of cement manufacturers were contributors to a common fund and had the right to participate in surplus, the surplus would not be assessable as the assessee's income on the ground of mutuality—*CIT* v. *Cement Allocation & Co-ordinating Org.* [1999] 236 ITR 553 (Bom.). Rent receipts from the members to whom the rooms were let out by the assessee-club, along with other facilities, would not be assessable to income-tax on the doctrine of mutuality—*Chelmsford Club* v. *CIT* [2000] 109 Taxman 215 (SC). Where, however, the assessee fund/trust, created for the benefit of its employees, receives contributions from members, management and donations from others also and the assessee deposits the said amount in a bank and earns interest, such interest income earned by it cannot be said to be exempt on the principle of mutuality—*CIT* v. *I.T.I. Employees Death & Superannuation Relief Fund* [1998] 101 Taxman 315/234 ITR 308 (Kar.) [*see* also para 101.9].

■ *Society for maintenance of housing complex - Is it governed by the doctrine of mutuality* - If the members of an association for maintaining housing complex take the following precautions, the association will be governed by the principle of mutuality :

a. every flat owner should be the member/shareholder of the associations;

b. the association can be in the form of a company, co-operative society, etc.;

c. only the members of the association (their family members) and guests of the members should use common facilities;

d. facilities may be provided on a 'no profit no loss' basis; and

e. surplus, if any, should be utilised in order to create new facilities.

Once the principle of mutuality applies to the association, its income connected with mutuality will not be liable to tax.

■ *Group co-operative housing society* - The concept of mutuality is applicable to group co-operative housing societies, provided contributors and the participators to funds are the same—*Maker Tower A&B Co-op. Hsg. Society Ltd.* v. *ITO* [2008] 20 SOT 253 (Mum.). The concept of mutuality is not applicable, in respect of transfer fees received from transferees since at time of transfer, the transferee is not a member of the housing society. However, the principle of mutuality, would apply in respect of transfer fees received from transferor of flat inasmuch as he is a member of the housing society on the date when the transfer fee is paid. Where the assessee, a co-operative housing society, received transfer fees from both the transferors and the transferees on account of transfer of its flats, it would be entitled to deduction to the extent of transfer fees received from the transferors in view of the principle of mutuality—***Maker Tower A&B Co-op. Hsg. Society Ltd.*** v. ***ITO*** [2008] 20 SOT 253 (Mum.).

6.1-9 *APPROPRIATION OF PAYMENT BETWEEN CAPITAL AND INTEREST* - Where interest is due on a capital sum and the creditor gets an open payment from the debtor, the creditor is at liberty to appropriate the payment towards principal—*CIT* v. *Pateshwari Prasad Singh* [1970] 76 ITR 208 (All.). If, however, neither the debtor nor the creditor makes any appropriation of payment as between capital and interest, the Income-tax Department is entitled to treat the payment as applicable to the outstanding interest and assess it as income—*CIT* v. *Kameshwar Singh* [1933] 1 ITR 94 (PC).

■ While allocating a realisation between interest and principal when claim is realised by auction sale of decree, or when a claim is satisfied by executing a fresh mortgage, the following principles are relevant :

1. To give security for a debt is not to pay a debt ; execution of a fresh mortgage does not pay a debt.

2. The excess of realisation over the principal sum is to be allocated towards interest.

3. The income represented by interest arises when the sale is confirmed.

4. Payment made to a prior mortgagee by the auction purchaser or to a claimant is not deductible; if the purchaser was aware of the claims, he would have taken that into account when he made a bid.

5. Expenses incurred on completing the title (after the court sanction) are not deductible as he would have taken them into account while making a bid.

6. The value of property to be taken into account is the amount of bid offered and not the value put on it by the court when inviting bids.

■ When the interest due on a previous advance is capitalised and a fresh promise is made for payment of the aggregate, there is no payment of the interest. It makes no difference whether the fresh promise takes the form of a promissory note or a bond or a mortgage, whether simple or usufructuary. Capitalisation of interest is not equal to payment of it —*Fakir Chand* v. *CIT* [1963] 49 ITR 842 (All.).

6.1-10 *TEMPORARY AND PERMANENT INCOME* - For the purpose of income-tax, there is no distinction between temporary and permanent income. Even temporary income is taxable.

6.1-11 *LUMP SUM RECEIPT* - Income, whether received in lump sum or in instalments, is liable to tax. For instance, arrears of bonus, received in lump sum, is income and taxable as salary.

6.1-12 *PERSONAL GIFTS* - Gifts of a personal nature, *e.g.*, birthday gifts, marriage gifts, etc., do not constitute income and, therefore, recipient of such gifts is not liable to income-tax. However, if an individual/HUF, gets a sum of money exceeding Rs. 50,000 in aggregate during a financial year without consideration from persons other than relatives, it will be taxable under section 56(2)(*vi*) in some cases [*see* para 199].

■ *Business gift* - If the recipient of a gift is a businessman, that fact does not alter the character of the thing given. In order that a payment, with a gift element or an element of bounty, may be treated as part of the taxable income of a businessman, it must be shown that that gift had been received in the course of, or as a necessary incident of, the recipient's business. Whether this is so or not in any given case would depend upon so many considerations, such as, for instance, the nature of the business, the relationship between the giver of the gift and the recipient, and various other attendant circumstances.

6.1-13 *TAX-FREE INCOME* - If a person receives tax-free income on which tax is paid by the person making payment on behalf of the recipient, it has to be grossed up for inclusion in his total income.

For instance, X pays Rs. 25,000 per month to Y as tax-free salary (tax of Rs. 3,000 per month is borne by X and directly paid to the Government). In this case, the amount taxable in the hand of Y is Rs. 28,000 per month.

6.1-14 *RECEIPT ON ACCOUNT OF DHARMADA* - Receipt on account of *dharmada, gaushala* and *pathshala* is not income and, therefore, not liable to tax—*CIT* v. *Manoo Ram Ram Karan Dass* [1979] 116 ITR 606 (All.), *CIT* v. *Bijli Cotton Mills (P.) Ltd.* [1979] 116 ITR 60 (SC) and *CIT* v. *Om Oil & Oil Seeds Exchange Ltd.* [1980] 3 Taxman 470 (Delhi).

6.1-15 *DEVALUATION OF CURRENCY* - If an assessee receives extra money on account of devaluation of currency, it is taxable [*see* also para 160]. If the fund is utilised in the course of business for a trading purpose, there will be realisation of the profit arising on devaluation and the profit would be taxable. If, on the other hand, the fund is not utilised for a business operation (*i.e.*, for non-trading purpose), like payment of income-tax in the foreign country, there is no profit and the difference in the exchange value cannot be assessed to income-tax—*CIT* v. *Mogul Line Ltd.* [1962] 46 ITR 590 (Bom.).

6.1-16 *INCOME INCLUDES LOSS* - Income includes loss. While income and profits and gains represent "plus income" losses represent "minus income"—*CIT* v. *Karamchand Premchand Ltd.* [1960] 40 ITR 106 (SC). In *CIT* v. *Harprasad & Co. (P.) Ltd.* [1975] 99 ITR 118, the Supreme Court *held* that loss is a negative income and in calculation of total income of an assessee both negative and positive income should be taken into account.

6.1-17 *PRIZE ON WINNING A MOTOR RALLY* - Up to the assessment year 1972-73, receipts of a casual and non-recurring nature were exempt from tax. The Finance Act, 1972 introduced a statutory fiction so as to enlarge the concept of "income" by including with effect from the assessment year 1973-74, 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. In the context of this legislative step and the dictionary meaning of the word "winnings", it is clear that what is intended to be taxed is only a windfall that reaches a person without any effort or without any skill [for further details, *see* para 38.4].

6.1-18 *SAME INCOME CANNOT BE TAXED TWICE* - It is a fundamental rule of the law of taxation that, unless otherwise expressly provided, the same income cannot be taxed twice.

■ It is also not open to the Assessing Officer, if income has accrued to the assessee and is liable to be included in the total income of a particular year on "accrual" basis, to ignore the accrual and thereafter to tax it as income of another year on the basis of receipt—*Laxmipat Singhania* v. *CIT* [1969] 72 ITR 291 (SC).

But the same person can be taxed both as individual as well as the karta of his family—*CIT* v. *Rameshwarlal Sanwarmal* [1971] 82 ITR 628 (SC). Though the rule that the same income cannot

be charged twice over in the hands of the same person is well settled, there is no rule of law that income which has borne tax in the hands of a particular individual becomes wholly immune from tax in all its subsequent devolutions or passage to another person—*T.N.K. Govindaraju Chetty & Co. (P.) Ltd.* v. *CIT* [1964] 51 ITR 731 (Mad.).

6.1-19 *INCOME SHOULD BE REAL AND NOT FICTIONAL* - Income means real income and not fictional income. A person cannot make a profit of trading with himself or out of transfer of funds/assets from one pocket to another pocket—*Sir Kikabhai Premchand* v. *CIT* [1953] 24 ITR 506 (SC). Similarly, income does not arise in a transaction between head office and branch office, even if goods are invoiced at a price higher than the cost price—*Ram Lal Bechairam* v. *CIT* [1946] 14 ITR 1 (All.). Likewise, income does not accrue or arise at the time of revaluation of assets.

Whether an accrual has taken place or not must, in appropriate cases, be judged on the principles of real income theory. In determining the question whether it is hypothetical income or whether real income has materialised or not, various factors will have to be taken into account.

6.1-20 *MERE PRODUCTION DOES NOT AMOUNT TO INCOME UNDER SECTION 2(24)* - Under section 2(*24*) "income" is defined, which postulates that the word "income" has to be given a very wide meaning, but certainly it does not mean mere production or receipt of a commodity which may be converted into money; it certainly cannot be construed to be an income in its normal connotation of the term "income" as envisaged under section 2(*24*)—*Keshkal Co-operative Marketing Society Ltd.* v. *CIT* [1987] 165 ITR 437 (MP).

6.1-21 *SOURCE OF INCOME NEED NOT EXIST IN THE ASSESSMENT YEAR* - It is not necessary that source of income should exist in the assessment year. If there is an income during the previous year, it is chargeable to tax for the following assessment year, even if the source of income does not exist during the assessment year—*Beharilal Mullick* v. *CIT* 2 ITC 328 (Cal.).

6.1-22 *PIN MONEY* - Pin money received by wife for her dress/personal expenses and small savings made by a woman out of money received from her husband for meeting household expenses, is not treated as her income—*R.B.N.J. Naidu* v. *CIT* [1956] 29 ITR 194 (Nag.).

6.1-23 *AWARD RECEIVED BY A SPORTSMAN* - The Central Board of Direct Taxes had considered the question whether the award received by a sportsman, who is not a professional, will be taxable in his hands or not. In the case of a sportsman, who is a professional, the award received by him will be in the nature of a benefit in exercise of his profession and, therefore, will be liable to tax under the provisions of the Income-tax Act.

In the case of non-professional the award received by him will be in the nature of gift† and/or personal testimonial. The question whether a sportsman is a professional or not will depend upon the facts and circumstances of the each case—Circular No. 447, dated January 22, 1986.

6.1-24 *ENTRIES IN BOOKS OF ACCOUNT ARE NOT CONCLUSIVE* - It is well settled that the way in which entries are made by the assessee in his books of account is not determinative of the question whether the assessee has earned any profit or suffered any loss—*State Bank of India* v. *CIT* [1986] 157 ITR 67 (SC). A mere book keeping entry cannot be income unless income has actually resulted—*CIT* v. *Shoorji Vallabhdas & Co.* [1962] 46 ITR 144 (SC).

A receipt which in law cannot be regarded as income cannot become so merely because the assessee erroneously credited it to the profit and loss account—*CIT* v. *India Discount Co. Ltd.* [1970] 75 ITR 191 (SC).

6.1-25 *INCOME OF A STATE IS NOT LIABLE FOR UNION TAXATION* - By virtue of article 289(1) of the Constitution, the property or income of a State is not liable for Union taxation. However, income derived by a statutory road transport corporation from its trading activity cannot be said to be the income of the State under article 289(1) of the Constitution. Consequently, such corporation is not entitled to immunity from tax on its income—*Andhra Pradesh State Road Transport Corpn.* v. *ITO* [1964] 52 ITR 524 (SC).

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†For tax treatment of gift, *see* para 199.

This ruling does not, however, lay down the proposition that if a statutory corporation does not carry on any trading activities, it will automatically become the State as contemplated by article 289 of the Constitution of India.

6.1-26 *AMOUNT COLLECTED FOR SERVICE CHARGES* - Assessee-company carrying on business in television sets, collects certain amount from customers as charges for services to be rendered in future. Such service might be rendered or might not be rendered depending upon the requirement of customers. The assessee, therefore, bifurcates said amount into two items, one as pertaining to amount for relevant year and another pertaining to subsequent years. The amount for the subsequent years is excluded from consideration in determining total income of current year. In such a case, the assessee has a right over the amount deposited only when service is done and till then it cannot be considered as income of the assessee—***CIT*** v. ***Coral Electronics (P.) Ltd.*** [2005] 142 Taxman 481 (Mad.)

6.1-27 *RETENTION MONEY* - Retention money, deducted from the bills of the assessee-contractor for satisfactory completion of work, which is released to the assessee on furnishing bank guarantee, has to be treated as income accrued to the assessee in the year in which bills are raised—***CIT*** v. ***Amarshiv Construction (P.) Ltd.*** [2004] 88 ITD 381 (Ahd.)

6.1-28 *TAX PLANNING DEVICES* - *See* para 525.

6.1-29 *REVENUE RECEIPT v. CAPITAL RECEIPT* - A revenue receipt is taxable as income, unless it is expressly exempt under the Act. On the other hand, a capital receipt is generally exempt from tax, unless it is expressly taxable under section 45—*Cadell Wvg. Mill Co. (P.) Ltd.* v. *CIT* [2001] 116 Taxman 77 (Bom.) [for detailed discussion, *see* para 16].

6.1-30 *BURDEN OF PROOF* - Section 4 of the Act imposes a general liability to tax upon all income. But the Act does not provide that whatever is received by a person must be regarded as income liable to tax. In all cases in which a receipt is sought to be taxed as income, the burden lies upon the Income-tax Department to prove that it is within the taxing provision. Where, however, a receipt is in the nature of income, the burden of proving that it is not taxable because it falls within an exemption provided by the Act, lies upon the assessee—*Parimisetti Seetharamamma* v. *CIT* [1965] 57 ITR 532 (SC).

6.2 ***Receipts which are termed as "income" under section 2(24)*** - Under section 2(*24*), the term "income" specifically includes the following :

6.2-1 *PROFITS AND GAINS* - Income includes profits and gains. For instance, profit generated by a businessman is taxable as "income".

6.2-2 *DIVIDEND* - Income includes "dividend". For instance, dividend declared/paid by a company to a shareholder is taxable as "income" in the hands of shareholders. However, dividend [not being dividend under section 2(*22*)(*e*)] declared/distributed/paid by a domestic company is not taxable in the hands of shareholders. On such dividends, the company declaring dividend will have to pay dividend tax.

6.2-3 *VOLUNTARY CONTRIBUTIONS RECEIVED BY A TRUST* - In the hands of a trust income includes voluntary contributions received by it. This rule is applicable in the following cases :

a. such contribution is received by a trust created wholly or partly for charitable or religious purposes; or

b. such contribution is received by a scientific research association; or

c. such contribution is received by any fund or institution established for charitable purposes and notified under section 10(*23C*)(*iv*)/(*v*); or

d. such contribution is received by any university or other educational institution or hospital referred to in section 10(*23C*)(*vi*)/(*via*).

From the assessment year 2007-08, even voluntary contributions received by university or other educational institution or hospital referred in section 10(*23C*)(*iiiad*) or (*iiiae*) shall be deemed as income.

Provisions illustrated - XY Trust is created for public charitable purposes. On June 10, 2008, it receives a sum of Rs.1 lakh as voluntary contribution (not being with any specific direction) from a business house. Rs.1 lakh would be included in the income of the trust.

6.2-4 ***PERQUISITES IN THE HANDS OF EMPLOYEE*** - Any perquisite or profits in lieu of salary is treated as "income" in the hands of an employee [for detailed discussions *see* para 51].

Provisions illustrated - X is employed by A Ltd. Apart from salary, he has been provided a rent-free house by the employer. The value of perquisite in respect of rent-free house is taxable as "income" in the hands of X.

6.2-5 ***ANY SPECIAL ALLOWANCE OR BENEFIT*** - Any special allowance or benefit specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment is treated as "income".

Provisions illustrated - X is employed by A Ltd. He gets Rs.3,000 per month as conveyance allowance apart from salary. Rs. 3,000 per month is treated as "income" [any amount which is spent for official purposes out of conveyance allowance is exempt under section 10(*14*)].

6.2-6 ***CITY COMPENSATORY ALLOWANCE/DEARNESS ALLOWANCE*** - City compensatory allowance or dearness allowance is treated as "income".

6.2-7 ***ANY BENEFIT OR PERQUISITE TO A DIRECTOR*** - A non-monetary benefit or perquisite is treated as "income" in the hands of the following :

a. if it is given by a company to a director (whole-time or part-time) or a relative of a director; or

b. if it is given by a company to a person who has a substantial interest in the company or a relative of such person.

Relative for this purpose means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual. If a person is beneficial owner of 20 per cent (or more) of equity share capital in a company then such person is known as a person who has substantial interest in the company.

The aforesaid rule is also applicable if any sum is paid by a company in respect of any obligation which, but for such payment, would have been payable by the director or any other aforesaid person.

■ The following propositions should be kept in view :

- The value of any benefit arising to a company-director has to be quantified at an amount that he would have spend otherwise with regard to his personal needs—*CIT* v. *P.R. Ramakrishnan* [1980] 124 ITR 545 (Mad.).
- The words "benefit/perquisite" obtained from company would only include such benefit which company has agreed to provide and the person concerned can claim it as a matter of right. A mere advantage without authority or knowledge of company is not included in it— *CIT* v. *A.R. Adaikappa Chettiar* [1973] 91 ITR 90 (Mad.).
- Even remission of loan taken by the director amounts to chargeable "benefit"— *K.S. Malik* v. *CIT* [1980] 124 ITR 522 (Delhi).
- The amount received by the assessee as a partner in the erstwhile partnership, on separation of some of the partners, cannot be described as a benefit or perquisite having arisen from the business or the exercise of a profession. The amount had been received by the assessee-partner when four of his partners separated from the erstwhile partnership and shares of erstwhile partners in that firm were divided along with the assets—*CIT* v. *Bharatkumar R. Panchal* [2002] 125 Taxman 183 (Guj.).
- The word 'benefit' occurring in section 2(*24*)(*iv*) would mean 'any advantage, gain or improvement in condition' and as such even if the benefit received by the director of the company is of

capital nature, it can also be brought under the term 'value of any benefit' as contemplated under section 2(*24*)(*iv*)—***Diwan Rahul Nanda*** v. ***CIT*** [2008] 25 SOT 454 (Mum.)

Provisions illustrated - The following illustrations are given to have better understanding:

1. X holds 20 per cent equity share capital in A Ltd. A Ltd. repays a loan of Rs.15,000 on behalf of X. Rs.15,000 is treated as "income" of X.

2. B is a director in C Ltd. C Ltd. pays a sum of Rs.17,000 to ITC Hotels on behalf of Mrs. B (payment is made only because B is director). Rs.17,000 is treated as "income" of B.

6.2-8 *ANY BENEFIT OR PERQUISITE TO A REPRESENTATIVE ASSESSEE* - Any non-monetary benefit or perquisite to a representative assessee (like a trustee appointed under a trust) is treated as "income".

Provisions illustrated - X is one of trustees of a charitable trust. The trust provides him a residential accommodation. The perquisite value of the accommodation is treated as "income" of X.

6.2-9 *ANY SUM CHARGEABLE UNDER SECTIONS 28, 41 AND 59* - The following receipts are treated as "income":

Section	*Nature of receipt*	*Example*
28(*ii*)	Compensation or other payments due or received by any person specified in section 28(*ii*)	X is an agent of A Ltd. He gets a compensation of Rs. 20,000 at the time of termination of his agency from A Ltd. Rs. 20,000 is treated as "income" of X.
28(*iii*)	Income derived by a trade, professional or similar association from specific services performed for its members	XY is a trade association of chemical manufacturers. XY gets a payment of Rs. 80,000 from its members for advising them on how to reduce the cost of manufacturing. Rs. 80,000 is treated as "income" of XY.
28(*iiia*)	Profits on sale of a licence granted under the Imports (Control) Order, 1955	A profit of Rs. 2,50,000 is generated by A Ltd. on sale of licence granted under the Imports (Control) Order, 1955. Rs. 2,50,000 is treated as "income" of A Ltd.
28(*iiib*)	Cash assistance received by any person against exports under any scheme of the Government of India	A sum of Rs. 37,000 is received by B Ltd. as cash assistance against exports from the Government of India. It is treated as "income" of B Ltd.
28(*iiic*)	Any duty of customs or excise repaid as drawback to any person against exports	X Ltd. exports goods outside India. During the previous year 2008-09, it gets as duty drawback of a sum of Rs. 95,000. Rs. 95,000 is treated as "income" of X Ltd.
28(*iv*)	The value of any non-monetary benefit or perquisite arising from business or the exercise of a profession	A car owned by a partnership firm is used by one of the partners for private purposes. The perquisite value of the car is "income" in the hands of the partner.
28(*v*)	Any interest, salary, bonus, commission or remuneration received by a partner from a firm	X is a partner in ABC, a partnership firm. He gets Rs.2,000 per month as salary from the firm. Rs. 2,000 per month is treated as "income" of X.
28(*va*)	Any sum received for not carrying out any activity in relation to any business or not to share any know-how, patent, copyright, trademark, etc.	X Ltd. gets a sum of Rs. 60,000 from A Ltd. for not carrying out the activity of selling goods in Agra for a period of two years from June 1, 2009. Rs. 60,000 is treated as "income" of X Ltd.
41 or 59	Deemed profit taxable under section 41 or 59	During the previous year 2003-04, X Ltd. writes off a sum of Rs. 69,000 as bad debt. During the previous year 2008-09, X Ltd. recovers a sum of Rs. 23,000 from the defaulting debtor. Rs. 23,000 is treated as "income" of X Ltd. for the previous year 2008-09.

6.2-10 *CAPITAL GAINS* - Any capital gain under section 45 is treated as "income".

6.2-11 *INSURANCE PROFIT* - Any insurance profit computed under section 44 is treated as "income".

6.2-12 ***INCOME OF BANKING OF A CO-OPERATIVE SOCIETY*** - Income from banking business (including providing credit facilities) carried on by a co-operative society with its members is treated as "income" from the assessment year 2007-08.

6.2-13 ***WINNINGS FROM LOTTERY*** - The following are treated as "income":

1. Winnings from lottery (it includes winnings from prizes awarded to any person by draw of lots or by chance or in any other manner).

2. Winnings from crossword puzzles.

3. Winnings from races including horse races.

4. Winnings from card game and other games of any sort (it includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game).

5. Winnings from gambling.

6. Winnings from betting.

6.2-14 ***EMPLOYEES' CONTRIBUTION TOWARDS PROVIDENT FUND*** - Any sum received by an employer from his employees as employees' contribution to the following is treated as "income" of the employer:

1. Employees' contribution to any provident fund (recognised or unrecognised).

2. Employees' contribution to superannuation fund.

3. Employees' contribution to any fund set up under the provisions of the Employees' State Insurance Act, 1948.

4. Employees' contribution to any other fund for the welfare of employees

Provisions illustrated - Net profit of X Ltd. for the previous year 2008-09 is Rs. 1,86,000. It is calculated after debiting salary to employees: Rs. 5 lakh. Out of Rs. 5 lakh, Rs. 50,000 is employees' contribution towards provident fund. Rs. 50,000 is transferred by X Ltd. to the provident fund account of the employees as follows – Rs. 30,000 before the due date of making such payment and Rs. 20,000 after the due date of such payment. Income of X Ltd. shall be calculated as under:

	Rs.
Net profit as per profit and loss account	1,86,000
Add : Employees' contribution towards provident fund which is treated as "income" of X Ltd.	50,000
Total	2,36,000
Less: Amount paid by X Ltd. on or before the due date of making provident fund payment [see para 130]	30,000
Taxable income of X Ltd.	2,06,000

6.2-15 ***AMOUNT RECEIVED UNDER KEYMAN INSURANCE POLICY*** - Any sum received under a Keyman insurance policy (including bonus) is treated as "income" in the hands of the recipient.

6.2-16 ***GIFT OF EXCEEDING RS. 50,000*** - Amount exceeding Rs. 50,000 received without consideration is taxable as income in a few cases [*see* para 199].

Gross total income

7. As per section 14, income of a person is computed under the following five heads :

1. Salaries

2. Income from house property

3. Profits and gains of business or profession

4. Capital gains

5. Income from other sources.

The following propositions should also be kept in view :

- The aggregate income under these heads is termed as "gross total income". In other words, gross total income means total income [*see* para 8] computed in accordance with the provisions of the Act before making any deduction under sections 80C to 80U [*see* paras 237 to 267].
- The several heads into which income is divided under the Act do not make different kinds of taxes. Tax is always one ; but it may arise under different heads to which the different rules of computation have to be applied. These heads are in a sense exclusive to one another and income which falls within one head cannot be assigned to or taxed under another head—*Karanpura Development Co. Ltd.* v. *CIT* [1962] 44 ITR 362 (SC).
- Income has to be brought under one of the heads under section 14 and can be charged to tax only if it is chargeable under the computing section corresponding to that head—*Nalinikant Ambalal Mody* v. *CIT (supra)* [*see* also para 191].
- The method of book-keeping followed by an assessee cannot decide under which head a particular income should go—*Nalinikant Ambalal Mody* v. *CIT (supra).*

7.1 ***Expenditure incurred in relation to exempt income, not deductible [Sec. 14A]*** - Section 14A has been inserted from the assessment year 1962-63. It provides that no deduction shall be made in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under the Act.

- *Scheme of section 14A* - The scheme of section 14A is given below—

1. The taxpayer generates an income which is exempt from tax.

2. For earning such income some expenditure has been incurred. If no expenditure is incurred for earning income exempt from tax, then section 14A is applicable.

3. Having regard to the accounts of the assessee, the Assessing Officer is not satisfied with the correctness of the claim of the taxpayer in respect of the aforesaid expenditure which is incurred in relation to income exempt from tax.

4. The Assessing Officer shall determine the quantum of such expenditure in accordance with the method prescribed by the Board which is given below—

7.1-1 *EXPENDITURE PERTAINING TO INCOME NOT CHARGEABLE TO TAX - PRESCRIBED MODE* - The expenditure in relation to income which does not form part of total income shall be the aggregate of the following—

1. Expenditure directly relating to such income.

2. Expenditure by way of interest not attributable to any particular income or receipt (proportionate amount to be calculated as follows - $A \times B \div C$, where A is expenditure by way of interest not included in (*1*) (*supra*); B is average value of investment, income from which does not form part of total income on the basis of value appearing in balance sheet on the first and last day of the previous year; C is average total assets in the balance sheet on the basis of first and last day of the previous year (ignoring increase on account of revaluation but including decrease on account of revaluation).

3. Half per cent of the average value of investment which appears in B (*supra*).

7.1-2 *COMPLETED ASSESSMENTS NOT TO BE REOPENED* - Section 14A was introduced retrospectively in order to clarify and state the position of law that any expenditure relatable to income which does not form part of total income cannot be set off against other taxable income. This section was not introduced with prospective effect, as that would have implied that before the introduction of the said provisions, expenditure incurred to earn exempt income was allowable.

Reopening of past completed assessments, having attained finality, on the basis of provisions of section 14A is likely to cause hardship to a large number of taxpayers and would result in increasing avoidable litigation.

A provision is, therefore, made that assessments for the assessment year 2001-02 (or earlier years) will not be reopened under section 147 or 154 whether the original was made under section 143(1) or 143(3) — ***V. Lippalaiah*** v. ***CIT*** [2005] 94 ITD 178 (Hyd.). No action can be taken by the Assessing

Officer or Commissioner in such cases—***Paul John, Delicious Cashew Co.*** v. ***ITO*** [2005] 1 SOT 890 (Coch.).

7.1-3 *JUDICIAL RULING* - One should keep in view the following judicial ruling—

- The expression 'expenditure incurred by assessee in relation to income which does not form part of total income' in section 14A signifies and implies both direct and indirect relationship between expenditure and exempt income—***CIT*** v. ***S.G. Investments & Industries Ltd.*** [2004] 89 ITD 44 (Kol.).
- Tax on dividend is paid by the payer company under section 115-O. The recipient shareholder cannot claim that the dividend income is not exempt (being dividend tax is paid). Consequently interest on capital borrowed to finance investment in shares is not deductible—***Harish Krishnakant Bhatt*** v. ***ITO*** [2004] 91 ITD 311 (Ahd.).
- Section 14A shows clearly that in order to claim deduction of expenditure in relation to a particular income, assessee has to show that said income forms part of total income—***CIT*** v. ***Dakshesh S. Shah*** [2004] 90 ITD 519 (Mum.)(SMC).
- Even if money is borrowed for the purpose of business, it can be disallowed if it is shown that such money is utilized for earning of income not forming part of total income. Hence, the purpose for which money is received or borrowed would be irrelevant if such money is found to be utilized for earning income not forming part of total income—***Maruti Udyog Ltd.*** v. ***CIT*** [2005] 142 Taxman 68.
- If the revenue wants to disallow an expenditure under a provision, then the onus would be on the department to prove that conditions for disallowance are satisfied—***Maruti Udyog Ltd.*** v. ***CIT*** [2005] 142 Taxman 69.
- The provisions of section 14A cannot be applied to the provisions of Chapter VI-A (sections 80A to 80U) where deductions are to be made in computing the total income and in no way that can be compared with the exempted income which does not form part of the total income as provided in sections 10 to 13A—***CIT*** v. ***Tamil Nadu Silk Producers Federation Ltd.*** [2006] 103 TTJ (Chennai) 716.
- If a very small and negligible amount of time, effort and expenditure is required to earn dividend income, disallowance of only a nominal amount is justified—***Jubiliant Enpro Ltd.*** v. ***CIT*** [2007] 12 SOT 194 (Delhi), ***CIT*** v. ***Eicher Ltd.*** [2007] 160 Taxman 80 (Mag.).
- All expenses connected with exempt income have to be disallowed under section 14A regardless of whether they are direct or indirect, fixed or variable and managerial or financial in accordance with law—***Kalpataru Construction Overseas (P.) Ltd.*** v. ***CIT*** [2007] 13 SOT 194 (Mum.). It is not open to Assessing Officer to make disallowance under section 14A according to his own discretion or on *ad hoc* basis and he is statutorily required to compute disallowance in manner provided by sub-sections (2) and (3) of section 14A—***CIT*** v. ***Citicorp Finance (India) Ltd.*** [2007] 12 SOT 248 (Mum.).
- Unless method for working out disallowance of expenditure in case of an indivisible business is prescribed as provided in sub-section (2) of section 14A, no disallowance is permissible—***Dhanlakshmi Bank Ltd.*** v. ***CIT*** [2007] 12 SOT 625 (Coch.).

Total income and tax liability [Sec. 2(45)]

8. Total income of an assessee is gross total income as reduced by amount deductible under sections 80C to 80U [*see* paras 237 to 267]. The scheme of computation of total income and tax liability thereon can be easily understood with the help of the following chart :

COMPUTATION OF INCOME FOR THE ASSESSMENT YEAR		
	Rs.	*Rs.*
1. Income from salaries		
- Income from salary [*see* para 49]	.....	
- Income by way of allowance [*see* para 50]	.....	
- Taxable value of perquisite [*see* paras 51 and 52]	.....	
Gross salary	———	

	Rs.	*Rs.*
Less : Deduction under section 16 :		
- Entertainment allowance [*see* para 50.3]	.....	
- Professional tax [*see* para 53.3]	.....	
Taxable income under the head "Salaries"	———	.....
2. *Income from house property*		
Adjusted net annual value [*see* paras 90 and 91]	.....	
Less : Deductions under section 24 [*see* para 92]	.....	
Taxable income under the head "Income from house property"	———	.....
3. *Profits and gains of business or profession*		
Net profit as per Profit and Loss Account	.....	
Add : Amounts which are debited to P & L A/c but are not allowable as deductions under the Act [*see* paras 142 to 155]	.....	
Less : Expenditures which are not debited to P & L A/c but are allowable as deductions under the Act [*see* paras 105 to 141]	.....	
Less : Incomes which are credited to P & L A/c but are exempt under sections 10 to 13A [*see* paras 38, 39, 40 and 343 to 346] or are taxable under other heads of income	.....	
Add : Those incomes which are not credited to P & L A/c but are taxable under the head "Profits and gains of business or profession"	.....	
Taxable income under the head "Profits and gains of business or profession"	———	.....
4. *Capital gains*		
Amount of capital gains [*see* para 166]	.....	
Less : Amount exempt under sections 54, 54B, 54D, 54EC, 54ED, 54F, 54G and 54GA [*see* paras 179 to 184]	.....	
Taxable income under the head "Capital gains"	———	.....
5. *Income from other sources*		
Gross income [*see* paras 191 and 192]	.....	
Less : Deductions under section 57 [*see* para 200]	.....	
Taxable income under the head "Income from other sources"	———	.....
		———
Total [*i.e.*, (*1*) + (*2*) + (*3*) + (*4*) + (*5*)]		
Less : Adjustment on account of set-off and carry forward of losses		.....
[*see* paras 226 to 232]		———
Gross total income		.....
Less : Deductions under sections 80C to 80U [*see* paras 237 to 267]		.....
		———
Total income or net income liable to tax [rounded off - *see* para 8.2]		.....
		———
Computation of tax liability		
Tax on net income [*see* para 8.1 and Annex 1]		.....
Add : Surcharge		.....
Tax and surcharge		.....
Add: Education cess and secondary and higher education cess		.....
Less : Rebate under sections 86, 89, 90, 90A and 91		.....
Tax		.....
Less : Pre-paid taxes		
Tax paid on self-assessment		.....
Tax deducted or collected at source [*see* paras 405 to 429]		.....
Tax paid in advance [*see* para 381]		.....
		———
Tax liability [rounded off - *see* para 8.3]		.....
		———

8.1 *Tax rates* - Provisions for computation of taxable income are given by the Income-tax Act. Tax rates are not given by the Income-tax Act, but by the Finance Act which is passed by Parliament along with budget for the Central Government every year. For instance, the Finance Act, 2008, provides tax rates in the First Schedule (Parts I, II and III) as follows —

■ *Part I of the First Schedule to the Finance Act, 2008* - It gives income-tax rates for different assessees for the assessment year 2008-09.

■ *Part II of the First Schedule to the Finance Act, 2008* - It gives rates for deduction of tax at source applicable for the financial year 2008-09. To put it differently, if a person is responsible for making a payment on which he is supposed to deduct tax at source during the financial year 2008-09, then tax has to be deducted at source during the financial year 2008-09 at the rates given in Part II of the First Schedule to Finance Act, 2008. However, the rates for tax deduction from salary are given by Part III.

■ *Part III of the First Schedule to the Finance Act, 2008* - It gives tax rates for different assessees for the payment of advance tax during the financial year 2008-09 (*i.e.*, for the assessment year 2009-10). The same rates are applicable for the tax deduction from salary payment during the financial year 2008-09.

Generally, Part III of the First Schedule of a Finance Act becomes Part I of the First Schedule of the subsequent Finance Act. For instance, Part III of the First Schedule to the Finance Act, 2008 will become Part I of the First Schedule to the Finance Act, 2009 (which is yet to be passed by Parliament).

8.1-1 *COMPUTATION OF TAX LIABILITY* - Income-tax shall be calculated according to the rates given in relevant Finance Act. For the assessment year 2009-10, tax is calculated for the purpose of this book at the rates prescribed by the Finance Act, 2008. In this book, these rates are given in Annex 1. Different assessees are taxable at different rates.

■ *Special tax rates* - Tax rates are given in the Finance Act, 2008. Besides these tax rates, some incomes are taxable at special rates given under the Income-tax Act [these rates are given in the book in Annex 1, para 0.1-6]. For instance, long-term capital gains are taxable at the rate of 20 per cent* [sec. 112], winnings from lotteries, races, card games, etc., are taxable at the rate of 30 per cent* [sec. 115BB], royalty income in the hands of a foreign company is taxable at the rate of 10 per cent or 20 per cent or 30 per cent* [sec. 115A(1)(*b*)].

■ *Surcharge* - Surcharge rates for the assessment year 2009-10 are as follows—

❑ *Surcharge - Income-tax* - Surcharge on income-tax for the assessment year 2009-10 is as follows—

Individuals/HUF/AOP/BOI if net income does not exceed Rs. 10 lakh	*Nil*
Individuals/HUF/AOP/BOI if net income exceeds Rs. 10 lakh	10%
Co-operative society, local authority	*Nil*
Firm and domestic company if net income does not exceed Rs. 1 crore	*Nil*
Firm and domestic company if net income exceeds Rs. 1 crore	10%
Artificial juridical person	10%
Foreign company if net income does not exceed Rs. 1 crore	*Nil*
Foreign company if net income exceeds Rs. 1 crore	2.5%

In some cases, marginal relief is available.

❑ *Surcharge - Minimum alternate tax* - Surcharge on minimum alternate tax for the assessment year 2009-10 is as follows—

Domestic company if book profit does not exceed Rs. 1 crore	*Nil*
Domestic company if book profit exceeds Rs. 1 crore	10%
Foreign company if book profit does not exceed Rs. 1 crore	*Nil*
Foreign company if book profit exceeds Rs. 1 crore	2.5%

**Plus* surcharge, education cess and secondary and higher education cess [*see* Annex 1].

The above surcharge is subject to a marginal relief.

❑ *Surcharge - Dividend tax and distribution tax* - Surcharge on dividend tax/distribution tax under section 115-O or under section 115R(2) for distribution of dividend/income during the financial year 2008-09 will be 10 per cent of dividend tax/distribution tax. Surcharge in this case is applicable irrespective of the quantum of dividend/income distributed by a company/mutual fund or irrespective of the income of the company declaring dividend.

❑ *Surcharge - Fringe benefit tax* - Surcharge in the case of fringe benefit tax for the assessment year 2009-10 is as follows—

AOP/BOI if fringe benefits do not exceed Rs. 10 lakh	*Nil*
AOP/BOI if fringe benefits exceed Rs. 10 lakh	10%
Firm, domestic company and artificial juridical person (irrespective of quantum of fringe benefits or income)	10%
Foreign company (irrespective of quantum of fringe benefits or income)	2.5%

■ *Education cess/secondary and higher education cess* - Education cess is 2 per cent of income-tax and surcharge and secondary and higher education cess is 1 per cent of income-tax and surcharge.

■ *Marginal relief* - For the assessment year 2009-10, marginal relief is applicable as follows—

❑ *Marginal relief in the case of individual/HUF/AOP/BOI* - In the case of an individual/HUF/AOP/BOI if net income exceeds Rs. 10,00,000, surcharge is 10 per cent of income-tax. To avoid hardship, in the case of a taxpayer whose income is slightly higher than Rs. 10,00,000, a provision has been made to provide for relief in marginal cases. The said relief is as follows—

If net income exceeds Rs. 10,00,000, the total amount payable as income-tax and surcharge on such income shall not exceed the total amount payable as income-tax on a net income of Rs. 10,00,000 by more than the amount of income that exceeds Rs. 10,00,000.

This marginal relief would be applicable in case net income falls in the following range—

Resident woman	Rs. 10,00,000 - Rs. 10,30,140
Resident senior citizen	Rs. 10,00,000 - Rs. 10,29,470
Any other individual or any HUF/AOP/BOI	Rs. 10,00,000 - Rs. 10,30,590

Note : The above net income ranges would remain valid only if the taxpayer does not have any income which is chargeable to tax at special rate(s) of tax (*e.g.*, long-term capital gain, short-term capital gains under section 111A, lottery income, etc.).

❑ *Marginal relief in the case of a company* - In the case of a domestic company if net income exceeds Rs. 1 crore, surcharge is 10 per cent of income-tax. Likewise, in the case of foreign company if net income exceeds Rs. 1 crore, surcharge is 2.5 per cent of income-tax. This surcharge is also applicable in the case of minimum alternate tax if book profits exceed Rs. 1 crore.

To avoid hardship, in the case of a company whose income is slightly higher than Rs. 1 crore, a provision has been made to provide for relief in marginal cases. The said relief is as follows—

If net income exceeds Rs. 1 crore, the total amount payable as income-tax and surcharge on such income shall not exceed the total amount payable as income-tax on a net income of Rs. 1 crore by more than the amount of income that exceeds Rs. 1 crore.

This marginal relief will be applicable in case net income falls in the following range—

Domestic company	Rs. 100 lakh - Rs. 104.4776 lakh
Foreign company	Rs. 100 lakh - Rs. 101.6949 lakh

Note: The above net income ranges would remain valid only if the company does not have any income which is chargeable to tax at special rate(s) of tax (*e.g.*, long-term capital gain, short-term capital gains under section 111A, lottery income, etc.).

In the case of minimum alternate tax, marginal relief will be applicable in case book profit falls in the following range—

Domestic company	Rs. 100 lakh - Rs. 101.12359 lakh
Foreign company	Rs. 100 lakh - Rs. 100.2785 lakh

■ *Maximum marginal rate of tax* - It is defined by section 2(*29C*) as the rate of income-tax applicable in relation to the highest slab of income in the case of an individual as specified by the relevant Finance Act. For instance, for the assessment year 2009-10, the maximum marginal rate of tax is 33.99 per cent.

■ *Exemption limit or exempted slab* - The amount of the first slab of income which is taxable at *nil* rate is known as exemption limit or exempted slab [*see* Annex 1]. The amount of exemption limit is as follows for different assessees—

	Assessment year 2009-10 Rs.
Individual	
- Resident woman (not being a senior citizen)	1,80,000
- Resident senior citizen (65 years or more)	2,25,000
- Any other individual	1,50,000
Hindu undivided family	1,50,000
Company	*Nil*
Firm	*Nil*
Association of persons or body of individuals	1,50,000
Local authority	*Nil*
Artificial juridical person	1,50,000

The above limit is not applicable in a case where special tax rates are applicable† [these rates are given in Annex 1, para 0.1-6]. For instance, if an individual gets a lottery prize of Rs. 33,000 on March 1, 2009 and he does not have any other income, then Rs. 33,000 is taxable (even if it is below Rs. 1,50,000) at the rate of 30.9 per cent (*i.e.*, Rs. 10,197).

8.2 *Rounding-off of income [Sec. 288A]* - The taxable income shall be rounded off to the nearest multiple of ten rupees and for this purpose any part of a rupee consisting of *paise* shall be ignored and thereafter if such amount is not a multiple of ten, then, if the last figure in that amount is five or more, the amount shall be increased to the next higher amount which is a multiple of ten and if the last figure is less than five, the amount shall be reduced to the next lower amount which is a multiple of ten.

8.3 *Rounding-off of tax [Sec. 288B]* - Any sum payable by an assessee and the amount of refund due, under the provisions of the Act shall be rounded off to the nearest ten rupees (with effect from July 13, 2006).

8-P1 *X (30 years) is a resident. His net income for the assessment year 2009-10 is Rs. 10,30,500 (Situation 1), or Rs. 10,30,800 (Situation 2).*

SOLUTION :

	Situation 1 Rs.	*Situation 2 Rs.*
Income-tax on net income	2,14,150	2,14,240
Add: Surcharge @10%	21,415	21,424
Income-tax and surcharge under normal computation (a)	2,35,565	2,35,664

†*See*, however, paras 186.1 and 186.3.

	Situation 1 Rs.	*Situation 2* Rs.
Computation for marginal relief		
Step 1 - Income-tax on Rs. 10,00,000	2,05,000	2,05,000
Step 2 - Tax @ 100% of income in excess of Rs. 10 lakh	30,500	30,800
Tax under marginal relief computation (b)	2,35,500	2,35,800
Normal tax or tax under marginal relief, whichever is lower [(a) or (b), whichever is lower] (c)	2,35,500	2,35,664
Add: Education cess @ 2% of (c)	4,710	4,713
Add: Secondary and higher education cess @ 1% of (c)	2,355	2,357
Tax liability (rounded off)	2,42,570	2,42,730

8-P2 *Mrs. X (60 years) is resident but not ordinarily resident in India. Her net income for the assessment year 2009-10 is Rs. 10,30,000 (Situation 1), or Rs. 10,30,500 (Situation 2).*

SOLUTION :

	Situation 1 Rs.	*Situation 2* Rs.
Income-tax on net income	2,11,000	2,11,150
Add: Surcharge @10%	21,100	21,115
Income-tax and surcharge under normal computation (a)	2,32,100	2,32,265
Computation for marginal relief		
Step 1 - Income-tax on Rs. 10,00,000	2,02,000	2,02,000
Step 2 - Tax @ 100% of income in excess of Rs. 10 lakh	30,000	30,500
Tax under marginal relief computation (b)	2,32,000	2,32,500
Normal tax or tax under marginal relief, whichever is lower [(a) or (b), whichever is lower] (c)	2,32,000	2,32,265
Add: Education cess @ 2% of (c)	4,640	4,645
Add: Secondary and higher education cess @ 1% of (c)	2,320	2,323
Tax liability (rounded off)	2,38,960	2,39,230

8-P3 *X is resident but not ordinarily resident in India. His date of birth is February 20, 1944. Consequently, he is resident senior citizen for the assessment year 2009-10. His gross income is Rs. 11,15,000 (salary: Rs. 4,00,000, lottery winnings: Rs. 2,27,000 and long-term capital gain: Rs. 4,88,000). He is entitled to a deduction of Rs. 95,000 under sections 80C to 80U.*

SOLUTION :

	Rs.
Salary income	4,00,000
Long-term capital gain	4,88,000
Lottery winnings	2,27,000
Gross total income	11,15,000
Less: Deductions	95,000
Net income	10,20,000
Tax computation under normal provisions	
Tax on lottery winnings of Rs. 2,27,000 @ 30%	68,100
Tax on long-term capital gain of Rs. 4,88,000 @ 20%	97,600

	Rs.
Tax on remaining income of Rs. 3,05,000 (first Rs. 2,25,000: *Nil*, next Rs. 75,000 @ 10%: Rs. 7,500; next Rs. 5,000 @ 20%: Rs. 1,000)	8,500
Tax	1,74,200
Add: Surcharge @ 10%	17,420
Total	1,91,620
Tax computation under marginal relief	
Step 1 - Find out the tax payable if income is Rs. 10,00,000 (it may be assumed that salary is Rs. 3,05,000, lottery winning is Rs. 2,07,000 and long-term capital gain is Rs. 4,88,000):	
Tax on Rs. 3,05,000	8,500
Tax on Rs. 2,07,000 @ 30%	62,100
Tax on Rs. 4,88,000 @ 20%	97,600
Total	1,68,200
Step 2 - To the tax determined on Rs. 10,00,000 under Step 1, add tax @ 100% in respect of income exceeding Rs. 10,00,000 (*i.e.*, Rs. 20,000)	20,000
The aggregate tax is Rs. 1,88,200 (*i.e.*, Rs. 1,68,200 + Rs. 20,000) which is lower than the regular tax of Rs. 1,91,620. Therefore, tax liability will be calculated in this case as follows—	
Tax as computed above	1,88,200
Add: Education cess @ 2%	3,764
Add: Secondary and higher education cess @ 1%	1,882
Tax liability (rounded off)	1,93,850

8-P4 X Ltd. is a domestic company. Net income of the company for the assessment year 2009-10 is Rs. 1.02 crore (Situation 1), or Rs. 1.1 crore (Situation 2). Minimum alternate tax is not applicable as book profit is just Rs. 5 lakh.

SOLUTION :

	Situation 1 Rs. in thousand	Situation 2 Rs. in thousand
Income-tax on net income	3,060	3,300
Add: Surcharge @10%	306	330
Income-tax and surcharge under normal computation (*a*)	3,366	3,630
Computation for marginal relief		
Step 1 - Income-tax on Rs. 1 crore	3,000	3,000
Step 2 - Tax @ 100% of income in excess of Rs. 1 crore	200	1,000
Tax under marginal relief computation (*b*)	3,200	4,000
Normal tax or tax under marginal relief, whichever is lower [(*a*) or (*b*), whichever is lower] (c)	3,200	3,630
Add: Education cess @ 2% of (c)	64	72.6
Add: Secondary and higher education cess @ 1% of (c)	32	36.3
Tax liability	3,296	3,738.9

8-P5 *X Ltd. is a domestic company. It is engaged in the business of dealing in shares. Besides, it has a manufacturing plant situated in Maharashtra. Income of the company for the assessment year 2009-10 is as follows—*

	(Rs. in thousand)
Dealing in shares (computed under the Income-tax Act but after deducting securities transaction tax of Rs. 11,000)	4,00
Income from manufacturing (computed under the Income-tax Act)	6,00
Book profit after deducting securities transaction tax	1,00,70

SOLUTION :

	Rs.
Income from dealing in shares	4,00,000
Income from manufacturing	6,00,000
Net income	10,00,000
Income-tax	3,00,000
Add: Surcharge	*Nil*
Income-tax and surcharge (*a*)	3,00,000
Minimum alternate tax (under normal provisions)	
Tax on book profit of Rs. 1,00,70,000 @ 10%	10,07,000
Add: Surcharge @10%	1,00,700
Tax on book profit and surcharge (*b*)	11,07,700
Minimum alternate tax (under marginal relief)	
Tax on book profit of Rs. 1,00,00,000 @ 10%	10,00,000
Add: 100% of book profit in excess of Rs. 1,00,00,000	70,000
Total (*c*)	10,70,000
Minimum alternate tax (including surcharge) after marginal relief [(*b*) or (*c*) whichever is lower] (*d*)	10,70,000
Normal tax or minimum alternate tax whichever is higher [(*a*) or (*d*) whichever is higher]	10,70,000
Add: Education cess	21,400
Add: Secondary and higher education cess	10,700
Tax liability of the company for the assessment year 2008-09 (*e*)	11,02,100
Less: Tax liability if minimum alternate tax is ignored [(*a*) + EC + SHEC] (*f*)	3,09,000
Tax credit available under section 115JAA(2A)	7,93,100

Agricultural income

9. Agricultural income in India is not chargeable to tax. It is defined by section 2(*1A*). For detailed discussion please refer to paras 278 to 281.

Difference between exemption and deduction

10. If an income is exempt from tax, it is not included in the computation of income. Exemption can never exceed the amount of income. Deduction is generally given from income chargeable to tax. Deduction can be less than or equal to or more than amount of income. If amount deductible is more than the amount of income, the resulting amount will be taken as loss.

Assessment [Sec. 2(8)]

11. Under section 2(*8*), the word "assessment" is defined to include reassessment. In general context the word "assessment" means computation of tax and procedure for imposing tax liability.

Under the Act, there are seven kinds of assessments—self-assessment, provisional assessment, regular assessment, best judgment assessment, reassessment, jeopardy assessment under sections 172 and 174 to 176, and precautionary assessment [for details, *see* paras 362 to 367].

Business [Sec. 2(13)]

12. *See* para 101.

Capital asset [Sec. 2(14)]

13. *See* para 167.

Company [Sec. 2(17)]

14. *See* para 333.

Fair market value [Sec. 2(22B)]

15. Fair market value in relation to a capital asset means the price that the capital asset would ordinarily fetch on sale in the open market on the relevant date. Where, however, such price is not ascertainable, it may be determined in accordance with the prescribed rules.

Capital receipts vs. Revenue receipts

16. Receipts are of two types, *viz.*, capital receipts and revenue receipts. The distinction between the two is vital because capital receipts are exempt from tax unless they are expressly taxable (for instance, capital gains are taxable under section 45, even if they are capital receipts). On the other hand, revenue receipts are taxable unless they are expressly exempt from tax. For instance, incomes exempt under sections 10.

As the Act does not define the terms "capital receipts" and "revenue receipts", one has to depend upon natural meaning of the concepts as well as the decided cases.

According to the *Shorter Oxford English Dictionary*, while the word "capital" means "accumulated wealth employed reproductively", the word "revenue" means "the return, yield, or profit of any lands, property or other important source of income ; that which comes in to one as a return from property or possessions ; income from any source".

The essential difference between capital and revenue is that capital is a fund ; revenue is a flow—*French* v. *Wolf* 160 SO 396, 181 La. 733.

16.1 ***Broad propositions*** - In the light of aforesaid definition and different decided cases, the following broad propositions can be stated :

16.1-1 *CIRCULATING CAPITAL AND FIXED CAPITAL* - A receipt on account of circulating capital is revenue receipt, whereas a receipt on account of fixed capital is capital receipt. Fixed capital is what the owner turns to profit by keeping it in his own possession ; circulating capital is what he makes profit of by parting with it and letting it change matters—*John Smith* v. *Moore* [1922] 12 TC 266 (HL). In other words, fixed capital is one which the owner keeps in his possession for making profits. It may be in the form of tangible assets (*e.g.*, plant, machinery, building) or in the form of intangible assets (*e.g.*, patent rights, commission agency contracts). Circulating capital, on the other hand, is one which is turned over and in the process of being turned over yields income or loss. It is worthwhile to mention that the same asset may be fixed capital in one business and circulating capital in another business and, therefore, the nature of a receipt may vary according to the nature of trade in connection with which it arises.

16.1-2 *RECEIPT IN THE HANDS OF RECIPIENT IS MATERIAL* - In order to determine whether a receipt is capital or revenue in nature, one has to go by its nature in the hands of the recipient. The source from which the payment is made has no bearing on the question—*CIT* v. *Kamal Behari Lal Singha* [1971] 82 ITR 460 (SC). It, therefore, follows that even if the amount is paid (wholly or partly), out of capital, it may partake of the character of a revenue receipt in the hands of the recipient. Payment received on the redemption of debentures, held as investment, is a capital receipt in the hands of the recipient, even if the company makes payment out of its profits.

16.1-3 *PAYER'S MOTIVE IRRELEVANT* - The motive of payer is not relevant while deciding whether a particular receipt is revenue or capital in nature—*P.H. Divecha* v. *CIT* [1963] 48 ITR 222 (SC).

16.1-4 *RECEIPT IN LIEU OF SOURCE OF INCOME* - A receipt in lieu of source of income is a capital receipt. A receipt in lieu of income is revenue receipt. For instance, compensation for loss of employment is a capital receipt, as it is in lieu of source of income†. Likewise, sale proceeds of trees removed from land together with their roots, leaving behind no prospect of regeneration, is a capital receipt as the receipt is in lieu of source of income—*A.K.T.K.M. Vishnudatta Antharjanam* v. *CAIT* [1970] 78 ITR 58 (SC). Where, however, trunks of trees of spontaneous growth are cut so that the stumps are allowed to remain in the land with the bark adhering to the stumps to permit regeneration of the trees, receipts from sale of the trunks would be revenue receipts—*V. Venugopala Varma Rajah* v. *CIT* [1970] 76 ITR 460 (SC). But if the trees have been so cut that they regenerate in course of time the amount of receipt would be revenue receipt—*Maharaja Dharmendra Pratap Narain Singh* v. *State of U.P.* [1980] 121 ITR 806 (All.).

16.1-5 *LUMP SUM PAYMENT* - In order to determine whether a receipt is capital or revenue in nature, the fact that it is a lump sum payment, large payment or periodic payment, is not relevant. It is not necessary that a revenue receipt should be recurring or a capital receipt should be a single receipt.

16.1-6 *NATURE OF RECEIPT UNDER COMPANY LAW OR COMMON LAW IRRELEVANT* - Treatment of a receipt under the company law or general law is not relevant while deciding whether a receipt is capital or revenue in nature under the tax law. Moreover, a particular treatment of a receipt in accounts of the assessee is not conclusive against or in favour of the assessee—*Punjab Distilling Industries Ltd.* v. *CIT* [1965] 57 ITR 1 (SC), *Hoshiarpur Electric Supply Co.* v. *CIT* [1961] 41 ITR 608 (SC). It is the true nature and the quality of the receipt and not the head under which it is entered in the account books that would prove decisive. If a receipt is a trading receipt, the fact that it is not so shown in the account books of the assessee would not prevent the assessing authority from treating it as trading receipt—*Chowringhee Sales Bureau (P.) Ltd.* v. *CIT* [1973] 87 ITR 542 (SC).

16.1-7 *COMPENSATION MEASURED BY ESTIMATED PROFITS* - The mere fact that a compensation is measured by estimated annual profits cannot make the receipt a revenue receipt. There is no relation between the measure that is used for the purpose of calculating a particular result and the quality of the figure that is arrived at by means of the application of that test—*Glenboig Union Fireclay Co. Ltd.* v. *IRC* [1922] 12 TC 427 (HL). It is the quality of payment that is decisive of the character of the payment (rather than the method of the payment or its measure) and makes it fall within capital or revenue—*Senairam Doongarmall* v. *CIT* [1961] 42 ITR 392 (SC).

16.1-8 *INCOME OF WASTING ASSETS* - Profits from capital which is exhausted or consumed during the process of realisation are chargeable to tax—*Coltness Iron Co.* v. *Black* 1 TC 287 (HL). Therefore, income from mines and quarries is not realisation of capital consumed but chargeable to tax as revenue receipt. Thus, the consumption of capital involved in the process of income earning is wholly irrelevant.

16.1-9 *DISALLOWANCE TO PERSON MAKING PAYMENT* - The fact that the amount paid is not allowed as permissible deduction in the assessment of person making payment, cannot affect the character of receipt in the hands of the recipient.

16.1-10 *INSURANCE RECEIPTS* - A receipt under a general insurance policy may be a capital receipt, if the policy relates to a capital asset. Alternatively, it may be a revenue receipt, if the policy relates to circulating asset.

Taxability of the amount paid on settlement of claim by the insurance company depends both on the nature of payment and purpose of insurance.

Where payment is made by an insurance company to compensate for loss of use of any goods in which the assessee does not carry on any business it would be a capital receipt (for example, compensation received for loss of machinery due to fire). Generally, such a capital receipt is not taxable. In some cases, however, such capital receipt is chargeable to tax.

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†It is, however, chargeable to tax as "profits in lieu of service"— *see* para 49.14.

16.1-11 *CHANGES IN RATE OF EXCHANGE OF CURRENCY* - If by virtue of change in exchange rate of currency excess amount is realised by an assessee, it shall be treated as capital receipt if it is kept as an investment ; otherwise it is a revenue receipt—*CIT* v. *Canara Bank Ltd.* [1967] 63 ITR 328 (SC).

16.1-12 *ANNUITIES* - It is often difficult to distinguish whether an agreement is for payment of a debt by instalments or for making annual payments in the nature of income. The court has, on an appraisal of all facts, to assess whether a transaction is commercial in character yielding income or is one in consideration of parting with property for repayment of capital in instalments. No single test of universal application can be discovered for a solution of the problem. The name which the parties may give to a transaction which is the source of the receipt and the characterisation of the receipt by them are of little importance. Where capital is repaid in instalments, it is not liable to tax. But where property is conveyed in consideration of what in truth is annuity payable for a definite or definable period, the annuity is not payment on capital account and is taxable—*National Cement Mines Industries* v. *CIT* [1961] 42 ITR 69 (SC).

16.1-13 *COMPENSATION* - If the assessee himself has treated the payment in his account books as compensation for consideration received or loss of earnings or profits, it is revenue receipt. If, on the other hand, the payment received is towards compensation for extinction partly or fully, of a profit earning source (capital asset), such receipt, not being in the ordinary course of the assessee's business, it must be construed as capital receipt.

16.1-14 *COMPENSATION ON TERMINATION OF AN AGREEMENT* - If it is found that a contract is entered into in the ordinary course of business, any compensation received for its termination would be a revenue receipt, irrespective of the fact whether its performance is to consist of a single act or a series of acts spread over a period. Where, however, a person who is carrying on business, is prevented from doing so by external authority in exercise of a paramount power and is awarded compensation thereof whether the receipt is a capital or revenue receipt will depend upon whether it is compensation for injury inflicted on a capital asset or on stock-in-trade—*CIT* v. *Rai Bahadur Jairam Valji* [1959] 35 ITR 148 (SC).

In *Barr Crombie & Co. Ltd.* v. *IRC* [1947] 15 ITR (Suppl.) 56, the agency was found to be practically the sole business of the assessee, and the receipt of compensation on account of it was accordingly *held* to be a capital receipt, while in *Kelsall Parsons & Co.* v. *IRC* [1938] 21 TC 608, the terminated agency was one of the several agencies held by the assessee and the compensation amount received therefor was held to be a revenue receipt.

The Supreme Court in the case of *CIT* v. *Best & Co. (P.) Ltd.* [1966] 60 ITR 11, held that where compensation is paid for loss of agency on the condition that the assessee will not carry on competitive business for five years, that part of the compensation which is relatable to the loss of the agency is a revenue receipt and that part of compensation which is relatable to the restrictive covenant is capital receipt.

Ordinarily, compensation for loss of agency is regarded as a capital receipt and it is for the department to establish that the impugned case is an exception to this rule—*Karam Chand Thapar & Bros. (P.) Ltd.* v. *CIT* [1971] 80 ITR 167 (SC).

16.1-14a SPECIAL PROVISIONS IN THE ACT TO SUPERSEDE THE AFORESAID PRINCIPLES - The aforesaid principles have been superseded to a very large extent by sections 17 and 28 [for detailed discussion, *see* paras 49.14 and 101.8].

On a combined reading of the aforesaid principles and sections 17(3)(*i*) and 28(*ii*), the following position emerges :

1. Any compensation (or any other payment) due or received in connection with termination of management or office or agency or modification of the terms and conditions relating thereto by the following persons is taxable under section 28(*ii*), even if it is a capital receipt :

a. any person (by whatever name called) managing the whole (or substantially the whole) of the affairs of an Indian company ;

b. any person (by whatever name called) managing the whole (or substantially the whole) of the affairs of a foreign company in India ;

c. any person (by whatever name called) holding an agency in India for any part of the activities relating to the business of any other person.

In the aforesaid case, compensation is taxable under section 28, even if the recipient (*i.e.*, manager, managing director, etc.) is an employee and his regular income is taxable under section 15, or even if he holds an office and regular income is taxable under section 56.

2. Any compensation (or any other payment) due to (or received by) any person in connection with the vesting of the management of any property or business in the Government or a corporation owned or controlled by Government, is taxable under section 28(*ii*). In such case, whether the compensation is a capital receipt or revenue receipt is immaterial.

3. In a case not covered by section 28(*ii*), any compensation due to (or received) by an individual from his employer (or former employer) at or in connection with termination, or modification of terms of employment is taxable as profit in lieu of salary under section 17(*3*)(*i*) and in such case the principles governing capital and revenue receipts are not relevant.

4. Any other compensation for loss of an office which does not fall under section 28(*ii*) or 17(*3*)(*i*) will be governed by the principles specified in para 16.1-14 and tax incidence will be attracted only when the receipt is a revenue receipt. In other words, any other compensation [which does not fall under sections 28(*ii*) and 17(*3*)(*i*)] is not taxable if it is a capital receipt.

16.1-15 ***COMPENSATION FOR REFRAINING FROM COMPETITION*** - Compensation paid for agreeing to refrain from carrying on competitive business in commodities in respect of which an agency was terminated, or for loss of goodwill will *prima facie* be of the nature of a capital receipt—*Gillanders Arbuthnot & Co. Ltd.* v. *CIT* [1964] 53 ITR 283 (SC). Similarly, compensation for restraint on exercise of profession is a capital receipt. However, such compensation is chargeable to tax under section 28(*va*).

16.1-16 ***COMPENSATION FOR ACQUISITION, REQUISITION, DAMAGE OR USE OF ASSESSEE'S ASSET*** - Any compensation (or any other payment) due to (or received by) any person in connection with the vesting of the management of any property or business in the Government (or a corporation owned or controlled by the Government) is taxable under section 28(*ii*), even if it is a capital receipt.

16.1-17 ***SALAMI OR PREMIUM RECEIVED BY LESSOR*** - The real test of a *salami* or premium is whether the amount paid, in a lump sum or in instalments, is the consideration paid by the tenant for being let into possession. When the interest of the lessor is parted with for a price, the price paid is premium or *salami.* But the periodical payments made for the continuous enjoyment of the benefits under the lease are in the nature of rent. The former is a capital receipt and latter is a revenue receipt. But merely because a certain amount paid to the lessor is termed as *salami,* it does not follow that no enquiry can be made to determine whether it has or has not an element of revenue receipt in the shape of royalty or rent. The onus, however, is on revenue to show the aforesaid—*Maharaja Chintamani Saran Nath Sah Deo* v. *CIT* [1971] 82 ITR 464 (SC).

16.1-18 ***EARNEST MONEY/DEPOSIT*** - Earnest deposit or earnest money is distinct and different from advance. It may be that the amounts paid under both counts will be given credit to, if the contract is carried out. But in the case the purchaser fails to carry out the terms of the contract, the legal consequences flowing therefrom regarding the earnest deposit and advance are distinct and different. *Prima facie,* the moment an earnest money or deposit is received, certain legal incidents are attached to it. It is the security received for the due performance of the contract. If the purchaser commits breach of the agreement, earnest money can be forfeited. If, on the other hand, the transaction goes through, the earnest money received will be given credit to, towards the consideration fixed in the agreement.

On the other hand, in case of advance, even if purchaser commits a default, he will be entitled to the refund of the deposit— *CIT* v. *Travancore Rubber & Tea Co. Ltd.* [1991] 90 ITR 508 (Ker.).

16.1-19 ***SUBSIDY*** - Payments in the nature of a subsidy from public funds made to an undertaker to assist in carrying on the undertaker's trade or business are trading receipts. It is not the source from which the amount is paid to the assessee which is determinative of the question whether the subsidy payments are of revenue or capital nature.

If any subsidy is given, the character of the subsidy in the hands of the recipient—whether revenue or capital—will have to be determined by having regard to the purpose for which the subsidy is given. If it is given by way of assistance to the assessee in carrying on of his trade or business, it has to be treated as trading receipt. But, if the scheme is that the assessee will be given refund of sales-tax on purchase of machinery as well as on raw materials to enable the assessee to acquire new plants and machinery for further expansion of its manufacturing capacity in backward area, the entire subsidy has to be treated as a capital receipt in the hands of the assessee—*Sahney Steel & Press Works Ltd.* v. *CIT* [1997] 94 Taxman 368/228 ITR 253 (SC).

16.1-20 *ONUS TO PROVE* - The onus to prove that the amount received represents a revenue receipt is on the department. If, in a given case, the department is able to show it, then the onus shifts to the assessee to rebut it—*Baghapurana Co-operative Marketing Society Ltd.* v. *CIT* [1989] 178 ITR 653 (Punj. & Har.).

16.2 ***Few instances of capital receipts*** - The following are a few instances of capital receipts :

■ *Excess collections by an electricity company* - Contributions collected in excess of actual cost by an electricity company from consumers for installation of electricity service lines were *held* to be a capital receipt—*Hoshiarpur Electric Supply Co.* v. *CIT* [1961] 41 ITR 608 (SC).

■ *Capital sum payable in instalments* - Capital sum payable in instalments is treated as capital receipts—*CIT* v. *Kunwar Trivikram Narain Singh* [1965] 57 ITR 29 (SC).

■ *Sale of loom hours* - Receipt on account of sale of surplus loom hours is a capital receipt—*CIT* v. *Maheshwari Devi Jute Mills Ltd.* [1965] 57 ITR 36 (SC).

■ *License to prospect the land* - Where the licensee is granted the right to enter upon land to prospect, search and mine, quarry, bore, dig and prove all bauxite lying in or within the land and to remove, take away and appropriate samples and specimens of bauxite in reasonable quantities, it was *held* that the rent received by the assessee from the licensee was a capital receipt—*Maharaja Chintamani Saran Nath Sah Deo* v. *CIT* [1961] 41 ITR 506 (SC).

■ *Profits after sale of business* - The assessee-company, though authorised by its memorandum of association to sell and manufacture chemicals, never exercised the said power. It sold its business as a going concern. Due to the purchaser's default in making payment of purchase consideration, it carried on business even after its sale on the purchaser's behalf. It earned profits on two transactions of sale of chemicals. Deciding the question whether the said profits were revenue receipts, it was *held* that the impugned sale was a winding up sale with a view to realising the capital assets of the company and not a sale in the course of business operation ; hence, the receipts were capital in nature—*CIT* v. *West Coast Chemicals & Industries Ltd.* [1962] 46 ITR 135 (SC).

■ *Interest on LC for purchasing machine* - Interest earned on the amount deposited to open letter of credit for purchase of machinery required for setting up the plant is a capital receipt—*CIT* v. *Karnal Co-operative Sugar Mills Ltd.* [2000] 243 ITR 2 (SC).

■ *Damages from supplier of machine* - Receipt of liquidated damages by an assessee from a machinery supplier on account of the delay in supply of machinery, is a capital receipt—*CIT* v. *Saurashtra Cement & Chemicals Industries Ltd.* [2002] 121 Taxman 223/253 ITR 373 (Guj.).

16.3 ***Few instances of revenue receipts*** - The following are a few instances of revenue receipts :

■ *Compensation for loss of a trading asset* - Compensation received in respect of loss of a trading asset or stock-in-trade was *held* to be a revenue receipt—*Shadbolt* v. *Salmon Estate Ltd.* 25 TC 52.

■ *Subsidy from Government* - Subsidy received from Government, under scheme for promotion of industry, by way of refund of sales tax is a revenue receipt—*Kesoram Industries & Cotton Mills Ltd.* v. *CIT* [1991] 191 ITR 518 (Cal.).

■ *Surplus due to reduction in export duty* - Surplus left with seller due to reduction in export duty is a revenue receipt—*General Fibre Dealers Ltd.* v. *CIT* [1970] 77 ITR 23 (SC).

■ *Interest under Land Acquisition Act* - Statutory interest received under section 34 of the Land Acquisition Act is interest for delayed payment of compensation and is, therefore, a revenue receipt liable to tax—*Shamlal Narula* v. *CIT* [1964] 53 ITR 151 (SC).

■ *Termination of sole selling agency* - When the assessee (engaged in a variety of businesses, including the sole selling agency, terminable at will, of A Ltd.), on termination of sole selling agency received compensation for three successive years based upon commission paid in past, it was *held* that compensation received was a revenue receipt—*Gillanders Arbuthnot & Co. Ltd.* v. *CIT*[1964] 53 ITR 283 (SC).

■ *Exchange of capital asset for a perpetual annuity* - Where an owner of an estate exchanges a capital asset for a perpetual annuity, it is ordinarily taxable income in his hands (the position will be different if he exchanges his estate for a capital sum payable in instalments, the instalments when received would not be taxable)—*CIT* v. *Kunwar Trivikram Narain Singh* [1965] 57 ITR 29 (SC).

■ *Interest on refund of estate duty* - Interest on refund of estate duty paid in excess is a revenue receipt—*RM.AR.AR.RM.AR.AR. Ramanathan Chettiar* v. *CIT*[1967] 63 ITR 458 (SC).

■ *Acquisition of land from dealers* - Compensation received by the assessee-company (a dealer in land) from the Government on account of requisition of land belonging to the assessee was held to be a revenue receipt—*Nawn Estates (P.) Ltd.* v. *CIT*[1982] 10 Taxman 292 (Cal.).

■ *Under-charges remaining unclaimed* - Where the assessee, a *del credere* agent of collieries as well as of purchasers of coal used to collect, on his own, from collieries under-charges on account of underloading of railway wagons, amount of such under-charges as remained unclaimed by purchasers of coal, would constitute the assessee's trading receipts—*CIT* v. *Karam Chand Thapar* [1996] 88 Taxman 40/222 ITR 112 (SC).

■ *Forfeiture of security deposit* - Forfeited security deposits would be revenue receipts where they are related to the assessee's trading activity—*CIT* v. *State Trading Corporation* [2000] 112 Taxman 117 (Delhi).

Capital expenditure vs. Revenue expenditure

17. *See* para 141.2.

Method of accounting [Sec. 145]

18. Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" is to be computed in accordance with the method of accounting regularly employed by the assessee.

18.1 ***Types of accounting methods*** - Mainly there are two types of accounting methods—mercantile system and cash system. Under the mercantile system, income and expenditure are recorded at the time of their occurrence during the previous year. For instance, income accrued during the previous year is recorded whether it is received during the previous year or during a year preceding or following the previous year. Similarly, expenditure is recorded if it becomes due during the previous year, irrespective of the fact whether it is paid during the previous year or not. The profit calculated under the mercantile system is profit actually earned during the previous year, though not necessarily realised in cash. In other words, where accounts are kept on mercantile basis, the profits or gains are credited, though they are not actually realised and entries, thus, made really show nothing more than an accrual or arising of the said profits at the material time—*Indermani Jatia* v. *CIT*[1959] 35 ITR 298 (SC).

Under the cash system of accounting, revenue and expenses are recorded only when received or paid. For instance, income received during the previous year is included in taxable income whether it is earned during the previous year or it is earned during a year preceding or following the previous year. Similarly, expenditure is deductible from the taxable income only if it is paid during the previous year, irrespective of the fact whether it relates to the previous year or not. Income under cash system of accounting is, therefore, excess of receipts over disbursements during the previous year.

18.2 ***Choice of accounting method*** - An assessee may select cash or mercantile system of accounting in respect of income chargeable under the heads "Profits and gains of business or

profession" and "Income from other sources". The choice of the method of accounting lies with the assessee but the assessee must show that he has regularly followed the method of accounting chosen by him—*B.C.G.A. (Punjab) Ltd.* v. *CIT*[1937] 5 ITR 279 (Lahore). In other words, once a particular method of accounting is followed by the assessee, he must follow it on a consistent basis.

Only in the year where a change in the method of accounting is introduced for the first time, one has to examine whether the change introduced is meant to be regularly followed or not. When it is found that an assessee has changed his regular method of accounting by another recognized method and he has followed the latter regularly thereafter, it is not open to the Assessing Officer to go into the question of *bona fides* of the introduction and continuance of the change—*Snow White Food Products Co. Ltd.* v. *CIT* [1983] 141 ITR 861/[1982] 10 Taxman 37 (Cal.). One cannot contend that a change has to be supported by cogent reasons showing the *bona fides* of the assessee in so changing the method.

18.3 ***Accounting standards*** - The Central Government has been empowered to prescribe by notification in the Official Gazette, the accounting standards which an assessee will have to follow in computing his income under the head "Profits and gains of business or profession" or "Income from other sources". The Government will consult expert bodies like the Institute of Chartered Accountants of India while laying down such standards. *Vide* Notification No. 9949, dated January 25, 1996, the Government has notified Accounting Standard-I relating to disclosure of accounting policies and Accounting Standard-II relating to disclosure of prior period and extraordinary items and changes in accounting policies (to be followed by the assessee following mercantile system of accounting).

■ *Accounting practice* vis-a-vis *accounting standard* - Accounting practice cannot override any provision of the Act—*Tuticorin Alkali Chemicals & Fertilizers Ltd.* v. *CIT*[1997] 227 ITR 172 (SC). However, provisions of section 145(1) are subject to provisions of section 145(2) which, in turn, provide that accounting standards, as may be notified by Central Government from time to time, are to be followed by any class of assessee or in respect of any class of income and, therefore, notified Accounting Standards are to be followed by an assessee even if these Accounting Standards provide for an accounting treatment contrary to mercantile system of accounting or cash system of accounting as may be regularly followed by the assessee and, to that extent, notified accounting standards are to have precedence—***Western Maharashtra Development Corpn. Ltd.*** v. ***CIT*** [2008] 22 SOT 13 (Pune).

18.4 ***Method of accounting irrelevant in some cases*** - In the case of income chargeable under the heads "Salaries", "Income from house property" and "Capital gains", the method of accounting adopted by the assessee is not relevant in determining its taxable income. For calculating taxable income under the aforesaid heads, one has to follow the statutory provisions of the Income-tax Act which expressly provide whether revenue (or expenditure) is taxable (or deductible) on "accrual" basis or "cash" basis.

18.5 ***Assessment under section 144*** - In the following cases, the Assessing Officer may make a best judgment assessment in the manner provided under section 144 [*see* para 366]—

Case 1	Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee.
Case 2	Where the method of accounting mentioned in para 18.2 *supra* has not been regularly followed by the taxpayer.
Case 3	Where the accounting standards, as notified by the Government, have not been regularly followed by the taxpayer.

Section 145(3) empowers the Assessing Officer to make a best judgment assessment when he is not satisfied about the correctness or completeness of the accounts of the assessee. It is not possible to categorise various types of defects, which may justify rejection of books of account of an assessee on the ground that the accounts are not complete or correct. Each case has to be considered on its own peculiar facts, having regard to the nature of business. Though it is true that the absence of

stock register, in a given situation, may not *per se* lead to an inference that the accounts are incomplete or false, the absence of such a register, coupled with other factor like fall in profits, etc., may lead to an inference that the accounts are not correct—*Action Electricals* v. *CIT* [2002] 258 ITR 188 (Delhi).

Definitions of amalgamation, demerger, infrastructure capital company and infrastructure capital fund

19. The following definitions are given—

19.1 ***Amalgamation [Sec. 2(1B)]*** - *See* para 516.1.

19.2 ***Demerger [Sec. 2(19AA)]*** - *See* para 517.1.

19.3 ***Infrastructure capital company [Sec. 2(26A)]*** - It means such company which makes investments by way of acquiring shares or providing long-term finance to any of the following undertakings or enterprises—

1. An undertaking wholly engaged in the business referred to in section 80-IA(4).

2. An undertaking wholly engaged in the business referred to in section 80-IAB(1).

3. An undertaking wholly engaged in the business of developing and building housing projects referred to in section 80-IB(10).

4. An undertaking wholly engaged in a project for constructing a hotel of not less than three-star category as classified by the Central Government.

5. An undertaking wholly engaged in a project for constructing a hospital with at least one-hundred beds for patients.

19.4 ***Infrastructure capital fund*** - The expression "infrastructure capital fund" means such fund operating under a trust deed (which is registered under the Registration Act), established to raise moneys by the trustees for investment by way of acquiring shares or providing long-term finance to any of the following enterprises or undertakings—

1. An undertaking wholly engaged in the business referred to in section 80-IA(4).

2. An undertaking wholly engaged in the business referred to in section 80-IAB(1).

3. An undertaking wholly engaged in the business of developing and building housing projects referred to in section 80-IB(10).

4. An undertaking wholly engaged in a project for constructing a hotel of not less than three-star category as classified by the Central Government.

5. An undertaking wholly engaged in a project for constructing a hospital with at least one-hundred beds for patients.

Rules of interpretation

20. Interpretation implies interpretating the provisions of the fiscal statute. The task of interpretation is not a mechanical task. It is more than a mere reading of mathematical formula. It is possible that the same word used in different parts of statute may sound differently. It is through task of interpretation that the whole enactment is given a harmonious reasoning.

20.1 ***What is the need for interpretation*** - English literature would have been much poorer if English language could have been such that statute could be drafted with divine precision. However, judiciary cannot simply fold hands and blame draftsman of the enactment. Judiciary must set to work on the interpretational activity of bringing out the true legislative intent.

20.2 ***Interpretation*** v. ***Construction*** - While interpretation is interpretating the provisions of the statute and bringing out of the basic legislative intent behind the enactment, construction of statute stands on a different footing. When provisions of the statute are drafted in such a way that plain interpretation of statutory provisions produces manifestly absurd and unjust result or provisions

are contradicting one-another so that they cannot be harmonised, Court may modify the language used by the Legislature or even do some violence to it, so as to achieve the obvious intention of the Legislature and produce a rational construction—*K.P. Varghese* v. *ITO* [1981] 7 Taxman 13 (SC), *CIT* v. *Sodra Devi* [1957] 32 ITR 615 (SC), *CWT* v. *Hasmatunnisa Begum* [1989] 42 Taxman 133 (SC). So also where the plain literal interpretation of a statutory provision produces a manifestly unjust result which could never have been intended by the Legislature, the Court might fine tune the language used by the Legislature so as to achieve the intention of the Legislature and produce a rational construction—***Narang Overseas (P.) Ltd.*** v. ***ITAT*** [2007] 165 Taxman 558 (Bom.).

20.3 ***What are the different rules of interpretation*** - The following are the different rules of interpretation :

20.3-1 *LITERAL RULE* - Primarily, statute should be interpreted according to the expressions used by it in the statute. If the language of the statute is clear and unambiguous and if two interpretations are not reasonably possible, it would be wrong to discard the plain meaning of the words used in order to meet a possible injustice—*CIT* v. *T.V. Sundaram Iyengar & Sons (P.) Ltd.* [1975] 101 ITR 764 (SC), *Murarilal Mahabir Prasad* v. *B.R. Vad* [1976] 37 STC 77. One of the pillars of statutory interpretation, *viz.*, literal rule, demands, that if the meaning of the statutory interpretation is plain, the courts must apply the same regardless of the result—*CWT* v. *Hasmatunnisa Begum* [1989] 42 Taxman 133 (SC). So long as the provision is free from ambiguity, the words used therein should be given their plain meaning without importing into it any foreign words and without subtracting any words therefrom—*CIT* v. *Champarun Sugar Works Ltd.* [1997] 225 ITR 863 (All.).

When there is a doubt about the meaning of any statutory provision, the provision is to be understood in the sense in which it can harmonise with the subject of the enactment and the object which the Legislature has in view—*CIT* v. *Chandanben Maganlal* [2002] 120 Taxman 38 (Guj.).

20.3-2 *GOLDEN RULE* - If strict literal interpretation leads to an absurd result and object sought to be accomplished would be defeated by such interpretation, then a construction that would avoid such absurdity shall be thought of. The words are modified so as to avoid the absurdity and inconsistency. Under such circumstances a construction which results in equity rather than injustice shall be preferred although it is often said that equity and taxation are strangers—*T.N. Vasavan* v. *CIT* [1991] 99 CTR (Ker.) 103, *Grey* v. *Pearson* [1857] 6 HL Cas. 61. Golden rule is, thus, also known as "*rule of reasonable construction*".

20.3-3 *MISCHIEF RULE* - When a statute is amended or previous enactment is repealed to give place to a new enactment to meet some specific purposes, in such a case regard shall be had to the mischief which was earlier prevailing in the law and now stood rectified.

The following principles enunciated in *Heydon's* case [1584] 3 Co. Rep. 7a, and firmly established, are still in full force and effect :

"that for the sure and true interpretation of all statutes in general (be they penal or beneficial, restrictive or enlarging of the common law), four things are to be discerned and considered : (*1*) what was the common law before the making of the Act ; (*2*) what was the mischief and defect for which the common law did not provide ; (*3*) what remedy Parliament has resolved and appointed to cure the disease of the common-wealth ; and (*4*) the true reason of the remedy. And then, the office of all the judges is always to make such construction as shall suppress the mischief and advance the remedy, and to suppress subtle inventions and evasions for the continuance of the mischief and *pro privato commando,* and to add force and life to the cure and remedy according to the true intent of the makers of the Act *pro bono publico.*"

There is now the further addition that regard must be had not only to the existing law but also to prior legislation and to the judicial interpretation thereof—*Dr. Baliram Waman Hiray* v. *Mr. Justice B. Lentin* [1989] 176 ITR 1 (SC).

20.4 ***Other concepts of interpretation*** - Some other guidelines for interpretation are as follows :

20.4-1 *RULE OF "EJUSDEM GENERIS"* - The maxim *"generalia specialibus non derogant"* is regarded as a cardinal principle of interpretation—*State of Gujarat* v. *Ramjibhai* AIR 1979 SC 1098. The

literal meaning of the expression is that if there is an apparent conflict between two independent provisions of law, the special provision must prevail—*Union of India* v. *Indian Fisheries (P.) Ltd.* [1965] 57 ITR 331 (SC). The general provision, however, controls the cases where the special provision does not apply as the special provision is applicable to the extent of its scope—*South India Corpn. (P.) Ltd.* v. *Board of Revenue* AIR 1964 SC 207. In other words, a special rule controls or cuts down the general provision—*Bengal Immunity* v. *State of Bihar* AIR 1955 SC 661.

20.4-2 *BENEFICIAL TO THE ASSESSEE* - It is necessary to remember that when a provision is made in the context of a law providing for concessional rates of tax for the purpose of encouraging an industrial activity, a liberal construction should be put upon the language of the statute—*CIT* v. *Strawboard Mfg. Co. Ltd.* [1989] 177 ITR 431 (SC). When two views are possible, the view that favours the assessee or is beneficial to him should be followed—*CIT* v. *P.R.S. Oberoi* [1990] 52 Taxman 267 (Cal.), *Shankar Construction Co.* v. *CIT* [1991] 56 Taxman 98 (Kar.).

20.4-3 *RETROSPECTIVE LEGISLATION* - There is a well-settled principle against interference with vested rights by subsequent legislation unless the legislation has been made retrospective expressly or by necessary implication. If an assessment has already been made and completed, the assessee cannot be subjected to reassessment unless the statute permits that to be done—*CED* v. *M.A. Merchant* [1989] 177 ITR 490 (SC). Legislative amendment or enactment is principally concerned with establishment of future rules of conduct. This presumption must be given effect to in the absence of any express intention to operate the law retrospectively— *Maneka Gandhi* v. *Indira Gandhi* AIR 1984 Delhi 428. *See* also *Jagdamba Prasad Lalla* v. *Anandi Nath Roy* AIR 1938 Pat. 337.

20.4-4 *USE OF EXPRESSIONS 'MAY' , 'SHALL', 'AND', 'OR'* - Use of word "may" denotes discretion in complying with the provision of the statute, while "must" or "shall" denotes imperative to comply with statutory provision. Yet, these words may be interpreted, interchangeably. "Shall" or "must" can be interpretated as "may" depending upon the nature and intention of the Legislature. When obligation to exercise a power is coupled with a duty cast upon, or non-performance of provisions of statute would make the purpose null and void, then "may" can be construed as "shall" or "must"—*Ambica Quarry Works* v. *State of Gujarat* AIR 1987 SC 1073, *P.C. Puri* v. *CIT* [1985] 151 ITR 584 (Delhi).

20.4-5 *FINANCE MINISTERS' SPEECH* - The object clause and the Finance Ministers' speech are relevant only when the provision itself is not clear and is ambiguous—*Blue Star Ltd.* v. *CBDT* [1990] 52 Taxman 113 (Bom.). The speech made by the mover of a Bill explaining the reason for the introduction of the Bill can certainly be referred to for the purpose of ascertaining the mischief sought to be remedied by the legislation and the object and purpose for which the legislation is enacted. This is in accord with the recent trend in juristic thought not only in western countries but also in India that interpretation of a statute being an exercise in the ascertainment of meaning, everything which is logically relevant should be admissible—*K.P. Varghese* v. *ITO* [1981] 7 Taxman 13 (SC).

20.4-6 *MARGINAL NOTES* - It is undoubtedly true that the marginal note to a section cannot be referred to for the purpose of construing the section but it can certainly be relied upon as indicating the drift of the section. It cannot control the interpretation of the words of a section particularly when the language of the section is clear and unambiguous but, being part of the statute, it *prima facie* furnishes some clue as to the meaning and purpose of the section—*K.P. Varghese* v. *ITO* [1981] 7 Taxman 13 (SC).

20.4-7 *EXECUTIVE INSTRUCTIONS* - Instructions issued by the Ministry or Department for guidance of its officers are of no assistance in interpreting a taxing statute—*Commercial Corpn. of India Ltd.* v. *ITO* [1993] 201 ITR 348 (Bom.). Instructions are not binding on Commissioner (Appeals), Income-tax Appellate Tribunal, High Court and the Supreme Court. Even an assessee is not bound by the executive instructions issued by CBDT. However, departmental officers/Assessing Officers are bound by such instructions and circulars. The interpretation of the Central Board of Direct Taxes can be considered only as an aid to understanding the intention of Parliament in enacting a section—*Yogendra Chandra* v. *CWT* [1991] 187 ITR 58 (HP).

20.4-8 *SCHEDULES TO ACT* - Schedules to Act cannot override simple and plain provisions of the Act.

20.4-9 *CONSTITUTIONAL VALIDITY* - Any provision of law affecting the rights of individuals, will have to be read in the context of the Indian Constitution. The provisions of law should not contravene the constitutional provisions like the fundamental rights—*CIT* v. *Herekar's Hospital & Maternity Home* [1991] 96 CTR (Kar.) 182.

20.4-10 *CHARGING SECTION* - Charging section has to be construed strictly. If a person has not been brought within the ambit of the charging section by clear words, he cannot be taxed at all—*CWT* v. *Ellis Bridge Gymkhana* [1997] 95 Taxman 143 (SC).

20.4-11 *CATCH PHRASE* - A catch-phrase possibly used as a populist measure to describe some provisions in the Finance Bill in the explanatory memorandum while introducing the Bill in Parliament can neither be determinative of, nor can it camouflage the true object of the legislation—*Sashikant Laxman Kale* v. *Union of India* [1990] 52 Taxman 352 (SC).

20.4-12 *RE-ENACTMENT* - It is very well-recognised rule of interpretation of statutes that where a provision of an Act is omitted by an Act and the said Act simultaneously re-enacts a new provision which substantially covers the field occupied by the repealed provision with certain modification, in that event such re-enactment is regarded having force continuously and the modification or changes are treated as amendment coming into force with effect from the date of enforcement of re-enacted provision—*CIT* v. *Venkateswara Hatcheries (P.) Ltd.* [1999] 103 Taxman 503/237 ITR 174 (SC).

20.4-13 *INCLUSIVE DEFINITION* - It is well-settled that when there is an inclusive definition, ordinarily the ordinary meaning of the words prevails over and above the words of inclusive definition for the purposes of that statute. The scope of an inclusive definition cannot be restricted to those categories only which occur in the definition, but an inclusive definition will extend to so many other things ordinarily falling within the parent expression, which are not talked of in the section—***Aditya Cement Staff Club*** v. ***Union of India*** [2003] 131 Taxman 609 (Raj.).

CHAPTER TWO

Residential status and tax incidence

Residential status - General norms

23. One has to keep in mind the following norms while deciding the residential status of an assessee :

23.1 ***Different taxable entities*** - Section 6 lays down the test of residence for the following taxable entities :

a. an individual ;

b. a Hindu undivided family ;

c. a firm or an association of persons or a body of individuals ;

d. a company ; and

e. every other person.

23.2 ***Different kinds of residential status*** - Assessees 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, *viz.*, (*a*) resident and ordinarily resident, or (*b*) resident but not ordinarily resident. All other assessees (*viz.*, a firm, an association of persons, a company and every other person) can simply be either a resident or a non-resident.

23.3 ***Different residential status in respect of different previous years of the same assessment year not possible [Sec. 6(5)]*** - If a person is resident in a previous year relevant to an assessment year in respect of any source of income, he shall be deemed to be resident in India in the previous year(s) relevant to the same assessment year in respect of each of his other sources of income [*see* problem 24-P9].

23.4 ***Different residential status for different assessment years*** - An assessee may enjoy different residential status for different assessment years. For instance, an individual who has been regularly assessed as resident and ordinarily resident, has to be treated as non-resident in a particular assessment year if he satisfies none of the conditions of section 6(*1*) in that year [*see* para 24.1].

23.5 ***Resident in India and abroad*** - It is not necessary that a person who is resident in India, cannot become resident in any other country for the same assessment year. A person may be resident in more than one country at the same time for tax purposes, though he cannot have two domiciles simultaneously. It is, therefore, not necessary that a person, who is resident in India, will be non-resident for all other countries for the same assessment year.

23.6 ***Onus of proof*** - Whether an assessee is a resident or a non-resident is a question of fact and it is the duty of the assessee to place all relevant facts before the Income-tax authorities—*Rai Bahadur Seth Teomal* v. *CIT* [1963] 48 ITR 170 (Cal.).

In the case of *V.VR. N.M. Subbayya Chettiar* v. *CIT* [1951] 19 ITR 168, the Supreme Court *held* that section 6(*2*) makes a presumption that a Hindu undivided family, a firm or association of persons has to be a resident in India and the onus of proving that they are not residents is on them. However, the burden of proving that an individual or a company is resident in India lies on the department—*Moosa S. Madha & Azam S. Madha* v. *CIT* [1973] 89 ITR 65 (SC).

Residential status of an individual [Sec. 6]

24. An individual may be (*a*) resident and ordinarily resident, (*b*) resident but not ordinarily resident, or (*c*) non-resident.

24.1 ***Resident and ordinarily resident [Sec. 6(1), 6(6)(a)]*** - To find out whether an individual is "resident and ordinarily resident" in India, one has to proceed as follows —

Step 1	First find out whether such individual is "resident" in India.	*See* para 24.1-1
Step 2	If such individual is "resident" in India, then find out whether he is "ordinarily resident" in India. However, if such individual is a "non-resident" in India, then no further investigation is necessary.	*See* para 24.1-2

24.1-1 ***BASIC CONDITIONS TO TEST AS TO WHEN AN INDIVIDUAL IS RESIDENT IN INDIA*** - Under section 6(*1*) an individual is said to be resident in India in any previous year, if he satisfies at least one of the following basic conditions—

Basic condition (a)	He is in India in the previous year for a period of 182 days or more.
Basic condition (b)	He is in India for a period of 60 days or more during the previous year and 365 days or more during 4 years immediately preceding the previous year.

24.1-1a EXCEPTIONS - The aforesaid rule of residence is subject to the following exceptions :

■ *Exception one* - By virtue of *Explanation (a)* to section 6(*1*), the period of "60 days" referred to in (*b*) above has been extended as follows —

Who can take the benefit of extended period	*Extended period*
An Indian citizen who leaves India during the previous year for the purpose of employment outside India [*see* para 24.1-1a[1]] or an Indian citizen who leaves India during the previous year as a member of the crew of an Indian ship	182 days

■ *Exception two* - By virtue of *Explanation (b)* to section 6(*1*), the period of "60 days" referred to in (*b*) above has been extended as follows —

Who can take the benefit of extended period	*Extended period*
Indian citizen or a person of Indian origin [*see* para 24-1-1a[2]] who comes on a visit to India during the previous year	182 days

24.1-1a[1] *Employment outside India - Meaning of* - The requirement is not leaving India for employment but it is leaving India for purposes of employment outside India. Consequently, an individual need not be an unemployed person who leaves India for employment outside India— ***British Gas India (P.) Ltd., In re*** [2006] 155 Taxman 326 (AAR - New Delhi).

For instance, a private sector company in India employs X, an Indian citizen. He leaves India (for the first time) on September 27, 2008 for Tokyo for completing an overseas project of the employer-company. He will come back after 6-7 months. X can take the benefit of the exception given above. Since his total stay in India during the previous year 2008-09 is less than 182 days, he will be non-resident in India for the previous year 2008-09.

24.1-1a[2] *Person of Indian origin* - A person is deemed to be of Indian origin if he, or either of his parents or any of his grand-parents, was born in undivided India. It may be noted that grand parents include both maternal and paternal grand parents.

24.1-2 ***ADDITIONAL CONDITIONS TO TEST WHEN A RESIDENT INDIVIDUAL IS ORDINARILY RESIDENT IN INDIA*** - Under section 6(*6*), a resident individual is treated as "resident and ordinarily resident" in India if he satisfies the following two additional conditions—

Additional condition (i)	He has been resident in India in at least 2 out of 10 previous years [according to basic condition noted above] immediately preceding the relevant previous year.
Additional condition (ii)	He has been in India for a period of 730 days or more during 7 years immediately preceding the relevant previous year.

In brief it can be said that an individual becomes resident and ordinarily resident in India if he satisfies at least one of the basic conditions and the two additional conditions [*i.e., (i)* and *(ii)*].

24.1-3 *OTHER POINTS* - In determining the residential status of an assessee, the following settled propositions have to be borne in mind :

■ *Stay at the same place not necessary* - It is not essential that the stay should be at the same place—*Kinloch* v. *IRC* 14 TC 736. It is equally not necessary that the stay should be continuous. Similarly place of stay or purpose of stay is not material.

■ *Stay in territorial waters* - A stay by an individual on a yacht moored in the territorial waters of India would be treated as his presence in India for the purpose of this section—*Baryard Brown* v. *Burt* 5 TC 667.

■ *Presence for a part of a day* - Where a person is in India only for a part of a day, the calculation of physical presence in India in respect of such broken period should be made on an hourly basis. A total of 24 hours of stay spread over a number of days is to be counted as being equivalent to the stay of one day—*Walkie* v. *IRC* [1952] 1 AER 92. If, however, data is not available to calculate the period of stay of an individual in India in terms of hours, then the day on which he enters India as well as the day on which he leaves India shall be taken into account as stay of the individual in India—*Advance Ruling P. No.7 of 1995, In re* [1997] 90 Taxman 62 (AAR - New Delhi).

24.2 ***Resident but not ordinarily resident [Sec. 6(1), 6(6)(a)]*** - An individual who satisfies at least one of the basic conditions mentioned in para 24.1-1 but does not satisfy the two additional conditions [*i.e.*, conditions (*i*) and (*ii*) mentioned in para 24.1-2], is treated as a resident but not ordinarily resident in India. In other words, an individual becomes resident but not ordinarily resident in India in any of the following circumstances :

Case 1	If he satisfies at least one of the basic conditions [*i.e.*, condition (*a*) or (*b*) of para 24.1-1] but none of the additional conditions [*i.e.*, (*i*) and (*ii*) of para 24.1-2].
Case 2	If he satisfies at least one of the basic conditions [*i.e.*, condition (*a*) or (*b*) of para 24.1-1] and one of the two additional conditions [*i.e.*, (*i*) and (*ii*) of para 24.1-2].

24.3 ***Non-resident*** - An individual is a non-resident in India if he satisfies none of the basic conditions [para 24.1-1]. In the case of non-resident, the additional conditions [*i.e.*, (*i*) and (*ii*) of para 24.1-2] are not relevant.

24.4 ***Rule of residence in brief*** - The Table given below summarises the rule of residence for the assessment year 2009-10—

RULE OF RESIDENCE

Resident and ordinarily resident	*Resident but not ordinarily resident*	*Non-resident*
Must satisfy at least one of the basic conditions and the two additional conditions [*i.e.*, one of (*a*) or (*b*) and both of (*i*) and (*ii*)]	Must satisfy at least one of the basic conditions and one or none of the additional conditions [*i.e.*, one of (*a*) or (*b*) and one or none of (*i*) or (*ii*)]	Should not satisfy any of the basic conditions.

BASIC CONDITIONS AT A GLANCE

In the case of an Indian citizen who leaves India during the previous year for the purpose of employment or who leaves India as a member of the crew of an Indian ship	*In the case of an Indian citizen or a person of Indian origin (who is abroad) who comes to India on a visit during the previous year*	*In the case of any individual (other than mentioned in the cases (1) and (2))*
(1)	(2)	(3)
a. Presence for at least 182 days in India during the previous year 2008-09	*a.* Presence for at least 182 days in India during the previous year 2008-09.	*a.* Presence for at least 182 days in India during the previous year 2008-09.
b. Not functional	*b. Not functional*	*b.* Presence in India for at least 60 days during the previous year 2008-09 and 365 days during 4 years immediately preceding the previous year (*i.e.*, during April 1, 2004 and March 31, 2008).

ADDITIONAL CONDITIONS AT A GLANCE

i. Resident in India in at least 2 out of 10 years immediately preceding the previous year [*i.e.*, he must satisfy at least one of the basic conditions, in 2 out of 10 immediately preceding previous years (*i.e.*, during previous years 1998-99 and 2007-08)].

ii. Presence in India for at least 730 days during 7 years immediately preceding the previous year (*i.e.*, during April 1, 2001 and March 31, 2008).

24-P1 *X, a foreign national (not being a person of Indian origin), came to India for the first time from USA on July 11, 2002. He stayed here for a stretch of 3 years and left for Japan on July 11, 2005. He returned to India on April 10, 2006 and remained here till August 17, 2006, when he went back to USA. He again came back to India on January 30, 2009 at 11.59 p.m. and continued to stay in India thereafter. Determine his residential status for the assessment year 2009-10.*

SOLUTION : For the assessment year 2009-10, financial year 2008-09 is previous year. During the previous year 2008-09, X is in India for a period of 60 days (*i.e.*, January 2009 : 1 + February 2009 : 28 days + March 2009 : 31 days). Moreover, during 4 years immediately preceding the previous year 2008-09, he is in India for 597 days (*i.e.*, 2004-05 : 365 days, 2005-06 : 102 days, 2006-07 : 130 days and 2007-08 : *Nil*). Thus, he satisfies condition (*b*) mentioned in para 24.1-1 (namely, presence of at least 60 days during the previous year and 365 days during 4 years preceding the previous year). He, therefore, becomes resident in India. A resident individual may either be ordinarily resident or not ordinarily resident in India. To determine it, one has to apply the test of two additional conditions mentioned in para 24.1-2.

During 7 years immediately preceding the previous year 2008-09, X is in India for 1227 days and during 10 years immediately preceding the previous year 2008-09, he is resident in India for 5 years as follows :

Year	*Presence in India (number of days)*	*Resident (R) or non-resident (NR)*	*Which of the condition (a) or (b) of para 24.1-1 is satisfied to become resident or non-resident*
2007-08	*Nil*	*NR*	*None*
2006-07	130	*R*	*(b)*
2005-06	102	*R*	*(b)*
2004-05	365	*R*	*(a) as well as (b)*
2003-04	366	*R*	*(a)*
2002-03	264	*R*	*(a)*
2001-02	*Nil*	*NR*	*None*
2000-01	*Nil*	*NR*	*None*
1999-2000	*Nil*	*NR*	*None*
1998-99	*Nil*	*NR*	*None*

Thus, he satisfies one of the basic conditions and the two additional conditions. He will, therefore, be treated as resident and ordinarily resident in India for the assessment year 2009-10. If X comes to India at any time after zero hour on January 30, 2009, he will be non-resident for the assessment year 2009-10.

24-P2 *X, a chief executive of a company had undertaken foreign tour on various occasions for company's work and was out of India for a total number of 225 days during the previous year ending March 31, 2009. He submits his return of income for the assessment year 2009-10 in the status of non-resident. Is he justified ? He visited a foreign country for the first time during May 2007.*

SOLUTION : By virtue of section 6(1)(c), an individual will be resident in India in any previous year if he has been in India for a period of at least 60 days during the previous year and at least 365 days during 4 years preceding the previous year. However, as per *Explanation (a)* where an Indian citizen leaves India for the purpose of employment outside India, the above period of 60 days has been extended to 182 days.

In the given problem, X had left India for purposes of employment outside India. In other words, *Explanation (a)* will be applicable. Accordingly, X will be treated as non-resident for the assessment year 2009-10. Hence, the submission of his return of income for the assessment year 2009-10 in the status of non-resident is justified.

24-P3 *During his 196 days' stay in India in the previous year 2008-09 X, a citizen of U.K. is all the time moving from one place to another. He claims that he is non-resident in India for the assessment year 2009-10 on the following grounds :*

1. *He had never visited India before April 1, 2007.*
2. *During 2008-09, though he is in India for 196 days, he could not spend two consecutive nights at any one place.*
3. *For the assessment year 2009-10, he is resident in U.K. according to the English Income-tax Act. He insists that he cannot be resident of two countries for the same assessment year. Do you agree with him ?*

SOLUTION : The claim of X is not tenable, as he is in India for 196 days during the previous year 2008-09. He satisfies one of the two basic conditions (namely, presence of 182 days or more during the previous year 2008-09) and none of the additional conditions. He is, therefore, resident but not ordinarily resident in India for the assessment year 2009-10. The fact that he could not spend two consecutive nights at any one place is immaterial. Moreover, a person who is resident in India, may become resident of any other country according to the tax laws of that country for the same or a different assessment year.

24-P4 *X, after about 30 years' stay in India, returns to America on January 29, 2006. He returns to India in June 2008 to join an American company as its overseas branch manager. Determine his residential status for the assessment year 2009-10.*

SOLUTION : For the assessment year 2009-10, the year 2008-09 is the previous year. During 2008-09, X is in India for more than 274 days. He is, therefore, resident in India. He is resident in India for 2 years out of 10 years (*i.e.*, 1998-99 to 2007-08), and he has stayed for more than 730 days during the seven years preceding the previous year 2008-09. He is, therefore, resident and ordinarily resident in India for the assessment year 2009-10.

24-P5 *X sets up a new profession on January 14, 2008 and keeps his books of account on the basis of financial year. Though he has never gone out of India, he claims that he is resident and not ordinarily resident for the assessment year 2009-10. For the support of his claim, he submits that he does not fulfil one of the additional conditions (i.e., he is not resident in India for at least 2 out of 10 preceding years), as he has not been assessed as resident during 2 out of the preceding 10 years due to absence of taxable income. Comment on the claim of X and determine his residential status for the assessment year 2009-10.*

SOLUTION : The claim of X is not acceptable. Section 6(6) prescribes additional conditions for deciding whether or not a resident individual is ordinarily resident. These conditions are based upon physical presence in the preceding 7 years and residential status during preceding 10 years. Residential status during preceding 10 years is to be determined, whether or not an individual is assessed as resident in the past. In other words, an individual who does not have taxable income during preceding 10 years, does not become non-resident (in preceding 10 years) merely because of the fact that he was not assessed as resident during these years. Claim of X is, therefore, not justified. As X has never gone out of India, he will satisfy basic as well as additional conditions and, accordingly, he will be resident and ordinarily resident for the assessment year 2009-10.

24-P6 *X is a foreign citizen, not being a person of Indian origin. Determine his residential status for the assessment year 2009-10 on the assumption that during financial years 1994-95 to 2008-09 he was present in India as follows :*

1994-95	*221 days*	*1997-98*	*72 days*
1995-96	*22 days*	*1998-99*	*130 days*
1996-97	*50 days*	*1999-2000*	*340 days*

2000-01	*30 days*	*2004-05*	*100 days*
2001-02	*160 days*	*2005-06*	*182 days*
2002-03	*96 days*	*2006-07*	*85 days*
2003-04	*286 days*	*2007-08*	*280 days*
		2008-09	*86 days*

SOLUTION : For the assessment year 2009-10, financial year 2008-09 is the previous year. During 2008-09, X is in India for a period of 86 days and during four years preceding the previous year 2008-09, he is in India for 647 days. Thus, he satisfies one of the two basic conditions laid down by section 6(*1*) [*i.e.*, condition (*b*) mentioned in para 24.1-1] and, consequently, he becomes resident in India. A resident individual may either be an ordinarily resident or not ordinarily resident. To determine whether X is ordinarily resident or not ordinarily resident, one has to test the two additional conditions as laid down by section 6(*6*)(*a*) [see conditions (*i*) and (*ii*) in para 24.1-2]. Information presented in the Table given below may be used to test the additional conditions :

Year	*Presence in India (number of days)*	*Status*	*Which of condition (a) or (b) [para 24.1-1] is satisfied to become resident or non-resident*
2007-08	280	Resident	(*a*) or (*b*)
2006-07	85	Resident	(*b*)
2005-06	182	Resident	(*a*) or (*b*)
2004-05	100	Resident	(*b*)
2003-04	286	Resident	(*a*) or (*b*)
2002-03	96	Resident	(*b*)
2001-02	160	Resident	(*b*)
2000-01	30	Non-resident	None
1999-2000	340	Resident	(*a*)
1998-99	130	Resident	(*b*)
1997-98	72	Not necessary to determine	
1996-97	50		
1995-96	22		
1994-95	221		

Condition (i) of para 24.1-2 - This condition requires that an individual should be resident in India for at least 2 out of 10 years immediately preceding the relevant previous year. X, in the present case, is resident in India in 9 years out of 10 years (*i.e.*, during 1998-99 to 2007-08, he is resident in India in all the years except 2000-01). He, thus, satisfies this condition.

Condition (ii) of para 24.1-2 - This condition requires that an individual should be present in India for at least 730 days during 7 years immediately preceding the relevant previous year. X is in India for 1189 days during 2001-02 to 2007-08. He, thus, satisfies this condition.

X satisfies one of the two basic conditions and the two additional conditions. He is, therefore, resident and ordinarily resident in India for the assessment year 2009-10.

24-P7 *X, an Indian citizen, who is appointed as Senior Taxation Officer by the Government of Iran, leaves India, for the first time on September 10, 2007 for joining his duties in Iran. During the previous year 2008-09, he comes to India on a visit for 181 days. Determine the residential status of X for the assessment years 2008-09 and 2009-10.*

SOLUTION : During the previous year 2007-08, X is in India for 163 days (and during four years immediately preceding the previous year 2007-08, he was in India for more than 365 days). Though he satisfies one of the conditions laid down in section 6(*1*), yet by virtue of *Explanation* to section 6(*1*), he will be non-resident for the assessment year 2008-09 (an Indian citizen, leaving India for the purpose of employment, will be treated as resident in India only if he has been in India in that year for at least 182 days).

During the previous year 2008-09 (for the assessment year 2009-10), X comes to India for 181 days. Therefore, X does not satisfy one of the conditions laid down by section 6(*1*) [read with *Explanation* to section 6(*1*)]. He will, accordingly, be treated as non-resident in India for the assessment year 2009-10.

24-P8 *X is a foreign citizen (not being a person of Indian origin). Since 1981, he visits India every year in the month of April for 100 days. Find out the residential status of X for the assessment year 2009-10.*

SOLUTION : During the previous year 2008-09, X is in India for 100 days and during 4 years preceding the year 2008-09 (i.e., 2004-05 to 2007-08), he is in India for 400 days. Thus, he satisfies basic condition (b) to become resident in India. To determine, whether a resident individual is ordinarily resident or not ordinarily resident, one has to test two additional conditions as laid down by section 6(6)(a).

Condition (i) of para 24.1-2 - Every year X satisfies basic condition (b), as he is in India for 100 days during the relevant previous year and 400 days during 4 years preceding the previous year. Therefore, he satisfies this condition.

Condition (ii) of para 24.1-2 - X is in India for 700 days during 7 years prior to the previous year 2008-09. He does not satisfy this condition.

X satisfies one of the basic conditions and one of the two additional conditions. He is, therefore, resident but not ordinarily resident in India for the assessment year 2009-10.

24-P9 *X comes to India for the first time on September 1, 2008. On September 15, 2008, he joins a company on monthly salary of Rs. 60,000, as a part-time production consultant (duty hours : 6.30 PM to 9.30 PM). Prior to September 15, 2008, X does not have any source of income. On October 9, 2008, he starts a trading business in computer hardware after obtaining approval of his employer. For the previous year ending March 31, 2009, he has the following income :*

Salary from the part-time employment : Rs. 3,90,000, income from the business of trading in computer hardware in India : Rs. 7,86,000 ; and foreign income from the same business : $ 40,000. Find out the residential status of X for the assessment year 2009-10.

SOLUTION : For the assessment year 2009-10, X has the following sources of income in India :

Sources of income	Previous year	Number of days when X was in India
Salary income	September 15, 2008 to March 31, 2009	198 days
Business income	October 9, 2008 to March 31, 2009	174 days

For the first source of income, X becomes resident in India by satisfying one of the basic conditions. As he comes to India for the first time in 2008, he is unable to satisfy any of the additional conditions. Thus, he is a resident but not ordinarily resident in India for the first previous year.

For the second source of income, X is a non-resident, as he satisfies none of the basic conditions. It may be noted that he is non-resident in India for the business income and resident but not ordinarily resident for the salary income. In view of section 6(5), if a person is resident in India for one of the sources of income, he will be deemed to be resident in India for all other sources of income in the same assessment year. In respect of the assessment year 2009-10, X will, therefore, be regarded as resident but not ordinarily resident for all sources of income.

Residential status of a Hindu undivided family [Sec. 6(2)]

25. A Hindu undivided family (like an individual) is either resident in India or non-resident in India. A resident Hindu undivided family is either ordinarily resident or not ordinarily resident.

25.1 ***When a Hindu undivided family is resident or non-resident*** - A Hindu undivided family is said to be resident in India if control and management of its affairs is wholly or partly situated in India. A Hindu undivided family is non-resident in India if control and management of its affairs is wholly situated outside India.

The table given below highlights the same proposition —

Control and management of the affairs of a Hindu undivided family is —	Residential status of family	Ordinarily resident or not
▪ Wholly in India	Resident	*See* para 25.2
▪ Wholly out of India	Non-resident	—
▪ Partly in India and partly outside India	Resident	*See* para 25.2

Note - In order to determine whether a Hindu undivided family is resident or non-resident, the residential status of the karta of the family during the previous year is not relevant. Residential status of the karta during the preceding years is considered for determining whether a resident family is "ordinarily resident"—*see* para 25.2.

25.1-1 *WHAT IS "CONTROL AND MANAGEMENT"* - Different courts have defined the term "control and management" as follows —

■ *De facto control* - Control and management means *de facto* control and management and not merely the right to control or manage—*CIT* v. *Nandlal Gandalal* [1960] 40 ITR 1 (SC).

■ *Place of control and management* - Control and management is situated at a place where the head, the seat and the directing power are situated. The head and brain is situated where vital decisions concerning the policies of the business, such as, raising finance and its appropriation for specific purposes, appointment and removal of staff, expansion, extension, or diversification of business, etc., are taken—*San Paulo (Brazilian) Railway Co.* v. *Carter* [1886] AC 31 (HL).

■ *Residence of HUF in India* - The mere fact that the family has a house in India, where some of its members reside or the karta is in India in the previous year, does not constitute that place as the seat of control and management of the affairs of the family, unless the decisions concerning the affairs of the family are taken at that place. The mere fact of the absence of karta from India does not make the family non-resident—*Annamalai Chettiar* v. *ITO* [1958] 34 ITR 88 (Mad.).

■ *Broad propositions* - The following propositions can be stated on the basis of the rulings given in *Subbayya Chettiar* v. *CIT* [1951] 19 ITR 163 (SC) and *Narasimha Rao Bahadur* v. *CIT* [1950] 18 ITR 181 (Mad.)—

1. Generally, HUF shall be taken to be resident in India unless control and management of its affairs is situated wholly outside India.

2. HUF may be residing in one place and doing a great deal of business in other place.

3. Occasional visit of a non-resident karta to the place of HUF's business in India would be insufficient to make HUF ordinarily resident in India.

25.2 ***When a resident Hindu undivided family is ordinarily resident in India*** - A resident Hindu undivided family is ordinarily resident in India if the karta or manager of the family (including successive karta) satisfies the following two additional conditions as laid down by section 6(*6*)(*b*) :

Additional condition (a)	Karta has been resident in India in at least 2 out of 10 previous years [according to the basic condition mentioned in para 24.1-1] immediately preceding the relevant previous year
Additional condition (b)	Karta has been present in India for a period of 730 days or more during 7 years immediately preceding the previous year.

If the karta or manager of a resident Hindu undivided family does not satisfy the two additional conditions, the family is treated as resident but not ordinarily resident in India.

25-P1 *The Head Office of XY, a Hindu undivided family, is situated in Hong Kong. The family is managed by Y (since 1980) who is resident in India in only 3 out of 10 years preceding the previous year 2008-09 and he is present in India for more than 729 days during the last 7 years. Determine the residential status of the family for the assessment year 2009-10 if the affairs of the family's business are (a) wholly controlled from Hong Kong, (b) partly controlled from India.*

SOLUTION : If affairs of a Hindu undivided family are controlled from a place outside India, the family will be non-resident. Accordingly XY Hindu undivided family is non-resident for the assessment year 2009-10 under situation (a). Under situation (b), affairs of the family's business are partly controlled from India during the previous year 2008-09. Therefore, the family is resident in India. However, it would be ordinarily resident in India if karta satisfies the following two conditions laid down by section 6(*6*)(b) :

1. He has been resident in India in at least 2 out of 10 years preceding the previous year.

2. He has been present in India for at least 730 days during seven years preceding the previous year.

As the karta is resident in India in 3 out of 10 years preceding the previous year, the family would be resident and ordinarily resident in India for the assessment year 2009-10 in situation (b).

25-P2 *A Hindu undivided family (X is karta, A, B and C are other coparceners) carries on cloth business in Burma. A comes to India and starts a cloth business at Bombay in partnership with some other persons. The capital supplied by A to this firm is found to have come from the family. Subsequently, B joins the firm as partner. Later on another business is started at Benaras with the same persons and one outsider as partner. C joins this firm. The Assessing Officer wants to treat the family as resident on the ground that its coparceners are partners in the firms, financed out of the family funds, and the firms are resident in India. Is the Assessing Officer legally correct ?*

SOLUTION : A case on similar facts was examined by the Supreme Court of India in the case of *CIT* v. *Nandlal Gandalal* [1960] 40 ITR 1, wherein the Court pointed out that both under the Hindu law and under the law of partnership, the Hindu undivided family as such could exercise no control over the management of a firm in which some of its coparceners were partners, even if capital contributed by coparceners was found to have come from the family.

The position in Hindu law with regard to coparcener who has entered into partnership with others is well settled. The partnership is a contractual partnership and is governed by the Indian Partnership Act, 1932. The partnership is between the coparcener individually and partners and not between the family and other partners. This remains so even if the coparcener is accountable to the family for the income received. Thus, control and management over the firm's business lies in the hands of individual coparceners and not in the hands of the family. The Assessing Officer is, therefore, not justified while holding the Hindu undivided family as resident in India.

Residential status of the firm and association of persons [Sec. 6(2)]

26. A partnership firm and an association of persons are said to be resident in India if control and management of their affairs are wholly or partly situated within India during the relevant previous year. They are, however, treated as non-resident in India if control and management of their affairs are situated wholly outside India.

■ The above rule may be summarised as follows —

Place of control	*Residential status*
Control and management of the affairs of a firm/association of persons is —	
❑ Wholly in India	Resident
❑ Wholly outside India	Non-resident
❑ Partly in India and partly outside India	Resident

Note - A firm/an association of persons cannot be "ordinarily" or "not ordinarily resident". The residential status of the partners/members of the firm/association is not relevant in determining the status of the firm/association.

26.1 ***What is "control and management"*** - While in the case of a firm, control and management is vested in partners, in case of an association of persons it is vested in the principal officer. Control and management means *de facto* control and management and not merely the right to control or manage. Control and management is usually situated at a place where the head, the seat and the directing power are situated. Where the partners of a firm are resident in India the normal presumption is that the firm is resident in India. This presumption can, however, be effectively rebutted by showing that the control and management of the affairs of the firm is situated wholly outside India. The onus of rebutting the presumption is on the assessee.

Residential status of a company [Sec. 6(3)]

27. An Indian company is always resident in India. A foreign company is resident in India only if, during the previous year, control and management of its affairs is situated *wholly* in India. In other words, a foreign company is treated as non-resident if, during the previous year, control and management of its affairs is either wholly or partly situated out of India. The table given below highlights the same proposition —

Place of control	*Residential status*	
	An Indian company [for meaning see para 333.2]	*A company other than an Indian company*
Control and management of the affairs of a company [for meaning *see* para 333.1] is —		
■ Wholly in India	Resident	Resident
■ Wholly outside India	Resident	Non-resident
■ Partly in India and partly outside India	Resident	Non-resident

Note - A company can never be "ordinarily" or "not ordinarily resident" in India.

27.1 ***What is control and management*** - In determining residential status of a company, the following broad propositions should be kept in view :

■ *Control and management* - The term "control and management" refers to "head and brain" which directs the affairs of policy, finance, disposal of profits and vital things concerning the management of a company. Control is not necessarily situated in the country in which the company is registered. Under the tax laws a company may have more than one residence—*Unit Construction Co. Ltd.* v. *Bullock* [1961] 42 ITR 340 (HL). The mere fact that a company is also resident in a foreign country, would not necessarily displace its residence in India.

■ *Meeting of board of directors* - Usually control and management of a company's affairs is situated at the place where meetings of board of directors are held. Moreover, control and management referred to in section 6 is central control and management and not the carrying on of day to day business by servants, employees or agents—*Narottam & Pereira Ltd.* v. *CIT* [1953] 23 ITR 454 (Bom.) and *CIT* v. *Bank of China (in-liquidation)* [1985] 23 Taxman 46 (Cal.).

■ *Partial control from outside India* - 'Control and management' does not mean carrying on a day-to-day business. Even a partial control of the company outside India is sufficient to hold a foreign company as a non-resident—***Radha Rani Holdings (P.) Ltd.*** v. ***DIT*** [2007] 16 SOT 495 (Delhi).

Residential status of "every other person" [Sec. 6(4)]

28. Every other person is resident in India if control and management of his affairs is wholly or partly situated within India during the relevant previous year. On the other hand, every other person is non-resident in India if control and management of his affairs is wholly situated outside India.

Relation between residential status and incidence of tax [Sec. 5]

29. Under the Act, incidence of tax on a taxpayer depends on his residential status and also on the place and time of accrual or receipt of income.

29.1 ***Indian income and foreign income*** - In order to understand the relationship between residential status and tax liability, one must understand the meaning of "Indian income" and "foreign income".

29.1-1 *"INDIAN INCOME"* - Any of the following three is an Indian income —

1. If income is received (or deemed to be received) in India during the previous year and at the same time it accrues (or arises or is deemed to accrue or arise) in India during the previous year.

2. If income is received (or deemed to be received) 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.

29.1-2 *FOREIGN INCOME* - If the following two conditions are satisfied, then such income is "foreign income" -

a. income is not received (or not deemed to be received) in India; and

b. income does not accrue or arise (or does not deem to accrue or arise) in India.

29.1-3 ***PROVISIONS IN BRIEF*** - The above provisions may be explained in brief as follows:

Whether income is received (or deemed to be received) in India during the relevant years	*Whether income accrues (or arises or is deemed to accrue or arise) in India during the relevant years*	*Status of the income*
Yes	*Yes*	Indian income
Yes	*No*	Indian income
No	*Yes*	Indian income
No	*No*	Foreign income

29.2 ***Incidence of tax for different taxpayers*** - Tax incidence of different taxpayers is as follows—

Individual and Hindu undivided family			
	Resident and ordinarily resident in India	*Resident but not ordinarily resident in India*	*Non-resident in India*
▪ Indian income†	Taxable in India	Taxable in India	Taxable in India
▪ Foreign income†	Taxable in India	Only two types of foreign incomes (*i.e., Case 1* and *Case 2* given below) are taxable in India Any other foreign income is not taxable in India	Not taxable in India

The following foreign incomes are taxable in the hands of a resident but not ordinarily resident in India—

Case 1 - Business income and business is controlled wholly or partly from India.

Case 2 - Income from profession which is set up in India.

No other foreign income (like salary, rent, interest, etc.) is taxable in India in the hands of a resident but not ordinarily resident taxpayer.

Any other taxpayer (like company, firm, co-operative society, association of persons, body of individual, etc.)		
	Resident in India	*Non-resident in India*
Indian income†	Taxable in India	Taxable in India
Foreign income†	Taxable in India	Not taxable in India

29.3 ***Conclusions*** - The following broad conclusions can be drawn —

1. Indian income - Indian income† is always taxable in India irrespective of the residential status of the taxpayer.

2. Foreign income - Foreign income† is taxable in the hands of resident (in the case of a firm, AOP company and every other person) or resident and ordinarily resident (in the case of an individual or a Hindu undivided family) in India. Foreign income is not taxable in the hands of non-resident in India.

In the hands of resident but not ordinarily resident taxpayer, foreign income is taxable only if it is (*a*) business income and business is controlled wholly or partly from India, or (*b*) professional income from a profession which is set up in India. In any other case, foreign income is not taxable in the hands of resident but not ordinarily resident taxpayers.

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† For meaning of "Indian income" and "foreign income", *see* para 29.1

29.4 *Provisions illustrated* - Different situations are covered in the table given below —

Nature of income	*Reasons*	*Conclusions — Is it taxable in India for the assessment year 2009-10*		
		*If taxpayer is not ordinarily resident**	*If taxpayer is not resident***	*Non-resident*
1. Rental income of Rs. 36,000 is received in India on May 10, 2008 (it may accrue outside India or in India)	It is Indian income. Indian income is always taxable	*Yes*	*Yes*	*Yes*
2. Interest income of Rs. 46,000 accrues in India on March 31, 2009 (it may be received in India or outside India)	It is Indian income. Indian income is always taxable	*Yes*	*Yes*	*Yes*
3. Income of Rs. 56,000 is deemed to be received in India on April 20, 2008 [for meaning of "deemed to be received", *see* para 30.4] (it may accrue outside India or in India)	It is Indian income. Indian income is always taxable	*Yes*	*Yes*	*Yes*
4. Income of Rs. 66,000 is deemed to accrue or arise in India during the previous year 2008-09 [for meaning of "deemed to accrue or arise" *see* para 32] (it may be received in India or outside India)	It is Indian income. It is always taxable	*Yes*	*Yes*	*Yes*
5. Business income / professional income of Rs. 76,000 is received and accrued outside India during the previous year 2008-09. Business is controlled from outside India or profession is set up outside India	It is foreign income. It is taxable in the case of resident and ordinarily resident taxpayer. It is not taxable in the case of a non-resident. Since it is business or profession income and business is controlled from outside India or profession is set up outside India, it is not taxable in the case of resident but not ordinarily resident taxpayer	*Yes*	*No*	*No*
6. In 5 *supra,* suppose business is controlled from India or profession is set up in India	It is foreign income. Since it is business/professional income and the business is controlled from India or profession is set up in India, it is taxable in all cases except non-resident	*Yes*	*Yes*	*No*
7. Rental income or salary income or interest income of Rs. 86,000 is received outside India in the previous year 2008-09 and at the same time it accrues or arises outside India	It is foreign income. It is taxable in the case of resident and ordinarily resident taxpayer. It is not taxable in the case of non-resident. Since it is foreign income which is neither business income nor professional income, it is not taxable in the case of resident but not ordinarily resident	*Yes*	*No*	*No*

*In case of a firm, AOP, company and every other person.

**In case of an individual or a Hindu undivided family.

Nature of income	Reasons	Conclusions—It is taxable in India for the assessment year 2009-10		
		Resident or resident and ordinarily resident*	Resident but not ordinarily resident**	Non-resident
8. Gift† of Rs. 2 lakh received outside India by an individual on November 6, 2008 from a friend.	It is foreign income. It is taxable in the case of resident and ordinarily resident taxpayer. It is not taxable in the case of non-resident. Since it is foreign income which is neither business income nor professional income, it is not taxable in the case of resident but not ordinarily resident	*Yes*	*No*	*No*
9. Gift† of Rs. 1 lakh received in Delhi by an individual on November 30, 2008 from a friend.	It is Indian income. It is taxable	*Yes*	*Yes*	*Yes*
10. Income of Rs. 96,000 earned and received outside India in 2003-04 but later on remitted to India in 2008-09	This income pertains to the previous year 2003-04. It cannot be taxed at the time of remittance in 2008-09	*No*	*No*	*No*

Receipt of income

30. Income received in India is taxable in all cases irrespective of residential status of the assessee.

The following points are worth mentioning in this respect :

30.1 ***Receipt vs. Remittance*** - The "receipt" of income refers to the first occasion when the recipient gets the money under his control. Once an amount is received as income, any remittance or transmission of the amount to another place does not result in "receipt" at the other place—*Keshav Mills Ltd.* v. *CIT*[1953] 23 ITR 230 (SC). For instance, an assessee, after receiving an income outside India, cannot be said to have received the same again when he brings or remits the same to India. The position will remain the same if income is received outside India by an agent of the assessee (may be a bank or some other person) who later on remits the same to India. Income after the first receipt merely moves as a remittance of money. The same income cannot be received by the same person twice, once outside India and once within India.

30.2 ***Cash vs. Kind*** - It is not necessary that income should be received in cash. Income may be received in cash or kind. For instance, value of a free residential house provided to an employee is taxable as salary in the hands of the employee though the income is not received in cash.

30.3 ***Receipt vs. Accrual*** - Receipt is not the sole test of chargeability to tax. If an income is not taxable on receipt basis, it may be taxable on accrual basis.

30.4 ***Actual receipt vs. Deemed receipt*** - It is not necessary that an income should be actually received in India in order to attract tax liability. An income deemed to be received in India, in the previous year, is also included in the taxable income of the assessee.

The Act enumerates the following as income deemed to be received in India :

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*In case of a firm, AOP, company and every other person.

**In case of an individual or a Hindu undivided family.

†If aggregate amount of gift received by an individual/HUF during a financial year exceeds Rs. 50,000, it is taxable as "income". This rule is, however, not applicable if gift is received by an individual from a relative or at the time of marriage or by will—*see* para 199 for detailed discussion.

- Annual accretion (*i.e.*, interest in excess of 9.5 per cent) to the credit balance of an employee in the case of recognised provident fund [*see* paras 56 and 56.1-2].
- Excess contribution of employer (*i.e.*, in excess of 12 per cent of salary) in the case of recognised provident fund [*see* para 56.1-2].
- Transfer balance [*see* para 49.12].
- Contribution made by the Central Government or any other employer in the previous year, to the account of an employee under a notified pension scheme referred to in section 80CCD (applicable from the assessment year 2004-05).
- Tax deducted at source [sec. 198—*see* paras 405 to 427].
- Deemed profit under section 41 [*see* para 156].

30.5 *Receipt by agent* - Receipt of income by a bank, broker or other agent of the assessee, is treated as receipt of income on behalf of the assessee—*Keshav Mills Co. Ltd.* v. *CIT* [1953] 23 ITR 230 (SC). If goods are sent by VPP, income is received at the time of payment by buyer to the Post Office, irrespective of the fact whether buyer directs the goods to be sent by VPP or the seller does so on his own accord. Similarly, where goods are sent by rail and the railway receipt is sent through a bank for being delivered to the purchaser against payment, income is received at time and place of payment to the bank—*CIT* v. *P.M. Rathod & Co.* [1959] 37 ITR 145 (SC).

30.6 *Receipt of income in the case of advance money* - In *CIT* v. *Mysore Chromite Ltd.* [1955] 27 ITR 128, the Madras branch of Eastern Bank Ltd. used to advance to the assessee, in Madras, 80 per cent of the amount of provisional invoice consigned by the assessee and sale proceeds were received from the foreign buyers on behalf of the assessee by Eastern Bank Ltd. in London, which adjusted against the sale consideration. The Supreme Court *held* that the entire price was received in London. The payment of 80 per cent of the amount of provisional invoice by the Madras branch of Eastern Bank Ltd., was not a payment on account of price, but was an advance made by them to their own customer on security of goods covered by the bill of lading. The Court further observed that the price was first received by the Eastern Bank Ltd., London, on behalf of the assessee. Accordingly the Court held that the entire price was received outside India.

30.7 *Receipt in the case of sale by commission agent* - In *CIT* v. *S.K.F. Ball Bearing Co. Ltd.* [1960] 40 ITR 444, the Supreme Court *held* that where a commission agent effected sale and recovered the proceeds in India on behalf of a foreign principal, profits on sale would be received in India, even if the commission agent had remitted a substantial portion of the value of goods to the foreign principal abroad before the actual realisation of sale proceeds in India. Similarly, where a foreign consignor sent goods to an Indian consignee who effected sales in India and collected sale proceeds and after deducting its commission remitted the balance to the foreign consignor, it was *held* that income from sale of goods was received in India by the consignee on behalf of the consignor—*Turner Morrison & Co. Ltd.* v. *CIT* [1953] 23 ITR 152 (SC).

30.8 *Receipt by cheque* - A receipt of cheque is equivalent to receipt of money. In other words, when a cheque, bond or other negotiable instrument is received, the date of receipt is the date when instrument is received and not the date when the instrument is encashed—*Raja Mohan Raja Bahadur* v. *CIT* [1967] 66 ITR 378 (SC), *Gurdas Singh* v. *CIT* [1964] 54 ITR 259 (Punj.). This rule is applicable even if the cheque/instrument was accepted conditionally, provided the cheque is not dishonoured subsequently on presentation for payment.

30.9 *Receipt when cheque is sent by post* - In the absence of an express or implied request by the creditor or an agreement between the parties regarding the sending of cheque by post, the mere posting of cheque would not operate as delivery of the cheque to the creditor. In such a case, receipt would be at the place where the cheque is delivered by the post office to addressee. Where, however, a cheque is sent by post in pursuance of an express/implied agreement/request, the post office would be treated as an agent of the creditor and the receipt would be at the place where cheque is posted—*Azamjahi Mills Ltd.* v. *CIT* [1976] 103 ITR 449 (SC).

▪ *Determining place of payment* - In the case of payment by cheques sent by post the determination of the place of payment would depend upon the agreement between the parties or the course of conduct of the parties. If it is shown that the creditor authorised the debtor either expressly or impliedly to send a cheque by post, the property in the cheque passes to the creditor as soon as it is posted. Therefore, the post office is an agent of the person to whom the cheque is posted if there be an express or implied authority to send it by post—*CIT* v. *Patney & Co.* [1959] 36 ITR 488 (SC).

If there was nothing more, the position in law is that the post office would not become the agent of the addressee—*Shri Jagdish Mills Ltd.* v. *CIT* [1959] 37 ITR 114 (SC).

30.10 ***When sale proceeds are received in kind*** - If sale proceeds or payment is received in the form of immovable property, the date of receipt of income is the date when conveyance is executed—*CIT* v. *Kameshwar Singh* [1933] 1 ITR 94 (PC). On the other hand, if sale proceeds/payment is received in the form of movable property, the date of receipt of income is the date when the movable asset is received. In case of sale of trading assets for fully paid shares in another company, date of realisation of income is the date of allotment of shares—*Gold Coast Selection Trust Ltd.* v. *Humphrey* [1949] 17 ITR (Suppl.) 19 (HL). These propositions are applicable even if the assets (movable, immovable or shares) are neither realised nor realisable till later.

30.11 ***Mere book entry is not sufficient*** - To constitute a receipt of anything there must be a person to receive and a person from whom he receives, and something received by the former from the latter. A mere entry in an account which does not represent such a transaction does not prove any receipt, whatever else it may be worth—*Gresham Life Assurance Society* v. *Bishop* [1902] AC 287 (HL). When, however, amount due to an assessee is credited on his instruction to an account in the books of the payer, such credit amounts to receipt by assessee.

Moreover, entry in balance sheet does not amount to receipt of income [*Explanation 1* to sec. 5].

30.12 ***Burden of proving*** - The burden of proving that any income is received by an assessee in India is on the revenue—*CIT* v. *Bikaner Trading Co. Ltd.* [1970] 78 ITR 12 (SC).

30.13 ***Question of fact*** - The question regarding place of receipt of income is a question of fact.

Accrual of income

31. Income accruing in India is chargeable to tax in all cases irrespective of the residential status of the assessee. The words "accrues" and "arises" are used in contradistinction to the word "receive". Income is said to be received when it reaches the assessee ; when the right to receive the income becomes vested in the assessee, it is said to accrue or arise—*CIT* v. *Ashokbhai Chimanbhai* [1965] 56 ITR 42 (SC).

One should keep in view the following broad propositions :

31.1 ***"Accrual" is generally unconditional*** - Income has been said to "accrue" when there is a right to payment and when there is unconditional liability on behalf of the payer to pay it to the taxpayer—*H. Liebes & Co.* v. *CIR* CCA 90 F.2d.932, 936. If it not dependent upon happening of some contingency, the right or obligation may be classified as "accrued"—*Helvering* v. *Russian Finance & Construction Corp.* CCA, 77 F.2d.324, 327.

In other words, a liability depending upon a contingency is not a debt *in praesenti* or *in futuro* till the contingency happens. But if it is a debt, the fact that the amount has to be ascertained does not make it any the less a debt if the liability is certain and what remains is only the quantification of the amount—*CIT* v. *Shri Goverdhan Ltd.* [1968] 69 ITR 675 (SC).

31.2 ***Income is said to accrue when it becomes due*** - Income can be said to accrue when it is due. Postponement of date of payment has a bearing only insofar as the time of payment is concerned, but it does not affect the accrual of income—*Morvi Industries Ltd.* v. *CIT* [1971] 82 ITR 835 (SC). However, income "accrues" to the taxpayer at the time it becomes due only where there is reasonable expectancy that the right will be converted into money or its equivalent—*Franklin County Distilling Co.* v. *CIR* CCA 6, 125 F.2d 800, 804, 805. A mere claim to a profit or a liability is not sufficient to make the profit accrue—*CIT* v. *Associated Commercial Corpn.* [1963] 48 ITR 1 (Bom.).

31.3 ***Accrual of business profit*** - The concept of accrual of profit of a business involves its determination by the method of accounting at the end of the accounting year. If profits accrue to the assessee directly from the business the question whether they accrue day by day or at the close of the year of account has at best an academic significance, but when upon ascertainment of profit the right of a person to a share therein is determined, the question assumes practical importance, for it is only on the right to receive profits or income, profits accrue to that person. In case of partnership, where accounts are to be made at stated intervals, right of a partner to demand his share of profits does not arise until the contingency which gives rise to that right has arisen—*CIT* v. *Ashokbhai Chimanbhai* [1965] 56 ITR 42 (SC).

Where under a contract, income arises on rendering of a year's service and is linked to annual profits, no income can accrue before the year end—*E.D. Sassoon & Co. Ltd.* v. *CIT* [1954] 26 ITR 27 (SC). Where the managing agency agreement provides for payment of commission at the end of the year, commission will accrue to managing agents only thereafter—*Cotton Agents Ltd.* v. *CIT* [1960] 40 ITR 135 (SC).

31.4 ***It is incorrect to state that profits do not accrue until actually computed*** - Unless the right to profits comes into existence, there is no accrual of profit. If, however, there is *right to receive* profit, the tax incidence cannot be suspended merely because profits are not actually computed—*CIT* v. *K.R.M.T.T. Thiagaraja Chetty & Co.* [1953] 24 ITR 525 (SC).

It is, thus, true that the accrual of income does not depend upon its ascertainment or the accounts cast by the assessee. The accounts may be made up at a much later date.

It is not a universal rule that in respect of a single venture spread over a period of years, profits accrue only when the accounts of that venture are closed by the assessee. However, where the assessee himself treats a transaction spread over a number of years as a single venture, returns income from such venture only at the end of it and the accounts maintained by the assessee does not show any relevant details for finding the profit at the end of each year, the profit from such transaction will accrue only at the end of the transaction—*Chinnathambi Rowther & Co.* v. *CIT* [1975] 99 ITR 490 (Mad.).

31.5 ***If income is taxable at the time of accrual, it cannot be taxed on receipt basis*** - If a particular income is taxable on accrual basis, it is not possible for the Assessing Officer to ignore the accrual and thereafter to tax it as the income of another year on the basis of receipt—*Laxmipat Singhania* v. *CIT* [1969] 72 ITR 291 (SC). This rule is, however, subject to exceptions provided by sections 15(*c*) and 45(5).

31.6 ***Accrual of business income in the case of composite business*** - In case of composite business, *i.e.*, in the case of a person who is carrying on a number of businesses, it is always difficult to decide as to the place of accrual of profits and their apportionment *inter se*. For instance, where a person carries on manufacture, sale, export and import it is not possible to say that the place where the profits accrue to him is the place of sale. The profits received relate firstly to his business as manufacturer, secondly to his trading operations, and thirdly to his business of import or export. Profit or loss has to be apportioned between these businesses in a business-like manner and according to the well established principles of accountancy. In such cases, the profits attributable to manufacturing business are said to accrue or arise at the place where manufacturing operation is being done and profits which arise by reason of sale are said to arise at the place where the sales are made and the profits in respect of import/export business are said to arise at the place where the business is conducted—*CIT* v. *Ahmedbhai Umarbhai & Co.* [1950] 18 ITR 472 (SC).

31.7 ***Place where property in goods passes decides accrual of profit in the case of sale of goods*** - In the case of sale of goods, profit arises at a place where the property in goods passes to the purchaser—*Seth Pushalal Mansinghka (P.) Ltd.* v. *CIT* [1967] 66 ITR 159 (SC).

■ *Retaining control over goods till destination* - Where, for instance, the seller retains his control over goods sold by taking bill of lading in his name and property in goods passes only at destination (*i.e.*, outside India), the profits embedded in the transaction arise outside India—*CIT* v. *Mysore Chromite*

Ltd. [1955] 27 ITR 128 (SC). Where seller retains control over goods by obtaining bill of lading, not with an intention of withdrawing goods from contract but for securing contract price, property may pass either forthwith subject to seller's lien or conditional on performance by buyer of his part of contract.

■ *Place of contract of sale and place of sale are different* - In cases where the contracts of sale are made in one place and the sales take place in another, the profits should be apportioned ; a part of the profits accrue at a place where the income producing contracts for sale are made and a part at the place where contracts are performed or sales are actually effected—*see CIT* v. *A.S.T.F. Rodriguez & Co.* [1951] 20 ITR 247 (Mad.) and *CIT* v. *Union Tile Exporters* [1969] 71 ITR 453 (SC).

■ *Goods sent by rail* - Where goods are sent by rail consigned to self, income accrues at place of delivery of goods—*CIT* v. *P.M. Rathod & Co.* [1959] 37 ITR 145 (SC). Where goods are sent by VPP, income accrues at the place where goods are delivered on payment to postal authorities.

■ *Ascertained goods* - In the case of specific goods in a deliverable state, whose sale is an unconditional one, the property in the goods passes to the buyers at the place where the contract of sale is made—*Chhaganlal Savchand* v. *CIT* [1966] 62 ITR 133 (Bom.).

■ *Unascertained goods* - In the case of sale of unascertained goods, the sale takes place at the place where the property in the goods passes to the purchaser. Sections 18 to 23 of the Sale of Goods Act only come into play if there is no agreement between the parties. If it is possible to infer from the contract itself the place and the time when the property in the goods was to pass, there is no scope for pressing the Sale of Goods Act into service—*Binod Mills Co. Ltd.* v. *CIT* [1966] 62 ITR 424 (All.).

31.8 ***Accrual of profit in the case of forward contract*** - In the case of speculative forward contract, profits accrue at the place where the contract is made—*Rupajee Ratnachand* v. *CIT* [1955] 28 ITR 282 (AP).

31.9 ***Selling agents' commission accrues at a place where sales are effected*** - Selling agents' commission accrues at the place where sales are effected. If, however, contract of sale is made in one place and the sale takes place at another place, a part of selling agents' commission accrues at the place where contract is made—*CIT* v. *Union Tile Exporters* [1969] 71 ITR 453 (SC).

31.10 ***Commission payable for other services accrues at the place where service is rendered*** - Normally commission payable to managing director accrues at the place where duties of managing director are performed—*Shoorji Vallabhdas & Co.* v. *CIT* [1960] 39 ITR 775 (SC). If commission is payable to the managing director at a percentage of net profit, the entire commission accrues at the place where service is performed, even if a part of the profit arises outside India—*see K.R.M.T.T. Thiagaraja Chetty & Co.* v. *CIT* [1953] 24 ITR 535 (SC). Similarly, remuneration of a director accrues at the place of rendering service—*Lakshmipat Singhania* v. *CIT* [1969] 72 ITR 291 (SC). Commission payable for rendering other services accrues at the place where services are rendered—*Kathiawar Coal Distributing Co.* v. *CIT* [1958] 34 ITR 182 (Bom.).

31.11 ***Interest accrues where money is lent*** - In case of a money-lending transaction, the place of accrual of interest would be the place where the money is actually lent, irrespective of where it came from, since, without actual advance, no commission or interest accrues or arises. The actual place of user of the money may not have a bearing in deciding the situs. Moreover, money-lending transaction is not comparable to the business of manufacturing and sale of goods and it is not possible to extend the doctrine of apportionment to a case of money-lending—*C.G. Krishnaswami Naidu* v. *CIT* [1966] 62 ITR 686 (Mad.).

31.12 ***Interest in the case of compulsory acquisition*** - Under section 34 of the Land Acquisition Act, the right to recover interest arises the moment the owner is deprived of his property under the Land Acquisition Act. The rate at which he is entitled to interest is also specified. The owner of property after his dispossession under section 17 of the Land Acquisition Act is deprived of the income from the same. Therefore, it is obvious that the benefit which he was to acquire from the property or land was benefit accruing every year which is compensated by way of interest under section 34. The interest is definitely accruing each year and is payable as such after the possession

is taken from the owner. Therefore, only the interest relating to a particular previous year is assessable in the corresponding assessment year—*CIT* v. *Dr. Sham Lal Narula* [1972] 84 ITR 625 (Punj. & Har.), *Joyanarayan Panigrahi* v. *CIT* [1974] 93 ITR 102 (Ori.), *CIT* v. *Santi Devi* [1983] 139 ITR 489 (Cal.).

31.13 ***No profit arises on the valuation of closing stock*** - It is a misconception to think that any profit "arises out of the *valuation* of closing stock". Valuation of unsold stock at the close of an accounting period is a necessary part of the process of determining the trading result of that period and can in no sense be regarded as the "source" of such profits, nor can the place where such valuation is made be regarded as the *situs* of their accrual—*Chainrup Sampatram* v. *CIT* [1953] 24 ITR 481 (SC).

31.14 ***Profit does not accrue in transfers between head office and branch office*** - If a branch office situated outside India sends goods to its head office in India at an invoice price (which includes a margin of profit), the entire profit accrues at the head office where goods are sold. In such a case, profit does not accrue or arise at the branch office because one man cannot trade with himself—*Ram Lal Bechairam* v. *CIT* [1946] 14 ITR 1 (All.).

31.15 ***Dividends accrue at the place where the register of members is kept*** - Dividends declared by a non-Indian company accrue or arise at the place where the register of members is kept—*Kusumben D. Mahadevia* v. *CIT* [1963] 47 ITR 214 (Bom.). On the other hand, dividend paid by an Indian company outside India is always deemed to accrue or arise in India by virtue of section 9(1)(*iv*) [*see* para 32.6].

31.16 ***Damages accrue when the amount is decreed or admitted*** - Damages for breach of contract accrue when the amount is decreed or admitted. Time of making payment is not relevant—*CIT* v. *Associated Commercial Corpn.* [1963] 48 ITR 1 (Bom.).

31.17 ***Commission payable on passing of audited accounts accrues only on the date of meeting*** - If commission is to be paid on passing of audited accounts in the general meeting of shareholders of the company paying commission, commission can accrue to the recipient only on the date of said meeting—*see J.P. Shrivastava & Sons* v. *CIT* [1965] 57 ITR 624 (SC).

31.18 ***Profit on devaluation arises in the year of devaluation*** - Profit on devaluation arises in the year in which currency is devalued.

31.19 ***Share of profit from a resident firm accrues or arises in India*** - Share of profit from a resident firm accrues or arises in India. It, therefore, follows that a non-resident partner of a resident firm is not entitled to exclude from his share of income of the firm, determined under section 182, income accruing or arising to the firm outside India—*Rm. Ramanathan Chettiar* v. *CIT* [1970] 78 ITR 10 (SC).

31.20 ***Profit on mortgage sale arises on the date of confirmation of sale*** - Where a mortgagee purchases the mortgaged property in Court sale and thus realises the amount due, the profits must be deemed to have arisen on the date of confirmation of the sale, and not on the date of decree or date of actual sale—*Raja Raghunandan Prasad Singh* v. *CIT* [1933] 1 ITR 113 (PC).

31.21 ***Mesne profit*** - Mesne profit is taxable in the year in which such profits are determined—*P. Mariappa Gounder* v. *CIT* [1998] 232 ITR 2 (SC).

31.22 ***Question as to source of income is not relevant*** - The question as to the source of the income is not relevant for the purpose of ascertaining whether the income accrues or arises in India, because section 5(2) provides that all income "from whatever source derived" is to be included in the total income of a non-resident assessee if the income accrues or arises in India during the relevant years—*Performing Right Society Ltd.* v. *CIT* [1977] 106 ITR 11 (SC).

31.23 ***Question of fact/law*** - The question whether, on given facts, certain income can be said to have accrued to a taxpayer is a question of law—*CIT* v. *Jai Parkash Om Parkash Co. Ltd.* [1964] 52 ITR 23 (SC). On the other hand, the question as to what income has accrued is a question of fact—*CIT* v. *Western India Engg. Co.* [1971] 81 ITR 712 (Guj.).

Income deemed to accrue or arise in India [Sec. 9]

32. Certain income is deemed to accrue or arise in India under section 9, even though it may actually accrue or arise outside India. Section 9 applies to all assessees irrespective of their residential status and place of business. The categories of income which are deemed to accrue or arise in India are as under :

Nature of income	*From whom income is received*	*Payer's source of income*	*Whether income is deemed to accrue or arise in India in the hands of recipient*	*For detailed discussion, see para given below*
Income from business connection in India			Yes	32.1
Income from any property, asset or source of income in India			Yes	32.2
Capital profit on transfer of a capital asset which is situated in India			Yes	32.3
Income from salary if service is rendered in India			Yes	32.4
Income from salary (not being perquisite/allowance) if service is rendered outside India, the employer is Government of India and the employee is a citizen of India			Yes	32.5
Income from salary if service is rendered outside India (not being a case stated above)			No	
Dividend paid by the Indian company			Yes	32.6
Interest	Government of India	Any	Yes	32.7
Interest	A person resident in India	Borrowed capital was used by the payer of interest for carrying on business/profession outside India or earning any income outside India	No	32.7
		Borrowed capital used by the payer of interest for any other purpose	Yes	32.7
Interest	A person non-resident in India	Borrowed capital was used by the payer of interest for carrying on business/profession in India	Yes	32.7
		Borrowed capital used by the payer of interest for any other purpose	No	32.7
Royalty/fees for technical services	Government of India	Any	Yes	32.8 and 32.9
Royalty/fees for technical services	A person resident in India	Payment is relatable to a business or profession or any other source carried by the payer outside India	No	32.8 and 32.9
		Payment is relatable to any other source of income	Yes	32.8 and 32.9
Royalty/fees for technical services	A person non-resident in India	Payment is relatable to a business or profession or any other source carried by the payer in India	Yes	32.8 and 32.9
		Payment is relatable to any other source of income	No	32.8 and 32.9

32.1 ***Income from business connection [Sec. 9(1)(i)]*** - The following conditions should be satisfied—

- *Condition One* - The taxpayer has a "business connection" in India.
- *Condition Two* - By virtue of "business connection" in India, income actually arises outside India.

If the above two conditions are satisfied, income which arises outside India because of "business connection" in India is deemed to accrue or arise in India.

A business connection involves a relation between a business carried on by a non-resident which yields profits or gains and some activity in India which contributes to the earning of these profits or gains. A business connection can arise between a non-resident and a resident if both of them carry on business and if the non-resident earns income through such a connection—*CIT* v. *Ashok Jain* [2002] 121 Taxman 328 (Delhi) (Mag.). It predicates an element of continuity between the business of the non-resident and the activity in India : a stray or isolated transaction is not normally regarded as business connection.

Business connection may take several forms : it may include carrying on a part of main business of the non-resident through an agent, or it may merely be a relation between the business of the non-resident and the activity in India which facilitates or assists the carrying on of that business. The expression "business connection" postulates a real and intimate relation between the trading activity carried on outside India and the trading activity within India, the relation between the two contributing to the earning of income by the non-resident in his trading activity—*CIT* v. *R.D. Aggarwal & Co.* [1965] 56 ITR 20 (SC). The matter in which one has a right of interference comes within the ambit of the expression "business connection"—*Barendra Prosad Roy* v. *ITO* [1973] 91 ITR 82 (Cal.). An isolated transaction between a non-resident and a resident in India without any course of dealings such as might fairly be described as business connection does not attract section 9. There is no question of continuing business relation when a person purchases machinery or other goods abroad and uses them in India and earns profit—*CIT* v. *Fried Krupp Industries* [1981] 128 ITR 27 (Mad.). Where, however, there is a continuity of business relationship between the person in India who helps to make the profits and the person outside India who receives and realises the profit, such relationship does constitute a business connection—*Anglo French Textile Co. Ltd.* v. *CIT* [1953] 23 ITR 101 (SC). In each such case whether there is a business connection from or through which income arises or accrues must be determined upon the facts and circumstances of that case—*Blue Star Engg. Co. (Bom.)(P.) Ltd.* v. *CIT* [1969] 73 ITR 283 (Bom.).

32.1-1 ***WHAT IS BUSINESS CONNECTION AS DEFINED IN THE ACT*** - It includes a profession connection. It includes a person acting on behalf of a non-resident and who performs any one or more of the following —

- *Activity one* - He exercises in India an authority to conclude contracts on behalf of the non-resident (it does not cover the activity of only the purchase of goods or merchandise for the non-resident).
- *Activity two* - He has no such authority but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident.
- *Activity three* - He habitually secures order in India (mainly or wholly) for the non-resident or for non-residents under the same management.

Where a business is carried on in India through a person referred to in Activity one, two or three (*supra*) only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India.

32.1-1a INDEPENDENT BROKERS/AGENTS ARE EXCLUDED - The "business connection", shall not include cases where the non-resident carries on business through a broker, general commission agent or any other agent of an independent status, provided that such a person is acting in the ordinary course of his business.

Where a broker, general commission agent or any other agent works (mainly or wholly) on behalf of a non-resident or other non-residents under the same management, he shall not be deemed to be a broker, general commission agent or an agent of an independent status.

32.1-3 ***OPERATIONS NOT TAKEN AS BUSINESS CONNECTIONS*** - The following operations do not amount to business connection by virtue of specific provisions in the Act :

32.1-3a WHERE ALL OPERATIONS ARE NOT CARRIED OUT IN INDIA [EXPLANATION (a) TO SEC. 9(1)(i)] - If all business operations are not carried out in India, the income of the business deemed to accrue or arise in India shall be only such part of income as is reasonably attributable to the operations carried out in India.

The apportionment of profits should be on a rational basis and should not be arbitrary—*Bikaner Textile Merchants Syndicate Ltd.* v. *CIT* [1965] 58 ITR 169 (Raj.).

■ The Assessing Officers shall compute the advertising income in the cases of the foreign telecasting companies (FTC) which are not having any branch office or permanent establishment in India or are not maintaining country-wise accounts, by adopting presumptive profit rate of 10 per cent of the gross receipts meant for remittance abroad or the income returned by such companies, whichever is higher*—Circular No. 742, dated May 2, 1996 and Circular No. 765, dated March 15, 1998. The Board has, however, withdrawn Circular No. 742 with effect from the assessment year 2002-03—*Circular No. 6/2001*, dated March 3, 2001†.

32.1-3b PURCHASE OF GOODS FOR EXPORT [EXPLANATION (b) TO SEC. 9(1)(i)] - In the case of non-resident no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export.

Where the assessee, a non-resident, carried on business in readymade garments in Japan and he had an arrangement with a commission agent in India to purchase readymade garments on his behalf and export them to him, the assessee's case was covered by clause (*b*) of *Explanation* to section 9(1)(*i*) and not by clause (*a*) thereof and, therefore, the assessee was not liable to be taxed on any income deemed to accrue or arise from conversion of materials purchased for the purpose of export—*CIT* v. *N.K. Jain* [1994] 206 ITR 692/77 Taxman 13 (Delhi).

32.1-3c COLLECTION OF NEWS AND VIEWS [EXPLANATION (c) TO SEC. 9(1)(i)] - No income shall be deemed to accrue or arise in the case of a non-resident engaged in the business of running a news agency or of publishing newspapers, magazines or journals from activities confined to collection of news and views in India for transmission out of India.

32.1-3d SHOOTING OF CINEMATOGRAPH FILM IN INDIA [EXPLANATION (d) TO SEC. 9(1) (i)] - In the case of a non-resident no income shall be deemed to accrue or arise in India through or from operations which are confined to the shooting of any cinematograph film in India, if such non-resident is either an individual, who is not a citizen of India, or a firm which does not have any partner who is a citizen of India or who is a resident in India, or a company which does not have any shareholder who is a citizen of India or is resident in India.

32.1-4 ***CLARIFICATION FROM BOARD*** - The following clarifications given by the Central Board of Direct Taxes *vide* Circular Nos. 23 (dated July 23, 1969) and 163 (dated May 29, 1975) would be found useful in deciding questions regarding the applicability of the provisions of section 9 in certain specific situations :

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*It is applicable even in respect of pending assessments.

†The total income of FTCs from advertisements shall now be determined by the Assessing Officers in accordance with the other provisions of the Act, in relation to the assessment year 2002-03 and the subsequent assessment years. In case, accounts for Indian operations are not available, the provisions of rule 10 may be invoked. Where the FTC is a resident of a country with which India has a Double Taxation Avoidance Agreement (DTAA), its business income (including receipts from advertisement) can be taxed only if it has a permanent establishment in India. Therefore, the taxability of a FTC in this regard shall be determined on the facts and circumstances of each case. Taxation of FTCs which are residents of countries with which India does not have a DTAA, shall be governed by the provisions of section 5, read with section 9.

32.1-4a NON-RESIDENT EXPORTER SELLING GOODS FROM ABROAD TO INDIAN IMPORTER - No liability will arise on accrual basis to the non-resident on the profits made by him where the transactions of sale between the two parties are on a principal-to-principal basis. In all cases, the real relationship between the parties has to be looked into on the basis of agreement existing between them but where :

a. the purchases made by resident are outright on his own account ;

b. the transactions between the resident and the non-resident are made at arm's length and at prices which would be normally chargeable to other customers ;

c. the non-resident exercises no control over the business of the resident and sales are made by the latter on his own account ; or

d. the payment to the non-resident is made on delivery of documents and is not dependent in any way on the sales to be effected by the resident,

it can be inferred that the transactions are on the basis of principal-to-principal.

■ A question may arise in the above type of cases whether there is any liability of the non-resident under section 5(1)(*a*) on the basis of receipt of sale proceeds including the profit in India. If the non-resident makes over the shipping documents to a bank in his own country which discounts the documents and sends them for collection to the bankers in India, the non-resident will not be liable to tax on the profit arising out of the sales on receipt basis. Even if the shipping documents are not discounted in the foreign country, but are handed over in India against payment or acceptance, no portion of the profits will be chargeable to tax under the Act, if this is the only operation carried on in India on behalf of the non-resident.

32.1-4b NON-RESIDENT COMPANY SELLING GOODS FROM ABROAD TO ITS INDIAN SUBSIDIARY - A question may arise whether the dealings between a non-resident parent company and its Indian subsidiary can at all be regarded as being on a principal-to-principal basis since the former would be in a position to exercise control over the affairs of the latter. In such a case, if the transactions are actually on a principal-to-principal basis and are at arm's length and the subsidiary company functions and carries on business on its own, instead of functioning as an agent of the parent company, the mere fact that the Indian company is a subsidiary of the non-resident company will not be considered a valid ground for invoking section 9 for assessing the non-resident.

32.1-4c SALE OF PLANT AND MACHINERY TO AN INDIAN IMPORTER ON INSTALMENT BASIS - Where the transaction of sale and purchase is on a principal-to-principal basis and the exporter and the importer have no other business connection, the fact that the exporter allows the importer to pay for the plant and machinery in instalments will not by itself render the exporter liable to tax on the ground that the income is deemed to arise to him in India. The Indian importer will not, in such a case, be treated as an agent of the exporter for the purposes of assessment.

32.1-4d FOREIGN AGENTS OF INDIAN EXPORTERS - A foreign agent of an Indian exporter operates in his own country and no part of his income arises in India. His commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. Such an agent is not liable to income-tax in India on the commission.

32.1-4e NON-RESIDENT PERSON PURCHASING GOODS IN INDIA - A non-resident will not be liable to tax in India on any income attributable to operations confined to purchase of goods in India for export. Where a resident person acts in the ordinary course of his business in making purchases for a non-resident party, he would not normally be regarded as an agent of the non-resident under section 163. But, where the resident person is closely connected with the non-resident purchaser and the course of business between them is so arranged that the resident person gets no profits or less than the ordinary profits which might be expected to arise in that business, the Assessing Officer is empowered to determine the amount of profits which may reasonably be deemed to have been derived by the resident person from that business and include such amount in the total income of the resident person.

32.1-4f SALES BY A NON-RESIDENT TO INDIAN CUSTOMERS EITHER DIRECTLY OR THROUGH AGENTS - Where a non-resident allows an Indian customer facilities of extended credit for payment, there would be no assessment merely for this reason, provided that (*i*) the contracts to sell were made outside India, and (*ii*) the sales were made on a principal-to-principal basis.

- Where a non-resident has an agent in India and makes sales directly to Indian customers, section 9 will not be invoked, even if the resident pays his agent an overriding commission on all sales to India, provided that (*i*) the agent neither performs nor undertakes to perform any service, directly or indirectly, in respect of these direct sales and making of these sales can, in no way, be attributed to the existence of the agency or to any trading advantage or benefit accruing to the principal from the agency, (*ii*) the contracts to sell are made outside India, and (*iii*) the sales are made on a principal-to-principal basis.
- Where a non-resident's sale to Indian customers accrue through the services of an agent in India, the assessment in India of the income arising out of the transaction will be limited to the amount of profit which is attributable to the agent's services, provided that (*i*) the non-resident principal's business activities in India are wholly channelled through his agent, (*ii*) the contracts to sell are made outside India, and (*iii*) the sales are made on a principal-to-principal basis. While assessing profits, allowance will be made for the expenses incurred, including the agent's commission in making the sales. If the agent's commission fully represents the value of the profit attributable to his service, it should *prima facie* extinguish the assessment.
- Where a non-resident principal's business activities in India are not wholly channelled through his agent in India, the assessment in India will be on the sum total of the amount of profit attributable to his agent's activities in India and the amount of profit attributable to his own activities in India, *less* the expenses incurred in making the sales.

32.2 ***Income through or from any property, asset or source of income in India [Sec. 9(1)(i)]***- Income through or from any property, asset or source of income in India is deemed to accrue or arise in India. The term "source" means a real source of income. The term "property" does not refer to merely house property but it includes any tangible movable or immovable property. The term "asset" includes all intangible rights and, consequently, interest, dividends, patent and copyright royalties, rents, etc., will find room in the four corners of the term "asset".

> ***Provisions illustrated*** - X Ltd. a foreign company, owns a property in Mumbai. It is given on rent (rent being 2,000 US dollar per month) to B Ltd. another foreign company. The two companies are non-resident in India. The agreement is made outside India. Rent is payable in foreign currency outside India. As per agreement rent is accrued outside India.
>
> As the property is situated in India, rent of the property will deemed to be earned in India.

32.3 ***Income through the transfer of capital asset situated in India [Sec. 9(1)(i)]*** - Any capital gain, within the meaning of section 45 [*see* para 166], earned by a person by transfer of any capital asset situated in India, is deemed to accrue or arise in India.

32.4 ***Income under the head "Salaries" [Sec. 9(1)(ii)]*** - Income chargeable to tax under the head "Salaries" is deemed to accrue or arise in India if it is earned in India. Income chargeable under the head "Salaries" payable for service rendered in India is regarded as income earned in India.

Any salary payable for rest period or leave period which is preceded and succeeded by service in India, will also be regarded as salary earned in India.

32.5 ***Salary payable abroad by the Government to a citizen of India [Sec. 9(1)(iii)]*** - Salary received by Indian nationals from the Indian Government, in respect of services rendered out of India, is deemed to accrue or arise in India. By virtue of section 10(7), any allowance or perquisite paid abroad is, however, fully exempt from tax.

32.6 ***Dividend paid by an Indian company [Sec. 9(1)(iv)]*** - Any dividend paid by an Indian company outside India is deemed to accrue or arise in India. In the case of a company other than an Indian company, dividend shall be deemed to accrue or arise at a place where register of

members is kept—*Kusumbai D. Mahadevia* v. *CIT* [1963] 47 ITR 214 (Bom.). The following points should be noted —

1. Dividend [not being dividend under section 2(*22*)(*e*)] declared, distributed or paid by a domestic company during June 1, 1997 and March 31, 2002 or after March 31, 2003 is not taxable in the hands of shareholders.

2. Only dividend "paid" is covered by section 9(1)(*iv*) — ***Pfizer Corpn.*** v. ***CIT*** [2003] 129 Taxman 459 (Bom.).

32.7 ***Income by way of interest [Sec. 9(1)(v)]†*** - Interest income of the following types are deemed to accrue or arise in India :

32.7-1 ***RECEIVED FROM GOVERNMENT*** - Interest received from the Central Government or any State Government is deemed to accrue/arise in India in the hands of recipients.

32.7-2 ***RECEIVED FROM RESIDENT*** - Interest received from a resident shall be deemed to accrue/arise in India in the hands of recipient in all cases except in the following :

a. interest received from a resident in respect of any debt incurred, or any money borrowed and used by the payer of the interest, for the purpose of a business or profession carried on by him outside India ; and

b. interest received from a resident in respect of any debt incurred, or any money borrowed and used by the payer of interest for the purposes of making or earning any income from any source outside India.

It may be noted that where money borrowed by a resident for the purposes of a business or profession carried on by him outside India are actually used for any other purpose, interest payable thereon is deemed to accrue or arise in India. Similarly, interest payable on money borrowed by a resident for purposes of making or earning any income from any source outside India is deemed to accrue or arise in India if the money is actually used for any purpose in India.

32.7-3 ***RECEIVED FROM A NON-RESIDENT*** - Interest received from a non-resident shall be deemed to accrue/arise in India in the hands of recipient if it is in respect of any debt incurred, or money borrowed and used, for purposes of a business or profession carried on by the payer in India.

It may be noted that interest received from a non-resident in respect of any debt incurred, or money borrowed and used, for the purposes of making or earning any income from any source, other than the business or profession carried on by him in India, is not to be deemed to accrue or arise in India.

Provision illustrated - X is non-resident in India. Only Indian income is taxable in the hands of X in India. During the previous year 2008-09, he receives interest on different dates as given below. In all these cases, interest is received outside India. If in these cases, interest accrues or arises in India, then it will be Indian income and taxable in India. Conversely, if in these cases, interest does not deem to accrue or arise in India, it will become foreign income which will not be taxable in the hands of X, who is non-resident—

Date	Nature of interest received by X	Whether deemed to accrue or arise in India	Whether taxable in India in the hands of X
April 10, 2008	Rs. 10,50,000 is received from the Government of India	Yes	Yes
May 1, 2008	Rs. 9,00,000 is received from A Ltd. (resident in India) and A Ltd. has utilized the capital borrowed from X for carrying on business or profession outside India or earning any income outside India	No	No
May 10, 2008	Rs. 2,00,000 is received from B Ltd. (resident in India) and B Ltd. has utilized the capital borrowed from X for carrying on business or profession in India or earning any income in India	Yes	Yes

Date	Nature of interest received by X	Whether deemed to accrue or arise in India	Whether taxable in India in the hands of X
June 1, 2008	Rs. 7,00,000 is received from C Ltd. (non-resident in India) and C Ltd. has utilized the capital borrowed from X for carrying on business or profession in India	Yes	Yes
June 10, 2008	Rs. 3,00,000 is received from D Ltd. (non-resident in India) and D Ltd. has utilized the capital borrowed from X for carrying on business or profession outside India or earning any income outside India or earning income (not being business or professional income) in India	No	No

32.8 ***Income by way of royalty [Sec. 9(1)(vi)]***† - Under clause (*iv*) of section 9(1), royalty income of the following types will be deemed to accrue or arise in India in the hands of recipients :

a. royalty received from the Central Government or any State Government ;

b. royalty received from a resident (except where the payment is relatable to a business or profession carried on by him outside India or to any other source of his income outside India) ; and

c. royalty received from a non-resident (if the payment is relatable to a business or profession carried on by the payer in India or any other source of his income in India).

Thus, royalty income consisting of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of any data, documentation, drawings or specifications relating to any patent, invention, model, design, secret formula or process or trade mark or similar property are ordinarily chargeable to tax in India under section 9(1)(*vi*).

Provision illustrated - See the illustration given in para 32.9.

32.8-1 *MEANING OF ROYALTY* - For the aforesaid purposes, "royalty" has been defined in *Explanation 2* to section 9(1)(*vi*). The definition is wide enough to cover both industrial royalties as well as copyright royalties. The definition specifically excludes income which would be chargeable to tax under the head "Capital gains" and accordingly such income is charged to tax as capital gains on a net basis under the relevant provisions of the law.

"Royalty" means consideration for—

a. the 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 ;

b. the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property ;

c. the use of any patent, invention, model, design, secret formula or process or trade mark or similar property ;

d. the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill ;

e. the use or right to use, any industrial, commercial or scientific equipment but not being the amount referred to in section 44BB (applicable from the assessment year 2002-03);

f. 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

g. the rendering of any services in connection with the aforesaid activities.

†For the purpose of section 9(1)(*v*)/(*vi*)/(*vii*) income shall be chargeable to tax according to the provisions given above in the hands of non-resident regardless of the fact whether (or not) he has a residence or place of business or business connection in India.

32.8-2 ***EXCEPTIONS*** - In the following two cases income shall not be deemed to accrue/arise in India :

32.8-2a EXCEPTION ONE - APPROVED AGREEMENTS MADE BEFORE APRIL 1, 1976 - In order to ensure that foreign suppliers of technical know-how who had entered into agreements or had finalised proposals for the receipt of such lump sum royalties with the approval of the Central Government on the understanding that such payment would be exempt from income-tax, it has been provided that such lump sum payments received under approved agreements made before April 1, 1976 are not to be deemed to accrue or arise in India. If an agreement is entered into prior to April 1, 1976, the royalty payable under the agreement is not liable to be taxed under section 9(1)(*vi*), irrespective of the date on which the agreement is approved by the Central Government—*CIT* v. *Sri Krishna Oil Complex Ltd.* [1999] 107 Taxman 100 (AP).

▪ *When agreement made after April 1, 1976 is deemed to have been made prior to that date* - If an agreement is made on or after April 1, 1976, it will be deemed to have been made before that date if the following conditions are fulfilled :

a. in the case of a taxpayer other than a foreign company, if the agreement is made in accordance with proposals approved by the Central Government before that date ;

b. in the case of a foreign company, if the condition referred to in (*a*) above is satisfied, and the foreign company exercises an option by furnishing a declaration in writing to the Income-tax Officer that the agreement may be regarded as having been made before April 1, 1976.

The option in this behalf has to be exercised before the expiry of the time allowed under section 139(1) or section 139(2) (whether fixed originally or on extension) for furnishing the return of income for the assessment year 1977-78 or the assessment year in which the royalty income first became chargeable to tax, whichever assessment year is later. The option so exercised is final not only for the assessment year in relation to which it is made but also for every subsequent year.

32.8-2b EXCEPTION TWO - ROYALTY FOR COMPUTER SOFTWARE - So much of the income by way of royalty as consists of lump sum payment made by a person, who is a resident, for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non-resident manufacturer along with computer hardware under any scheme approved under the Policy on Computer Software Export, Software Development and Trading, 1986 of the Government of India, shall not be deemed to accrue or arise in India. The expression "computer software" means any computer programme recorded on any disk, tape, perforated media or other information storage device and includes any such programme or any customized electronic data.

32.9 ***Income by way of fees for technical services [Sec. 9(1)(vii)]***† - Clause (*vii*) specifies the circumstances in which fees for technical services are deemed to accrue or arise in India. Under this clause, income by way of "fees for technical services" of the following types are deemed to accrue or arise in India in the hands of recipient :

a. fees for technical services received from the Central Government or any State Government ;

b. fees for technical services received from a resident (except where the payment is relatable to a business or profession carried on by the payer outside India or to any other source of his income outside India); and

c. fees for technical services received from a non-resident (if the payment is relatable to a business or profession carried on by the payer in India or to any other source of his income in India).

Even if services are rendered outside India, it is irrelevant for purpose of section 9(1)(*vii*); place where services are utilised is relevant—***Raymond Ltd.*** v. ***CIT*** [2003] 86 ITD 791 (Mum.).

Provision illustrated - X is non-resident in India. Only Indian income is taxable in the hands of X in India. During the previous year 2008-09, he receives royalty/technical fees on different dates as given below. In all these cases,

†For the purpose of section 9(1)(*v*)/(*vi*)/(*vii*) income shall be chargeable to tax according to the provisions given above in the hands of non-resident regardless of the fact whether (or not) he has a residence or place of business or business connection in India.

royalty/technical fee is received outside India. If in these cases, royalty/technical fee accrues or arises in India, then it will be Indian income and taxable in India. Conversely, if in these cases, royalty/technical fee does not deem to accrue or arise in India, it will become foreign income which will not be taxable in the hands of X, who is non-resident—

Date	Nature of royalty/technical fee received by X	Whether deemed to accrue or arise in India	Whether taxable in India in the hands of X
June 26, 2008	Rs. 40,000 is received from the Government of India	Yes	Yes
July 15, 2008	Rs. 60,000 is received from A Ltd. (resident in India) and the receipt pertains to a business or profession carried on by A Ltd. outside India or earning any income by A Ltd. outside India	No	No
July 16, 2008	Rs. 70,000 is received from B Ltd. (resident in India) and the receipt pertains to a business or profession carried on by B Ltd. in India or earning any income in India	Yes	Yes
July 20, 2008	Rs. 12,500 is received from C Ltd. (non-resident in India) and the receipt pertains to a business or profession carried on by C Ltd. in India or earning any income in India	Yes	Yes
August 11, 2008	Rs. 17,000 is received from D Ltd. (non-resident in India) and the receipt pertains to a business or profession carried on by D Ltd. outside India or earning any income by D Ltd. outside India	No	No

32.9-1 *FEES FOR TECHNICAL SERVICE - MEANING OF* **[EXPLANATION 2 TO SEC. 9(1)(vii)]** - The term "fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, 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 like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries".

■ *Some connection to construction* - Mere connection of supervisory services undertaken by the assessee would not tantamount to undertaking construction or assembly of the plant which could exclude it from the definition of 'fees for technical services' given in *Explanation 2* to section 9(1)(*vii*)—*ITO* v. *SMS Schloemann Siemag Aktiengesells Chaft Dusseldorf* [1996] 57 ITD 254 (Hyd.).

■ *Relation with supply of plant and equipment* - When a receipt satisfies ingredients of section 9(1)(*vii*) and *Explanation 2* thereunder, it has to be treated as fees for technical services, irrespective of the fact that it has a relation to supply of plant and equipment—*ITO* v. *SMS Schloemann Siemag Aktiengesells Chaft Dusseldorf* [1996] 57 ITD 254/89 Taxman 23 (Hyd.) (Mag.).

32.9-2 *EXCEPTION* - The aforesaid provisions of section 9(1)(*vii*) shall not apply in relation to any income by way of fees for technical services payable in pursuance of an agreement made before April 1, 1976, and approved by the Central Government.

An agreement made on or after April 1, 1976 shall be deemed to have been made before that date if the agreement is made in accordance with proposals approved by the Central Government before that date.

Hints for tax planning in respect of residential status

33. For the purposes of tax planning the following broad propositions should be borne in mind. However, these propositions would hold good only in the context in which they have been made :

■ In order to enjoy non-resident status, individuals, who are visiting India on a business trip or in

‡It means consideration for actual construction activities undertaken in India and not consideration for any services in connection with construction project—***Hotel Scopevista Ltd.*** v. ***CIT*** [2007] 18 SOT 183 (Delhi).

some other connection, should not stay in India for more than 181 days during one previous year and their total stay in India during any four previous years preceding the relevant previous year should in no case exceed 364 days.

- If individuals, having been in India for more than 365 days during four years preceding the relevant previous year, wish to stay in India for more than 60 days, they should plan their visit to India in such a manner that their total stay in India falls under two previous years. To illustrate, such persons can come to India any time in the first week of February and stay up to May 29 without incurring any risk of losing their non-resident status.
- An Indian citizen or a person of Indian origin (whether rendering service outside India or not) can stay for a maximum period of 181 days on a visit to India without losing his non-resident status. If, however, such persons wish to stay in India for more than 181 days, they should plan their visit in such a manner that their maximum stay of 362 days fall under 2 previous years, stay in each previous year being not more than 181 days.
- An Indian citizen, leaving India for the purpose of *employment*, will not be treated as resident in India, unless he has been in India in that year for 182 days or more. In other words, Indian citizens going abroad for the purpose of *employment* can stay in India for 181 days without becoming resident in that year, even if they were in India for more than 365 days during the four preceding years. This concession is available only to those who want to leave the country for the purpose of *employment*. However, the term "employment" is not defined in the Act. One has, therefore, to depend upon judicial pronouncements. It would be useful to quote Denman and Vaisey, JJ. in this context :
  - Per Denman, J. - "I do not think that employment means only where one is set to work by others to earn money ; a man may employ himself so as to earn profits in many ways"—*Partridge* v. *Mallandaine* [1886] 18 QBD 276 (DC).
  - Per Vaisey, J. - "The word 'employment' is one of very wide significance. But the words 'employer' and the 'employee' are much more restricted in their meanings. Thus I may be said to 'employ' my time or my talents without being in any proper sense an employer, and I may also be said to be employed in some pursuit or activity without being an 'employee'"— *Westall Richardson Ltd.* v. *Roulson* [1954] 2 AER 448.

Applying the aforesaid ratios, there is no reason why a professional who expects to set-up an independent practice in, or a businessman who wants to shift his activities to, a foreign country should be denied the benefit of concession.

- A non-resident can escape tax liability in respect of income earned out of India if he first receives it out of India and then remits the whole or part of it to India, even though the business is controlled from India.
- A person, who is not ordinarily resident, earning income outside India from a business controlled outside India, can avoid tax liability if he first receives such income in a foreign country and then remits the whole or part of it to India, either in the same year or in the following year(s).
- Not ordinarily resident persons can claim set-off of losses sustained in the business controlled outside India against their income taxable in India, provided they shift the control of the business to India.

Problems on residential status and tax incidence

34-P1 *X and Mrs. X are foreign citizens. They come to India on October 15, 2008 for a visit of 270 days. In the earlier previous years, they are in India as follows :*

	X	Mrs. X
2007-08	*265 days*	*310 days*
2006-07	*26 days*	*240 days*
2005-06	*25 days*	*4 days*
2004-05	*120 days*	*208 days*
2003-04	*30 days*	*75 days*

	X	Mrs. X
2002-03	20 *days*	360 *days*
2001-02	100 *days*	240 *days*
2000-01	5 *days*	195 *days*
1999-2000	6 *days*	176 *days*
1998-99	130 *days*	146 *days*

During the previous year 2008-09, X and Mrs. X have the following incomes :

	X Rs.	Mrs. X Rs.
Interest on company deposit in India	1,40,000	2,40,000
Income deemed to be earned in India	62,000	1,55,000
Income from business situated in Nepal and controlled from India (40 per cent is received in India and 60 per cent is received outside India)	84,000	98,000
Salary received in India for service rendered outside India	92,000	86,000
Interest received from the Government of India (received outside India)	1,58,000	46,000
Interest received from a foreign company outside India (on capital which is utilised outside India)	80,000	25,000
Interest received from a foreign company outside India (on loan which is utilised for doing business in India)	68,000	92,000
Royalty received in India from the Government of India	9,10,000	6,05,000
Royalty received in India from a non-resident in respect of technology used by such person outside India	48,000	37,000

The following information is also available :

	Place of birth	Year of birth
X	*Delhi*	*1951*
Mrs. X	*Bombay*	*1952*
Father of X	*Muscat*	*1922*
Mother of X	*Kathmandu*	*1925*
Grandfathers of X	*Mexico and Dubai*	*1893*
Grandmothers of X	*Taipei and Lagos*	*1895*
Father of Mrs. X	*Dubai*	*1926*
Mother of Mrs. X	*Belfast*	*1927*
Grandfathers of Mrs. X	*Chicago and Muscat*	*1901*
Grandmothers of Mrs. X	*Karachi and Dubai*	*1902*

Find out the residential status and gross total income of X and Mrs. X for the assessment year 2009-10.

SOLUTION : X and Mrs. X are foreign citizens. While Mrs. X is a person of Indian origin [her grandmother was born in undivided India (Karachi)], X is not a person of Indian origin (X or his parents or grand parents was not born in undivided India).

X and Mrs. X can become resident in India only if they satisfy any of the following basic conditions :

	X		Mrs. X	
	Presence of X in India during 2008-09	Presence of X in India during April 1, 2004 and March 31, 2008	Presence of Mrs. X in India during 2008-09	Presence of Mrs. X in India during April 1, 2004 and March 31, 2008
Condition 1	182 days	—	182 days	—
Condition 2	60 days	365 days	Non-functional	

As X satisfies basic condition 2, he is a resident in India. However, he is unable to satisfy one of the additional conditions (he is not resident in at least two out of preceding 10 years). X is, therefore, resident but not ordinarily resident in India for the assessment year 2009-10. Mrs. X is a non-resident in India, as she is not in India for at least 182 days during the previous year 2008-09.

Net income of X and Mrs. X shall be determined as follows :

	X (Resident but not ordinarily resident) Rs.	Mrs. X (Non-resident) Rs.
Interest on company deposits in India	1,40,000	2,40,000
Income deemed to be earned in India	62,000	1,55,000
Income from business in Nepal		
- 40% received in India	33,600	39,200
- 60% received outside India (as business is controlled in India)	50,400	—
Salary from outside India	92,000	86,000
Interest from Government of India	1,58,000	46,000
Interest from foreign company (borrowed money is utilised outside India)	—	—
Interest from a foreign company (borrowed money is utilised in India)	68,000	92,000
Royalty from the Government	9,10,000	6,05,000
Royalty received in India	48,000	37,000
Gross total income	15,62,000	13,00,200

34-P2 *X furnishes the following particulars of his income earned during the previous year relevant to the assessment year 2009-10 :*

	Rs.
1. *Interest on German Development Bonds (one-sixth is received in India)*	*36,000*
2. *Income from agriculture in Pakistan, received there but later on Rs. 86,000 is remitted to India*	*3,41,000*
3. *Interest from property in USA received outside India [Rs. 92,000 is used in Canada for meeting the education expenses of X's son in Canada and Rs. 2,48,000 is later on remitted to India]*	*3,40,000*
4. *Income earned from business in Iran which is controlled from New Delhi (Rs. 70,000 is received in India)*	*4,05,000*
5. *Dividend paid by an Indian company on May 10, 2008 but received outside India*	*1,95,800*
6. *Past untaxed profit of 2005-06 brought to India in May 2008*	*2,10,000*
7. *Profits from a business in New Delhi and managed from outside India (60 per cent of the profit is received outside India)*	*92,000*
8. *Profits on sale of a building in India but received in Nepal*	*18,74,000*
9. *Pension from a former employer in India, received in Iran (amount net of standard deduction)*	*2,15,000*
10. *Gift in foreign currency from a friend received in India on September 6, 2008*	*80,000*

Find out the gross total income of X : (i) if he is resident and ordinarily resident in India, (ii) if he is resident but not ordinarily resident in India, and (iii) if he is non-resident for the assessment year 2009-10.

SOLUTION :

	Resident and ordinarily resident Rs.	Resident but not ordinarily resident Rs.	Non-resident Rs.
(1)	(2)	(3)	(4)
1. Interest on German Development Bonds :			
❑ One-sixth is taxable on receipt basis	6,000	6,000	6,000
❑ Five-sixths is taxable in the case of resident and ordinarily resident on accrual basis	30,000	—	—
2. Income from agriculture in Pakistan :			
❑ Income accrued and received outside India	3,41,000	—	—
3. Income from property in USA received outside India :			
❑ Income received outside India	3,40,000	—	—
4. Income earned from a business in Iran controlled from New Delhi :			
❑ Rs. 70,000 is taxable on receipt basis	70,000	70,000	70,000
❑ Balance is not taxable in the case of non-resident	3,35,000	3,35,000	—

(1)	(2)	(3)	(4)
5. Dividend paid by an Indian company			
❑ Income deemed to accrue or arise in India (exempt from tax)	—	—	—
6. Past untaxed profit brought to India :			
❑ Not an income, hence, not taxable	—	—	—
7. Profit from a business in New Delhi and managed from outside India :			
❑ Income accrued in India	92,000	92,000	92,000
8. Profit on sale of a building in India but received in Nepal :			
❑ Income deemed to accrue or arise in India	18,74,000	18,74,000	18,74,000
9. Pension from an Indian former employer received in Iran :			
❑ Income deemed to accrue or arise in India	2,15,000	2,15,000	2,15,000
10. Gift in foreign currency			
❑ Now taken as income	80,000	80,000	80,000
Gross total income	33,83,000	26,72,000	23,37,000

CHAPTER THREE

Incomes exempt from tax

Incomes exempt under section 10

38. The following incomes are absolutely exempt from tax under section 10, as they do not form part of total income. The burden of proving that a particular item of income falls within this section is on the assessee—*Bacha F. Guzdar* v. *CIT* [1955] 27 ITR 1 (SC), *H.E.H. Nizam's Religious Endowment Trust* v. *CIT* [1966] 59 ITR 582 (SC) and *CIT* v. *Ramakrishna Deo* [1959] 35 ITR 312 (SC).

38.1 ***Agricultural income [Sec.10(1)]*** - Agricultural income is exempt from tax if it comes within the definition of "agricultural income" as given in section 2(*1A*). In some cases, however, agricultural income is taken into consideration to find out tax on non-agricultural income. For detailed discussion, *see* paras 278 to 281.

38.2 ***Receipts by a member from a Hindu undivided family [Sec.10(2)]*** - Any sum received by an individual, as a member of a Hindu undivided family, either out of income of the family or out of income of estate belonging to the family, is exempt from tax. Such receipts are not chargeable to tax in the hands of an individual member even if tax is not paid or payable by the family on its total income. The exemption is based upon the principle of avoidance of double taxation. Income of a Hindu undivided family is taxable in its own hand. Section 10(*2*), therefore, exempts income received by a member from his Hindu undivided family. Only those members of a Hindu undivided family can claim exemption under this clause who are entitled to demand share on partition or are entitled to maintenance under the Hindu law. Some of the receipts from a Hindu undivided family are, however, taxable *vide* section 64(*2*) [*see* para 214].

Provisions illustrated - X, an individual, has personal income of Rs. 7,86,000 for the previous year 2008-09. He is also a member of a Hindu undivided family which has an income of Rs. 4,08,000 for the previous year 2008-09. Out of income of the family, X gets Rs. 2,10,000, being his share of income. Rs. 2,10,000 will be exempt in the hands of X by virtue of section 10(2). The position will remain the same whether (or not) the family is chargeable to tax. X shall pay tax only on his income of Rs. 7,86,000.

38.3 ***Share of profit from partnership firm [Sec. 10(2A)]*** - Share of profit received by partners from a firm is not taxable in the hands of partners. For detailed discussion, *see* para 322.

A sub-partnership which is in receipt of share of profit of a partner in main partnership, has to be deemed to be a partner in main partnership for limited purpose of section 10(*2A*)—***Radha Krishna Jalan*** v. ***CIT*** [2007] 165 Taxman 538 (Gau.).

38.4 ***Casual and non-recurring receipts [Sec. 10(3)]*** - The exemption of Rs. 5,000 in respect of casual and non-recurring receipts shall not be available from the assessment year 2003-04.

38.5 ***Interest to non-residents [Sec. 10(4), (4B)]*** - The following interest incomes are exempt from tax :

a. in the case of a non-resident, interest on bonds or securities notified by the Central Government including income by way of premium on the redemption of such bonds ;

b. in the case of a person resident outside India [under section 2(*q*) of the Foreign Exchange Regulation Act] income from interest on money standing to credit in a Non-Resident (External) Account in India, in accordance with the said Act.

■ The Central Board of Direct Taxes have clarified that the joint holders of the Non-resident (External) Accounts do not constitute an "association of persons" by merely having these accounts in joint names. The benefit of exemption under section 10(*4*)(*ii*) will be available to such joint account

holders, subject to fulfilment of other conditions contained in that section by each of the individual joint account holder—Circular No. 592, dated February 4, 1991.

38.6 ***Leave travel concession to an Indian citizen [Sec. 10(5)]*** - *See* para 52.17.

38.7 ***Value of concessional passage to a foreign national employee [Sec. 10(6)(i)]*** - The exemption is not available from the assessment year 2003-04.

38.8 ***Remuneration received by a foreign diplomat and other foreign nationals [Sec. 10(6)(ii)/(vi)]*** - *See* para 55.

38.9 ***Remuneration of a technician in India [Sec. 10(6)/(5B)]*** - The exemption is not available from the assessment year 2003-04.

38.10 ***Salary received by a ship's crew [Sec. 10(6)(viii)]*** - *See* para 55.3.

38.11 ***Remuneration of foreign trainee [Sec. 10(6)(xi)]*** - *See* para 55.4.

38.12 ***Exemption from tax paid on behalf of foreign companies in respect of certain income [Sec. 10(6A)]*** - The following conditions should be satisfied—

Condition 1	The taxpayer is a foreign company.
Condition 2	It has income by way of royalty or fees for technical services.
Condition 3	Such royalty is received from the Central Government or State Government or an Indian concern under an agreement made after May 31, 1976 but before June 1, 2002.
Condition 4	The above agreement is in accordance with the industrial policy of the Indian Government or it is approved by the Central Government.
Condition 5	The payer of income pays tax liability of the foreign company in respect of the above income.

If all the aforesaid conditions are satisfied, the tax liability of the foreign company borne by the payer is not taxable in the hands of the foreign company (income will not be grossed up).

Provisions illustrated - X Ltd., a foreign company, provides technical services to B Ltd., an Indian company, in accordance with an approved agreement (date of agreement being January 2, 2001). As per the agreement, X Ltd. annually gets Rs. 80,000. Tax on Rs. 80,000 (*i.e.*, Rs. 16,000) is borne by B Ltd. If this exemption is not available, then the amount taxable in the hand of X Ltd., will be Rs. 96,000 (*i.e.*, Rs. 80,000 + Rs. 16,000). But because of the exemption under section 10(6A) the amount taxable in the hand of X Ltd. will be Rs. 80,000. Rs. 16,000, being the amount paid by B Ltd. on behalf of X Ltd. will not be chargeable in the hand of X Ltd.

38.13 ***Tax paid on behalf of non-residents/foreign companies in respect of other income [Sec. 10(6B)]*** - The following conditions should be satisfied—

Condition 1	The taxpayer is a non-resident (not being a company) or a foreign company.
Condition 2	It gets income (not being salary, royalty or technical fees) from the Central Government, State Government or an Indian concern.
Condition 3	The above income is generated in pursuance of an agreement entered into (before June 1, 2002) by the Central Government with a foreign Government/international organization or any related agreement approved by the Central Government (before June 1, 2002).
Condition 4	Tax liability of the recipient [*i.e.*, given in *Condition 1 (supra)*] in respect of the above income is met by the payer.

If the above conditions are satisfied, then the tax liability of the recipient borne by the payer, is not taxable in the hands of the recipient (income will not be grossed up).

38.14 ***Technical fees received by a notified foreign company [Sec. 10(6C)]*** - Income by way of royalty or fees for technical services received by a notified foreign company is exempt, if such income is received in pursuance of an agreement entered into with the Central Government to provide services in or outside India in projects connected with security of India.

The following companies have been declared for the purpose of section 10(*6C*) by the Central Government—

Company	*Project*
■ Redecon Australia Pvt. Ltd., Australia; and Nedeco, Netherland	Technical fees payable for the project "Seabird"
■ State Foreign Economic Corpn. for Export & Import of Armament and Equipment, Russia	Technical fees for projects connected with security of India
■ Rolls Royce Military Aero Engines Ltd., England	Technical fees for projects connected with security of India
■ Dowty Aerospace Gloucester Ltd., UK	Project connected with security of India.
■ Rosoboron Export, Russia	Project connected with security of India
■ BAe System (Operations) Ltd., UK	Technical fees
■ Rolls Royce Turbomeca Ltd., London	Technical fees

38.15 ***Foreign allowance [Sec. 10(7)]*** - *See* para 50.5.

38.16 ***Income of a foreign Government employee under co-operative technical assistance programmes [Sec. 10(8)]*** - Income of an individual serving in India in connection with any co-operative technical assistance programme in accordance with an agreement entered into by the Central Government and a foreign Government, is exempt from tax. The exemption is, however, available only if :

a. the remuneration is received by the individual, directly or indirectly, from the foreign Government ; and

b. any other income of such individual which accrues or arises outside India and is not deemed to accrue or arise in India, provided such individual is required to pay income-tax (including social security tax) to the foreign Government.

38.17 ***Remuneration or fees received by non-resident consultants and their foreign employees [Sec. 10(8A), (8B)]*** - The following will not be chargeable to tax :

38.17-1 *UNDER SECTION 10(8A)* - The following two incomes in the case of a consultant are exempt from tax—

Case 1	Any remuneration or fee received by him or it (directly or indirectly) out of the funds made available to an international organisation [hereafter referred to as the agency] under a technical assistance grant agreement between the agency and the Government of a foreign State.
Case 2	Any other income which accrues or arises to him or it outside India, and is not deemed to accrue or arise in India, in respect of which such consultant is required to pay any income or social tax to the Government of the country of his or its origin.

Who is a consultant - The expression "consultant" has been defined to mean any individual who is either not a citizen of India or, being a citizen of India, is not ordinarily resident in India or any other person who is a non-resident and is engaged by the agency for rendering technical services in India in accordance with an agreement entered into by the Central Government and the said agency and the agreement relating to the engagement of the consultant is approved by the prescribed authority*.

38.17-2 *UNDER SECTION 10(8B)* - The remuneration received by an employee of the consultant referred to in the aforesaid para is exempt from income-tax, provided such employee is either not a citizen of India or, being a citizen of India, is not ordinarily resident in India and the contract of his service is approved by the prescribed authority before the commencement of his service.

38.18 ***Income of family members of an employee serving under a co-operative technical assistance programme [Sec. 10(9)]*** - Any family member of an employee, mentioned in paras 38.16

*"Prescribed authority" for this purpose is the Additional Secretary, Department of Economic Affairs in the Ministry of Finance, Government of India in concurrence with Member (Income-tax) of the Board.

and 38.17 accompanying him to India enjoys tax exemption in respect of foreign income or an income not deemed to accrue or arise in India, if the family member is required to pay income-tax (including social security tax) to the foreign Government.

38.19 ***Gratuity [Sec. 10(10)]*** - *See* para 49.8.

38.20 ***Pension and leave salary [Sec. 10(10A), (10AA)]*** - *See* paras 49.9 and 49.3. Besides, any payment received by way of commutation of pension by an individual out of annuity plan of the Life Insurance Corporation of India from a fund set up by that Corporation shall be exempt under section 10(*10A*).

38.21 ***Retrenchment compensation [Sec. 10(10B)]*** - *See* para 49.13.

38.22 ***Compensation received by victims of Bhopal gas leak disaster [Sec. 10(10BB)]*** - Pursuant to the decision of the Supreme Court, victims of Bhopal gas leak disaster are to be paid compensation in accordance with the provisions of the Bhopal Gas Leak Disaster (Processing of Claims) Act, 1985. With a view to providing relief to these persons, a new clause (*10BB*) has been inserted in section 10 with effect from the assessment year 1992-93 to provide for exemption from income-tax on such compensation. However, compensation received by an assessee in respect of an expenditure which has been incurred and allowed as a deduction from taxable income, will not be exempt from income-tax.

38.22A ***Compensation on account of any disaster [Sec. 10(10BC)]*** - Clause (*10BC*) has been inserted in section 10 with retrospective effect from the assessment year 2005-06. It provides that any amount received or receivable from the Central Government or State Government or a local authority by an individual or his legal heir by way of compensation on account of any disaster shall not be included in the total income. However, the exemption will not be available in respect of the amount received or receivable to the extent such individual or his legal heir has been allowed a deduction under the Act on account of any loss or damage caused by such disaster.

Disaster for this purpose means a catastrophe, mishap, calamity or grave occurrence in any area, arising from natural or man-made causes, or by accident or negligence which results in substantial loss of life or human suffering or damage to, and destruction of, property, or damage to, or degradation of, environment, and is of such a nature or magnitude as to be beyond the coping capacity of the community of the affected area.

38.23 ***Payment from an approved public sector company and other entities at the time of voluntary retirement [Sec. 10(10C)]*** - *See* para 49.20.

38.23A ***Tax on perquisite paid by employer [Sec. 10(10CC)]*** - If tax is paid by an employer on behalf of an employee, the same being in the nature of an obligation which, but for such payment, would have been payable by the employee, is considered a perquisite, and is chargeable to tax.

However, an employer has been given an option to pay tax on the whole or part of the value of perquisite (not provided for by way of monetary payments), on behalf of an employee, without making any deduction from the income of the employee. The amount of tax actually paid by an employer, at his option, on non-monetary perquisites on behalf of an employee, is not taxable in the hands of the employee. Such tax paid by the employer shall not be treated as an allowable expenditure in the hands of the employer under section 40.[1]

The aforesaid exemption is available only in respect of tax on non-monetary perquisite paid by employer. If tax on salary is paid by the employer on behalf of the assessee, it is a perquisite provided for by way of non-monetary payment and, therefore, the provisions of section 10(*10CC*) would be applicable—***RBF Rig Corpn. LIC (RBFRC)*** v. ***CIT*** [2007] 165 Taxman 101 (Delhi)(SB).

38.24 ***Amount paid on life insurance policies [Sec. 10(10D)]*** - Any sum received on life insurance policy (including bonus) is not chargeable to tax. Exemption is, however, not available in respect of the amount received on the following policies—

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1. For detailed discussion, *see* problem 63-P19 and para 143.8.

a. any sum received under section 80DD(3) or 80DDA(3) ;

b. any sum received under a Keyman insurance policy ;

c. any sum received under an insurance policy (issued after March 31, 2003) in respect of which the premium paid in any year during the term of policy, exceeds 20 per cent of the actual sum assured.

In respect of (*c*) (*supra*), the following points should be noted—

1. Any sum received under such policy on the death of a person shall be exempt.

2. The value of any premiums agreed to be returned or of any benefit by way of bonus (or otherwise), over and above the sum actually assured, which is received under the policy by any person, shall not be taken into account for the purpose of calculating the actual capital sum assured.

38.25 ***Payment from provident fund [Sec. 10(11), (12)]*** - *See* para 56.2.

38.26 ***Payment from an approved superannuation fund [Sec. 10(13)]*** - *See* para 57.

38.27 ***House rent allowance [Sec. 10(13A)]*** - *See* para 50.2.

38.28 ***Special allowances [Sec. 10(14)]*** - *See* para 50.4.

38.29 ***Income received as exchange risk premium [Sec. 10(14A)]*** - No exemption is available under section 10(*14A*) from the assessment year 2003-04.

38.30 ***Interest on securities [Sec. 10(15)]*** - *See* para 196.5.

38.31 ***Lease rent of aircraft [Sec. 10(15A)]*** - Payment made to a foreign Government or a non-resident foreign enterprise under an agreement made before April 1, 1997 or after March 31, 1999 but before April 1, 2007 (and approved by the Central Government) by an Indian company, engaged in the business of operation of aircraft is not taxable in the hands of recipient. However, the exemption is available only if payment is made to acquire an aircraft or an aircraft engine (other than a payment for providing spares, facilities or services in connection with operation of leased aircraft) on lease.

■ The aforesaid exemption shall be available only in respect of agreement entered before April 1, 1997 or after March 31, 1999 but before April 1, 2007. If the agreement is entered during April 1, 1997 and March 31, 1999 or after March 31, 2007, the exemption under section 10(*15A*) will not be available. However, if the tax is paid by the payer of lease rent, the tax so borne by it, will not be grossed up in the hands of recipient by virtue of the exemption given by section 10(*6BB*).

Provisions illustrated - Under agreements approved by the Government of India, X Airways Ltd. (an Indian company) pays lease rent to Y Inc. (a foreign enterprise) for providing aircrafts on lease. During the previous year 2008-09, the following payments are made by X Airways Ltd. —

Date of agreement under which payment is made	*Lease rent of aircraft/aircraft engine* Rs.	*Payment for services and spares* Rs.	*Amount taxable in the hands of Y Inc.* Rs.
▶ *As per agreement dated March 1, 2004**			
- Payment to Y Inc.	15,40,000	2,90,000	2,90,000
- Tax borne by X Airways Ltd.	—	60,000	60,000
Total	15,40,000	3,50,000	3,50,000
▶ *As per the agreement dated April 10, 1998†*			
- Payment to Y Inc.	20,90,000	5,48,000	26,38,000
- Tax borne by X Airways Ltd.	9,70,000	3,10,000	3,10,000
Total	30,60,000	8,58,000	29,48,000

*The same rule will be applicable if the agreement is entered after March 31, 1999 but before April 1, 2007.

†The same rule will be applicable if the agreement is made after March 31, 2007.

Note - In this case, for the assessment year 2009-10, Y Inc. can claim exemption of Rs. 15,40,000 and Rs. 9,70,000 under section 10(15A) and 10(6BB), respectively.

38.32 ***Educational scholarship [Sec. 10(16)*** - Scholarship granted to meet the cost of education is exempt from tax.

■ *Finance by the Government not necessary* - It is not necessary that scholarship should be financed by the Government. Once it is proved that the amount received is "scholarship", it will be fully exempt from tax irrespective of its terms of award. The position will remain so even if the scholarship is received for pursuing a course of education not leading to a degree—*see A. Ratnakar Rao* v. *CIT* [1981] 6 Taxman 144 (Kar.).

■ *No further enquiry, if object is to meet cost of education* - The exemption in the hands of recipient depends on what it is meant for the person paying or disbursing the scholarships. If it is paid only for meeting the cost of education, it is exempt from tax even if the recipient, does not spend the whole amount towards education or that he is able to save something out of it—*CIT* v. *V.K. Balachandran* [1984] 147 ITR 4 (Mad.). To put it differently, if the whole object of the payment is to meet cost of education, then no further inquiry is called for in order to exclude the amount from taxable income under section 10(*16*).

■ *Incidental expenses* - The term "cost of education" takes within its ambit not only tuition fee but all other incidental expenses incurred for acquiring education—*Dr. J.C.N. Joshipura* v. *Asstt. CIT* [1996] 56 ITD 424 (Bom.).

38.33 ***Daily allowance of Members of Parliament [Sec. 10(17)]*** - Section 10(*17*) provides exemption to Members of Parliament and State Legislatures in respect of the following allowances :

	Nature of allowance	*Exemption in the case of Members of Parliament*	*Exemption in the case of Members of State Legislature*
Case 1	Daily allowance	Entire amount	Entire amount
Case 2	Any other allowance received by a Member of Parliament under the Members of Parliament (Constituency Allowance) Rules, 1986	Entire amount is exempt	NA
Case 3	Constituency allowance received by a member of State Legislature	NA	Entire amount from the assessment year 2007-08

38.34 ***Awards [Sec. 10(17A)]*** - The following awards, whether paid in cash or in kind, are exempt from tax —

■ Any payment made in pursuance of any award instituted in the public interest by the Central Government or any State Government or instituted by any other body and approved by the Central Government.

■ Any payment made as reward by the Central Government or any State Government for such purposes as may be approved by the Central Government in this behalf in the public interest.

38.35 ***Pension to gallantry award winners [Sec. 10(18)]*** - Income is exempt under section 10(*18*) if the following conditions are satisfied—

Condition 1	Pension is received by the taxpayer.
Condition 2	The taxpayer was an employee of the Central Government or State Government.
Condition 3	The taxpayer has been awarded Param Vir Chakra or Maha Vir Chakra or Vir Chakra or any other notified gallantry award.

Exemption is also available, if family pension is received by any member of the family of an individual [who satisfies conditions (*2*) and (*3*) *supra*].

38.35A ***Exemption of family pension received by the family members of armed forces [Sec. 10(19), applicable from the assessment year 2005-06]*** - Clause (*19*) has been inserted in section 10 with effect from the assessment year 2005-06. Section 10(*19*) is applicable if the following conditions are satisfied :

Condition 1	Family pension is received by the widow (or children or nominated heirs) of a member of the armed forces including para-military forces) of the Union.
Condition 2	The death of such member has occurred in the course of operational duties.
Condition 3	The death has occurred in the following circumstances— *a.* acts of violence or kidnapping or attacks by terrorists or anti-social elements; *b.* action against extremists or anti-social elements; *c.* enemy action in international war; *d.* action during deployment with a peace keeping mission abroad; *e.* border skirmishes; *f.* laying or clearance of mines including enemy mines as also mine sweeping operations; *g.* explosions of mines while laying operationally oriented mine-fields or lifting or negotiation mine-fields laid by the enemy or own forces in operational areas near international borders or the line of control; *h.* in the aid of civil power in dealing with natural calamities and rescue operations; *i.* in the aid of civil power in quelling agitation or riots or revolts by demonstrators. It shall be certified by the Head of the Department where the deceased member of the armed forces last served.

If the above conditions are satisfied, family pension is exempt from tax from the assessment year 2005-06.

38.36 ***Former rulers of Indian States [Sec. 10(19A)]*** - Annual value of any one palace in the occupation of a former ruler is exempt from tax under section 10(*19A*). The exemption is limited to one palace in occupation of the ex-ruler. Hence, even if only a part of a palace is in the occupation of a ruler and the rest has been let out, the exemption would be available for the entire palace—*CIT* v. *Bharatchandra Banjdeo* [1986] 27 Taxman 456 (MP), *CIT* v. *H.H. Maharao Bhim Singhji* [1988] 173 ITR 79 (Raj.). If a part of the palace is let out; the exemption will be limited to that portion of the palace which is in occupation of the ex-ruler—*Maharaval Lakshman Singh* v. *CIT* [1986] 160 ITR 103 (Raj.).

38.37 ***Income of local authority [Sec. 10(20)]*** - The following income of a local authority is exempt from tax—

a. income under the heads "Income from house property", "Capital gains" or "Income from other sources";

b. income from a business carried on by it, which accrues or arises from the supply of a commodity or services (not being water or electricity) within its own jurisdictional area; and

c. income from business from supply of water or electricity within or outside its own jurisdictional area.

By virtue of this clause, entire income of a local authority is exempt from tax except income from one source, *i.e.*, the income derived from the supply of a commodity or service (other than water or electricity) outside its own jurisdictional area.

■ The expression "local authority" means Panchayats and Municipalities as referred to in Articles 243(*d*) and 243P(*e*) of the Constitution of India, Municipal Committees and District Boards, legally entitled to or entrusted by the Government with the control or management of a Municipal or a local fund and Cantonment Boards as defined under section 3 of the Cantonments Act, 1924. The exemption under clause (*20*) of section 10 would, therefore, not be available to Agricultural Marketing Societies and Agricultural Marketing Boards, etc. despite the fact that they may be deemed to be treated as local authorities under any other Central or State Legislation. Exemption under this clause would not be available to Port Trusts.

38.38 ***Income of housing authority [Sec. 10(20A)]*** - The exemption under section 10(*20A*) is not available from the assessment year 2003-04.

38.39 ***Income of scientific research association [Sec. 10(21)]*** - Any income of a scientific research association, approved [Form No. 3CF for obtaining approval] under section 35(1)(*ii*)* is exempt from tax if the following conditions are satisfied :

* For the list of approved research associations, *see Taxmann's Direct Taxes Circulars*, Vol. 1, 2003 edition. Moreover, section 10(*21*) does not apply to institution approved under section 35(1)(*iii*).

■ It has to apply its income or accumulate it for application (notice for accumulation shall be given in Form No. 10), wholly and exclusively to the objects for which it is established. Such accumulation will be governed by the provisions of section 11(2)/(3).

■ It has not invested/deposited its fund for any period during the previous year otherwise than in any one or more of the forms/modes specified in section 11(5). However, this condition is not applicable in respect of the following :

Exception 1	Any asset held by the scientific research association where such assets form part of the corpus of the fund of the association as on June 1, 1973.
Exception 2	Debentures of company acquired by the scientific research association before March 1, 1983.
Exception 3	Any accretion to the shares, forming part of the corpus of the fund mentioned in (1) *supra*, by way of bonus shares allotted to the scientific research association.
Exception 4	Voluntary contributions received and maintained in the form of jewellery, furniture or any other article as the Board may, by notification in the Official Gazette, specify.

Exemption shall not be denied in relation to voluntary contribution [other than the voluntary contribution in cash or voluntary contributions of the nature referred in (*1*), (*2*), (*3*) or (*4*) *supra*] subject to the condition that such voluntary contribution is not held by the scientific research association otherwise than in any one or more of the forms or modes specified in section 11(5), after the expiry of one year from the end of the previous year in which such asset is acquired.

■ Exemption is not available in relation to any income of such association being profits and gains of business, unless the business is incidental to the attainment of its objectives and separate books of account are maintained in respect of such business.

■ Where the scientific research association is approved by the Central Government and, subsequently, that Government is satisfied that the scientific research association has not applied its income in accordance with the aforesaid provisions or the scientific research association has not invested or deposited its funds in accordance with the aforesaid provisions or the activities of the scientific research association are not genuine or the activities of the scientific research association are not being carried out in accordance with all or any of the conditions subject to which such association was approved, it may, at any time after giving a reasonable opportunity of showing cause against the proposed withdrawal to the concerned association, by order, withdraw the approval and forward a copy of the order withdrawing the approval to such association and to the Assessing Officer.

38.40 ***Income of educational institutions [Sec. 10(22)]*** - Under section 10(*22*), income of an educational institution is exempt up to the assessment year 1999-2000. From the assessment year 1999-2000, an educational institution can claim exemption under section 10(*23C*) or 11.

38.41 ***Income of hospitals [Sec. 10(22A)]*** - Under section 10(*22A*), income of a hospital is exempt from tax upto the assessment year 1999-2000. From the assessment year 1999-2000, exemption can be claimed under section 10(*23C*) or 11.

38.42 ***Income of specified news agency [Sec. 10(22B)]*** - Any income of notified* news agency, set up in India solely for collection and distribution of news, is exempt from income-tax.

■ The following points should be noted—

1. The exemption is subject to the condition that the news agency applies its income or accumulates it for application solely for collection and distribution of news and it does not distribute its income in any manner to its members.

2. The notification granting exemption under this clause shall, at any one time, have effect for not more than three assessment years (including an assessment year or years commencing before the date of issue of such notification), as may be specified in the notification.

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*Press Trust of India for the assessment years 1994-95 to 2008-09 and United News of India for the assessment years 1994-95 to 2008-09 for this purpose.

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

38.43 ***Income of games association [Sec. 10(23)]*** - The exemption under section 10(*23*) is not available from the assessment year 2003-04.

38.44 ***Income of professional institution [Sec. 10(23A)]*** - Any income (other than income from house property or income received for rendering any specific service, or income by way of interest or dividend on investment) of a professional institution is exempt from tax if the following conditions are satisfied :

Condition 1	Professional institution is established in India for the purpose of control, supervision, regulation or encouragement of the profession of law, medicine, accountancy, engineering or architecture or any other notified profession (namely, company secretary, materials management, chemistry and town planning).
Condition 2	The institution applies its income or accumulates it for application solely to the objects for which it is established.
Condition 3	The institution is approved by the Central Government.

■ Section 10(*23A*) concerns professional associations and has no application to a sports club—*Sports Club of Gujarat Ltd.* v. *CIT* [1988] 171 ITR 504 (Guj.).

■ Where the aforesaid association or institution has been approved by the Central Government and, subsequently, that Government is satisfied that such association or institution has not applied or accumulated its income in accordance with the above stated provisions or the activities of the association or institution are not being carried out in accordance with all or any of the conditions subject to which such association or institution was approved, it may (at any time after giving a reasonable opportunity of showing cause against the proposed withdrawal to the concerned association or institution) by order, withdraw the approval and forward a copy of the order withdrawing the approval to such association or institution and to the Assessing Officer.

38.45 ***Income received on behalf of Regimental Fund [Sec. 10(23AA)]*** - Any income received by any person on behalf of any Regimental Fund or Non-Public Fund established by the armed forces of the Union for the welfare of the past and present members of such forces or their dependents, is exempt from tax.

38.46 ***Income of fund established for welfare of employees [Sec. 10(23AAA)]*** - Exemption under section 10(*23AAA*) is available if the following conditions are satisfied—

Condition 1	There is a fund established for purposes (given below) as may be notified by the Board, for the welfare of employees or their dependents.
Condition 2	Employees are members of the fund.
Condition 3	The fund applies its income, or accumulates it for application wholly and exclusively to the objects for which it is established.
Condition 4	The aforesaid fund shall invest its funds and contributions made by the employees and other sums received by it in any one or more of the forms or modes specified in section 11(5).
Condition 5	The said fund is approved by the Commissioner (Form No. 9 for application) in accordance with the rules made in this behalf. At one time approval cannot be given for more than 3 assessment years.

38.46-1 *PURPOSES NOTIFIED BY THE BOARD* - The Board has notified the following purposes for the purpose of section 10(*23AAA*)—

a. cash benefits to a member of the fund,—

i. on superannuation, or

ii. in the event of his illness or illness of his spouse or dependent children, or

iii. to meet the cost of education of his dependent children ; or

b. cash benefits to the dependents of a member of the fund in the event of the death of such member.

38.47 ***Income of pension fund [Sec. 10(23AAB)]*** - Any income of a fund set up by the Life Insurance Corporation of India on or after August 1, 1996 or any other insurer to which contribution is made by any person for receiving pension from such fund, and which is approved by the Controller of Insurance or the Insurance Regulatory and Development Authority, has been exempted from income-tax.

38.48 ***Income from khadi or village industries [Sec. 10(23B)]*** - Exemption under section 10(*23B*) is available if the following conditions are satisfied—

Condition 1	An institution constituted as a public charitable trust or society.
Condition 2	It is solely for the development of khadi and village industries and not for purpose of profit.
Condition 3	The income is attributable to the business of production, sale or marketing of khadi or products of village industries.
Condition 4	The institution applies its income or accumulates it for application solely for the development of khadi or village industries.
Condition 5	The institution is approved by the Khadi and Village Industries Commission ("Commission").

Notes :

1. If after giving approval—

a. the Commissioner is satisfied that the institution has not applied or accumulated its income in accordance with the provisions or the activities of the institution are not being carried out in accordance with all or any of the conditions subject to which such institution was approved,

b. he may, at any time after giving a reasonable opportunity of showing cause against the proposed withdrawal to the concerned institution,

c. by order, withdraw the approval and forward a copy of the order withdrawing the approval to such institution and to the Assessing Officer.

2. For this purpose "khadi" means any cloth woven on handlooms in India from cotton, silk or woollen yarn handspun in India or from a mixture of any two or all of such yarns. "Village industries" means the following industries :

1. Bee-keeping	*6.* Ghani oil industry
2. Cottage match industry.	*7.* Hand-made paper.
3. Cottage pottery industry.	*8.* Manufacture of cane-gur and *Khandsari.*
4. Cottage soap industry.	*9.* Palm-gur making and other palm products industry.
5. Flaying, curing and tanning of hides and skins and ancillary industries connected with the same and cottage leather industry.	*10.* Processing of cereals and pulses.

38.49 ***Income of Khadi and Village Industries Boards [Sec. 10(23BB)]*** - Any income of Khadi and Village Industries Boards is exempt from tax.

38.50 ***Income of statutory bodies for the administration of public charitable trust [Sec. 10(23BBA)]*** - Any income of bodies or authorities established or constituted or appointed under any enactment for the administration of public, religious or charitable trusts or endowments (including maths, temples, gurdwaras, *wakfs,* churches, synagogues, agiaries or other public places of religious worship) or societies for religious or charitable purposes, is exempt from tax. It has, however, been clarified that the exemption will not apply to the income of any such trust, endowment or society.

38.51 ***Income of European Economic Community [Sec. 10(23BBB)]*** - Any income of the European Economic Community derived in India by way of interest, dividends or capital gains, from investments made out of its funds under a notified scheme [*i.e.,* European Community International Institutional Partners (ECIIP) Scheme, 1993] is exempt from tax.

38.52 ***Income of SAARC fund [Sec. 10(23BBC)]*** - Any income derived by the SAARC fund for Regional Projects is exempt from tax.

38.52A *Income of the Secretariat of Asian Organisation of Supreme Audit Institutions [Sec. 10(23BBD)]* - Income of the Secretariat of the Asian Organisation of the Supreme Audit Institutions is exempt from tax for the assessment years 2001-02 to 2010-11.

38.52B *Income of Insurance Regulatory Authority [Sec. 10(23BBE)]* - Income of Insurance Regulatory and Development Authority is exempt from tax.

38.52C *Income of North-Eastern Development Finance Corporation Limited [Sec. 10(23BBF)]* - Income-tax exemption is available to North-Eastern Development Finance Corporation Limited on the following lines—

Assessment year	*Quantum of exemption*	*Amount chargeable to tax*
2006-07	80%	20%
2007-08	60%	40%
2008-09	40%	60%
2009-10	20%	80%
2010-11 onwards	*Nil*	100%

38.52D *Income of Central Electricity Regulatory Commission* - Clause (*23BBG*) provides exemption from income-tax to any income of Central Electricity Regulatory Commission with effect from the assessment year 2008-09.

38.53 *Income of certain national funds, educational institutions and hospitals [Sec. 10(23C)]* - Exemption given by section 10(*23C*) is given below :

38.53-1 *INCOME OF CERTAIN NATIONAL FUNDS* - Any income received by any person on behalf of the following funds is exempt from tax :

a. the Prime Minister's National Relief Fund [sec. 10(*23C*)(*i*)] ; or

b. the Prime Minister's Fund (Promotion of Folk Art) [sec. 10(*23C*)(*ii*)] ; or

c. the Prime Minister's Aid to Students Fund [sec. 10(*23C*)(*iii*)] ; or

d. the National Foundation for Communal Harmony [sec. 10(*23C*)(*iiia*)] ; or

e. any other charitable fund or institution which is notified by the Central Government† [sec. 10(*23C*)(*iv*)] ; or

f. any trust (including any other legal obligation) or institution wholly for public religious purposes or wholly for religious and charitable purposes which is notified by the Central Government† [sec. 10(*23C*)(*v*)].

■ A fund or institution mentioned at (*e*) or (*f*) *supra* will have to satisfy a few conditions to claim exemption [*see* para 38.53-4].

38.53-2 *INCOME OF EDUCATIONAL INSTITUTIONS* - Income of the following educational institutions is exempt from tax under section 10(*23C*) :

Case 1	Any university or other educational institution existing solely for educational purposes and not for purposes of profit, and which is wholly or substantially‡ financed by the Government [sec. 10(*23C*)(*iiiab*)].
Case 2	Any university or other educational institution existing solely for educational purposes and not for purposes of profit if the aggregate annual receipts of such university or educational institution do not exceed Rs. 1 crore [sec. 10(*23C*)(*iiiad*)].
Case 3	Any university or other educational institution existing solely for educational purposes and not for purposes of profit, other than those mentioned in *case 1* and *case 2* (*supra*) and which may be approved by the prescribed authority (*i.e.*, the Chief Commissioner) [sec. 10(*23C*)(*vi*)].

†Prescribed authority from June 1, 2007.

‡The word 'substantial' has not been defined in the Act. The dictionary meaning of the word 'substantial' is 'considerable', 'for most part' and 'mainly'. Hence, if considerable finance is provided by the Government, then such a situation would be covered under section 10(*23C*)(*iiiab*)—***ITO*** v. ***Deeshiya Vidya Shala Samithi*** [2007] 12 SOT 617 (Bang.).

■ An educational institution mentioned under *case 3* will have to satisfy a few conditions to claim exemption [*see* para 38.53-4].

■ In ***American Hotel & Lodging Association Educational Institute*** v. ***Central Board of Direct Taxes*** [2007] 158 Taxman 146 (Delhi) the assessee having head office in America claimed exemption against educational incomes having been applied outside of India. The Delhi High Court held that application of income is required to be applied in India for the purpose of exemption even if it is not so specifically stated in the section.

38.53-3 *INCOME OF HOSPITAL* - If the following conditions are satisfied, income of hospital is exempt from tax under section 10(*23C*) :

Condition 1	*1.* Income arises to a hospital or other institution for the reception and treatment of persons — *a.* suffering from illness or mental defectiveness ; or *b.* during convalescence ; or *c.* requiring medical attention or rehabilitation.
Condition 2	*2.* The hospital or other institution exists solely for philanthropic purposes and not for the purpose of profit.
Condition 3	*3.* The hospital or other institution is : *a.* wholly or substantially financed by the Government [sec. 10(*23C*)(*iiiac*)] ; or *b.* the aggregate annual receipts of such hospital or institution do not exceed Rs. 1 crore [sec. 10(*23C*)(*iiiae*)] ; or *c.* it is approved by the prescribed authority (*i.e.*, the Chief Commissioner) [sec. 10(*23C*)(*via*)] [one has to satisfy a few conditions for getting approval - *see* para 38.53-4]

38.53-4 *CONDITIONS GOVERNING EXEMPTION UNDER SECTION 10(23C)(iv)/(v)/(vi)/(via)* - Exemption under section 10(*23C*)(*iv*)/(*v*)/(*vi*)/(*via*) is subject to the following conditions :

1. Government has been empowered (for the purpose of grant of exemption) to notify any fund or institution established for charitable purposes, having regard to its objects and importance throughout India or throughout any one or more States ; and any trust or institution, which is either wholly for public religious purposes or wholly for public religious and charitable purposes, having regard to the fact that it is administered and supervised in a manner to ensure that its income is properly applied for its objects.

A complete list of funds or institutions notified under this clause is available in *Taxmann's Direct Taxes Circulars*, Vol. 1, 2007 edn.

2. For availing the exemption, the fund, trust or institution should satisfy the following conditions—

Condition 1	It should make an application in Form No. 56 to the prescribed authority [*i.e.*, Director-General (Income-tax Exemptions)] for the purpose of grant of such exemption, or continuance thereof.† On or after June 1, 2006, such application for grant of exemption or continuance thereof shall have to be filed during the financial year immediately preceding the assessment year from which such exemption is sought.
Condition 2	It should furnish such documents (including audited annual accounts) or information, which the Central Government may consider necessary in order to satisfy itself about the genuineness of the activities of the fund or trust or institution.
Condition 3	It should apply its income or accumulate it for application, wholly and exclusively for the objects for which it is established (there is an additional requirement, in a case where more than 15 per cent income of fund, trust, institution, university, hospital, etc., is accumulated after March 31, 2002, the period of accumulation of the amount exceeding 15 per cent of the income shall in no case exceed 5 years).
Condition 4	It should not invest or deposit its funds for any period during the previous year otherwise than in any form or mode specified in section 11(5) [*see* para 349.4-2].

†A university, educational institution or hospital shall apply in Form No. 56D to the Chief Commissioner or Director-General.

Condition 5	It should disinvest by March 30, 1993*, all the investments made before April 1, 1989**, otherwise than in any one or more of the forms or modes specified in section 11(5) [*see* para 349.4-2].
Condition 6	If taxable income [before giving exemption under section 10(*23C*)] exceeds the exemption limit, the institution should get books of account audited in Form No. 10BB audit report should be submitted along with the return of income.

Condition (*4*) is not applicable in respect of the following :

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

ii. any asset in the form of equity shares of a public company along with accretions by way of bonus shares thereof, held by any university or other educational institution or any hospital or other medical institution as on June 1, 1998 and which forms part of their corpus ;

iii. any assets (being debentures issued by, or on behalf of, any company or corporation), acquired by the fund, trust or institution or any university or other educational institution or any hospital or other medical institution before March 1, 1983 ;

iv. any accretion to the shares, forming part of the corpus mentioned (*i*) *supra* by way of bonus shares allotted to the fund, trust or institution or any university or other educational institution or any hospital or other medical institution ;

v. voluntary contributions received and maintained in the form of jewellery, furniture or any other articles as the Board may, by notification in the Official Gazette, specify.

3. The prescribed authority will have power to call for documents or information or to hold such enquiries as it deems fit before the university or other educational institution or a hospital or other medical institution is approved by it. The order granting the approval or rejecting the application shall be passed within twelve months from the end of the month in which such application is received. This rule is applicable in respect of an application made on or after the date on which the Taxation Laws (Amendment) Bill, 2006 receives the assent of the President (*i.e.*, July 13, 2006).

4. Exemption shall not be denied in relation to voluntary contribution (other than the voluntary contribution in cash or voluntary contribution received and maintained in the form of jewellery, furniture or a notified article) subject to the condition that such voluntary contribution is not held by the association or institution, otherwise than in any one or more of the forms or modes specified in section 11(5), after the expiry of one year from the end of the previous year in which such asset is acquired.

5. The exemption does not apply in respect of profits and gains of business unless the business is incidental to the attainment of its objectives and separate books of account are maintained by it in respect of such business.

6. Notification relating to exemption cannot be issued for more than 3 assessment years.‡

7. Where out of accumulated income, any credit or payment is made to any trust or institution registered under section 12AA or to any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (*iv*), (*v*), (*vi*) or (*via*) of section 10(*23C*), it shall not be treated as application of income to the objects for which such fund or trust or institution or university or educational institution or hospital or medical institution, as the case may be, is established.

8. Where after giving approval the Government or the prescribed authority is satisfied that such fund or institution or trust or university or other educational institution or hospital or other medical institution has not applied its income in accordance with the above provisions or the activities of such fund or trust or institution, etc., are not genuine or are not being carried out in accordance with

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*March 30, 2001 in case of university/hospital, etc.

**June 1, 1998 in case of university/hospital, etc.

‡However, this time-limit is not applicable in the case of institutions covered by sections 10(*23C*)(*iv*)/(*v*) on or after July 13, 2006.

all or any of the conditions subject to which such association was notified or approved, it may, rescind the notification or withdraw the approval and forward a copy of the order rescinding the notification or withdrawing the approval to such fund or institution or trust or university, etc., and to the Assessing Officer.

The above action can be taken at any time after giving a reasonable opportunity of showing cause against the proposed action to the concerned fund or institution or trust, etc.

38.53-5 *DONATION RECEIVED FOR PROVIDING RELIEF TO THE VICTIMS OF EARTHQUAKE IN GUJARAT* - Any amount of donation received by the trust or institution mentioned in paras 38.53-1, 38.53-2 and 38.53-3 in terms of section 80G(2)(*d*) (*i.e.*, for providing relief to victims of earthquake in Gujarat) in respect of which accounts have not been rendered to the prescribed authority or which has been utilised for purposes other than providing relief to the victims of earthquake in Gujarat or which remains unutilised on March 31, 2004 and not transferred to the Prime Minister's National Relief Fund on or before the said date shall be deemed to be the income of the previous year and shall be charged to tax.

38.53-6 *ANONYMOUS DONATION* - With effect from the assessment year 2007-08, any anonymous donation referred to in section 115BBC on which tax is payable at the rate of 30 per cent (+SC+EC+ SHEC) shall be included in taxable income of the aforesaid institutions. For section 115BBC, please refer to para 349.7.

38.54 ***Income of a mutual fund [Sec. 10(23D)]*** - Any income of the following mutual funds (subject to provisions of sections 115R to 115T) is not chargeable to tax —

a. a mutual fund registered under the Securities and Exchange Board of India Act or regulation made thereunder ;

b. a notified mutual fund set up by a public sector bank, or a public financial institution or authorised by RBI.

38.55 ***Income of Exchange Risk Administration Fund [Sec. 10(23E)]*** - The exemption under section 10(*23E*) is not available from the assessment year 2003-04.

38.55A ***Income of investor protection fund [Sec. 10(23EA)]*** - Section 10(*23EA*) provides as follows—

1. Any income of a notified investor protection fund† set up by recognised stock exchanges in India is exempt from tax.

2. Such income should be by way of contribution received from recognised stock exchange and the members thereof.

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

38.55B ***Exemption of income of Credit Guarantee Fund Trust for Small Industries [Sec. 10(23EB)]*** - Any income of the Credit Guarantee Fund Trust for Small Industries (being a trust created by the Government of India and the Small Industries Development Bank of India) is exempt from tax for assessment years 2002-03 to 2006-07.

38.55C ***Incomes of Investor Protection Fund set up by commodity exchanges*** - Clause (*23EC*) has been inserted in section 10 with effect from the assessment year 2008-09. It provides that any income, by way of contributions received from commodity exchanges and the members thereof, of notified Investor Protection Fund set up by commodity exchanges in India, either jointly or separately, shall not be included in the total income. Where, however, any amount standing to the credit of the Fund and not charged to income-tax during any previous year is shared, either wholly or in part, with a commodity exchange, the whole of the amount so shared shall be deemed to be the income of the previous year in which the amount is so shared and shall accordingly be chargeable to income-tax.

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†Delhi Stock Exchange Customer's Protection Fund.

38.56 ***Income by way of dividend and long-term capital gains of venture capital funds and venture capital companies [Sec. 10(23FA)]*** - Clause (*23FA*) is applicable from the assessment year 2000-01 if the following conditions are satisfied—

38.56-1 *DIVIDEND/LONG-TERM CAPITAL GAINS* - Any income by way of dividends (not being dividend covered by section 115-O) or long-term capital gains of a venture capital fund or a venture capital company from investments made up to March 31, 2000* by way of equity shares in a venture capital undertaking is exempt if other conditions are satisfied.

Venture capital fund - It means a fund operating under a registered trust deed established to raise money by the trustees for the investments mainly by way of acquiring equity shares of a venture capital undertaking in accordance with the prescribed guidelines.

Venture capital company - It means such company as has made investments by way of acquiring equity shares of venture capital undertakings in accordance with the prescribed guidelines.

Venture capital undertaking - It means a domestic company whose shares are not listed in a recognised stock exchange in India. The business in which the undertakings may be engaged are software ; information technology ; production of basic drugs in the pharmaceutical sector ; bio-technology ; agriculture and allied sectors ; such other sectors as may be notified by the Central Government in this behalf or production and manufacture of any article or substance for which patent has been granted to the National Research Laboratory or any other scientific research institution approved by the Department of Science and Technology.

38.56-2 *APPROVAL BY THE CENTRAL GOVERNMENT* - The venture capital fund or the venture capital company would require the approval of the Central Government in accordance with the rules made in this behalf and would also be required to satisfy the prescribed conditions before being able to avail this exemption. At one time such approval can be given for a maximum number of three assessment years.

38.56-3 *DATE OF INVESTMENT* - Investment should be made before April 1, 2000**.

38.56A ***Income of venture capital fund or venture capital company [Sec. 10(23FB)]*** - Section 10(*23FB*) has been inserted with effect from the assessment year 2001-02. Exemption under section 10(*23FB*) is available if the following conditions are satisfied —

1. Condition one - There is a venture capital company or venture capital fund.

Venture capital company - It means a company which—

a. has been granted a certificate of registration under the Securities and Exchange Board of India Act, and regulations made thereunder;

b. fulfils the conditions as may be specified (with the approval of the Central Government) by the Securities and Exchange Board of India (SEBI) by notification in the Official Gazette.

Venture capital fund - It means a fund—

a. which operates under a trust deed registered under the provisions of the Registration Act or operates as a venture capital scheme made by UTI;

b. which has been granted a certificate of registration under the Securities and Exchange Board of India Act, and regulations made thereunder ;

c. which fulfils the conditions as may be specified (with the approval of the Central Government) by SEBI by notification in the Official Gazette.

2. Condition two - The venture capital company or venture capital fund has been set up to raise funds for investments in a venture capital undertaking.

Venture capital undertaking - It means a company—

a. which is a domestic company ;

b. whose shares are not listed in a recognised stock exchange in India ; and

*Section 10(*23FA*) is applicable from the assessment year 2000-01. A similar exemption is available under section 10(*23F*), if investment is made up to March 31, 1999.

**For investment made after March 31, 2000, exemption will be available under section 10(*23FB*).

c. which is engaged in the business for providing services, production or manufacture of an article or thing but does not include such activities or sectors which are specified (with the approval of the Central Government) by the SEBI by notification in the Official Gazette, in this behalf.

From the assessment year 2008-09, venture capital undertaking will mean such domestic company whose shares are not listed in a recognised stock exchange in India and which is engaged in the business of nanotechnology, information technology relating to hardware and software development, seed research and development, bio-technology, research and development of new chemical entities in the pharmaceutical sector, production of bio-fuels, or building and operating composite hotel-cum-convention centre with seating capacity of more than 3,000, or developing/operating and maintaining/developing, operating and maintaining any infrastructure facility as defined in *Explanation* to section 80-IA(4)(*i*) or engaged in the dairy industry or poultry industry.

■ *Consequences when the above conditions are satisfied* - If the aforesaid two conditions are satisfied, then any income of such venture capital fund or venture capital company is exempt from tax under section 10(*23FB*). The income of a venture capital company or venture capital fund shall continue to be exempt even if the shares of the venture capital undertaking in which the venture capital company or venture capital fund has made the initial investment, are subsequently listed in a recognised stock exchange in India.

38.57 ***Income of an infrastructure capital fund/company [Sec. 10(23G)]*** - Exemption under section 10(*23G*) is available up to the assessment year 2006-07.

38.58 ***Income of trade unions [Sec. 10(24)]*** - Any income, chargeable under the heads "Income from house property" and "Income from other sources", of a trade union registered under the Indian Trade Unions Act, 1926, formed primarily for the purpose of regulating the relations between workmen and employers or between workmen and workmen, is exempt from tax. A similar tax exemption is also available to an association of trade unions.

38.59 ***Income of provident funds [Sec. 10(25)]*** - The following income is exempt from tax under this clause :

a. interest on securities held by a statutory provident fund and any capital gains arising from the sale, exchange or transfer of such securities ;

b. any income received by the trustees on behalf of a recognised provident fund, and approved superannuation fund, or an approved gratuity fund ; and

c. any income received by the Board of Trustees on behalf of Deposit-linked Insurance Fund.

38.60 ***Income of Employees' State Insurance Fund [Sec. 10(25A)]*** - Clause (*25A*) provides income-tax exemption on any income of the Employees' State Insurance Fund of the Employees' State Insurance Corporation set up under the provisions of the Employees' State Insurance Act, 1948.

38.61 ***Income of a member of Scheduled Tribe [Sec. 10(26)]*** - Exemption under section 10(*26*) is available if the following conditions are satisfied —

1. The taxpayer is a member of a Scheduled Tribe [article 366(25) of the Constitution].

2. The taxpayer resides in any area in the State of Nagaland, Manipur, Tripura, Arunachal Pradesh, Mizoram or districts of North Cachar Hills, Mikir Hills, Khasi Hills, Jaintia Hills and Garo Hills or in the Ladakh region of the State of Jammu and Kashmir.

3. Exemption is available in respect of income which accrues or arises to him from any source in the areas or States specified above. Exemption is available in respect of income by way of dividend/interest on securities even if it arises from a source in the areas not specified above.

■ A member of a Scheduled Tribe notified in any tribal area as given above will be entitled to benefit of exemption under section 10(*26*) even if (*a*) he is residing in any other tribal area as described above; (*b*) income which accrues to him must arise from any source in such area; (*c*) tribe to which he belongs is also recognised as a scheduled tribe in other tribal areas where he is residing in connection with his vocation—***Dipti Doley Basumatary*** v. ***Union of India*** [2007] 163 Taxman 246 (Gauhati).

Provisions illustrated - X is a member of a Scheduled Tribe. He resides in the State of Nagaland. For the previous year 2008-09, he has the following income —

	Rs.
Interest on the Central Government securities	1,20,000
Interest on debentures of A Ltd. (having its registered office in Ambala)	60,000
Income of a business set up in Tripura	80,000
Income of a business set up in Delhi	2,26,000

Exemption under section 10(26) is available in respect of Rs. 1,20,000, Rs. 60,000 and Rs. 80,000 [Rs. 2,26,000 is chargeble to tax]. If, however, X resides in Amritsar, exemption under section 10(26) is not available.

38.62 ***Income of resident of Ladakh [Sec. 10(26A)]*** - Exemption under section 10(*26A*) is available up to the assessment year 1988-89.

38.62A ***Income of a "Sikkimese" individual [Sec. 10(26AA)]*** - Clause (*26AAA*) has been inserted in section 10. It provides the following—

1. The taxpayer is a Sikkimese individual. For this purpose, the term of "Sikkimese" is based on the Sikkim Subjects Regulation, 1961, read with Sikkim Subject Rules, 1961 and subsequent Government orders issued in this regard.

2. Income accrues or arises to him/her—

a. from any source in the State of Sikkim; or

b. by way of dividend or interest on securities (whether generated in Sikkim or any other place).

If the above two conditions are satisfied, income would be exempt from tax with retrospective effect from the assessment year 1990-91. However, the exemption will not be available to a Sikkimese woman who, on or after April 1, 2008, marries a non-Sikkimese individual.

■ *Income of "non-Sikkimese" individual* - Income accruing or arising to a non-Sikkimese individual residing in the State of Sikkim continues to be liable to tax under the Act. In the case of such individuals, it has been decided that—

1. For assessment year 2007-08 or any preceding assessment year, no assessment or reassessment shall be made with regard to the following income—

i. income from any source in the State of Sikkim; or

ii. income by way of dividend or interest on securities.

2. In case any proceedings have been initiated for assessment year 2007-08 or any preceding assessment year for not filing the return of income, such proceedings shall be dropped.

3. In case any assessment or reassessment proceeding has been initiated for assessment year 2007-08 or any preceding assessment year and assessment orders have not been passed, the aforesaid income shall be accepted as per the return.

4. For the assessment year 2008-09 and subsequent assessment years, assessment or re-assessment, if required, shall be made in accordance with the provisions of the Income-tax Act.

These instructions shall apply only to non-Sikkimese individuals residing in the State of Sikkim - **Instruction No. 8/2008,** dated July 29, 2008.

Provisions illustrated - The following cases are given in respect of individuals who are resident and ordinarily resident in India to explain the above provisions—

	Case 1	Case 2	Case 3	Case 4
Name of the taxpayer	X	Mrs. Y	Mrs. Z	Mrs. A
Whether Sikkimese individual	Yes	Yes	Yes	Yes
Date of marriage	*Not relevant*	January 1, 2005	April 1, 2008	April 1, 2008
Whether spouse of the taxpayer is Sikkimese	*Not relevant*	*Not relevant*	Yes	No

	Case 1	Case 2	Case 3	Case 4
Income from business situated in Sikkim/property situated in Sikkim/interest on bank deposit with a bank in Sikkim/ salary income from Sikkim	Exempt	Exempt	Exempt	Taxable
Income from business situated in Nepal/property situated in Nepal/interest on bank deposit with a bank in Nepal/ salary income from Nepal	Taxable	Taxable	Taxable	Taxable
Income from business situated in UP/property situated in UP/interest on bank deposit with a bank in UP/salary income from UP	Taxable	Taxable	Taxable	Taxable
Interest on debentures of a company whose registered office is situated in Maharashtra	Exempt	Exempt	Exempt	Taxable
Interest on debentures of, or dividend on shares in a foreign company	Exempt	Exempt	Exempt	Taxable
Interest on deposit with Punjab National Bank, New Delhi	Taxable	Taxable	Taxable	Taxable

38.62B ***Income of an agricultural produce marketing committee [Sec. 10(26AAB)]*** - With effect from the assessment year 2009-10, any income of an agricultural produce marketing committee/ board constituted under any law for the purpose of regulating the marketing of agricultural produce will be exempt from tax.

38.63 ***Income of a body for promoting interest of Scheduled Castes/Tribes [Sec. 10(26B)]*** - Any income of a corporation established by a Central, State or Provincial Act or of any other body, institution or association (wholly financed by the Government), formed for promoting the interests of the members of the Scheduled Castes/Tribes/backward classes[1], is exempt from tax.

■ State Forest Corporation, which was primarily formed with object to ameliorate suffering of tribal population of State of Arunachal Pradesh and for ushering concept of development activities in State, is entitled to exemption under section 10(*26B*)—***Arunachal Pradesh Forest Corporation Ltd.*** v. ***CIT*** [2007] 162 Taxman 277 (Gau.).

38.64 ***Income of National Minorities Development and Finance Corporation [Sec. 10(26BB)]*** - Any income of a corporation established by the Central Government or any State Government for promoting the interests of the members of such minority communities (as are notified by the Central Government from time to time) is exempt from tax.

"Minority communities" notified for this purpose are—(*1*) Muslims, (*2*) Christians, (*3*) Sikhs, (*4*) Buddhists, (*5*) Zoroastrians (Parsis) — Notification No. SO 613(E), dated July 5, 1995.

38.64A ***Income of ex-serviceman corporations [Sec. 10(26BBB)]*** - From the assessment year 2004-05, any income of a statutory corporation [*i.e.*, a corporation established by a Central, State or Provincial Act] for the welfare and economic uplift of ex-serviceman (being citizen of India) is not chargeable to tax.

These corporations can receive payments without tax deduction/collection at source—**Circular No. 7/2008,** dated August 1, 2008.

38.65 ***Income of co-operative societies promoting the interest of members of Scheduled Castes/ Tribes [Sec. 10(27)]*** - Any income of a co-operative society formed for promoting the interests of the members of either the Scheduled Castes or Scheduled Tribes or both [referred to in clause (*26B*)] is exempt from tax. However, the exemption is available only if the membership of the co-operative society consists of only other co-operative societies formed for similar purposes and the finances of the society are provided by the Government and such other societies.

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1. The expression "backward classes" has been defined so as to mean such classes of citizens, other than Scheduled Castes and Scheduled Tribes, as are notified by the Central Government or any State Government from time to time.

38.66 ***Income of marketing authority [Sec. 10(29)]*** - Exemption under section 10(*29*) is not available from the assessment year 2003-04.

38.67 ***Exemption of Commodity Boards and Authorities from income-tax [Sec. 10(29A)]*** - Any income accruing or arising to Coffee Board, Rubber Board, Tea Board, Tobacco Board, Marine Products Export Development Authority, Agricultural and Processed Food Products Export Development Authority, Spices Board and Coir Board, is exempt from tax.

38.68 ***Subsidy from the Tea Board [Sec. 10(30)]*** - In the case of an assessee, engaged in the business of growing and manufacturing tea in India, any subsidy received from or through the Tea Board under the notified scheme for replantation or replacement of tea bushes or for rejuvenation or consolidation of areas used for cultivation of tea in India, is exempt from tax. *Vide* Notification No. SO 3616, dated September 27, 1976, the Central Government has notified the following schemes for this purpose :

- Replantation Subsidy Scheme of the Tea Board from October, 1968.
- Amended Replantation Subsidy Scheme of the Tea Board as effective from May 12, 1970.
- Amended Replantation Subsidy Scheme of the Tea Board as effective from January 1, 1972.

This exemption applies only if such a scheme is specified by the Central Government in the Official Gazette and the assessee furnishes to the Assessing Officer, along with his return of income (or within such further time as may be allowed by the Assessing Officer), a certificate from the Tea Board, as to the amount of subsidy paid to the assessee during the year.

38.69 ***Subsidy received by planters [Sec. 10(31)]*** - Subsidies received by the assessees engaged in the business of growing and manufacturing rubber, coffee, cardamom [or such other commodities as the Central Government may by notification specify] is exempt from tax. The subsidy should be received from or through the concerned Board under any scheme for replantation or replacement of rubber plants, etc., or for rejuvenation or consolidation of areas used for their cultivation. To obtain this exemption, an assessee is required to furnish to the Assessing Officer along with his return of income for the assessment year concerned (or within such further period as the Officer may allow), a certificate from the concerned Board, as to the amount of such subsidy received during the previous year.

38.70 ***Income of minor [Sec. 10(32)]*** - In case the income of an individual includes the income of his minor child in terms of section 64(1A), such an individual shall be entitled to exemption of Rs. 1,500 in respect of each minor child if the income of such minor is includible under section 64(1A). However, the exemption cannot exceed the income of any minor so includible in the total income of the individual.

38.71 ***Capital gain on transfer of US64 [Sec. 10(33)]*** - Any income arising from the transfer of a capital asset being a unit of US 64 [referred to in Schedule I of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002] and where the transfer of such assets takes place on or after April 1, 2002, shall be exempt from tax. This rule is applicable whether the capital asset (US64) is long-term capital asset or short-term capital asset.

If income from a particular source is exempt from tax, loss from such source cannot be set off against income from another source under the same head of income—*see CIT* v. *S.S. Thiagarajan* [1981] 129 ITR 115 (Mad.), *Ramjilal Rais* v. *CIT* [1965] 58 ITR 181 (All.).

Consequently, loss arising on transfer of units of US64 cannot be set off against any income in the same year in which it is incurred and the same cannot be carried forward.

38.72 ***Dividends and interest on units [Sec. 10(34)/(35)]*** - The following income is not chargeable to tax from the assessment year 2004-05—

a. any income by way of dividend referred to in section 115-O [*i.e.*, dividend, not being covered by section 2(*22*)(*e*), from a domestic company];

b. any income in respect of units of a mutual fund;

c. income from units received by a unit holder of UTI;

d. income in respect of units from a specified company.

The person paying dividends on shares or interest on units will have to pay additional tax on dividend/income distributed under sections 115-O and 115R.

The following points should be noted—

1. In the case of a unit operating in a special economic zone (which started its operation after March 31, 2005) additional tax on dividend distribution is not payable by the payer company. Even in such a case, dividend income in the hands of shareholders is exempt from tax.

2. Income from transfer of units is not exempt under this provision.

38.73 ***Long-term capital gains on transfer of listed equity shares [Sec. 10(36)]*** - Capital gains is not chargeable to tax if the following conditions are satisfied—

Condition 1	The asset, which is transferred, is a long-term capital asset being an eligible equity share in a company.
Condition 2	Such shares are purchased on or after March 1, 2003 but before March 1, 2004.
Condition 3	The taxpayer holds such shares for a period of 12 months or more.

Note : Eligible equity share for the purpose means,—

a. any equity share in a company being a constituent of BSE-500 Index of the Stock Exchange, Mumbai as on March 1, 2003 and the transactions of purchase and sale of such equity share are entered into on a recognised stock exchange in India; or

b. any equity share in a company allotted through a public issue* on or after March 1, 2003 and listed in a recognized stock exchange in India before March 1, 2004 and the transaction of sale of such share is entered into on a recognised stock exchange in India.

If the aforesaid 3 conditions are satisfied, then the long-term capital gain arising on transfer is not chargeable to tax. Conversely, long-term capital loss arising on transfer cannot be adjusted against any income if the aforesaid conditions are satisfied.

38.74 ***Capital gain on compulsory acquisition of urban agricultural land [Sec. 10(37)]*** - In the case of an individual/Hindu undivided family capital gain arising on transfer by way of compulsory acquisition of urban agriculture land is not chargeable to tax from the assessment year 2005-06 if such compensation is received after March 31, 2004 and the agriculture land was used by the assessee (or by any of his parents) for agricultural purposes during 2 years immediately prior to transfer.

38.75 ***Long-term capital gains on transfer of equity shares/units in cases covered by securities transaction tax [Sec. 10(38)]*** - Long term capital gains arising on transfer of equity shares or units of equity oriented mutual fund is not chargeable to tax from the assessment year 2005-06 if such transaction is covered by securities transaction tax.

38.75-1 *OTHER POINTS* - The following points should be noted—

▪ *Where securities transaction tax is applicable* - The securities transaction tax is applicable if equity shares or units of equity oriented mutual fund are transferred on or after October 1, 2004 in a recognised stock exchange in India (or units are transferred to the mutual fund). If the securities transaction tax is applicable, long-term capital gain is not chargeable to tax, short-term capital gain is taxable @ 10 per cent (*plus* SC and EC). If income is shown as business income, the taxpayer can claim rebate under section 88E.

▪ *Exemption under section 10(38)* vis-a-vis *book profit under section 115JB* - With effect from the assessment year 2007-08, long-term capital gain generated by a company and which is exempt under section 10(*38*), will be taken into consideration to calculate book profit under section 115JB for the purpose of calculating minimum alternate tax. For detailed study, refer to para 336.2-2.

*Generally, in case of "public issue" the invitation is for fresh issue of share capital by a company. It is different from "other for sale" by an existing shareholder.

▪ *Equity oriented fund* - The definition of equity oriented fund has been amended from June 1, 2006. With effect from June 1, 2006, "equity oriented fund" will be a fund where the investible funds are invested by way of equity shares in domestic companies to the extent of more than 65 per cent (up to May 31, 2006, it is 50 per cent).

Proviso to section 10(*38*) provides that the percentage of equity shareholding of the fund shall be computed with reference to the annual average of the monthly averages of the opening and closing figures. Since the definition is amended with effect from June 1, 2006, one fails to understand as to how the aforesaid percentage will be calculated for the financial year 2006-07 on the basis of "annual" average of the monthly averages.

38.76 ***Income from any international sporting event [Sec. 10(39)]*** - Income arising from a notified international sporting event (*i.e.*, Commonwealth Games 2010) is exempt from tax from the assessment year 2006-07 if such event is approved by the international body and has participation by more than two countries.

38.77 ***Grant received by subsidiary company from holding company [Sec. 10(40)]*** - In the case of a reconstruction or revival of an existing business of power generation by way of transfer of the business to an Indian company [notified under section 80-IA(4)(*v*)(*a*)], if any grant (or otherwise) is received by a subsidiary company from its Indian holding company, it is not chargeable to tax.

38.78 ***Capital gain in the above case [Section 10(41)]*** - Any long-term/short-term capital gain arising in the aforesaid case is not chargeable to tax if the transfer takes place before April 1, 2006.

38.79 ***Income of notified non-profit body/authority [Sec. 10(42)]*** - Any specified income of a non-profit body or authority notified by the Central Government is exempt from tax. Such body or authority should be established, constituted or appointed under a multilateral treaty, agreement or convention, to which the Central Government is a signatory.

38.80 ***Loan in the case of reverse merger [Sec. 10(43)*** - Any amount received by an individual as a loan (either in lump sum or instalment) in a transaction of reverse mortgage, is not chargeable to tax.

38.80-1 *WHAT IS A REVERSE MORTGAGE* - In a regular mortgage, a person mortgages his property with the lender in return of loan amount. The loan amount may be used to finance purchase or construction of the same property or for any other purpose. The loan amount is charged at a specific interest rate and it has a pre-determined tenure. The person taking the loan has to repay the loan in the form of equated monthly instalments (popularly known as EMIs). EMIs generally comprise of both principal and interest amounts. The property which is mortgaged is utilised as a security to cover the risk of default on the borrower's part to make payment of EMIs.

In the reverse mortgage, borrower is generally a senior citizen who is 65 years or more (or in the case of a married couple if either husband or wife is senior citizen). He owns a house property. However, he does not have regular source of income. He can mortgage his property with National Housing Bank, or with a scheduled bank or a housing finance company registered with the National Housing Bank (*i.e.*, lender). The lender in return pays periodic instalments or lump sum to the borrower during his lifetime. The borrower can continue to stay in the property during his lifetime and as well continue to receive regular income from the lender. The borrower does not pay the principal as well as interest to the lender during his lifetime. The lender will recover the loan along with the accumulated interest by selling the house after the death of the borrower. However, before resorting to disposal of the property, an option will be given to the legal heirs to repay the loan amount, along with the interest, and to get the mortgaged property released. Any excess amount will be remitted back to the legal heirs of the borrower.

30.80-2 *PERIODICAL INSTALMENTS OR LUMP SUM TO THE BORROWER* - IS IT "INCOME" - Generally, a question is asked whether the loan, either in lump sum or in instalment, received under a reverse mortgage scheme amounts to income in the hands of the borrower. There is no doubt that receipt of such loan is in the nature of a capital receipt. However, with a view to providing certainty in the tax regime to the senior citizen, clause (*43*) has been inserted in section 10 with effect from the

assessment year 2008-09 to provide that such loan amounts will be exempt from income-tax. As the amendment is only clarificatory in nature, the same rule should be applicable even for earlier years.

30.80-3 *REVERSE MORTGAGE OF PROPERTY AND OBTAINING LOAN - IS IT "TRANSFER"* - Another question which is generally asked is whether mortgage of property for obtaining a loan under the reverse mortgage scheme is transfer within the meaning of the Income-tax Act and liable to capital gains tax liability under section 45. Section 2(*47*) provides an inclusive definition of 'transfer'. Further, 'transfer' within the meaning of the Transfer of Properties Act includes some types of mortgage. Therefore, a mortgage of property, in certain cases, is a transfer within the meaning of section 2(*47*). Consequently, any gain arising upon mortgage of a property may give rise to capital gains under section 45. However, in the context of a reverse mortgage, the intention is to secure a stream of cash flow against the mortgage of a residential house and not to alienate the property.

Clause (*xvi*) has, therefore, been inserted in section 47 with effect from the assessment year 2008-09 to provide that any transfer of a capital asset in a transaction of reverse mortgage under the Reserve Mortgage Scheme, 2008 [notified by the Government *vide* **Notification No. 93/2008,** dated September 30, 2008] shall not be regarded as a transfer and shall not attract capital gains tax.

Special provisions in respect of newly established undertakings in free trade zone, etc.

39. The provisions of section 10A are given below—

39.1 ***Conditions to be satisfied*** - In order to get deduction, an undertaking must satisfy the following conditions :

39.1-1 *MUST BEGIN MANUFACTURE OR PRODUCTION IN FREE TRADE ZONE* - It has begun or begins to manufacture/produce† articles or things or computer software during the following years—

Location	*Year*
Free Trade Zone	During the previous year relevant to the assessment year 1981-82 or any subsequent year.
Electronic hardware technology park or software technology park	During the previous year relevant to the assessment year 1994-95 or any subsequent year.
Special economic zone	During the previous year relevant to the assessment year 2001-02 or any subsequent year but before April 1, 2005.

Note : In the case of unit which begins to manufacture or produce an article or thing or computer software on or after April 1, 2005 in a special economic zone, deduction will not be available under section 10A. Such unit can claim deduction under section 10AA.

Free trade zones - Free Trade Zones are : Kandla Free Trade Zone, Santacruz Electronics Export Processing Zone, Falta Export Processing Zone, Madras Export Processing Zone, Cochin Export Processing Zone and Noida Export Processing Zone.

Electronic/software/hardware technology park - "Electronic hardware technology park" means any park set up in accordance with the Electronic Hardware Technology Park (EHTP) Scheme notified by the Government of India in the Ministry of Commerce and Industry.

Software technology park - "Software technology park" means any park set up in accordance with the Software Technology Park (STP) Scheme notified by the Government of India in the Ministry of Commerce and Industry.

Computer software - Computer software means—

a. any computer programme recorded on any disc, tape, perforated media or other information storage device; or

†The expression "manufacture or production" shall include the cutting and polishing of precious and semi-precious stone from the assessment year 2004-05.

b. any customized electronic data or any product or service of similar nature, as may be notified by the Board,

which is transmitted or exported from India to any place outside India by any means.

For the purpose of section 10A or 10B, as long as a unit in the EPZ/EOU/STP itself produces computer programmes and exports them, it should not matter whether the programme is actually written within the premises of the unit. Where a unit in the EPZ/EOU/STP develops software *sur place*, that is, at the client's site abroad, such unit should not be denied the tax holiday under section 10A or 10B on the ground that it was prepared on-site, as long as the software is a product of the unit, *i.e.*, it is produced by the unit.

The Central Board of Direct Taxes has specified the following Information Technology enabled products or services, as the case may be, for this purpose namely : (*i*) Back-office Operations; (*ii*) Call Centres; (*iii*) Content Development or Animation; (*iv*) Data Processing; (*v*) Engineering and Design; (*vi*) Geographic Information System Services; (*vii*) Human Resource Services; (*viii*) Insurance Claim Processing; (*ix*) Legal Databases; (*x*) Medical Transcription; (*xi*) Payroll; (*xii*) Remote Maintenance; (*xiii*) Revenue Accounting; (*xiv*) Support Centres; and (*xv*) Web-site Services.

39.1-2 ***SHOULD NOT BE FORMED BY SPLITTING/RECONSTRUCTION OF BUSINESS*** - The industrial undertaking should not have been formed by the splitting up or reconstruction of a business already in existence. However, where an industrial undertaking is formed as a result of re-establishment, reconstruction or revival by the assessee of the business of any such industrial undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section the same will qualify for the tax concession.

39.1-3 ***SHOULD NOT BE FORMED BY TRANSFER OF OLD MACHINERY*** - The industrial undertaking should not have been formed by the transfer of a new business of machinery or plant previously used for any purpose.

■ *Exception one* - For this purpose, any machinery or plant which was used outside India by any person other than the assessee is not regarded as machinery or plant previously used for any purpose if the following conditions are fulfilled, namely:

a. such machinery or plant was not previously used in India;

b. such machinery or plant is imported into India from a foreign country; and

c. no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable in computing the total income of any person for any period prior to the installation of the machinery or plant by the assessee.

■ *Exception two* - Further, this tax concession is not denied in a case where the total value of used machinery or plant transferred to the new business does not exceed 20 per cent of the total value of the machinery or plant used in that business.

39.1-4 ***THERE MUST BE REPATRIATION OF SALE PROCEEDS INTO INDIA*** - Sale proceeds of articles or things or computer software exported out of India must be received in (or brought into) India by the assessee in convertible foreign exchange during the previous year or within a period of six months from the end of the relevant previous year. For instance, for the assessment year 2009-10, the repatriation of the sale proceeds into India must be completed on or before September 30, 2009. The sale proceeds shall be deemed to have been received in India where such sale proceeds are credited to a separate account maintained for the purpose by the assessee with any bank outside India with the approval of the Reserve Bank of India.

39.1-4a EXTENSION OF TIME LIMIT - The aforesaid limit of six months can be extended by the Reserve Bank of India or such other competent authority as is authorised under any law for the time being in force for regulating payments and dealings in foreign exchange.

39.1-4b REMITTANCE AFTER THE EXPIRY OF TIME-LIMIT - If foreign exchange is not remitted within six months from the end of the previous year (or within the extended time-limit as approved by RBI), then deduction under sections 10A, 10B and 10BA is not available. In such a case—

a. if the foreign currency is remitted after the expiry of time-limit of 6 months (or after the expiry of extended time-limit);

b. the Assessing Officer shall amend the order of assessment so as to allow deduction under sections 10A, 10B and 10BA;

c. the order shall be amended within a period of 4 years from the end of the previous year in which the foreign currency is remitted.

39.1-5 *AUDIT* - The assessee should furnish audit report in Form No. 56F along with the return of income.†

39.1-6 *RETURN OF INCOME* - Return of income should be submitted on or before the due date of submission of return of income given by section 139(1). If return is not submitted or return is submitted belatedly, deduction under this section is not available.

39.2 ***Amount of deduction - General provisions*** - If the aforesaid conditions are satisfied, the deduction under section 10A may be computed as under :

$$\text{Profits of the business of the undertaking} \times \frac{\text{Export turnover}}{\text{Total turnover of the business carried on by the undertaking}}$$

■ The following points should be considered—

1. Export turnover - For this purpose, 'export turnover' means the consideration in respect of export by the undertaking of articles or things or computer software received in (or brought into) India by the assessee in convertible foreign exchange within the prescribed period but does not include the following :

a. freight;

b. telecommunication charges;

c. insurance attributable to the delivery of the articles or things or computer software outside India;

d. expenses, if any, incurred in foreign exchange in providing the technical services outside India.

Freight, telecommunication charges and insurance are deductible only if the assessee from the importers recovers these in addition to sale price of goods. If nothing is recovered from the importers but these expenses are incurred by the assessee, then no adjustment is required. What is to be excluded is out of what is received. If the consideration received is only against the goods then there is no need to deduct such expenses from the consideration received in convertible foreign exchange. In cases where such expenses are separately charged, the expenses are required to be reduced from the consideration received for the purpose of arriving the export turnover—***Patni Telecom (P.) Ltd.*** v. ***ITO*** [2008] 22 SOT 38 (Hyd.). When these expenses are excluded for the purposes of 'export turnover' then on the same assumption, reason and analogy it should be excluded from 'total turnover'.

2. Site development - On site development of computer software (including services for development of software) outside India shall be deemed to be export of computer software outside India.

In ***CIT*** v. ***Softsol India Ltd.*** [2008] 22 SOT 271 (Hyd.), it was held that expenditure towards on-site development of software could not be reduced from convertible foreign exchange received by the assessee for the purpose of reckoning the export turnover in terms of section 10A. If the technical services are rendered independently which is being agreed to separately charge in addition to the price of the goods, in such circumstances expenditure incurred could be in the nature of expenditure for the purpose of technical services. Conversely, if expenditure is incurred by an assessee on account of travelling allowances and others for the purpose of development of software at client's site outside India, *i.e.*, in respect of goods, such expenditure is not in the nature of expenditure for technical services. Since the expenditure is not for technical services, there is no

†It is not possible to attach any certificate, statement or audit report with new income-tax return forms. The assessee should himself retain the audit report in Form No. 56F. It may be furnished in original whenever the Assessing Officer wants to examine it in assessment proceedings or otherwise.

need to exclude these expenditures from consideration received in convertible foreign exchange for the purpose of calculating 'export turnover' as defined in clause (*iv*) of *Explanation 2* of section 10A.

3. Foreign exchange fluctuation - Deduction under section 10A has to be allowed in respect of profit on account of foreign exchange gain - ***Renaissance Jewellery (P.) Ltd.*** v. ***ITO*** [2005] 4 SOT 50 (Mum.).

4. Royalty - Royalty earned from export of software is entitled to relief under section 10A - ***Wipro Limited* v. *CIT*** [2005] 96 TTJ (Bang.) 211.

5. Interest - Interest income earned by assessee on bank fixed deposits is ineligible for deduction under section 10A. For the purposes of section 10A, only net interest income can be excluded from profits - ***Renaissance Jewellery (P.) Ltd.*** v. ***ITO*** [2005] 4 SOT 50 (Mum.). However, where the assessee needed funds to run industrial undertaking and the bank provided the funds on the condition of depositing sufficient margin money with the bank in the form of a fixed deposit, interest earned on such a fixed deposit is eligible for deduction under section 10A—***Samtex Fashions Ltd.*** v. ***CIT*** [2005] 92 ITD 535 (Delhi).

6. Losses of other undertakings - Profit for the business of undertaking shall be calculated without adjusting losses of other undertakings—***CIT*** v. ***Yokogawa India Ltd.*** [2007] 13 Taxman 471 (Bang.).

7. Brought forward losses - Brought forward losses (incurred after April 1, 2001) cannot be deducted from profit of the business of the undertaking. In other words, deduction under section 10A will be available in respect of profit of an eligible undertaking without setting off of brought forward losses.

8. Section 80AB - Deduction under section 10A is not controlled by section 80AB as deduction under section 10A is not a deduction under Chapter VI-A - ***Enercon Wind Farms (Krishna) Ltd.*** v. ***CIT*** [2008] 21 SOT 29 (Mum.).

39.2-1 *PERIOD OF DEDUCTION* - If the aforesaid conditions are satisfied, the assessee can claim deduction under section 10A from his total income, for a period of 10 consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce such articles or things or computer software.

- For the undertakings which have claimed exemption up to the assessment year 2000-01 under the old section 10A, the deduction shall be available for the unexpired period of 10 consecutive assessment years under the new section 10A.
- For an undertaking which was initially located in free trade zone or export processing zone and is subsequently located in a special economic zone by reason of conversion of such zones into a special economic zone, the deduction shall be available for 10 years from the previous year in which the undertaking begins to manufacture or produce such articles or things or computer software in such free trade zone or export processing zone.
- 'Relevant assessment year' means any assessment year falling within a period of ten consecutive assessment years referred to in section 10A.
- The aforesaid deduction is not available to any undertaking from the assessment year 2011-12.

39.3 ***Amount of deduction - Special provision*** - The deduction under section 10A in the case of an undertaking which begins to manufacture or produce articles or things or computer software during April 1, 2002 and March 31, 2005† in any special economic zone, shall be as follows—

It is available for first 10 assessment years (even beyond the assessment year 2010-11).

- *First 5 years* - 100 per cent of profits and gains derived from the export of such articles or things or computer software is deductible for a period of 5 consecutive assessment years (beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce such articles or things or computer software, as the case may be)
- *Sixth and seventh year* - 50 per cent of such profits and gains is deductible for further 2 assessment years.
- *Eighth, ninth and tenth year* - For the next 3 years, a further deduction would be available to the extent of 50 per cent of the profit provided an equivalent amount is debited to the profit and loss

†If these activities are commenced after March 31, 2005, one can claim deduction under section 10AA.

account of the previous year and credited to Special Economic Zone Re-investment Allowance Reserve Account (hereinafter referred to as Special Reserve Account). The following conditions should be satisfied—

1. The Special Reserve Account should be utilised for the purpose of acquiring new plant and machinery.

2. The new plant and machinery should be first put to use before the expiry of 3 years from the end of the year in which the Special Reserve Account was created.

3. Until the acquisition of new plant and machinery the Special Reserve Account can be utilised for the business purposes of the undertaking but it cannot be utilised for distribution of dividends/profits or for remittance outside India as profits or for creating an asset outside India.

4. Prescribed particulars [Form No. 56FF] should be submitted in respect of new plant and machinery along with the return of income for the previous year in which such plant and machinery was first put to use.

5. If the Special Reserve Account is misutilised then the deduction would be taken back in the year in which the Special Reserve Account is misutilised. If the Special Reserve Account is not utilised for acquiring new plant and machinery within three years as stated above then the deduction would be taken back in the year immediately following the period of three years.

39.4 ***Consequences of amalgamation/demerger*** - If a company which is entitled for deduction under section 10A is amalgamated/demerged with another company (before claiming tax holiday for 10 years), the amalgamated company/resulting company can avail the benefit under section 10A for the unexpired period of tax holiday (including the previous year in which amalgamation/demerger takes place). However, this facility is available only when transferor-company and transferee-company are Indian companies*.

39.5 ***Power of Assessing Officer to recompute profit*** - The Assessing Officer has power to recompute profit in the following two situations—

■ *Transfer between two businesses/units owned by the taxpayer* - The following conditions should be satisfied—

1. The taxpayer carries on two or more businesses. At least one of them is qualified for deduction under section 10A/10B.

2. From the business which is eligible for deduction under section 10A/10B, some goods are transferred to any other business carried on by the taxpayer which is not eligible for deduction under section 10A/10B, or *vice versa.*

3. The consideration for such transfer, which is recorded in the books of account, is not equal to the market value of such goods on the date of transfer.

If the aforesaid conditions are satisfied, the Assessing Officer will recompute profits of the business qualified for deduction under section 10A/10B as if the transfer in either case had been made at the market value of the goods on the date of transfer.

Provisions illustrated - X Ltd. has two undertakings - Unit A (which is eligible for deduction @ 100 per cent under section 10A/10B) and Unit B (which is not eligible for a similar deduction). Goods are transferred from Unit A to Unit B. For accounting purposes, the transaction is recorded at a price, which is higher than market value. Consequently, the accounting profit of Unit A has increased (which is not chargeable to tax because of 100 per cent deduction under section 10A/10B) and the profit of Unit B has been reduced (which is taxable at regular rates). To check this practice, the Assessing Officer has power to recalculate the profit as if the transaction is recorded at the market value.

■ *Transfer by the assessee to any other person* - The following conditions should be satisfied—

1. The taxpayer (eligible for deduction under section 10A/10B) has some business transactions with any other person.

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*A similar benefit is available in the case of sections 10AA, 10B, 80-IA, 80-IAB, 80-IB, 80-IC and 80-IE. However, under section 80-IA, the benefit is available only when amalgamation/demerger takes place before April 1, 2007.

2. The business transaction is so arranged that the business transacted between them produces to the taxpayer more than the ordinary profits that might be expected to arise in such eligible business.

3. This is due to close connection between the taxpayer and the other person or due to any other reason.

If the aforesaid conditions are satisfied, the Assessing Officer shall (in computing the profits of the business eligible for deduction under section 10A/10B for the purpose of deduction under that section) take the amount of the profits as may be reasonably deemed to have been derived therefrom.

Provisions illustrated - X Ltd. has an undertaking which is eligible for deduction @ 100 per cent under section 10A/10B. Y Ltd. is not eligible for a similar deduction. Goods are purchased by X Ltd. from Y Ltd. at a price which is lower than market value. Consequently, the accounting profit of X Ltd. has increased (which is not chargeable to tax because of 100 per cent deduction under section 10A/10B) and the profit of Y Ltd. has been reduced (which is taxable at regular rates). The aggregate tax bill of the two companies has been reduced. To check this practice, the Assessing Officer has power to recalculate the amount of profits as may be reasonably deemed to have been derived therefrom.

39.6 ***Impact of claiming deduction under section 10A*** - One should note the following consequences :

■ For the assessment year(s) succeeding the last assessment year for which the deduction is claimed under this section, deduction under section 32 and the expenditures under sections 35 and 36(1)(*ix*) pertaining to the assessment year 2000-01 (or earlier year) would be considered as had been given. Unabsorbed depreciation allowances or unabsorbed capital expenditure on scientific research or family planning (pertaining to the assessment year 2000-01 or earlier years) are not allowed to be carried forward and set off against the income of assessment years following the period of deduction (*i.e.*, the assessment year succeeding the last assessment year for which deduction is claimed under section 10A).

■ The losses under section 72(1) or 74(1) or 74(3) (pertaining to the assessment year 2000-01 or earlier years) are not allowed to be carried forward in assessment years succeeding the period of deduction. The deductions under section 80-IA or 80-IB shall also not be available to such undertakings after the expiry of tax holiday period. However, there is no bar to adjust losses under sections 70 and 71. In other words, if loss is incurred by an undertaking which is otherwise eligible for deduction under section 10A, it can be set off under the provisions of sections 70 and 71 against other incomes of the taxpayer—***Sovika Infotek Ltd.*** v. ***ITO*** [2008] 23 SOT 273 (Mum.).

■ In the assessment year following period of deduction, the depreciation will be computed on the written down value of the asset as if the depreciation has actually been allowed in respect of each assessment year falling in the period of exemption.

39.7 ***Option available to new undertakings not to claim deduction under section 10A*** - The benefits under this section are optional. If the assessee does not wish to claim the benefit under section 10A he has to file a declaration to this effect. The declaration should be submitted before the due date of filing the return for the first assessment year for which the deduction under this section is available to him.

Special provisions in respect of newly established units in Special Economic Zone [Section 10AA]

39A. Section 10AA has been inserted to give income-tax concession to newly established units in Special Economic Zone.

39A.1 ***Conditions*** - The following conditions should be satisfied to claim deduction under section 10AA—

■ *Condition 1* - The assessee is an entrepreneur as defined in section 2(*j*) of SEZ Act, 2005. Entrepreneur is a person who has been granted a letter of approval by the Development Commissioner to set up a unit in a Special Economic Zone.

■ *Condition 2* - The unit in Special Economic Zone begins to manufacture or produce articles or things or provide services during the financial year 2005-06 or any subsequent year. Manufacture for this purpose means to make, produce, fabricate, assemble, process or bring into existence, by hand or by machine, a new product having a distinctive name, character or use and shall include processes such as refrigeration, cutting, polishing, blending, repair, remaking, re-engineering and includes agriculture, aquaculture, animal husbandry, floriculture, horticulture, pisciculture, poultry, sericulture, viticulture and mining.

■ *Condition 3* - It is not formed by the splitting up, or reconstruction, of a business already in existence [for a few exceptions, *see* para 254.1-1a].

■ *Condition 4* - It is not formed by the transfer to a new business, of old plant or machinery. However, it can be formed by transfer of old plant or machinery to the extent of 20 per cent [for a few exceptions, *see* para 254.1-1b].

■ *Condition 5* - The assessee has income from export of articles or thing or from services from such unit. In other words, the assessee has exported goods or provided services out of India from the Special Economic Zone by land, sea, air or by any other mode, whether physical or otherwise.

■ *Condition 6* - Books of account of the taxpayer should be audited. The taxpayer should submit audit report in Form No. 56F along with the return of income.†

39A.2 *Amount of deduction* - If the above conditions are satisfied, one can claim deduction under section 10AA. Deduction depends upon quantum of profit derived from export of articles or things or services (including computer software). It is calculated as under—

Profits of the business of the undertaking × Export turnover of the undertaking ÷ Total turnover of the business carried on by the assessee**

■ *What is "export turnover"* - For this purpose, 'export turnover' means the consideration in respect of export by the undertaking of articles or things or services received in, or brought into India by the assessee, but does not include the following :

a. freight;

b. telecommunication charges;

c. insurance attributable to the delivery of the articles or things or computer software outside India;

d. expenses, if any, incurred in foreign exchange in providing the technical services (including computer software) outside India.

Freight, telecommunication charges and insurance are deductible only if the assessee from the importers recovers these in addition to sale price of goods. If nothing is recovered from the importers but these expenses are incurred by the assessee, then no adjustment is required. What is to be excluded is out of what is received. If the consideration received is only against the goods then there is no need to deduct such expenses from the consideration received in convertible foreign exchange. In cases where such expenses are separately charged, the expenses are required to be reduced from the consideration received for the purpose of arriving the export turnover—***Patni Telecom (P.) Ltd.*** v. ***ITO*** [2008] 22 SOT 38 (Hyd.). When these expenses are excluded for the purposes of 'export turnover' then on the same assumption, reason and analogy it should be excluded from 'total turnover'.

■ *Site development of computer software* - Profits and gains derived from on site development of computer software (including services fc · development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.

■ *Losses of other undertakings* - Losses of other undertakings shall not be adjusted against profit of a unit which is eligible for deduction under section 10AA.

**"Assessee" for the purpose of section 10AA(1) is "an entrepreneure as referred to in section 2(*j*) of the SEZ Act, 2005". Consequently, in the formula given above, "assessee" is an undertaking in Special Economic Zone.

†It is not possible to attach any certificate, statement or audit report with new income-tax return forms. The assessee should himself retain the audit report in Form No. 56F. It may be furnished in original whenever the Assessing Officer wants to examine it in assessment proceedings or otherwise.

■ *Brought forward losses* - Brought forward losses (incurred after April 1, 2001) cannot be deducted from profit of the business of the undertaking. In other words, deduction under section 10AA will be available in respect of profit of an eligible undertaking without setting off of brought forward losses.

■ *Section 80AB* - Deduction under section 10AA is not controlled by section 80AB as deduction under section 10AA is not a deduction under Chapter VI-A—***Enercon Wind Farms (Krishna) Ltd.*** v. ***CIT*** [2008] 21 SOT 29 (Mum.).

39A.2-1 *DEDUCTION FOR FIRST FIVE ASSESSMENT YEARS* - 100 per cent of the profit and gains derived from export of articles or things or from services is deductible for a period of 5 consecutive assessment years. Deduction for the first year is available in the assessment year relevant to the previous year in which the unit begins to manufacture or produce articles or things or provide services.

39A.2-2 *DEDUCTION FOR SIXTH ASSESSMENT YEAR TO TENTH ASSESSMENT YEAR* - 50 per cent of the profit and gains derived from export of articles or things or from services is deductible for the next 5 years.

39A.2-3 *DEDUCTION FOR ELEVENTH ASSESSMENT YEAR TO FIFTEENTH ASSESSMENT YEAR* - For the next 5 years, a further deduction would be available to the extent of 50 per cent of the profit provided an equivalent amount is debited to the profit and loss account of the previous year and credited to Special Economic Zone Re-investment Allowance Reserve Account (hereinafter referred to as Special Reserve Account). The following conditions should be satisfied—

1. The Special Reserve Account should be utilised for the purpose of acquiring new plant and machinery.

2. The new plant and machinery should be first put to use before the expiry of 3 years from the end of the year in which the Special Reserve Account was created. For instance, if the reserve account was created during the previous year ending March 31, 2009, it should be utilized for acquiring machinery or plant on or before March 31, 2012.

3. Until the acquisition of new plant and machinery the Special Reserve Account can be utilised for the business purposes of the undertaking but it cannot be utilised for distribution of dividends/ profits or for remittance outside India as profits or for creating an asset outside India.

4. Prescribed particulars [Form No. 56FF] should be submitted† in respect of new plant and machinery along with the return of income for the previous year in which such plant and machinery was first put to use.

5. If the Special Reserve Account is misutilised, then the deduction would be taken back in the year in which the Special Reserve Account is misutilised. If the Special Reserve Account is not utilised for acquiring new plant and machinery within three years as stated above then the deduction would be taken back in the year immediately following the period of three years. For instance, if Rs. 1,50,000 is transferred to the reserve account for the year ending March 31, 2009 and out of which only Rs. 96,000 is utilized for acquiring plant and machinery up to March 31, 2012, then Rs. 54,000 would be taxable for the previous year 2012-13.

39A.4 ***Consequences for merger and demerger*** - Where an undertaking is transferred to another company under a scheme of amalgamation or demerger, the deduction under section 10AA shall be allowable in the hands of the amalgamated or the resulting company for the unexpired period. However, no deduction shall be admissible under this section to the amalgamating company or the demerged company for the previous year in which amalgamation or demerger takes place*.

39A.5 ***Consequences of claiming deduction under section 10AA*** - One should note the following consequences—

*A similar benefit is available in the case of sections 10A, 10B, 80-IA, 80-IAB, 80-IB, 80-IC and 80-IE, if transferor and transferee companies are Indian companies. However, under section 80-IA the benefit is available only when amalgamation/demerger takes place before April 1, 2007.

†It is not possible to attach any certificate, statement or audit report with new income-tax return forms. The assessee should himself retain Form No. 56FF. It may be furnished in original whenever the Assessing Officer wants to examine it in assessment proceedings or otherwise.

■ Unabsorbed depreciation allowances or unabsorbed capital expenditure on scientific research or family planning (pertaining to the assessment year 2005-06 or earlier years) are not allowed to be carried forward and set off against the income of assessment years following the period of deduction.

■ The losses under section 72(1) or 74(1) or 74(3) (pertaining to the assessment year 2005-06 or earlier years) are not allowed to be carried forward in assessment years succeeding the period of deduction. The deductions under section 80-IA or 80-IB shall also not be available to such undertakings after the expiry of tax holiday period.

■ However, there is no bar to adjust losses under sections 70 and 71. In other words, if loss is incurred by an undertaking which is otherwise eligible for deduction under section 10AA, it can be set off under the provisions of sections 70 and 71 against other incomes of the taxpayer—***Sovika Infotek Ltd.*** v. ***ITO*** [2008] 23 SOT 273 (Mum.).

■ In the assessment year following period of deduction, the depreciation will be computed on the written down value of the asset as if the depreciation has actually been allowed in respect of each assessment year falling in the period of exemption.

39A.6 ***Power of Assessing Officer to recompute profit*** - The Assessing Officer has power to recompute profit in some cases. These cases are given by section 80-IA(8)/(10) [*see* para 253.1-3e].

Special provisions in respect of newly established hundred per cent export-oriented undertakings [Sec. 10B]

40. Section 10B has been inserted with a view to providing incentive (similar to tax holiday available under section 10A) to hundred per cent export-oriented units.

The provisions applicable from the assessment year 2001-02 are given below :

40.1 ***Conditions to be satisfied*** - An undertaking must satisfy the following conditions in order to avail the deduction under section 10B.

40.1-1 *IT MUST BE AN APPROVED HUNDRED PER CENT EXPORT-ORIENTED UNDERTAKING* - The expression "hundred per cent export-oriented undertaking" means an undertaking which has been approved as a hundred per cent export-oriented undertaking by the Board appointed in this behalf by the Central Government under section 14 of the Industries (Development and Regulation) Act, 1951.

Statutory approval by the Board as 100 per cent EOU has to be obtained for availing exemption under section 10B; a 100 per cent EOU under STP scheme cannot be equated with 100 per cent EOU approved by Board — ***Infotech Enterprises Ltd.*** v. ***CIT*** [2003] 85 ITD 325 (Hyd.).

40.1-2 *IT MUST PRODUCE OR MANUFACTURE ARTICLES OR THINGS OR COMPUTER SOFTWARE* - It must manufacture or produce† any article or thing or computer software. The expression computer software means—

a. any computer programme recorded on any disc, tape, perforated media or other information storage device; or

b. any customized electronic data or any product or service of similar nature as may be notified by the Board,

which is transmitted or exported from India to any place outside India by any means.

The Central Board of Direct Taxes has specified the following Information Technology enabled products or services, as the case may be, for this purpose : (*i*) Back-office Operations; (*ii*) Call Centres; (*iii*) Content Development or Animation; (*iv*) Data Processing; (*v*) Engineering and Design; (*vi*) Geographic Information System Services; (*vii*) Human Resource Services; (*viii*) Insurance Claim Processing; (*ix*) Legal Databases; (*x*) Medical Transcription; (*xi*) Payroll; (*xii*) Remote Maintenance; (*xiii*) Revenue Accounting; (*xiv*) Support Centres; and (*xv*) Web-site Services.

†The expression "manufacture or produce" will include the cutting and polishing of precious and semi-precious stones.

■ It is not the requirement of section 10B that the assessee-company should itself own plant, machinery or equipment and manufacture or produce computer software on the same in order to be eligible for the exemption—***ITO*** v. ***Techdrive (India) (P.) Ltd.*** [2008] 24 SOT 1 (Mum.).

40.1-3 *IT SHOULD NOT BE FORMED BY SPLITTING/RECONSTRUCTION OF BUSINESS* - *See* para 39.1-2.

40.1-4 *IT SHOULD NOT BE FORMED BY TRANSFER OF OLD MACHINERY* - *See* para 39.1-3.

40.1-5 *THERE MUST BE REPATRIATION OF SALE PROCEEDS INTO INDIA* - *See* paras 39.1-4, 39.1-4a and 39.1-4b.

40.1-6 *AUDIT REPORT SHOULD BE SUBMITTED† IN FORM NO. 56G* - *See* para 39.1-5.

40.1-7 *RETURN OF INCOME* - From the assessment year 2006-07, return of income should be submitted on or before the due date of submission of return of income given by section 139(1). If return is not submitted or return is submitted belatedly, deduction under this section is not available.

40.2 ***Amount of deduction*** - If the aforesaid conditions are satisfied, the deduction under section 10B may be computed as under :

Profits of the business of the undertaking × Export turnover ÷ Total turnover of the business carried on by the undertaking.

■ *Export turnover* - For this purpose, 'export turnover' means the consideration in respect of export by the undertaking of articles or things or computer software received in, or brought into India by the assessee in convertible foreign exchange within the prescribed period, but does not include the following :

a. freight;

b. telecommunication charges;

c. insurance attributable to the delivery of the articles or things or computer software outside India;

d. expenses, if any, incurred in foreign exchange in providing the technical services outside India.

■ *On site development of software* - Profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.

■ *Interest* - Interest received by an assessee on a deposit made for the purpose of getting a bank guarantee in favour of the Government of India to import goods free of duty is not eligible for deduction under section 10B—***Tocheunglee Stationery Mfg. Co. (P.) Ltd.*** v. ***ITO*** [2006] 5 SOT 428 (Chennai).

■ *Commercial basis* - The Karnataka High Court in ***CIT*** v. ***Himatasingike Seide Ltd.*** [2006] 156 Taxman 151 held that exemption in terms of section 10B cannot be allowed on commercial basis. It held that section 10B cannot be read in isolation, hence calculation must be made in accordance with the provision of the Act. Thus, amount of unabsorbed depreciation need to be adjusted while computing section 10B exemption. In this case the assessee computed exemption in section 10B without adjusting unabsorbed depreciation while it adjusted the same against other incomes.

■ *Sale by one EOU to another EOU* - The word "export", in the absence of any specific definition under the Act, would necessary have to be interpreted in accordance with the meaning ascribed to the said word under the relevant exim policy, which deems the sale by one EOU to another, as export—***ITO*** v. ***Anita Synthetics (P.) Ltd.*** [2006] 100 TTJ (Ahd.) 277.

■ *Deduction of freight, telecommunication charges, etc.* - Freight, telecommunication charges and insurance are deductible only if the assessee from the importers recovers these in addition to sale

†It is not possible to attach any certificate, statement or audit report with new income-tax return forms. The assessee should himself retain the audit report in Form No. 56G. It may be furnished in original whenever the Assessing Officer wants to examine it in assessment proceedings or otherwise.

price of goods. If nothing is recovered from the importers but these expenses are incurred by the assessee, then no adjustment is required. What is to be excluded is out of what is received. If the consideration received is only against the goods then there is no need to deduct such expenses from the consideration received in convertible foreign exchange. In cases where such expenses are separately charged, the expenses are required to be reduced from the consideration received for the purpose of arriving the export turnover—***Patni Telecom (P.) Ltd.*** v. ***ITO*** [2008] 22 SOT 38 (Hyd.). When these expenses are excluded for the purposes of 'export turnover' then on the same assumption, reason and analogy it should be excluded from 'total turnover'.

■ *Section 80AB* - Deduction under section 10B is not controlled by section 80AB as deduction under section 10B is not a deduction under Chapter VI-A—***Enercon Wind Farms (Krishna) Ltd.*** v. ***CIT*** [2008] 21 SOT 29 (Mum.).

40.3 ***Period of deduction*** - If the aforesaid conditions are satisfied, the assessee can claim deduction under section 10B, from his total income for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce such articles or things or computer software.

■ For the undertakings which have claimed exemption upto assessment year 2000-01 under the old section 10B, the deduction shall be available for the unexpired period of 10 consecutive assessment years under the new section 10B.

■ 'Relevant assessment year' means any assessment year falling within a period of ten consecutive assessment years referred to in section 10B.

■ No deduction under section 10B shall be allowed to any undertaking from the assessment year 2011-12.

40.4 ***Consequences in case of amalgamation or demerger*** - *See* para 39.4.

40.5 ***Power of Income-tax department to recompute profits*** - *See* para 39.5.

40.6 ***Impact of availing deduction under section 10B*** - In computing the total income of the assessee of the assessment year immediately succeeding the deduction period the following points should be noted—

■ For the assessment year(s) succeeding the last assessment year for which the deduction is claimed under this section, deduction under section 32 and the expenditures under sections 35 and 36(1)(*ix*) (pertaining to the assessment year 2000-01 or earlier years) would be considered as had been given full effect to for the period covered under the period of deduction. Thus, unabsorbed depreciation allowances or unabsorbed capital expenditure on scientific research or family planning (pertaining to the assessment year 2000-01 or earlier years) are not allowed to be carried forward and set off against the income of assessment years following the period of deduction.

■ The losses under section 72(1) or 74(1) or 74(3) (pertaining to the assessment year 2000-01 or earlier years) are not allowed to be carried forward in assessment years succeeding the period of deduction. The deductions under section 80-IA or 80-IB shall also not be available to such undertakings after the expiry of tax holiday period.

However, there is no bar to adjust losses under sections 70 and 71. In other words, if loss is incurred by an undertaking which is otherwise eligible for deduction under section 10B, it can be set off under the provisions of sections 70 and 71 against other incomes of the taxpayer—***Sovika Infotek Ltd.*** v. ***ITO*** [2008] 23 SOT 273 (Mum.).

■ In the assessment year following period of deduction, the depreciation will be computed on the written down value of the asset as if the depreciation has actually been allowed in respect of each assessment year falling in the period of deduction.

40.7 ***Option available to new undertaking not to claim deduction under section 10B*** - Section 10B will be applicable to all eligible undertakings unless the assessee opts out of scheme by making a

declaration under sub-section (8). The declaration should be submitted before the due date of furnishing return of income. If the assessee has opted out of provisions of section 10B by filing declaration under section 10B(7) during course of assessment proceedings of relevant assessment year, revenue cannot thrust exemption provided under section 10B upon assessee—***Moser Baer India Ltd.*** v. ***CIT*** [2007] 11 SOT 715 (Delhi).

40.8 ***Subsequent conversion into export oriented undertaking*** - There is an undertaking set up in Domestic Tariff Area (DTA). It derives profit from export of articles or things or computer software manufactured or produced by it. It is subsequently converted into an export oriented undertaking (EOU). It shall be eligible for deduction under section 10B, on getting approval as 100 per cent export oriented undertaking. In such a case, the deduction shall be available only from the year in which it has got the approval as 100 per cent EOU and shall be available only for the remaining period of ten consecutive assessment years, beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things or computer software, as a DTA unit. Further, in the year of approval, the deduction shall be restricted to the profits derived from exports, from and after the date of approval of the DTA unit as 100 per cent EOU. Moreover, the deduction on such units in any case will not be available after assessment year 2009-10—**Circular No. 1/2005**, dated January 6, 2005.

Provisions illustrated - To clarify the above position, the following illustrations are given—

Different situations	*The year in which the undertaking is set up in domestic tariff area*	*The year in which approval as 100 per cent EOU is granted*	*Previous years for which deduction is available under section 10B*
Situation A	1999-2000	2004-05 (with effect from October 15, 2004)	2004-05 (with effect from October 15, 2004) to 2008-09
Situation B	1996-97	2007-08	No deduction as the 10-year time-limit expires with the previous year 2005-06
Situation C	2000-01	2002-03 (in 2002-03 it acquires more than 20 per cent old plant and machinery to start development of computer software)	No deduction as there is transfer of old plant and machinery
Situation D	2003-04	2006-07	2006-07 to 2008-09
Situation E	1991-92	2004-05	No deduction as the 10-year time-limit has expired before 2004-05

Special provision in respect of export of artistic hand-made wooden articles [Sec. 10BA]

42. Section 10BA is applicable from the assessment year 2004-05.

42.1 ***Conditions*** - To claim deduction under section 10BA, an undertaking should satisfy the following conditions —

42.1-1 *IT SHOULD MANUFACTURE ELIGIBLE ARTICLES OR THINGS* - The undertaking should manufacture or produce eligible articles or things without the use of imported raw material. "Eligible articles or things" means all hand-made articles or things, which are of artistic value and which requires the use of wood as the main raw material.