profit as per books of account, before deduction of salary to partners and interest to partner C is Rs. 2,50,000. Compute the total income of the firm, applying the provisions of section 44AD. [MAY 2004]

■

Computation of total income of firm	*Rs.*
Income from business of civil construction (8% of Rs. 30,00,000)	2,40,000
Less: Expenses	
Salary and interest paid to partners as permitted by section 40*(b)* [*see* Note]	1,50,000
Other expenses [except salary/interest to partners in the case of a firm, no other expenditure is deductible]	*Nil*
Income from civil construction	90,000
Other income	*Nil*
Gross total income	90,000
Less: Deductions under sections 80C to 80U	*Nil*
Net income	90,000

Note : Salary to partners is Rs. 90,000 (*i.e.*, Rs. 2,500×3×12). Interest to partner C is allowable @ 12% per annum (*i.e.*, Rs. 5,00,000 @ 12%).

Problem 5.6-10 - *A company had an inventory of closing stock on March 31, 2009 the cost of manufacture of which is Rs. 10 lakh. Since the goods are liable to excise duty, a provision of Rs. 10 lakh towards the duty is also made in the accounts. Since the excise duty is eligible for deduction only on actual payment, the company valued the closing stock at cost,* viz., *Rs. 10 lakh. Discuss the position from the taxation point of view.* [MAY 2004]

■

In ***Berger Paints India Ltd.*** v. ***CIT*** [2004] 135 Taxman 586 (SC) it was held that the entire amount of excise duty paid by the assessee in a particular accounting year is an allowable deduction in respect of that year, irrespective of the amount of excise duty which is included in the valuation of the assessee's closing stock at the end of the accounting year.

In the present problem, the company should include the excise duty in the valuation of closing stock as per section 145A. Deduction of excise duty shall be available as per provisions of section 43B.

Problem 5.6-11 - *X Ltd., a manufacturing company, which maintains accounts under mercantile system, has disclosed a net profit of Rs. 12.50 lakh for the year ending March 31, 2009. You are required to compute the taxable income of the company for the assessment year 2009-10 after considering the following information, duly explaining the reasons for each item of adjustment :*

1. *Advertisement expenditure includes the sum of Rs. 60,000 paid in cash to the sister concern of a director, the market value of which is Rs. 52,000.*

2. *Legal charges include a sum of Rs. 45,000 paid to a consultant for framing a scheme of amalgamation duly approved by the Central Government.*

3. *Repairs of plant and machinery include Rs. 1.80 lakh towards replacement of worn out parts of machineries.*

4. *A sum of Rs. 6,000 on account of liability foregone by a creditor has been taken to general reserve. The same was charged to the revenue account in the assessment year 2004-05.*

5. *Sale proceeds of import entitlements amounting to Rs. 1 lakh has been credited to profit & loss account, which the company claims as capital receipt not chargeable to income-tax.*

6. *Being also engaged in the bio-technology business, the company incurred the following expenditure on in-house research and development as approved by the prescribed authority : (a) research equipments purchased : Rs. 1,50,000; (b) remuneration paid to scientists : Rs. 50,000. The total amount of Rs. 2,00,000 is debited to the profit & loss account.* [NOVEMBER 2003]

■

	Rs.
Net profit as per profit and loss account	12,50,000
Add : Disallowance under section 40A(2) on account of excessive payment made to the sister concern of a director (Rs. 60,000—Rs. 52,000)	(+) 8,000
Add : Disallowance under section 40A(3) on account of payment of a sum exceeding Rs. 20,000 in cash to the sister concern of a director (*i.e.*, 100% of Rs. 52,000)	(+) 52,000
Add : Expenditure incurred by an Indian company on amalgamation is allowable as deduction under section 35DD in five equal instalment for five successive previous years. Four-fifth of Rs. 45,000, being paid to a consultant for framing scheme of amalgamation is, therefore, added back to the net profit	(+) 36,000
Add : Benefit obtained by way of remission of liability forgone by creditor is taxable as business income under section 41(1)	(+) 6,000

	Rs.
Less : Expenditure incurred by a company engaged in business of bio-technology on in-house research qualified for a weighted deduction of 1.5 times of the expenditure under section 35(2AB). Rs. 3,00,000 [*i.e.*, Rs. 2,00,000 × 1.5] is deductible expenditure. However, Rs. 2,00,000 is debited to profit and loss account. Rs. 1,00,000 is, therefore, to be deducted from net profit.	(-) 1,00,000
Net income	12,52,000

Notes :

1. Repairs of plant and machinery towards replacement of worn out parts of machineries is fully deductible under section 37(1) — *see CIT* v. *Sri Hari Mills Pvt. Ltd.* [1999] 105 Taxman 210 (Mad.).

2. Sale proceeds of import entitlements, though it is a receipt of capital nature, is taxable under section 28(*iiia*).

Problem 5.6-12 - *The written down value of plant and machinery on April 1, 2008 of X Ltd. engaged in manufacturing of PVC granules is Rs. 10 crore. The company purchases additional plant and machinery of Rs. 8 crore on April 18, 2008 inclusive of a second-hand machine imported from China of Rs. 2 crore to increase its installed capacity of production from 1000 tonne per annum to 1500 tonne per annum. The production from new machine was taken with effect from December 1, 2008. Workout by giving reasons the amount of allowable depreciation.* [NOVEMBER 2003]

■

	Rs. (in lakh)
Depreciated value of block of asset on April 1, 2008	10,00
Add : Cost of plant and machinery purchased on April 18, 2008	8,00
Written down value of block of assets	18,00
Normal depreciation [1/2 of 15% of Rs. 800 lakh + 15% of Rs. 10,00 lakh]	210
Additional depreciation [1/2 of 20% of Rs. 600 lakh]	60

Note - No additional depreciation is available on second hand machinery.

Problem 5.6-13 - *Balance Sheet of X Ltd., a shipping company, shows the following details as at March 31, 2008:*

	Rs. (in lakh)
Balance in reserve created under section 33AC	*1,000*
Paid up capital	*500*
Balance in general reserve	*100*
Share premium account	*50*
Written down value of ships	*3,000*

Net profit for the year ending March 31, 2009 is Rs. 400 lakh. Following information is further collected from records:

1. Amount of Rs. 60 lakh being the deficit of written down value of a ship retired from the business and sold on June 13, 2008 for Rs. 150 lakh, was charged in P & L account.

2. Payments charged in miscellaneous expenses include an amount of Rs. 10 lakh paid to a DON who abducted one of its ships while it was in red sea.

3. Depreciation for the year, Rs. 800 lakh was charged on straight line method basis.

4. A ship added in its fleet during the year costed Rs. 920 lakh sailed for her first journey from JNPT on October 10, 2008.

5. A ship was added in 2005-06 with the financial assistance of a foreign bank. The last instalment of loan of US $ 50,000 was paid on September 18, 2008. The value of one US $ at the time when loan was taken was Rs. 44 but at the time of repayment it was Rs. 48. The exchange difference was charged in miscellaneous expenses in profit and loss account.

Compute the taxable income of X Ltd. for assessment year 2009-10, with reasons for adjustments made. [MAY 2003]

■

	(Rs. in lakh)
Net profit	400
Adjustments	
Add: Loss on sale of ship	(+)60
Add: Payment to DON	(+)10
Add: Depreciation taken separately	(+) 800
Add: Exchange difference	(+) 2
Less: Depreciation [*see* Note 1]	(-) 662.40
Balance	609.6

	(Rs. in lakh)
Less: Deduction under section 33AC [*see* Note 2]	*Nil*
Net income	609.6

Notes:

1. Computation of depreciation:

Depreciated value of the block on April 1, 2008	3,000
Add: Cost of new ship	920
Less: Sale proceeds of ship	(-)150
Add: Exchange difference	(+)2
Written down value	3,722
Depreciation [@20% of Rs. 2,852 lakh + @ 10% of Rs. 920 lakh]	662.40

2. Deduction under section 33AC is now not available . However, X Ltd. can opt for the Tonnage Tax Scheme [*see* para 532].

Problem 5.6-14 - *By virtue of an agreement entered into on September 1, 2008 between X Ltd. and Y Ltd., X Ltd. agrees not to carry on any business relating to computer software in India for next 3 years, for which Y Ltd. agrees to pay a sum of Rs. 12,00,000 to X Ltd. The said amount was paid on December 1, 2008. Indicate treatment of such receipt in the hands of X Ltd. for the assessment year 2009-10 ?* [MAY 2003]

■

It will be taxable in the hands of X Ltd. under section 28(*va*) [*see* para 101.12].

Problem 5.6-15 - *X Airlines incorporated as a company in USA operates its flights to India and* vice versa *during the year 2008-09 (April, 2008 to March, 2009) and collects charges of Rs. 125 lakh for carriage of passengers and cargo out of which Rs. 65 lakh were received in US dollars for the passenger fare booked from New York to Mumbai. The total expenses for the year on operation of such flights were Rs. 195 lakh. Income chargeable to tax of the foreign airlines may please be computed.* [NOVEMBER 2002 (New)]

■

By virtue of section 44BBA, 5 per cent* of the following is chargeable to tax in India—

a. the amount paid or payable (whether in or out of India) to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

b. the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

Amount taxable will be determined as follows—

	Fare booked from Mumbai to New York whether paid in India or not	*Fare booked from New York to Mumbai*	
		If paid in India	*If paid outside India*
	Rs.	*Rs.*	*Rs.*
Fare	60,00,000	65,00,000	65,00,000
Amount taxable @ 5%**	3,09,000	3,34,750	—

Problem 5.6-16 - *A company, carrying on business of a five star hotel, claims that the building in which the business is carried on has been specially designed and equipped and, therefore, must be treated as "plant" for deduction of depreciation under section 32. Will the claim be admissible? Give reasons for your answer.* [NOVEMBER 2002]

■

The definition of "plant" as given under section 43(*3*) has been amended. Under the amended version, a building cannot be taken as plant.

**Plus* surcharge (in case net income of a foreign company exceeds Rs. 1 crore) *plus* education cess *plus* secondary and higher education cess, *see* Annex 1.

***Plus* education cess @ 2% of tax and surcharge *plus* secondary and higher education cess @ 1% (surcharge @ 2.5% of tax is applicable if net income of a foreign company exceeds Rs. 1 crore).

Problem 5.6-17 - *A firm consisting of four partners was dissolved consequent to the death of one of the partners. The remaining partners reconstituted the firm immediately, without discontinuance of the business, and carried on the business as before. The inventory of stocks on the date of dissolution was valued at cost, which was lower than the market value and all other assets were valued at book value, for the purpose of transfer to the reconstituted firm. The Assessing Officer, while arriving at the total income of the firm as constituted prior to dissolution, valued the stocks as well as the other assets at market value. You are required to comment on the correctness of the Assessing Officer's action.* [MAY 2002]

■

In ***Sakthi Trading*** v. ***CIT*** [2001] 250 ITR 871/118 Taxman 301 (SC), it was held that where, on dissolution following death of one partner, the assessee-firm was reconstituted with remaining partners without discontinuation of business, the closing stock of the firms was to be valued at cost or market price whichever was lower.

In the present problem, in view of the aforesaid case, the decision of the Assessing Officer to value the stocks at market value is incorrect. However, in respect of other assets, section 45(4) would apply and accordingly, the Assessing Officer is correct in adopting market value while arriving at the total income of the firm.

Problem 5.6-18 - *Discuss the following :*

1. An assessee incurs expenditure of a capital nature on scientific research related to the business carried on by him. Such expenditure, which is allowable under section 35, remains unabsorbed in the business in which it was incurred. How will the unabsorbed portion be dealt with ?

2. You are engaged to carry out the tax audit of a firm under section 44AB and in carrying out this assignment, you are required to tackle the following issues. Indicate how you will deal with them:

i. *Duty of the auditor to report on a penalty or fine imposed on the firm.*

ii. *Expenditure incurred in respect of which payment has been made of a sum exceeding Rs. 20,000, otherwise than by a crossed cheque or crossed bank draft.*

iii. *Sum payable as an employer by way of contribution to provident fund.*

iv. *Particulars of loans or deposits exceeding the limit specified in section 269SS taken during the year.*

v. *Accounting ratios in a trading concern.* [NOVEMBER 2001]

■

Pointwise answer :

1. See para 114.9.

2. The following issues are raised—

(*i*) The tax auditor has to specify the penalty or fine for violation of law and any other penalty or fine as well as expenditure incurred for any purpose which is an offence or which is prohibited by law in Form No. 3CD. The tax auditor should obtain in writing the details of all payments by way of penalty or fine for violation of law or otherwise and how such amount has been dealt with in the books of account. He is to give details of such items as have been charged in the account and need not express any opinion as to the allowability or otherwise of the amount.

(*ii*) The tax auditor should obtain a list of all cash payments in respect of expenditure exceeding Rs. 20,000 made during the year, which should also include the list of payments exempted in terms of rule 6DD. The list should be verified with the books of account in order to ascertain whether the conditions precedent are specified.

Expenditure items in respect of which specific exemption has been granted are not required to be stated. If there are practical difficulties in verifying whether payments have actually been made through account payee crossed cheques or account payee crossed bank draft, suitable qualification should be made as under: "It is not possible to verify whether (or not) the payment in excess of Rs. 20,000 has been made by account payee crossed cheques or account payee bank draft as necessary evidence is not in possession of the assessee."

(*iii*) Detailed information is to be furnished with regard to amount received in respect of provident fund contributions during the previous year, due date for payment, amount paid during the previous year, liability incurred during the previous year, in case the amount is paid by cheque, whether realised within 15 days, etc.

In view of the voluminous nature of the information, the tax auditor can apply test checks and compliance tests to satisfy himself. In the case of big assessees, where the information to be stated is voluminous, the tax auditor may exercise his professional judgment and state only those cases where the actual date of payment is beyond the due date of payment.

(*iv*) The particulars such as (*a*) name and address of the lender or depositor; (*b*) amount of loans or deposit taken or accepted; (*c*) maximum amount outstanding in the account at any point during the previous year; and (*d*) whether the loan or deposit was taken or accepted otherwise than by an account payee cheque or bank draft should be noted by the tax auditor.

The tax auditor should verify all loans or deposits where the balance has reached Rs. 20,000 or more during the previous year, because the total of the deposits may be Rs. 20,000 and above, even though each individual item

may be less than Rs. 20,000. Where there are practical difficulties in verifying whether the loan or deposit is taken by crossed cheque or crossed draft, he should make a suitable comment as under:

"It is not possible to verify whether (or not) loans or deposits have been taken or accepted otherwise than by an account payee cheque or account payee bank draft as the necessary evidence is not available with the assessee".

(*v*) Gross profit turnover ratio, net profit turnover ratio, and stock turnover ratio should be computed by the tax auditor in the case of a trading concern. While calculating these ratios, the tax auditor should assign meanings to the above terms as understood by generally accepted accounting principles.

Problem 5.6-19 - *Discuss the following :*

1. *X traders engaged in manufacturing was in receipt of sales tax subsidy from the State Government as the unit was in backward area. The subsidy is related to the sale of its products and payable once the production is commenced. X traders claims that the subsidy is a capital receipt and hence cannot be included as income.*

2. *A corporation was set up by the State Government transferring all the buses owned by it for a consideration of Rs. 75 lakh, which was discharged by the corporation by issue of equity shares. The corporation in its assessment claimed depreciation. Can the depreciation be denied in the corporation hands on the ground that there was no registration of the buses in favour of the corporation.*

3. *X succeeded to his father's business in the year 2002. In the previous year ending March 31, 2009, X has written off the balance in the name of Y, which relates to supply made by his father, when he carried on business. X desires to know whether the write off could be eligible for deduction.*

4. *Discuss the tax treatment of surplus arising out of deep discount bonds :*

i. *On sale of such bonds.*

ii. *On realisation of such bonds on maturity.*

5. *X is an association governed by the provisions of section 44A. The subscription receipts for the year ended 2008-09 were Rs. 60,000. The expenditure in the normal course of its activities was Rs. 85,000. Its other income taxable works out to Rs. 75,000. On these facts, you are consulted as to :*

i. *How X's taxable income will be determined for assessment year 2009-10.*

ii. *In case the association did not have the other income taxable will there be any difference in the computation of its income.*

6. Income computed on the accrual basis is no longer relevant for taxation of income. Critically analyse the validity or otherwise of the same. [MAY 2001]

■

Pointwise answer :

1. See para 16.1-19 for Supreme Court's decision in *Sahney Steel & Press Works Ltd.* v. *CIT* [1997] 94 Taxman 368/228 ITR 253.

Since the payment in the nature of a subsidy is made to assist the assessee in carrying on his trade or business, it has to be treated as a trading receipt. Hence, the claim of X traders cannot be accepted.

2. In *CIT* v. *U.P. State Agro Industrial Corpn. Ltd.* [1981] 127 ITR 97 (All.), it was held that as a result of the transaction entered into between the State Government and the assessee, the latter came into the position of exercising the rights of the owner in respect of the property on its own behalf and not on behalf of the State Government. The State Government had received the consideration for transfer and had also put the assessee in possession and had to perform its part of the contract, *i.e.*, execution of the sale deed. Under section 53A of the Transfer of Property Act, 1882, the State Government is debarred from enforcing any right against the assessee and the assessee would continue to be the owner of the property even though no sale deed is executed in its favour. Therefore, the assessee is entitled to depreciation under section 32. The same opinion is expressed in *Mysore Minerals Ltd.* v. *CIT* [1999] 106 Taxman 166 (SC) and *CIT* v. *J.K. Tourism Development Corpn.* [2001] 114 Taxman 734 (J&K).

In the present problem, in view of the aforesaid case, the corporation is entitled to claim depreciation under section 32.

3. See para 132.7. In the present problem, X can claim the write off as deduction under section 36(1)(*vii*).

4. Taxability of income relating to deep discount bonds - On sale of such bonds - As per letter : F. No. 225/45/96 - IT (A-II), dated March 12, 1996 of the CBDT, on transfer of bonds before maturity the difference between the sale consideration and the issue price will be treated as capital gain/loss if the assessee purchased the bonds by way of investment. However, in the case of an assessee who deals in purchase and sale of bonds, securities, etc., the profit or loss shall be treated as trading profit or loss.

On realisation of such bonds on maturity - As per letter : F. No. 225/45/96-IT (A-II), dated March 12, 1996 of the CBDT, the difference between the issue price and the redemption price of deep discount bonds will be treated as interest income assessable under the Act.

5. Computation of taxable income of X association

	Rs.	*Rs.*
Subscription receipts	60,000	
Less : Expenditure allowable	85,000	
Income derived from performing specific services for members (*a*)		(-) 25,000
Other taxable income (*b*)		75,000
Less : Loss subject to a maximum of 50% of (*b*)		(-) 25,000
Net income		50,000

In case the association does not have the other income taxable, the net income shall be *nil* and the deficiency of Rs. 25,000 [as computed under (*a*) (*supra*)] shall not be allowed to be carried forward and set off against the income in the next assessment year.

6. As per section 145, 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 - *see* para 18.

For provisions of section 43B, *see* para 155.

For provisions of section 40A(7), *see* para 151 (provision of gratuity is allowable on payment basis only).

For provisions of section 145A, *see* para 163.11.

Problem 5.6-20 - *Discuss the following :*

1. *Successor in business for the purpose of profits chargeable to tax under section 41.*

2. *X Ltd., during the financial year ending March 31, 2009, paid production bonus of an amount of Rs. 3 lakh pursuant to a settlement arrived with the workers in addition to the statutory payment of Rs. 1 lakh as per Bonus Act, on these facts, your advise is sought.*

(i) *Whether the sum of Rs. 3 lakh is deductible as per the provisions of section 36(1)*(ii) ?

(ii) *If the claim is not so deductible, can it be claimed under any other provision ?* [NOVEMBER 2000]

■

Pointwise answer :

1. See para 156.

2. Rs. 3 lakh paid as production bonus is deductible as per the provisions of section 36(1)(*ii*) subject to section 43B. In case production bonus is not deductible under section 36(1)(*ii*), it can be claimed as a deduction under section 37(1) as the expenditure is laid out wholly and exclusively for the purpose of business.

Problem 5.6-21 - *Discuss the following :*

1. *A liability towards expenditure as per agreement was provided in the books. However, it was disputed for payment, before a court of law on interpretation of clauses of the agreement. Can it be claimed in the year of provision ?*

2. *A company paid the full consideration for building acquired for its administrative office and occupied the same as the possession was taken. The registration could not take place before the end of the previous year for some reason or other. Can the depreciation claim be made ?*

3. *Secret commission was paid and debited under commission account. Is it allowable as expenditure ?*

4. *An assessee purchases know-how for manufacture of fuel injection pipes on April 10, 2008. He wants proportional reduction for six assessment years under section 35AB commencing from assessment year 2009-10. Is this allowable ?* [MAY 2000]

■

Pointwise answer :

1. In *Kedarnath Jute Mills Ltd.* v. *CIT* [1971] 82 ITR 363 (SC), it was held that where liability exists *in praesenti*, the claim for the same cannot be denied merely because it has been disputed, in case the assessee maintains his books of account on mercantile basis of accounting. A liability *in praesenti* is not a contingent liability. It has to be provided so that the same cannot be denied at a later date on the premise that it has not been provided in the year in which the liability did really accrue.

In the present problem, in view of the aforesaid case, the liability can be claimed as deduction in the year of provision.

2. Anyone in possession of property in his own title exercising such dominion over the property as would enable others being excluded therefrom and having right to use and occupy the property and/or to enjoy its usufruct in his own right would be the owner of the buildings though a formal deed of title may not have been executed and registered as contemplated by the Transfer of Property Act, 1882, Registration Act, etc. The intention of the Legislature, in enacting section 32, would be best fulfilled by allowing deduction in respect of depreciation to the person in whom for the time

being vests the dominion over the building and who is entitled to use it in his own right and is using the same for the purpose of his business or profession—*Mysore Minerals Ltd.* v. *CIT* [1999] 106 Taxman 166/239 ITR 775 (SC).

In the present problem, in view of the aforesaid case, depreciation under section 32 can be claimed by the company.

3. Where the Tribunal upheld deduction of secret commission as business expenditure without satisfying itself that it was not incurred by the assessee for any purpose which was an offence or which was prohibited by law, as provided in *Explanation* to section 37(1), the matter should be remanded to the Tribunal to consider and decide the controversy in light of the said *Explanation*—*CIT* v. *Taraporvala Sons Co. (P.) Ltd.* [1999] 105 Taxman 438/239 ITR 319 (Bom.).

Where the Tribunal had found as a fact that the assessee had failed to establish that the secret commission was expended by it for the purpose indicated by it, commission was not allowable —*Fresh Dyes and Chemicals (I) (P.) Ltd.* v. *CIT* [1993] 201 ITR 253/71 Taxman 165 (SC). Secret commission paid to promote sales is not an allowable deduction—*Goodlas Nerolac Paints Ltd.* v. *CIT* [1982] 137 ITR 58 (Bom.).

In the present problem, in view of the aforesaid cases, secret commission paid by the company in contravention of the *Explanation* to section 37(1), is not allowable as a deduction.

4. In case capital expenditure on acquisition of technical know-how is incurred on or after April 1, 1998, one can claim depreciation under section 32. In other words, deduction of the capital expenditure on technical know-how in six equal annual instalments starting with the year in which payment is made is permissible if expenditure in respect of technical know-how is incurred up to March 31, 1998.

Problem 5.6-22 - *X purchased a house property on December 12, 2006 for Rs. 10,00,000. Till May 1, 2008, the same was self-occupied as a residence. On this date, the said building was brought into use for the purpose of his medical profession. What would be the depreciation allowable for the assessment year 2009-10, assuming that he owns no other building and the rate of depreciation is 10 per cent? Will the answer be different if the house property had been gifted to him by his father, who had purchased the same on May 1, 2005 for Rs. 9,00,000?* [NOVEMBER 1999]

■

According to *Explanation 5* to section 43(*1*), where a building, previously the property of the assessee is brought into use for the purpose of business or profession, the actual cost of the asset to the assessee will be the actual cost of the building to the assessee, as reduced by depreciation, calculated at the rates in force on that date, that would have been used for the purposes of business or profession since the date of its acquisition by the assessee.

Computation of depreciation for the assessment year 2009-10 :	*Rs.*
Purchase of house property on December 12, 2006	10,00,000
Less : Depreciation for the previous year 2006-07 [50% of 10% of Rs. 10,00,000, as the property is used for less than 180 days]	50,000
Written down value as on April 1, 2007	9,50,000
Less : Depreciation for the previous year 2007-08 [10% of Rs. 9,50,000]	95,000
Written down value as on April 1, 2008	8,55,000
Depreciation for the assessment year 2009-10	85,500

According to *Explanation 2* to section 43(*1*), where an asset is acquired by the assessee by way of a gift or inheritance, the actual cost of the asset to the assessee will be actual cost to the previous owner as reduced by the following :

a. depreciation actually allowed in respect of that asset in respect of any previous year relevant to the assessment year commencing before April 1, 1988; and

b. depreciation that would have been allowable from the assessment year 1988-89 onwards as if that asset was the only asset in the relevant block of assets.

Regardless of the fact whether the house property was used by X's father for self-residence or business purpose, the written down value of the property in the hands of X's father shall be determined as under :

	Rs.
Purchase of house property	9,00,000
Less : Depreciation for the previous year 2005-06	90,000
Written down value as on April 1, 2006	8,10,000
Less : Depreciation for the previous year 2006-07	81,000
Written down value as on April 1, 2007	7,29,000
Less : Depreciation for the previous year 2007-08	72,900
Written down value as on April 1, 2008	6,56,100

Depreciation for the assessment year 2009-10 is Rs. 65,610.

Problem 5.6-23 - *Discuss the following issues in the computation of income from business for the assessment year 2009-10 :*

1. *A company wants to claim depreciation on technical know-how acquired in August 14, 2008 for the manufacture of a new product for its business at a lump sum cost of Rs. 12 lakh.*

2. *A company imported machinery on September 15, 2008 at a cost of Rs. 10 crore. The custom duty payable thereon was 20 per cent. The company claimed Cenvat credit of Rs. 1 crore against purchase of raw materials. The rate of depreciation on the machinery is 15 per cent. Assuming that it was put to use on October 15, 2008 what is the depreciation allowable on the machinery ?*

3. *A company was a lessee of an old building under an agreement with the lessor. It demolished the old building and built a new building on the same site at a cost of Rs. 10 lakh and was permitted to reoccupy the new building for a further period of 20 years at the old rent. It claimed the expenditure of Rs. 10 lakh as revenue expenditure.*

4. *A company issued 1,00,000 debentures of the face value of Rs. 100 each at a discount of Rs. 10 per debenture. The discount of Rs. 10 lakh is claimed as an expenditure incurred for the purposes of business by the company.*

5. *The accounts of X & Co. were rejected by the Assessing Officer, who estimated the income applying the gross profit rate as in the earlier year, not allowing any specific expenditure. Further, he made an addition of Rs. 20,000 under section 40A(3) for certain cash payments effected in respect of purchases. Discuss the validity of the action of the Assessing Officer.*

6. *X Ltd. was amalgamated with Y Ltd. with effect from August 29, 2008. The written down value of its block of assets as on April 1, 2008, the rate of depreciation on each block and the values at which the block of assets were transferred by X Ltd. to Y Ltd. are given below :*

Block of asset	*Rate of depreciation*	*Written down value in the hands of X Co. Ltd. as on April 1, 2008* Rs.	*Transfer value to Y Co. Ltd.* Rs.
Buildings	*10 per cent*	*10,00,000*	*9,00,000*
Plant & machinery	*15 per cent*	*25,00,000*	*24,00,000*
Furniture	*10 per cent*	*5,00,000*	*4,50,000*

You are required to work out the deductions admissible under section 32 by way of depreciation to X Ltd. and to Y Ltd. in respect of these assets for the financial year 2008-09 relevant to the assessment year 2009-10. It may be noted that amalgamation is in terms of section 2(1B) of the Income-tax Act.

7. *Write a short note on valuation of inventory for tax purposes in view of insertion of section 145A.* [MAY 1999]

■

Pointwise answer :

1. In case capital expenditure on acquisition of technical know-how is incurred on or after April 1, 1998, depreciation @ 25% is admissible under section 32.

In the present problem, in view of the aforesaid provision Rs. 3,00,000 (*i.e.*, 25% of Rs. 12,00,000) will be deductible under section 32 for the assessment year 2009-10.

2. If any asset falling within a block of asset is acquired by the assessee during the previous year and it is put to use for the purposes of business or profession for a period of less than 180 days in that previous year, the deduction in respect of such asset shall be restricted to 50 per cent of the amount calculated at the percentage prescribed in the case of block of asset comprising such asset.

According to *Explanation 9* to section 43(*1*), in cases where duty of excise or additional duty leviable under the Customs Tariff Act, 1975 and duty leviable under Central Excise Rules, 1944 has been paid and has been included in the actual cost of the asset acquired on or after March 1, 1994, such duty shall be excluded as and when credit by way of MODVAT is allowed to the assessee under the Central Excise Rules, 1944.

In the present problem, in view of the aforesaid provisions, Rs. 82.5 lakh [*i.e.*, 50% × 15% of (Rs. 12 crore - Rs. 1 crore)] is admissible as depreciation for the assessment year 2009-10.

3. According to the Supreme Court in *CIT* v. *Madras Auto Services (P.) Ltd.* [1998] 233 ITR 468, where the assessee obtained the premises on lease for 39 years and according to the terms of the lease agreement, the assessee demolished the existing construction and constructed a new building to suit its business at its own expenses, the expenditure incurred by the assessee was allowable as revenue expenditure. However, in view of *Explanation 1* to section 32(1), such expenditure is eligible for depreciation even if the building is not owned by the taxpayer.

4. According to the Supreme Court in *Madras Industrial Investment Corpn.* v. *CIT* [1997] 91 Taxman 340, when a company issues debentures at a discount, it incurs a liability to pay a larger amount than the amount it has borrowed and this liability is to be spread over the period of the debentures. Such discount is essentially in the nature of business

expenditure. This is a case where liability incurred by the company is deferred since, there is a continuing benefit to the business and, therefore, only a proportionate amount of discount is deductible every year over the period of the debentures.

In the present problem, in view of the aforesaid case, out of the total discount of Rs. 10,00,000 (*i.e.*, 1,00,000 debentures @ Rs. 10) a proportionate amount of discount is deductible every year over the period of debentures.

5. According to ITAT Gauhati Bench in *Gupta Bros.* v. *Asstt. CIT* [1997] 93 Taxman 218 (Gauhati) (Mag.), where the gross profit of the assessee was not computed after considering allowability or disallowability of specific items of expenditure, there may not be any justification to pick up the purchases as an item of expenditure and consider its allowability or disallowability, as such an approach will be contrary to the view taken, *i.e.*, rejection of books of account and estimate of sales and rate of gross profit. In view of the above, there was no question of disallowance under section 40A(3) in respect of purchases made by the assessee. Similar views are expressed in *Hynoup Food & Oil Industries (P.) Ltd.* v. *Asstt. CIT* [1994] 48 ITD 202 (Ahd.), *New Narayan Builders* v. *ITO* [1992] 43 TTJ (Ahd.) 508 and *Sarwan Singh Contractors* v. *ITO* [1995] 55 ITD 192 (Chd.). [It is, respectfully, submitted that the contrary opinion given in *ITO* v. *D.D. Hazare* [1994] 48 ITD 595 (Bom.) requires reconsideration.]

In the present problem, in view of the aforesaid case, the addition of Rs. 20,000 made by the Assessing Officer is unjustified.

6. Computation of depreciation in the case of X Ltd. and Y Ltd., assuming Y Ltd. is an Indian company —

	Building Rs.	*Plant & machinery* Rs.	*Furniture* Rs.
Written down value as on April 1, 2008 in the hands of X Ltd.	10,00,000	25,00,000	5,00,000
Add : Purchases during the previous year 2008-09	*Nil*	*Nil*	*Nil*
Less : Assets transferred during the year	*Nil*	*Nil*	*Nil*
Written down value on March 31, 2009	10,00,000	25,00,000	5,00,000
Depreciation for the assessment year 2009-10	1,00,000	3,75,000	50,000

As per fifth proviso to section 32(1) the aggregate deduction for depreciation allowance in a year is restricted to the deduction computed at the prescribed rates and the allowance is apportioned between amalgamating company and amalgamated company in the ratio of the number of days for which the assets were used by them.

	Building Rs.	*Plant & machinery* Rs.	*Furniture* Rs.
Depreciation available to X Ltd. for the assessment year 2009-10 from April 1, 2008 to August 28, 2008 [*Rs. 1,00,000 × 150/365, **Rs. 3,75,000 × 150/365, ***Rs. 50,000 × 150/365]	40,096*	1,54,110**	20,548***
Depreciation available to Y Ltd. for the assessment year 2009-10 from August 29, 2008 to March 31, 2009	58,904	2,20,890	29,452
Depreciated value as on April 1, 2009 in the hands of Y Ltd.	9,41,096	22,79,110	4,70,548

If, however, Y Ltd. is not an Indian company, then *Explanation 2* to section 43(*6*) will not apply [*see* para 516.2-2]. It may be noted that fifth proviso to section 32(1) will be applicable whether or not Y Ltd. is a foreign company. Consequently, if Y Ltd. is a foreign company, the depreciation available to X Ltd. and Y Ltd. for the assessment year 2009-10 will be the same as above. However, for the assessment year 2010-11, depreciation available to Y Ltd. will be as follows, if Y Ltd. is not an Indian company—

	Building Rs.	*Plant & machinery* Rs.	*Furniture* Rs.
Actual cost of assets for Y Ltd. as on March 31, 2009 [*i.e.*, Y Ltd. not being an Indian company, actual cost in its hands will not be written down value of the transferor-company. The actual cost will be the amount at which assets are transferred to Y Ltd.]	9,00,000	24,00,000	4,50,000
Less : Depreciation available for the previous year 2008-09	(-) 58,904	(-) 2,20,890	(-) 29,452
Depreciated value as on April 1, 2009	8,41,096	21,79,110	4,20,548

Depreciation for the assessment year 2010-11 will be available on the basis of abovementioned depreciated value as on April 1, 2009 after making adjustments as given in section 43(*6*).

7. For section 145A, *see* para 163.11.

Problem 5.6-24 - *Discuss the following :*

1. *What are the provisions regarding the carry forward and set off of the unabsorbed depreciation under section 32. Write an elaborate note.*

2. *Write short note on assessment of profits of retail trader.*

3. *XYZ Ltd. incurs an expenditure of Rs. 100 crore for acquiring the right to operate telecommunication services for Haryana and Punjab circles. The payment of Rs. 100 crore was made in September 2007 and the licence to operate the services was valid for 10 years. In December 2008, the company transfers part of the licence, in respect of Haryana, to ABC Ltd. for a sum of Rs. 27 crore and continues to operate the licence in respect of Punjab. What is the amount allowable as deduction under section 35ABB to XYZ Ltd. in respect of the licence fee for assessment year 2009-10.*

4. *A contractor engaged in the business of civil construction work does not maintain regular books of account. The total bills submitted in respect of contracts for the period April 1, 2008 to March 31, 2009 are as under :*

	(Rs. in lakh)
Value of work carried out	*25*
Value of materials supplied at fixed costs by the contractee	*8*
Gross bills	*33*
Less *: Amount retained at 10 per cent by the contractee for due performance of the contract and refundable six months after the completion of the contract*	*3.30*
Net bills	*29.70*

How will the profit of the contractor be assessed by the Assessing Officer.

5. *XYZ Ltd. credited to its profit & loss account drawn for the financial year ending March 31, 2009, the following amounts :*

	Rs.
a. *unclaimed wages for the years 1994 to 1996*	*2,80,000*
b. *deposits received from its customers (during the financial year 1992-93 Rs. 84,000, and 1994-95 Rs. 1,26,000 for supply of spare parts - remaining unclaimed)*	*2,10,000*
c. *amounts claimed and recovered from the agents of its customers, the excess freight paid by the customers of the assessee company - remaining unclaimed by the customers during the last 4-5 years*	*3,42,000*
d. *amounts collected by way of sales tax from its customers in the financial year 1984-85 and deposited with the State Government in the same year - In September, 2008, the State Government refunded the amount to the assessee-company, when the relevant provision relating to levy of sales tax was struck down by the High Court*	*3,00,000*

The assessee-company contends that it is not liable to pay any tax in respect of any of the aforesaid credits made to its profit and loss account during the financial year 2008-09 for the following diverse reasons :

(1) There has been no cessation of assessee-company's liability to its workers and/or customers merely by its unilateral act of crediting the amounts to its profit & loss account.

(2) The way in which the entries are made by an assessee in his books of account is not determinative of the question, whether it has earned any assessable profit or suffered any assessable loss.

(3) Amounts received by it from the customers and/or recovered by it from the agents of the customers were never claimed by and/or allowed to it as a business deduction in any of the earlier years.

(4) The liability of the assessee-company in respect of the aforesaid sums became barred by limitations long before April 1, 2008.

Are you in agreement with company's contentions? Give your observations with reasons on each of the items credited to profit & loss account. [NOVEMBER 1998]

■

Pointwise answer :

1. See para 109.9.

2. The relevant provision for assessment of profits of a retail trader is contained in section 44AF. *See* para 162.6.

3. The amount deductible under section 35ABB in the hands of XYZ Ltd. for the assessment year 2009-10 will be as under —

	(Rs. in crore)
Cost of licence acquired by XYZ Ltd.	100
Less : Amount written off during previous year 2007-08 under section 35ABB	10
Written down value of telecom licence as on April 1, 2008	90
Less : Sale proceed of a part of licence	27
Remaining written down value	63
Amount deductible under section 35ABB for remaining 9 years [*i.e.*, Rs. 63 crore/9]	7

Therefore, for the assessment year 2009-10 Rs. 7 crore is deductible under section 35ABB.

4. The profit of the contractor shall be as follows :

The contractor shall be governed by the provision of section 44AD. According to section 44AD, income from the business of civil contractor will be estimated at 8% of the gross receipts paid or payable to an assessee if his gross receipts from such business does not exceed Rs. 40 lakh.

The words "gross receipts" imply the amount which the contractor receives from the client for the contract and it will not include the value of material supplied by the client—Circular No. 684, dated June 10, 1994.

According to Accounting Standard 7 on 'accounting for construction contracts' issued by ICAI, amounts retained by customer until the satisfaction of conditions specified in the contract, for release of such amounts are either recognised in financial statements as receivables or alternatively indicated by way of note.

In the present problem, in view of the aforesaid provisions, the words 'gross receipts' would include the 10% of the amount retained by the client for due performance of contract and refundable six months after the completion of contract. But it will not include value of material supplied at fixed costs by the client. Therefore, according to section 44AD net profit of the contractor from the business of civil construction work would be Rs. 2,00,000 [*i.e.*, 8% of Rs. 25,00,000].

Hence, the Assessing Officer shall assess the profit of the contractor at Rs. 2,00,000.

5. Pointwise answer to the company's contention shall be as follows :

(*1*) According to section 41(1), whether any allowance or deduction has been made in the assessment of any year in respect of loss, expenditure or trading liability and, subsequently, during any previous year, any amount is received by the assessee, whether in cash or in any other manner whatsoever, in respect of such loss or expenditure, or some benefits, in respect of trading liability by way of remission or cessation thereof, the amount obtained by him or by virtue of benefit accruing to him is chargeable to tax as business income. By inserting an *Explanation* to section 41(1), it has been provided to tax the remission or cessation of liability into the hands of taxpayer and for this purpose the expression "loss or expenditure or some benefit in respect of any such trading liability by way of remission or cessation thereof", shall be defined to include the remission or cessation of any liability by any unilateral act of the assessee by way of writing off such liability in his accounts.

In the present problem, in view of the aforesaid provision, by virtue of crediting unclaimed wages for the years 1994 to 1996 to the profit and loss account, there has been unilateral remission of the liability and, accordingly, Rs. 2,80,000 shall be taxable as business income under section 41(1).

(*2*) In *CIT* v. *Batliboi & Co. Pvt. Ltd.* [1985] 149 ITR 604 (Bom.) and *CIT* v. *Trade Links Ltd.* [1995] 54 ITD 108 (Delhi), it was held that in case the assessee writes back to profit and loss account certain unclaimed balances standing in the names of various customers which had been undisputably received as advance to be adjusted against supplies to be made subsequently, these unclaimed accounts constitute the trading receipts.

The Supreme Court in *CIT* v. *T.V. Sundaram Iyengar & Sons Ltd.* [1996] 222 ITR 344 has held that the assessee, because of the trading operation, had become richer by the amount which it transferred to its profit and loss account. The money had arisen out of ordinary trading transactions. The amounts remained with the assessee for a long period unclaimed by the trade parties. Hence, the amount should be treated as income of the assessee.

In the present problem, in view of the aforesaid cases, Rs. 2,10,000 shall be taxable as business income for the assessment year 2009-10.

(*3*) In *CIT* v. *Karam Chand Thapar* [1996] 222 ITR 112 (SC), it was held that an amount which was initially not received as a trading receipt can still become a trading receipt having regard to the subsequent conduct of the assessee in treating the same as his own money and crediting the same to his profit and loss account.

In the present problem, in view of the aforesaid case Rs. 3,42,000 shall be taxable as business income for the assessment year 2009-10.

(*4*) In *CIT* v. *Thirumalaiswamy Naidu and Sons* [1998] 230 ITR 534 (SC), it was held that the amount of sales tax refunded to the assessee by the Government was a revenue receipt liable to tax under the express provisions of section 41(1).

Section 41(1) will not be attracted for an assessee (being entitled to make payment in respect of a debt) when

debt becomes time barred. But it shall be attracted if a liability or a time-barred liability is written off in the books of account.

In the present problem, in view of the aforesaid provisions, Rs. 3,00,000 shall be taxable as business income under section 41(1) for the assessment year 2009-10.

5.7 Capital gains

Problem 5.7-1 *A piece of land owned by X located on Jaipur-Delhi highway was acquired by NHAI in the financial year 2005-06, but the award ordered in financial year 2006-07 was paid in the financial year 2008-09. This land was purchased by him on April 2, 1977 for Rs. 1,000. The fair market value of the land as on April 1, 1981 was Rs. 900. Compensation paid was Rs. 5 lakh.*

Other piece of land located in Chennai purchased in April 2005 for Rs. 25 lakh was also sold by him in February 2009 for Rs. 35 lakh, but sale deed thereof could not be executed by March 31, 2009. The value for the purpose of stamp duty applied by the stamp valuation authority was Rs. 38 lakh.

Compute the income chargeable to tax arising as a result of these transactions in the assessment year 2009-10. [NOVEMBER 2007]

■

Computation of income of X for the assessment year 2009-10	*Rs.*
Initial compensation	5,00,000
Less: Indexed cost of acquisition [Rs. 1,000 × 497 ÷ 100]	4,970
Long-term capital gain (*a*)	4,95,030
Full value of consideration	38,00,000
Less: Indexed cost of acquisition [Rs. 25,00,000 × 582 ÷ 497]	29,27,565
Long-term capital gain (*b*)	8,72,435

Problem 5.7-2 - *X, an individual, owned three residential houses which were let out. Besides, he and his four brothers co-owned a residential house in equal shares. He sold one residential house owned by him during the previous year relevant to the assessment year 2009-10. Within a month from the date of such sale, the four brothers executed a release deed in respect of their shares in the co-owned residential house in favour of X for a monetary consideration. X utilized the entire long-term capital gain arising out of the sale of the residential house for payment of the said consideration to this four brothers. X is not using the house, in respect of which his brothers executed a release deed, for his own residential purposes, but has let it out to another person, who is using it for his residential purposes. Is X eligible for exemption under section 54 for the assessment year 2009-10 in respect of the long-term capital gain arising from the sale of his residential house, which he utilized for acquiring the shares of his brothers in the co-owned residential house? Will the ownership of two more houses by him on the date of sale of the residential house and non-user of the new house for his own residential purposes disentitle him to exemption?* [MAY 2007]

■

For provisions of section 54, *see* para 179 and also Problem 179-P3. In the present problem, in view of these provisions, X is eligible for exemption under section 54 in respect of the long-term capital gain arising from the sale of his residential house. Ownership of two more houses by X on the date of sale of the residential house and non-user of the new house for his own residential purposes, will not disentitle him to exemption.

Problem 5.7-3 - *X, an individual, purchased a site on April 21, 2003 for Rs. 2,00,000. He completed construction of a building thereon on April 21, 2005 at a cost of Rs. 10,00,000. He sold the property consisting of site and building on December 7, 2008 for Rs. 20,00,000. X seeks your opinion on the nature of capital gain arising to him from the sale of the property for the assessment year 2009-10. Computation of capital gain is not necessary.* [NOVEMBER 2006]

■

The nature of capital gains is long-term.

Computation of capital gains	*Rs.*
Sales consideration	20,00,000
Less:	
Indexed cost of acquisition [Rs. 2,00,000 × 582 ÷ 463]	2,51,404
Indexed cost of improvement [Rs. 10,00,000 × 582 ÷ 497]	11,71,026
Long-term capital gains	5,77,570

Problem 5.7-4 - *Discuss the following:*

1. *X, an individual resident in India bought 1,000 equity shares of Rs. 10 each of A Ltd. at Rs. 50 per share on May 30, 2008. He sold 700 equity shares at Rs. 35 per share on September 30, 2008 and the remaining 300 shares at Rs. 25 per share on December 20, 2008. A Ltd. declared a dividend of 50 per cent, the record date being August 10, 2008. X sold on February 1, 2009 a house from which he derived a long-term capital gain of Rs. 75,000.*

Compute the amount of capital gain arising to X for the assessment year 2009-10.

2. *Y inherits a house property from his father, who had mortgaged it. Y discharges the mortgages the debt. Y later sells the property. Can he claim the amount paid to the mortgagee as cost of improvement in computing the capital gain?*

3. *Z mortgaged his house property and utilized the mortgage amount to perform the marriage of his son. He paid the amount to the mortgagee later. Upon sale of the said property thereafter, he claims the mortgage debt discharged as forming part of the cost of acquisition. Can capital gain be computed accepting his claim?* [MAY 2006]

■

Pointwise answer:

1. See answer to problem 239.6-P1.

2. The facts of the present problem are similar to the case *RM Aruna Chalam* v. *CIT* [1997] 227 ITR 222 (SC). In this case it was held that amount paid by the assessee to discharge a mortgage debt created by the previous owner is allowable as deduction as cost of improvement in the computation of capital gains.

3. The facts of the present problem are similar to the case *V.S.M.R. Jagadish Chandran (Decd.)* v. *CIT*[1997] 227 ITR 240 (SC). In this case, it was held that the amount paid by the assessee to clear the mortgage debt created by him is not allowable as deduction (neither as cost of acquisition not as cost of improvement) in the computation of capital gains.

Problem 5.7-5 *State the cases where the benefit of indexation of costs in not available for determination of capital gains.* [NOVEMBER 2005]

■

See para 170.1.

Problem 5.7-6 - *X acquires 10,000 equity shares of X Ltd., listed in stock exchanges in India and abroad in April 15, 2007 @ Rs. 2,250 per share. He transfers the shares at Rs. 5,000 per share on December 31, 2008. The brokerage and securities transactions tax deducted were at 0.5 per cent and 0.125 per cent respectively. Examine the liability of X to income-tax for the assessment year 2009-10. Will your answer be different, if instead of selling the shares in the market X privately transfer the shares to his son at the same price?* [MAY 2005]

■

As per section 10(*38*), long-term capital gain arising on equity shares will not be chargeable to tax if such transaction is covered by securities transaction tax. In the present problem, in view of the aforesaid provision, the long-term capital gain is exempt in the hands of X.

However, in case X privately transfers shares to his son, then the transaction is not covered by securities transaction tax and the resultant taxable long-term capital gain is determined as under :

	Rs.
Sales consideration	500,00,000
Less: Brokerage [0.5% of Rs. 500,00,000]	2,50,000
Less: Indexed cost of acquisition [Rs. 2,25,00,000 × 582 ÷ 551]	2,37,65,880
Long-term capital gain	2,59,84,120
Tax @ 20%	51,96,824
Add: Surcharge @ 10%	5,19,682
Tax and surcharge	57,16,506
Add: Education cess @ 2% of tax and surcharge	1,14,330
Add : Secondary and higher education cess (1% of income-tax and surcharge)	57,165
Tax liability (rounded off)	58,88,000
Optional treatment	
Sales consideration	500,00,000
Less: Brokerage	2,50,000
Less: Cost of acquisition (without indexation)	2,25,00,000
Long-term capital gain	272,50,000
Tax @ 10%	27,25,000
Add: Surcharge @ 10% of Rs. 27,25,000	2,72,500

	Rs.
Tax and surcharge	29,97,500
Add: Education cess @ 2% of tax and surcharge	59,950
Add : Secondary and higher education cess (1% of income-tax and surcharge)	29,975
Tax liability	30,87,430

The tax liability of X is Rs. 30,87,430 (being lower of the above two).

Problem 5.7-7 - *Your client, X Ltd. has two industrial undertakings—one engaged in production of audio music CDs and cassettes and the other engaged in production of video CDs. As a restructuring drive, the company has decided to sell its undertaking producing video CDs as a going concern by way of slump sale for Rs. 450 lakh to a new company called Y Ltd., in which it holds 75 per cent equity shares. The balance sheet of X Ltd. as on March 31, 2009 reads as follows:*

		Rs. in lakh
	Audio unit	*Video unit*
	Rs.	*Rs.*
Fixed assets	*150*	*225*
Debtors	*150*	*112.5*
Inventories	*75*	*37.5*
Liabilities	*42*	*75*
Paid-up share capital	*Rs. 378 lakh*	
General reserve	*Rs. 222 lakh*	
Share premium	*Rs. 33 lakh*	
Revaluation reserve	*Rs. 140 lakh*	

The company set up the video unit on April 1, 2002. The written down value of the block of assets for tax purpose as on March 31, 2009 is Rs. 200 lakh of which Rs. 85 lakh are attributable to video unit.

i. *Determine the tax liability, which would arise to X Ltd. from slump sale.*

ii. *Suggest modification of the restructuring plan of X Ltd. without changing the amount of consideration so as to make it more tax efficient.* [MAY 2005]

■

Computation of tax liability of X Ltd. from slump sale	*Rs.*
Sale proceeds	4,50,00,000
Less: Cost of acquisition [*i.e.*, net worth, *see* para 520.3, *see* Note I]	1,60,00,000
Long-term capital gain	2,90,00,000
Tax on long-term capital gain @ 20%	58,00,000
Add: Surcharge (10% of Rs. 58,00,000)	5,80,000
Tax and surcharge	63,80,000
Add: Education cess @2%	1,27,600
Add : Secondary and higher education cess (1% of income-tax and surcharge)	63,800
Tax liability	65,71,400

Note:

1. Computation of net worth

WDV of block of assets	85,00,000
Debtors	112,50,000
Inventories	37,50,000
	2,35,00,000
Less: Liabilities	75,00,000
Net worth	1,60,00,000

As an alternative to slump sale, X Ltd., should acquire 100% shareholding in Y Ltd. so that Y Ltd. becomes a 100% Indian subsidiary company of X Ltd. and, consequently, capital gain arising on transfer of video unit to Y Ltd. shall not be chargeable to tax by virtue of provision of section 47(*iv*), *see* para 521.4.

Problem 5.7-8 - *Redemption of preference shares amounts to "transfer" within the meaning of section 2(47) in the hands of the shareholder. Discuss.* [NOVEMBER 2004]

■

See para 169.1-4b.

Problem 5.7-9 - *What is meant by the term "demerger" ? What are the exemptions and benefits available as a result of a demerger transaction ?* [MAY 2004]

■

See para 517.

Problem 5.7-10 - *X is a partner in two partnership firms. He retires from the two firms in January 2009. On the date of retirement, his capital account is credited with a sum of Rs. 2,50,000 in each firm, over and above the amount due to him towards his capital and profits. He seeks your advice, whether the amount of Rs. 2,50,000 credited to his capital account, in each firm is taxable for the assessment year 2009-10.* [NOVEMBER 2003]

■

When, a partner retires from a partnership and the amount of his share in the net partnership assets after deduction of liabilities and prior charges, is determined on taking accounts on the footing of notional sale of the partnership assets and given to him, what he receives is his share in the partnership and not any consideration for transfer of his interest in the partnership to the continuing partners. There is, thus no element of transfer of interest in the partnership assets by the retiring partner to the continuing partners—*CIT* v. *R. Lingmallu Raghukumar* [2002] 124 Taxman 127 (SC).

In the present problem, in view of the aforesaid case, Rs. 2,50,000 is not chargeable as capital gains in the hands of X.

Problem 5.7-11 - *X had taken a loan under registered mortgage deed dated July 16, 2006 against the house, which was purchased by him on March 26, 1982 for Rs. 5 lakh. The said property is inherited by his son A on July 1, 2008 under Will who for obtaining a clear title thereof has paid the outstanding amount of loan on February 12, 2009 of Rs. 15 lakh. The said house property is sold by A on March 16, 2009 for Rs. 50 lakh. State with reasons the amount chargeable to capital gains for the assessment year 2009-10.* [NOVEMBER 2003]

■

	Rs.
Sale consideration	50,00,000
Less : Indexed cost of acquisition [(Rs. 5,00,000 + Rs. 15,00,000) × 582 ÷ 582]	20,00,000
Long-term capital gain	30,00,000

Note :

1. The Apex Court has held in *V.S.M.R. Jagdish Chandran* v. *CIT* [1997] 93 Taxman 389, that where a mortgage was created by the previous owner during his life time and the same is subsisting on the date of his death, the successor obtains only the mortgagor's interest in the property and by discharging the mortgage debt he acquires the mortgagee's interest in the property and, therefore, the amount paid to clear off the mortgage is the cost of acquisition of the mortgagee's interest in the property which is deductible as cost of acquisition under section 48.

2. In the absence of date on which the house is inherited, it is assumed that the house is inherited by A on July 15, 2008. Accordingly, cost inflation index of the financial year 2008-09 is taken into account for computing indexed cost of acquisition.

Problem 5.7-12 - *X purchased, on June 18, 1982, a house property for Rs. 2,25,000, which was sold to A on October 18, 2008 for Rs. 8,75,000. Sub-registrar at the time of registration of sale deed charged stamp duty on Rs. 12,50,000 which was paid by the buyer. The Assessing Officer while assessing for capital gain referred the matter to valuation officer who determined the value of property at Rs. 15,00,000 on the date of transfer. X seeks your advice on the following:*

1. Is the Assessing Officer correct to charge capital gain on the value of Rs. 15,00,000 as determined by valuation officer ?

2. The amount of capital gain on which X is required to pay capital gain tax. [May 2003]

■

The Assessing Officer is not correct in computing capital gain by adopting the value of Rs. 15 lakh determined by the Valuation Officer.

	Rs.
Sale proceeds [as per section 50C]	12,50,000
Less : Indexed cost of acquisition [Rs. 2,25,000 × 582 ÷ 109]	12,01,376
Long-term capital gains	48,624

Note - For provisions of section 50C, *see* para 176.21.

Problem 5.7-13 - *Specify the items of capital assets in respect of which the cost of acquisition shall be taken as* 'nil' *under the provisions of the Income-tax Act while computing capital gains.* [NOVEMBER 2002 (New)]

■

See paras 176.4-3, 176.6-1 and 176.7.

Problem 5.7-14 - *X entered into an agreement with Y for the sale of his property and received earnest money of Rs. 1,00,000 on April 1, 2008. The balance of Rs. 4,00,000 was to be paid within 3 months, failing which X was entitled*

to a compensation of Rs. 50,000. The earnest money was also liable to be forfeited. Y defaulted in the payment of the balance within the time specified and, therefore, the earnest money was forfeited. A suit was also filed for breach of contract and Rs. 50,000 was awarded, which was received on March 28, 2009. Discuss the nature of the two receipts from the point of view of liability to tax. [NOVEMBER 2001]

■

As per section 51, in computing cost of acquisition, where any capital asset was, on any previous occasion, subject to negotiations for its transfer, any advance, or other money received and forfeited by the assessee in respect of such negotiation is to be deducted from the cost for which the asset was acquired or from the written down value or fair market value, as the case may be. However, the amount forfeited by the previous owner shall not be considered.

For this purpose, no distinction is made between money received or retained by way of 'advance' and 'other money'. The phrase 'other money' would cover, for example, deposits made by the purchaser for guaranteeing the performance of the contract and not forming part of the consideration. The money received on the previous occasions and retained by the vendor/assessee cannot, therefore, be treated as a revenue receipt — *Travencore Rubber & Tea Co. Ltd.* v. *CIT* [2000] 109 Taxman 250 (SC).

In the present problem, in view of the aforesaid provisions, as per section 51 both amounts in question [*i.e.*, Rs. 1,00,000 (earnest money) + Rs. 50,000 (compensation)] received and retained by X in respect of the abortive sale transaction are capital receipts not exigible to tax.

Problem 5.7-15 - *Discuss the following :*

1. *X furnishes the following information :*

No. of shares	Month and year of purchase	Shares dematted month and year
1,000	*March 1994*	*July 2004*
500	*March 1997*	-
1,000	*December 1998*	*October 2003*

He sold 1,500 shares in January 2009 out of the dematted shares. He seeks your advise as to the taxability towards capital gains for the assessment year 2009-10.

2. *X Ltd. decided to effect buy back of share capital by purchase of shares in open market. During the previous year ending March 31, 2009, X Ltd. purchased 10,000 shares. Discuss the tax implications in the hands of X Ltd. and shareholders.*

3. *X Ltd., a public limited company, engaged in the generation and distribution of power had its business acquired by the Government in June 2007. Certain items of plant and machinery used by the company in its business were taken over by the Government at a price which resulted in the company realising a surplus of Rs. 26,60,000 over its written down value. The compensation was received by the company in April 2008 which was accepted by it under protest. The company proceeded to initiate arbitration proceedings under law and was granted an additional compensation of Rs. 16 lakh. This was decided by the arbitrators in December 2008 and received by the company in March 2009.*

The company claims that the assessment of the company to tax should not be made since the business was completely taken over by the Government in June 2006 and at the time of final determination of compensation in March 2009, the company did not exist.

Do you agree to the company's claim ? Discuss with reference to the assessment year(s) to which the claim to tax, if any, can be related. [MAY 2001]

■

Pointwise answer :

1. See para 176.11-1. The period of holding and the cost of acquisition of the first 1,000 shares should be taken as from December 1998 and the cost thereof, whereas the balance 500 shares will be treated as having been acquired in March 1994, at the relevant cost. The indexed cost is permissible as per section 48. The loss or gain shall be arrived at after deducting the indexed cost. It securities transaction tax is paid, long-term capital gain is not chargeable to tax.

2. See para 176.16. In the hands of X Ltd. there shall be no liability to tax as the payment is on capital account and will reduce its reserves.

In the case of shareholders, the difference between the consideration received by the shareholder and the cost of acquisition will be chargeable to tax as capital gains. Any payment made by a company on purchase of its own shares in accordance with section 77A of the Companies Act, 1956 will not constitute dividend [sec. 2(22)(*iv*)].

3. As per section 176(3A), where any business is discontinued in any year, any sum received after the discontinuance shall be deemed to be the income of the recipient and charged to tax accordingly in the year of receipt, if such sum would have been included in the total income of the person who carried on the business had such sum been received before such discontinuance.

However in case the conditions of rule 5(1A) are satisfied then, the provisions of section 41(2) shall be applicable. For provisions of section 41(2), *see* para 109.11-2.

In *CIT* v. *United Provinces Electric Supply Co.* [2000] 110 Taxman 134, the Supreme Court held that in case the assessee's business is acquired by the Government the amount of compensation received is taxable in the year of receipt of such compensation. If any additional compensation is received it will be taxable in the year of its receipt.

In the present problem, in view of the aforesaid provisions, short-term capital gain of Rs. 42,60,000 (*i.e.*, Rs. 26,60,000 + Rs. 16,00,000) shall be chargeable to tax under section 45(5) of the assessment year 2009-10 in the hands of the recipient. Hence the claim of X Ltd. is unacceptable.

Problem 5.7-16 - *Discuss the following :*

1. *A manufacturing company was transporting two of its machines from unit 'A' to unit 'B' (which is at a distance of 100 miles) on September 1, 2008 by a truck. On account of a civil disturbance, both the machines were damaged. The insurance company paid Rs. 5 lakh for the damaged machineries. On these facts, for submitting the return of income for the previous year ending March 31, 2009, your advise is sought as to :*

(i) *Whether the damage of machines result in any transfer ?*

(ii) *How the amounts received from the insurance company are to be treated for taxability ?*

(iii) *Would there be any impact on the written down value of the block of plant and machinery as on March 31, 2009 ?*

2. *X Ltd., located within the corporation limits, decided in December, 2008 to shift its industrial undertaking to non-urban area. The company sold some of the assets and acquired new assets in the process of shifting. The relevant details are as follows :*

(Rs. in lakh)

Particulars	*Land*	*Building*	*Plant and machinery*	*Furniture*
Sale proceeds (sale effected in March, 2009)	*8*	*18*	*16*	*3*
Indexed cost of acquisition	*4*	*10*	*12*	*2*
Cost of acquisition in terms of section 50	-	*4*	*5*	*2*
Cost of new assets purchased in July, 2008 for the purpose of business in the new place	*4*	*7*	*17*	*2*

Compute the capital gains of X Ltd. for the assessment year 2009-10. [NOVEMBER 2000]

■

Pointwise answer :

Section 45(1A) provides that where any person receives any money or other assets under any insurance from an insurer on account of damage to or destruction of any capital asset, as a result of flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature, riot or civil disturbance, accidental fire or explosion or because of action by an enemy or action taken in combating an enemy (whether with or without a declaration of war), then any profit or gain arising from receipt of such money or other assets shall be chargeable to income-tax under the head "Capital gains" and shall be deemed to be the income of such person for the previous year in which such money or other asset is received.

For this purpose, the value of any money or the fair market value of other asset (on the date of receipt) shall be deemed to be the full value of the consideration received or accruing as a result of transfer of such asset.

In the present problem, in view of the aforesaid provisions, the answer is as under :

(*i*) The damage of machines does not result in any transfer as per Supreme Court ruling in *Marybong & Kyel Tea Industries Ltd.* v. *CIT* [1997] 91 Taxman 11.

(*ii*) As per section 45(1A), Rs. 5 lakh received by the manufacturing company from the insurance company shall be deemed to be the full value of consideration. However, for the purposes of computation of capital gain, written down value as on April 1, 2008 of the relevant block is required. Since such value is not given, the actual amount of capital gain cannot be computed. It may be noted that capital gain shall be computed as per section 50 [*see* para 173.1-3].

(*iii*) As per section 43(6)(*c*)(B), money payable (together with scrap) in respect of an asset (falling within that block) which is sold, discarded, demolished or destroyed during the previous year shall be deducted from the written down value.

Section 43(6)(*c*)(*B*) postulates for its applicability that the plant and machinery, whether in whole or in part, should be sold, discarded, demolished or destroyed. It has no application to a case where plant or machinery is merely damaged

and by repairing the damage the asset is restored to working condition. If the machineries are only partly damaged by civil disturbances and after repairing the damage, the machineries are recommissioned, there is no scope for application of section 43(*6*)(*c*)(*B*)—*see CIT* v. *Sirpur Paper Mills Ltd.* [1978] 112 ITR 776 (SC). It, however, the machines are completely destroyed, then the insurance compensation of Rs. 5 lakh shall be reduced from the value of block of assets.

2. *Computation of capital gain :*

(*Rs. in lakh*)

Particulars	*Land* Rs.	*Building* Rs.	*Plant and machinery* Rs.	*Furniture* Rs.
Sale proceeds	8	18	16	3
Less : Cost of acquisition (being written down value as on April 1, 2008 of the different blocks as per section 50)	-	4	5	2
Indexed cost of acquisition in the case of land	4	-	-	-
Short-term capital gain	-	14	11	1
Long-term capital gain	4	-	-	-
Less : Exemption under section 54G [*see* Note]	3	14	11	-
Short-term capital gain	-	-	-	1
Long-term capital gain	1	-	-	-

Note : Capital gain arising on transfer of furniture is not qualified for any exemption under section 54G. Likewise, no exemption is available under section 54G in respect of investment of Rs. 2,00,000 in acquiring furniture. The qualifying investment for claiming exemption under section 54G is Rs. 28,00,000 (*i.e.*, Rs. 4,00,000 + Rs. 7,00,000 + Rs. 17,00,000). As tax incidence is higher in the case of short-term capital gain, the exemption is first utilized against short-term capital gains.

Problem 5.7-17 - *Discuss the following :*

1. *The assessee was a company carrying on business of manufacture and sale of art-silk cloth. It purchased machinery worth Rs. 4 lakh on May 1, 2004 and insured it with United India Assurance Ltd., against fire, flood, earthquake etc. Depreciation was granted at 15 per cent for each assessment year. The insurance policy contained a reinstatement clause requiring the insurance company to pay the value of the machinery, as on the date of fire, etc., in case of destruction or loss. A fire broke out in August, 2008 causing extensive damage to the machinery of the assessee rendering it totally useless. The assessee company received a sum of Rs. 6 lakh from the insurance company on March 15, 2009. Discuss the issues arising on account of the transactions and their tax treatment.*

2. *Balance sheet of X Ltd. as on March 31, 2008 reads as under :*

Paid-up capital *Rs. 252 lakh*

	Unit A Rs. (in lakh)	*Unit B Rs. (in lakh)*
Fixed assets	*100*	*150*
Debtors	*100*	*75*
Liabilities	*28*	*50*
Stock-in-trade	*50*	*25*
Reserves		*148*
Share premium		*22*
(Revaluation reserve)		*70*

The company acquired Unit B on April 1, 2006. It made certain capital additions in the form of generator set and additional building, etc., for Rs. 25 lakh during the year 2006-07. The members of the company have authorized the Board in their meeting held on January 28, 2009 to dispose of the Unit B. The company decides to sell the Unit B by way of slump sale for Rs. 225 lakh as consideration. The buyer has agreed with the vendor-company to give time for putting through the sale but not later than June 30, 2009 subject to a discount of 1 per cent on agreed sale consideration. However, this

discount is not applicable if the sale is completed after March 31, 2009. The company now approaches you to advise them as a measure of tax planning to determine the date of sale keeping in view of the capital gains tax.

3. *X entered into an agreement for sale of certain properties in which there were tenants subject to vacant possession. He had accordingly to pay certain consideration to the tenants for their agreeing to vacate the properties and claimed such payments to secure vacant possession as incurred in connection with the transfer of the property within the meaning of section 48(i). Would X succeed in his claim ?* [MAY 2000]

■

Pointwise answer :

1. In the present problem, the answer is as under :

Computation of written down value of the machinery as on April 1, 2008 :

	Rs.
Actual cost of machinery	4,00,000
Less : Depreciation for the year 2004-05	60,000
Written down value as on April 1, 2005	3,40,000
Less : Depreciation for the year 2005-06	51,000
Written down value as on April 1, 2006	2,89,000
Less : Depreciation for the year 2006-07	43,350
Written down value as on April 1, 2007	2,45,650
Less : Depreciation for the year 2007-08	36,847.50
Written down value as on April 1, 2008	2,08,802.50

Computation of capital gain chargeable to tax for the assessment year 2009-10 :	*Rs.*
Sales consideration (amount received)	6,00,000
Less : Cost of acquisition (written down value as on April 1, 2008)	2,08,802.50
Short-term capital gain	3,91,197.50

In the above answer, it is assumed that the machinery under consideration is the only asset under the relevant block of asset carrying 15 per cent depreciation rate. In case there are other assets also, forming part of the relevant block, then the short-term capital gain will be lower or may even be reduced to zero.

2. For the provisions of section 50B applicable for computation of capital gains in the case of slump sale, *see* para 520.3.

Computation of net worth of Unit B	*Rs. (in lakh)*
Assets of B	250
Less : Liabilities of B	50
Net worth	200

Case I

Computation of capital gain/loss if the slump sale takes place before March 31, 2009 :	
Sales consideration	225
Less : Discount (1% of Rs. 225 lakh)	2.25
Less : Cost of acquisition and cost of improvement (*i.e.*, net worth)	200
Short-term capital gain [in case Unit B is sold by way of slump sale before March 31, 2009, since it is held by the assessee for less than 36 months, the capital gain shall be deemed to be short-term capital gain]	22.75

Case II

Computation of capital gain/loss if the slump sale takes place after March 31, 2009 :	
Sales consideration	225
Less : Cost of acquisition and cost of improvement (*i.e.*, net worth)	200
Long-term capital gain	25

	Rs. (in lakh)
Tax liability of X Ltd. in Case I (*i.e.*, 30.9%* of Rs. 22.75 lakh)	7.02975
Tax liability of X Ltd. in Case II (*i.e.*, 20.6%** of Rs. 25 lakh)	5.15

X Ltd. is advised to sell Unit B by way of slump sale after March 31, 2009 so as to minimize the tax liability (tax liability on long-term capital gain is lower).

3. Amount paid to the tenant to get property vacated is deductible from gains arising from sale of property—*CIT* v. *A. Venkataraman* [1982] 137 ITR 846 (Mad.).

In the present problem, X can claim the amount paid to the tenants to secure vacant possession as expenditure incurred in connection with transfer of property within the meaning of section 48.

Problem 5.7-18 *Discuss the following :*

1. *See* Problem 176.9-P1.

2. *The power of attorney holder of an assessee misappropriated a sum of Rs. 2.5 lakh from out of sale consideration received at the time of registration consequent to sale of a house owned by the assessee. The assessee claims the same as deductible in the computation of capital gain. Is the claim valid?*

3. *A, an individual, was the sole proprietor of a business. His net investment in the business, on March 31, 2008, was Rs. 20 lakh represented by :*

	Rs.	*Rs.*
Fixed assets		*18,00,000*
Current assets		*10,00,000*
		28,00,000
Current liabilities	*5,00,000*	
Loans	*3,00,000*	*8,00,000*
Net investment		*20,00,000*

Finding himself unable to carry on business and also to attract additional capital, he formed a private limited company in April 2008 with an authorised capital of Rs. 1 crore. At the time of formation of the company, A and his wife had subscribed to 100 equity shares each fully paid in cash.

On June 10, 2008, A transfers his individual business in entirety, as a going concern, to the private limited company for Rs. 40 lakh for issue of shares in the following manner :

Preference shares :	
Wholly to Mrs. A and her sister Mrs. G (joint names)	*1,50,000 shares*
Equity shares :	
A	*1,30,000 shares*
C, major son of A	*20,000 shares*
D, a friend of A	*30,000 shares*
Mrs. E, a married sister of A	*20,000 shares*
F, husband of Mrs. E	*50,000 shares*

The shares of the face value of Rs. 10 each are to be issued fully paid up. No other purchase consideration for the transfer of the business to the company was due.

i. *Ascertain whether in A's hands any tax liability will be due ; if so, also indicate the assessment year relevant for this.*

ii. *If, on March 30, 2009, A had sold 10,000 equity shares allotted to him, at Rs. 50 per share, to a friend, what will be the consequences?* [NOVEMBER 1999]

■

*30 per cent income-tax *plus* 0.66 per cent education cess *plus* 0.33 per cent secondary and higher education cess [surcharge @ 10% of tax is applicable in case net income exceeds Rs. 1 crore].

**20 per cent income-tax *plus* 0.44 per cent education cess *plus* 0.22 per cent secondary and higher education cess [surcharge @ 10% of tax is applicable in case net income exceeds Rs. 1 crore].

Pointwise answer :

1. See answer to problem 176.9-P1.

2. In *G.Y. Chenoy* v. *CIT* [1998] 234 ITR 89 (AP), it was held that the amount embezzled by power of attorney holder while effecting sale of property in question would not constitute expenditure incurred in connection with transfer of asset so as to be allowed as deduction while computing capital gains.

In the present problem, in view of the aforesaid case, the claim of the assessee is invalid, *i.e.*, Rs. 2.5 lakh is not allowable as deduction in the computation of capital gain.

3. As per section 47(*xiv*), transfer of a capital asset to the company where a proprietary concern is succeeded by a company in the business carried on by it shall not be treated as transfer for the purpose of section 45. However, a few conditions have to be fulfilled [*see* para 518].

In the present problem, no capital gain tax liability will be due in A's hands under section 45 for the assessment year 2009-10 since, all the three conditions specified by section 47(*xiv*) have been fulfilled.

If A sells 10,000 equity shares allotted to him on March 30, 2009, then his shareholding in the private limited company will be less than 50 per cent of the total voting power in the company (total number of equity shares in the private limited company is 2,50,000 shares). Therefore, one of the conditions of section 47(*xiv*) shall be violated and, consequently, the transaction shall be treated as transfer for the purpose of section 45 for the assessment year 2009-10.

As per section 47A(3), gains arising from transfer of capital asset shall be deemed to be the profits and gains chargeable to tax in the hands of the successor, *i.e.*, the private limited company for the previous year 2008-09, *i.e.*, the year in which conditions of section 47(*xiv*) have been violated.

Problem 5.7-19 *X was the holder of a membership card of Bombay Stock Exchange acquired in 1975 for Rs. 12 lakh. He transferred the card to a company, ABC & Co. (Pvt.) Ltd. in September, 1998 and was allotted 25,000 shares of the value of Rs. 100 each in the company in consideration of the transfer. Due to ill health, he sold these shares at Rs. 120 per share in July, 2001. Discuss the consequences of these transfers. To avoid arithmetical calculations you are told to assume the indexed cost of the membership card in September, 1998 at Rs. 10 lakh.* [NOVEMBER 1998]

■

According to section 47(*xi*), any transfer by way of exchange of a capital asset being membership of a recognised stock exchange for shares of a company to which such membership is transferred if such exchange is effected on or before December 31, 1998, shall not be regarded as transfer. Therefore, transfer of membership card of Bombay Stock Exchange by X to ABC & Co. (Pvt.) Ltd. shall not be regarded as transfer.

However, according to section 47A(2), where at any time before the expiry of a period of three years from the date of transfer of membership of the stock exchange, if the shares allotted to the transferor in exchange of membership of stock exchange are transferred, capital gains not chargeable by virtue of section 47(*xi*) shall be deemed to be income under the head "Capital gains" of the previous year in which such shares are transferred.

Therefore, amount chargeable under the head "Capital gains" in the hands of X shall be as under—

	Rs.
Sale proceeds (for transfer of membership card of Bombay Stock Exchange) [*i.e.*, 25,000 shares × Rs. 100]	25,00,000
Less : Indexed cost of acquisition (of membership card)	10,00,000
Long-term capital gains [taxable by virtue of section 47A(2)]	15,00,000

Capital gains chargeable to tax on account of sale of shares in ABC & Co. (Pvt.) Ltd. in the hands of X :

	Rs.
Sale proceeds (*i.e.*, 25,000 shares × Rs. 120)	30,00,000
Less : Indexed cost of acquisition (25,00,000 × 426/351)	30,34,188
Long-term capital gains	(–)34,188

Therefore, long-term capital gains taxable in the hands of X for the assessment year 2002-03 shall be Rs. 14,65,812.

5.8 Income from other sources

Problem 5.8-1 - *Discuss the following:*

1. X Ltd. is a company in which the public are not substantially interested. Y is a shareholder of the company holding 15 per cent of the equity shares. The accumulated profits of the company as on March 31, 2008 amounted to Rs. 10,00,000. The company lent Rs. 1,00,000 to Y by an account payee bank draft on October 1, 2008. The loan was not connected with the business of the company. Y repaid the loan to the company by an account payee bank draft on March 30, 2009. Examine the effect of the borrowal and repayment of the loan by Y on the computation of his total income for the assessment year 2009-10.

2. Discuss the taxability or otherwise of the following gifts received by X, an individual, during the financial year 2008-09:

a. *Rs. 24,000 each from his four friends on the occasion of his birthday.*

b. *Wrist watch valued at Rs. 60,000 from his friend.* [MAY 2007]

■

Pointwise answer:

1. For provisions of section 2(*22*)(*e*), *see* para 193.2-6. In the present problem, the loan of Rs. 1,00,000 by X Ltd. to Y is chargeable to tax in the hands of Y as deemed dividend under section 2(*22*)(*e*) under the head "Income from other sources" for the assessment year 2009-10. The repayment of loan of Rs. 1,00,000 by Y to X Ltd. does not affect the taxability of it in his hands.

2. The answer is as under:

a. Rs. 96,000 (*i.e.*, Rs. 24,000 × 4) is chargeable to tax in the hands of X as income from other sources, *see* paras 199.1 and 199.2 [as the aggregate amount of cash gift exceeds Rs. 50,000, the entire sum is taxable as income under the head "Income from other sources".

b. Gift in kind is not covered by the provisions of section 56(2)(*vi*) and is, therefore, not chargeable to tax.

Problem 5.8-2 - *X, a lady received the following gifts during the year ending March 31, 2009: Rs. 30,000 from her elder sister. Rs. 50,000 from the daughter of her elder sister; and Rs.1,25,000 from various friends on the occasion of her marriage.*

Discuss the taxability or otherwise of these gifts in the hands of X. [MAY 2006]

■

For provision, relating to gift [section 56(2)(*v*), *see* para 199.1]. In the present problem, Rs. 50,000 shall be chargeable to tax in the hands of X as income from other sources for the assessment year 2008-09, elder sister is a relative; daughters of elder sister is not a relative and any sum of money received on the occasion of marriage of the individual is not covered by section 56(2)(*v*).

Problem 5.8-3 - *X has a deposit of Rs. 10 lakh in a bank on which he receives interest of Rs. 80,000. He has also borrowed Rs. 5 lakh from the same bank on the security of the deposit and is liable to pay Rs. 50,000 by way of interest to the bank. He, therefore, offers the difference between the two amounts of Rs. 30,000 as income from sources. Is this correct ?*[MAY 2004]

■

X has received Rs. 80,000 as interest. It is chargeable to tax under the head "Income from other sources". This interest can be utilized by X whichever way he likes. Merely because he utilizes it to repay the interest on loan, it cannot be reduced to that extent. To put it differently, Rs. 80,000 is taxable under section 56 under the head "Income from other sources". Rs. 50,000 being interest on loan paid by X to the bank, is governed by the relevant provision of Act. For instance, if the loan is taken for purchase, construction, etc., of a house property, interest on loan is deductible under section 24*(b)*. If loan is taken for business purposes, interest on loan is deductible under section 36(1). If loan is taken for acquiring a capital asset, then interest can be added to the cost of acquisition. If loan is taken for personal purposes, then interest on loan is not deductible. For detailed discussion, *see* Problem 109.10-1pP1. *See* also *CIT* v. *V.P. Gopinathan* [2001] 248 ITR 449 (SC).

Problem 5.8-4 *X, managing director of A Pvt. Ltd., holds 70 per cent of its paid up capital of Rs. 20 lakh. The balance as at March 31, 2008 in general reserve is Rs. 6 lakh. The company on April 1, 2008 gives an interest-free loan of Rs. 5 lakh to its supervisor having salary of Rs. 4,000 per month, who in turn on June 15, 2008 advances the said amount of loan so taken from the company to X. The Assessing Officer wants to tax the amount of advance in the hands of X. Is the action of Assessing Officer correct ?* [NOVEMBER 2003]

■

According to section 2(*22*)(*e*), any loan or advance to a shareholder or any payment on behalf or for the benefit of a shareholder is treated as dividend in the hands of shareholder, if payment or advance is given by a company in which

public is not substantially interested and shareholder is beneficial owner of at least 10 per cent equity shares of the company. It is deemed as loan or advance to the extent of accumulated profits of the company.

The Apex Court has held in *L. Alagusundaram Chettiar* v. *CIT* [2002] 121 Taxman 587, that where the assessee, a managing director of a company, asked an employee to take a loan from the company and the employee has passed on the same to him even without executing any pronote, such loans made by the company to the employee fell in the category of "benefit" to the assessee and were, therefore, assessable as deemed dividends in his hands.

In the present problem, in view of the aforesaid case, Rs. 5 lakh will be treated as deemed dividend under section 2(*22*)(*e*) in the hands of X for the assessment year 2009-10. The action of Assessing Officer is, therefore, correct.

Problem 5.8-5 - *X, a captain in Indian army, was killed at Kargil border during a war. Mrs. X was paid an* ex gratia *payment of Rs. 50,000 in March 2009, besides the family pension during the year of Rs. 90,000. She wants to know about the taxability of both the receipts.* [MAY 2003]

■

	Rs.
Ex gratia payment [not taxable — Circular No. 776, dated June 8, 1999]	—
Family pension	90,000
Less : Standard deduction under section 57(*iia*)	15,000
Income from other sources [it is exempt under section 10(*19*)]	75,000

Problem 5.8-6 - *An enterprise engaged in manufacturing of steel balls discontinued its activities and decided to lease out its factory building, plant and machinery and furniture from April 1, 2008 on a consolidated lease rent of Rs. 50,000 per month. Compute the income for assessment year 2009-10 of assessee from following information:*

	Rs.
i. *Interest received on deposits*	*1,00,000*
ii. *Brokerage paid on hundi loans taken*	*2,000*
iii. *Interest paid on hundi and other loans which were given as deposits on interest to others*	*75,000*
iv. *Expenses incurred on repairs of building, plant and machinery*	*15,000*
v. *Fire insurance premium of plant and machinery and furniture*	*12,000*
vi. *Depreciation for the year*	*1,47,500*
vii. *Legal fees paid to an advocate for drafting and registering the lease agreement*	*1,500*
viii. *Factory licence fees paid for the year*	*1,000*
ix. *There is unabsorbed depreciation of Rs. 2,75,000 for the assessment years 2007-08 and 2008-09.*	
x. *Interest paid includes an amount of Rs. 25,000 remitted outside India on which TDS was not deducted since the party had furnished Form 15G.* [NOVEMBER 2002 (New)]	

■

	Rs.
Lease rent	6,00,000
Interest	1,00,000
Total	7,00,000
Less:	
Brokerage	(-) 2,000
Interest (Rs. 75,000 – Rs. 25,000)	(-) 50,000
Repairs	(-) 15,000
Insurance	(-) 12,000
Depreciation	(-) 1,47,500
Legal fees	(-) 1,500
License fees	(-) 1,000
Unabsorbed depreciation	(-) 2,75,000
Net income	1,96,000

Note - It is assumed that interest is paid to a non-resident. Interest paid to a non-resident is covered by section 195 (and not by section 194A). Form No. 15G cannot be submitted by recipient under section 195. In other words, the payer in this case is supposed to deduct tax at source under section 195. If tax is not deducted, interest paid outside India is not deductible.

Problem 5.8-7 - *X is the managing director of X (P.) Ltd. The company had accumulated profits to the extent of Rs. 5 lakh as on March 31, 2008. It grants a loan of Rs. 3 lakh to his wife on June 1, 2008 for the purchase of a house, which was repaid on December 31, 2008. No interest was charged on the said loan by the company. Examine the consequences of these transactions. Make assumptions as required.* [NOVEMBER 2002]

■

If Mrs. X holds 10% equity share capital in X (P.) Ltd., then Rs. 3 lakh will be deemed as dividend in the hands of Mrs. X. If X holds 10% equity shares in X (P.) Ltd. (Mrs. X does not hold 10% shares) and loan is given for benefit of X, then it will be deemed as dividend in the hand of X.

Problem 5.8-8 - *X purchased, in 1992, 10,000 shares (non-listed) of ABC Ltd. for Rs. 5 lakh by borrowing money from a bank. He holds them as investments. He received dividend income on these shares of Rs. 1 lakh for the previous year 2008-09 on December 10, 2008. He has paid interest of Rs. 85,000 on the loan to the bank. Please advise X, how should he deal with these facts in computing his income. Would your advice be different if X had received dividend in the previous year 1995-96 and had paid the interest in that year ?* [NOVEMBER 1998]

■

The table given below highlights the provisions governing the problem —

Type of income arising from the investment	*If the assessee is an investor*	*If the taxpayer is a dealer-in-shares*
❑ Dividend income	Dividend income is exempt as per section 10(*34*), *see* Note 1	Dividend income is exempt as per section 10(*34*), *see* Note 1
❑ Profit on sale of shares	The long-term/short-term capital gain arising on sale of shares is chargeable to tax under section 45, *see* Note 2	The profit from sale of shares constitutes business income of the dealer which is chargeable to tax under section 28, *see* Note 3.

Notes :

1. According to section 10(*34*), any income by way of dividend referred to in section 115-O is exempt from tax. Therefore, in case dividend is paid, distributed or declared on or after April 1, 2003, it is not taxable in the hands of shareholders. In the present problem, X cannot set off interest of Rs. 85,000 against the dividend income as dividend income is not taxable in his hands by virtue of section 10(*34*) for the assessment year 2009-10. However, if X had received dividend in the previous year 1995-96, then the same shall be taxable in his hands under the head "Income from other sources" and, therefore, interest is deductible under section 57(*iii*) against dividend income. In case interest exceeds the dividend income, such excess can be set off against other income.

2. For the assessment year 2009-10, since dividend income is exempt, the assessee can treat the interest on money borrowed for the purpose of investment as part of "cost of acquisition of shares" for the purpose of computation of capital gain—*see CIT* v. *Mithlesh Kumari* [1973] 92 ITR 9 (Delhi).

3. For the assessment year 2009-10, a dealer-in-shares can claim interest on money borrowed as deduction under section 36(1)(*iii*) from business income, as capital was borrowed for earning business income (*i.e.*, profit on sale of shares) and dividend income (which is exempt). According to *CIT* v. *Bhopal Sugar Industries Ltd.* [1970] 78 ITR 209 (MP), expenses incurred for earning income which is partly taxable and partly tax-free and which is not apportionable between the two, shall be allowed as deduction in its entirety in computing the income of the assessee. Section 14A will be applicable in such case.

5.9 Income of other persons included in assessee's total income

Problem 5.9-1 - *X, a mentally retarded minor has a total income of Rs. 1,20,000 for the assessment year 2009-10. The total income of his father F and of his mother M for the relevant assessment year is Rs. 2,40,000 and Rs. 1,80,000 respectively. Discuss the treatment to be accorded to the total income of X for the relevant assessment year.* [MAY 2006]

■

For provisions regarding clubbing of income of minor child, *see* para 213. In the present problem, the income of X shall not be clubbed with the income of his parents as X is suffering from a disability specified under section 80U.

Problem 5.9-2 - *X, an individual engaged in the business of finance, advances Rs. 5 lakh to his HUF on interest at 12 per cent per annum, which is the prevailing market rate. The HUF invests the amount in its business and earn profit of Rs. 2 lakh from this money. Can the Assessing Officer add a sum of Rs. 1,40,000 (i.e., Rs. 2,00,000-Rs. 60,000) as income of X under section 64(2) ? Will the position remain the same, if X does not charge any interest ?* [NOVEMBER 2004]

■

Since the prevalent market rate is charged the Assessing Officer's action is not tenable. If X did not charge any interest, then also the income cannot be subjected to tax in his hands as the business (asset) belongs to HUF and is not owned by him individually.

Problem 5.9-3 - *X out of his own funds had taken a FDR for Rs. 10,00,000 bearing interest @10 per cent per annum payable half-yearly in the name of his wife Mrs. X. The income of interest earned for the year 2007-08 of Rs. 1,00,000 was invested by Mrs. X in the business of packed spices, which resulted into a net profit of Rs. 55,000 for the year ending March 31, 2009. How the income of interest on FDR and income from business shall be taxed for the assessment year 2009-10 ?* [NOVEMBER 2002 (New)]

■

Interest on FDR shall be taxed in the hands of X. Business income by investing interest on FDR is taxable in the hands of Mrs. X [*see* para 215].

Problem 5.9-4 - *X is a fashion designer having lucrative business. His wife is a model. X pays her monthly salary of Rs. 10,000. The Assessing Officer while admitting that the salary is an admissible deduction, in computing the total income of X had applied the provisions of section 64(1) and had clubbed the income (salary) of his wife in X hands. Discuss the correctness of the action of the Assessing Officer.* [NOVEMBER 2000]

■

In the present problem, since X is carrying on a sole proprietary business, he holds substantial interest in it. In case Mrs. X has a technical or professional qualification to justify the monthly salary of Rs. 10,000 then, no clubbing under section 64(1)(*ii*) will take place. However, if Mrs. X does not have any technical or professional qualification then, such salary income shall be clubbed with the income of X and shall be chargeable to tax in his hands. In such a case, the action of the Assessing Officer shall be correct [*see* para 208.3-6 for meaning of technical or professional qualification].

Problem 5.9-5 - *In an existing firm, a well-established one, X (42 years) is given an option of joining the partnership with 20 per cent share. Either he can join the firm himself or his wife can join as a partner. In either case, X would be paid a remuneration of Rs. 95,000 per annum. In addition, X is deriving a commission income (own) of Rs. 1,20,000. Mrs. X (40 years) has business (own) income of Rs. 80,000. X seeks your advice as to whether he should join the firm as a partner or his wife should join. Advice X suitably so that the total incidence of tax payable is the least.* [NOVEMBER 1999]

■

As per section 64(1)(*iii*), an individual is chargeable to tax in respect of any remuneration received by the spouse from a concern in which the individual has a substantial interest. For this purpose, salary has to be computed in accordance with the provisions of sections 15 to 17.

An individual is deemed to have substantial interest if he (individually or along with his relatives) beneficially holds equity share carrying not less than 20 per cent voting power in the case of a company or is entitled to not less than 20 per cent of the profits in the case of a concern other than a company, at any time during the previous year. However, remuneration which is solely attributable to the application of technical or professional knowledge and experience of the spouse will not be clubbed.

In the present problem in view of the aforesaid provisions, the following three cases are possible :

Case I : X joins the partnership firm as a partner.

Case II : Mrs. X joins the partnership firm as a partner and X is technically qualified for the job.

Case III : Mrs. X joins the partnership firm as a partner and X is not technically qualified for the job.

Computation of total income and tax liability for the assessment year 2009-10.

	Case I		*Case II*		*Case III*	
	X	Mrs. X	X	Mrs. X	X	Mrs. X
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Salary	—	—	95,000	—	—	95,000
Less : Standard deduction	—	—	—	—	—	—
Income under the head "Salaries"	—	—	95,000	—	—	95,000
Business income	1,20,000	80,000	1,20,000	80,000	1,20,000	80,000
Remuneration from partnership firm	95,000	—	—	—	—	—
Taxable income	2,15,000	80,000	2,15,000	80,000	1,20,000	1,75,000
Tax liability (including cess)	6,700	*Nil*	6,700	*Nil*	*Nil*	2,580

	Case I	*Case II*	*Case III*
Tax liability	6,700	6,700	2,580

Case III is recommended since it results in minimum tax liability.

Note : Remuneration received by a partner from the partnership firm is taxable as business income.

Problem 5.9-6 - *X gifted a house property to Miss Y on March 15, 2008. Miss Y married X's son Z on February 1, 2009. The income from gifted property was Rs. 30,000 which was added by the Assessing Officer in the hands of X under the provisions of section 64(1)*(vi). *Is this inclusion justified in law.* [MAY 1999]

■

According to section 64(1)(*vi*), if an individual, directly or indirectly, transfers assets, without adequate consideration to son's wife, income arising from such assets will be included in the total income of the transferor. However, the relationship of the father-in-law and daughter-in-law should subsist both at the time of transfer of asset and at the time of accrual of income. It means transfer of asset before son's marriage by an individual to his prospective daughter-in-law is outside the scope of clubbing even if income is accrued after son's marriage—*see Philip John Plasket Thomas* v. *CIT* [1963] 49 ITR 97 (SC).

In the present problem, in view of the aforesaid provision, the inclusion in the income of X by the Assessing Officer is unjustified.

5.10 Set off and carry forward of losses

Problem 5.10-1 - *Explain those conditions which are required to be fulfilled by both the predecessor and successor co-operative banks in order to claim benefit of section 72AB.* [MAY 2008]

■

See para 522.2.

Problem 5.10-1 - *An assessee sustained a loss under the head "Income from house property" in the previous year relevant to the assessment year 2008-09, which could not be set off against income from any other head in that assessment year. The assessee did not furnish the return of loss within the time allowed under section 139(1) in respect of the relevant assessment year. However, the assessee filed the return within the time allowed under section 139(4). Can the assessee carry forward such loss for set off against income from house property of the assessment year 2009-10?* [MAY 2006]

■

House property loss can be carried forward even if return of income is submitted after the due date. Provision of section 80 is not applicable [*see* para 229.5].

Problem 5.10-2 *M, an individual, was carrying on a business as sole proprietor. On his death, his legal heirs decide to continue the same business by forming a firm.*

At the time of death, M had a determined business loss of Rs. 2 lakh, under the provisions of the Income-tax Act, to be carried forward.

Does the firm, consisting of all the legal heirs of M, get a right to have this loss adjusted against its current income? Discuss. [NOVEMBER 2005]

■

See para 229.1-2*a* (point 5). Yes, the firm consisting of all the legal heirs of M can adjust the loss against current income. *See* also *CIT* v. *Madhukant M. Mehta* [2002] 124 Taxman 130 (SC).

Problem 5.10-3 - *X & Co., the sole proprietary concern of X, gets converted into partnership after his death on April 2, 2008 by his two sons and the business of X & Co. is continued to be carried in the same manner. There are business losses of Rs. 4.25 lakh till March 31, 2008. The net results of the business for the year ending March 31, 2009 is profits of Rs. 5 lakh. The partners want to set off the losses of Rs. 4.25 lakh from the profits of the firm. Can they do so ?* [NOVEMBER 2003]

■

It has been held by the Apex Court in *CIT* v. *Madhukant M. Mehta* [2002] 124 Taxman 130, that where legal heirs of a deceased-proprietor enters into partnership and carries on the same business in the same premises under the same trade name, there is succession by inheritance as contemplated in section 78(2) and the assessee-firm is entitled to carry-forward and set-off of the deceased's business loss against its income for the subsequent years.

In view of the aforesaid case, in the present problem, partners are entitled to set off the losses of Rs. 4.25 lakh from the business income of the firm.

Problem 5.10-4 - *Shiv Traders, a partnership firm, sustained business loss of Rs. 2 lakh, inclusive of admissible depreciation of Rs. 1.15 lakh (under section 32) for the year ending March 31, 2008. The firm did not file its return for that year. The Assessing Officer issued a notice under section 142(1) on March 1, 2009, in compliance to which the firm*

filed its return for the said year declaring the loss of Rs. 2 lakh and sought carried forward for next year. Is the firm's claim justified ? [MAY 2003]

■

Unabsorbed depreciation (*i.e.*, Rs.1.15 lakh) can be carried forward. The remaining loss of Rs. 85,000 cannot be carried forward, since the return is not filed within the due date given in section 139(1).

Problem 5.10-5 - *X Ltd. a pharmaceutical company having accumulated losses and unabsorbed depreciation to be set off in future for Rs. 130 lakh and Rs. 250 lakh as on March 31, 2008 was demerged on May 16, 2008 and 30 per cent of its total assets were transferred into the resulting Co. XY Ltd. How the accumulated losses and unabsorbed depreciation of the demerged company shall be dealt with in the return for assessment year 2009-10 of the resulting company :*

i. *when the same are not directly relatable to the undertakings transferred ; and*

ii. *when the same are directly relatable to the undertakings transferred.* [NOVEMBER 2002 (New)]

■

	Loss to be carried forward by	
	X Ltd. (Rs. in lakh)	***XY Ltd. (Rs. in lakh)***
When the losses are directly relatable to undertaking transferred		
- Loss	—	130
- Depreciation	—	250
When the losses are not directly relatable to undertaking transferred [70:30]		
- Loss	91	39
- Depreciation	175	75

Problem 5.10-6 - *Discuss the following :*

1. *Mrs. X carried on business with the gifted funds of her husband X. For the previous year ending March 31, 2009, Mrs. X incurred loss of Rs. 2 lakh which loss X wants to set off from his taxable income.*

2. *Mrs. X succeeded to the business of her husband X, who died on September 10, 2008. She carried on the business as proprietrix. The business of X up to the date of his death resulted in a loss. Mrs. X earned profit in business for the period ending March 31, 2009. Mrs. X wants to set off the loss of her husband for the period ending September 10, 2008 against her income.* [MAY 2001]

■

Pointwise answer :

1. See para 216.

In the present problem, in view of the aforesaid provision, X can claim set off of loss of Rs. 2 lakh from his taxable income.

2. As per section 78(2), where any person carrying on any business or profession has been succeeded in such capacity by another person otherwise than by inheritance nothing in Chapter VI shall entitle any person other than the person incurring the loss to have it carried forward and set off against his income.

In the present problem, in view of the aforesaid provision, Mrs. X can claim set off of loss of her husband against her income.

Problem 5.10-7 - *Amalgamation of companies 'A' and 'B' has been approved by the BIFR in order to rehabilitate the sick company 'B'. During the course of assessment of 'B' company, the Assessing Officer refuses to allow carry forward of losses under section 72A for the reason that the activities of the sick company had been closed consequent to labour unrest and that the loss suffered by the said company was a capital loss. Is the Assessing Officer justified?* [MAY 2000]

■

See para 516.5. In case the prescribed conditions are satisfied, the Assessing Officer is unjustified in refusing to allow carry forward of losses under section 72A in the course of assessment of company.

Problem 5.10-8 - *Write note on set off and carry forward of loss under the head "Income from house property" in view of insertion of section 71B.* [MAY 1999]

■

See para 229.5.

5.11 Deductions from gross total income

Problem 5.11-1 - *Explain the meaning of "eligible business" referred to in section 80-IE granting tax holiday in respect of profits and gains of certain undertakings in North-Eastern States.* [MAY 2008]

■

See para 255B.

Problem 5.11-2 - *X, an individual, resident in India, paid medical insurance premium amounting to Rs. 20,000 by cash during the year ending March 31, 2009 out of his income chargeable to tax in respect of the policy taken on the health of his dependent father in accordance with the scheme framed by the General Insurance Corporation of India and approved by the Central Government. Besides, he paid Rs. 90,000 during the year ending March 31, 2009 for the medical treatment of his dependent mother, aged 69 years, in respect of a disease specified in rule 11DD(1) of the Income-tax Rules, 1962. He received Rs. 20,000 from the insurance company for the said medical treatment of his mother. X seeks your advice on the deductions, if any, available in respect of these two payments.* [NOVEMBER 2006]

■

Deduction under section 80D is not available with respect to medical insurance premium paid in cash, *see* para 238.

Deduction under section 80DDB of Rs. 40,000 (*i.e.*, Rs. 60,000—Rs. 20,000) is available in respect of medical treatment expenses of dependent mother who is a senior citizen, *see* para 240.

Problem 5.11-3 - *An institution has been established wholly for charitable and religious purposes within the meaning of sections 11 and 12. Donations made to such an institution do not automatically qualify for deduction under section 80G. Discuss the validity of this proposition.* [MAY 2004]

■

One has to satisfy a few conditions which are given by section 80G(5). Donation given to a charitable institute which satisfies conditions of sections 11 to 13 but does not satisfy the additional conditions given by section 80G(5) is not eligible for deduction under section 80G. For conditions of section 80G(5), *see* para 242.5.

Problem 5.11-4 - *Expenditure on medical treatment of an assessee and members of his family constitutes a major element of a household budget, particularly if he or a member of his family suffers from physical disability. Discuss the relevant provisions which provide relief or deductions available to a non-salaried person, in this repect.* [MAY 2004]

■

See paras 239 and 240.

Problem 5.11-5 - *What is the deduction allowable in respect of donations for political purposes ? How will expenditure on advertisements in souvenirs of political parties be dealt with, in computing income from business?* [MAY 2004]

■

See paras 245 and 246 for deduction allowable in respect of donation given to political parties. In view of sub-section (2B) of section 37, no allowance is available in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlets or the like, published by a political party.

Problem 5.11-6 - *X Cine Arts Ltd. of Mumbai is engaged in distribution of cinematography films. It starts construction of a multiplex theatre and convention hall in Navi Mumbai in April 2008 and completes in December 2008. The profits for the year ending March 31, 2009 of all the activities are :*

	Rs. (in lakh)
Distribution of cinematography films	*5*
Convention centre	*2*
Multiplex theatre	*1*

Compute the taxable income for the assessment year 2009-10 with reasons. [NOVEMBER 2003]

■

Assessment year 2009-10

	Rs. (in lakh)
Business income	
Distribution of cinematography films	5
Convention centre	2
Multiplex theatre	1
Gross total income	8
Less : Deduction under section 80-IB [*see* Note]	1
Taxable income	7

Note : Deduction under section 80-IB is not available in respect of multiplex theatre as it is located within the municipality jurisdiction of Mumbai [*see* para 254.8]. However, in respect of income from convention centre, deduction

@ 50% of Rs. 2 lakh is available under section 80-IB as there is no stipulation regarding location of convention centre under section 80-IB [*see* para 254.9].

Problem 5.11-7 - *Write short note on manufacture in the context of section 80-IB.* [NOVEMBER 2002]

■

See para 254.1-1d[1].

Problem 5.11-8 - *A company engaged in growing and manufacturing tea furnishes, the following data for purposes of computing the deduction allowable under section 80HHC of the Income-tax Act. You are required to compute the deduction in respect of assessment year 2009-10 :*

	(Rs. in lakh)
Net profit computed under the head "Business"	*109*
Duty drawback included in net profit	*10*
Domestic sales	*60*
Export sales composed of:	
(i) *Direct sales*	*100*
(ii) *Transfer to branch outside India*	*50*
(iii) *Freight and insurance beyond customs station*	*10*
Total	*160*
Remittances received in convertible foreign exchange within 6 months of the end of the previous year	*140*
Amount retained in a separate bank account outside India with the approval of RBI	*20*

[NOVEMBER 2002]

■

Deduction under section 80HHC is not available.

Problem 5.11-9 - *Write short note on deduction in respect of loan taken for higher education.* [MAY 2002]

■

For provisions of section 80E, see para 241.

Problem 5.11-10 - *X Ltd., an industrial undertaking not set up in an industrially backward State, eligible for deduction under section 80-IB had commenced its manufacturing in the financial year ending March 31, 2004, furnishes the following data for the financial year ended March 31, 2009:*

	(Rs. in lakh)
Net profit as per profit and loss A/c	*8*
Determined unabsorbed business loss (for the assessment year 2008-09)	*6*

You are requested to (i) *compute the eligible deduction under section 80-IB, and* (ii) *the net income under the head "Profits and gains of business or profession". The answer should be supported with reasoning.* [NOVEMBER 2000]

■

Computation of deduction under section 80-IB for the assessment year 2009-10 :

	Small scale industrial undertaking I Rs.	*Industrial undertaking set up in Category A notified backward district* II Rs.	*Industrial undertaking set up Category B notified backward district* III Rs.	*Any other* IV Rs.
Amount of deduction in case of company assessee	60,000 (*i.e.*, 30% of Rs. 2 lakh)	2,00,000 (*i.e.*, 100% of Rs. 2 lakh)	2,00,000 (*i.e.*, 100% of Rs. 2 lakh)	*Nil* (*see* Note)
Income from business	1,40,000	*Nil*	*Nil*	2,00,000

Note : In case IV, no deduction under section 80-IB is available since the time-limit for commencement of manufacturing for claiming deduction is between April 1, 1991 and March 31, 1995.

Problem 5.11-11 - *X, who is not a supporting manufacturer, gives the following particulars and his only source of income is from the proprietary export business :*

Trading and Manufacturing Account

Particulars	Rs.	Particulars	Rs.
To purchase of trading goods	*10,00,000*	*By sales export - trading goods*	*12,00,000*
To purchase of raw materials for manufacturing	*5,00,000*	*By sales export - manufactured goods FOB*	*9,00,000*
To wages, electricity, etc., for manufacturing	*2,00,000*		
To Gross profit	*4,00,000*		
Total	*21,00,000*		*21,00,000*
To administration expenses	*3,00,000*	*By gross profit*	*4,00,000*
To Net profit	*6,00,000*	*By brokerage, commission interest, rent, etc.*	*2,00,000*
		By duty drawback and profit on sale of import licence	*3,00,000*
Total	*9,00,000*		*9,00,000*

Disallowance under sections 28 to 44AD is estimated at Rs. 20,000. You are required to compute the relief under section 80HHC. [MAY 2000]

■

Deduction under section 80HHC is now not available.

Problem 5.11-12 - *Write a note on deduction in respect of repayment of loan taken for higher education as contemplated under section 80E.* [MAY 1999]

■

See para 241.

Problem 5.11-13 - *One of the objects of a religious trust is the establishment and maintenance of public places of worship and prayer halls open to all communities. The Assessing Officer allows exemption in respect of the income of the religious trust under section 11, but declines to grant deduction under section 80G in the hands of the donors in respect of donations made to the trust. Comment on the seeming contradiction in the two decisions of the Assessing Officer.* [NOVEMBER 1998]

■

In *Upper Ganges Sugar Mills Ltd.* v. *CIT* [1998] 227 ITR 578 (SC), it was held that section 80G sets out the deductions to be made, in accordance with and subject to its provisions, in computing the total income of an assessee in respect of donations to certain funds, charitable institutions, etc. It applies to any other fund or any institution to which the section applies if it is established in India "for a charitable purpose" and fulfils the condition, *inter alia*, that it "is not expressed to be for the benefit of any particular religious community or caste". According to *Explanation 3* to section 80G 'charitable purpose' does not include any purpose the whole or substantially the whole of which is of a religious nature. This *Explanation* takes note of the fact that an institution or fund established for a charitable purpose may have a number of objects. If any one of these objects is wholly, or substantially wholly, of a religious character, the institution or fund falls outside the scope of section 80G and a donation to it does not secure the advantage of the deduction that it gives. To reiterate, *Explanation 3* requires ascertainment of whether there is one purpose within the institution or fund's overall charitable purpose which is wholly, or substantially wholly, of a religious nature.

In the present problem, in view of the aforesaid case, one of the objects of the religious trust is the establishment and maintenance of public place of worship and prayer halls open to all communities. This object of trust is of a religious nature. Although section 11 exempts from tax the income derived from property held on trust for charitable or religious nature, yet the distinction between a charitable purpose and religious purpose is implicit in *Explanation 3* to section 80G, which provides that for claiming deduction under section 80G, "charitable purpose" does not include any purpose the whole or substantially the whole of which is of a religious nature.

Therefore, the Assessing Officer is justified in disallowing the deduction under section 80G.

5.12 Agricultural income

Problem 5.12-1 - *Rent of Rs. 60,000 charged from tenants occupying house constructed on the land situated in India and used for agricultural purposes.* [MAY 2008]

■

If the building is a farm building, then the rental income shall be treated as agricultural income. A building shall be treated as farm building, only where the building is on or in the immediate vicinity of the agricultural land, and is a building which the receiver of the rent or revenue or the cultivator, or the receiver of rent-in-kind by reason of his connection with the land, requires it as a dwelling house, storehouse or other out building.

Problem 5.12-2 - *An Indian company is engaged in the manufacture and sale of coffee grown by it in its own estates. Will it liable to tax. If so, how will its income be determined in respect of assessment year 2008-09 ?* [MAY 2002]

■

For provisions of rule 7B, *see* para 279.3.

In the present problem, in view of the aforesaid provisions, 40% of such income shall be deemed to be income liable to tax and 60% of such income is treated as agriculture income.

5.13 Tax treatment of Hindu undivided families

Problem 5.13-1 - *A Hindu undivided family is carrying on the business of purchase and sale of foodgrains. The Karta of the family manages the business. Can the Hindu undivided family pay salary to the Karta and claim the payment made as a deduction from the profits of its business? If so, what are the conditions and limitations for such payment?* [NOVEMBER 2006]

■

Yes, *see* para 300.

Problem 5.13-2 - *X, his wife Mrs. X and his unmarried daughter, V, living together, do not own any ancestral property. X's sister, S, makes a declaration under which she transfers a house property owned by her for the benefit of X's and his family members to be jointly owned and enjoyed by them. In what status will the income from the house property be assessed in the hands of the transferee?* [NOVEMBER 2002]

■

An outsider may provide some funds by way of gift and it can become the nucleus or corpus for the HUF. A specific direction by the donor for the joint enjoyment of the fund by the donee's family including accretions thereon is sufficient for creating a HUF. *See* also *CIT* v. *Satyendra Kumar* [1998] 232 ITR 360 (SC) and *CIT* v. *M. Balasubramaniam* [1990] 182 ITR 117 (Mad).

Problem 5.13-3 - *X was the karta of a HUF. He died leaving behind his major son Y, his widow, his grandmother and brother's wife. Can the HUF retain its status as such or the surviving persons become co-owners. Discuss.* [NOVEMBER 2000]

■

There need not be more than one male member to form a Hindu undivided family as taxable entity under the Act. The expression "Hindu undivided family" in the Act is used in the sense in which a Hindu undivided family is understood under the personal law of Hindus. Under the Hindu system of law, a joint family may consist of single male member and widows of deceased male members and the Income-tax Act does not indicate that a Hindu undivided family as an assessable entity must consist of at least two male members. Property of a joint family, therefore, does not cease to belong to the family merely because the family is represented by a single coparcener who possesses rights which an owner of property may possess —*Gowli Buddanna* v. *CIT* [1966] 60 ITR 293 (SC).

The HUF, in the given problem, retains its status and the surviving persons do not become co-owners.

5.14 Special provisions governing assessment of firms and association of persons

Problem 5.14-1 - *X Enterprises, a partnership firm constituted by a doctor and a non-doctor engaged in running a multi-speciality hospital seeks your opinion in the context of provisions of the Act as to allowability/chargeability of the following transactions for preparing its return for assessment year 2009-10—*

a. *Depreciation on the instruments, imported from U.K. for Rs. 2 lakh cleared by customs on March 22, 2009 on payment of duty of Rs. 1 lakh, installed and ready for use on March 26, 2009. Only one operation with the help of such instruments was performed till March 31, 2009.*

b. *The book profits calculated as per section 40(*b*) are Rs. 3 lakh and payment of salary to working partners was Rs. 1 lakh. Clause for payment of salary to working partners though appears in the deed, but the same is silent as to quantum and the manner of distribution.*

c. *Salary of Rs. 10,000 per month paid to the wife of a partner for working as an anesthesist. The normal salary of an anesthesist in the town is Rs. 7,500 per month or less.*

d. *Purchase of medicines in cash on December 18, 2008 for Rs. 35,000.*

e. *Revenue expenditure of Rs. 10,000 incurred for promoting family planning amongst its employees.*

f. *Interest of Rs. 3,000 paid on an overdraft of Rs. 1 lakh taken for making payment of instalment of advance tax of Rs. 1.25 lakh.* [MAY 2008]

■

Depreciation - The instruments were installed and ready for use on March 26, 2009. The instruments have been put to use before March 31, 2009. Consequently, depreciation would be available under section 32 at the rate of 7.5 per cent of actual cost.

Salary to working partner - Since the deed is silent on the remuneration payable to the working partners as regards the quantum and the manner of distribution, it is not eligible for deduction under section 40(*b*). The quantum or the method of arriving at the quantum of working partner salary is compulsorily required.

Salary to spouse of a partner - The excess payment of Rs. 2,500 per month shall be disallowed under section 40A(2). However, in the hands of the recipient, the entire salary is chargeable to tax.

Cash purchase - Cash payment above Rs. 20,000 being in contravention of section 40A(3), the entire amount is to be disallowed.

Family planning expenditure - Only in the case of companies the expenditure towards promotion of family planning amongst employees, is deductible. In the case of firms, it is not eligible for deduction.

Interest on capital borrowed for payment of income-tax - It is not a deductible expenditure —*East India Pharmaceutical Works Ltd.* v. *CIT* [1997] 224 ITR 627 (SC).

Problem 5.14-2 - *HSP, a partnership firm engaged in the business of running a heritage hotel approved by the competent authority provides the following information relating to the year ending on March 31, 2009:*

1. *Net profit as per P & L account of Rs. 200 lakh was arrived at after charge of the following:*

a. *Depreciation on hotel building having W.D.V. on April 1, 2008 of Rs. 500 lakh was charged by treating the same as plant and machinery.*

b. *Expenses of Rs. 1,00,000 incurred for the purpose of promoting family planning among its employees.*

c. *Payment of Rs. 50,000 for an advertisement published in the souvenir released on August 15 by Bhartiya Janta Party.*

d. *Compensation of Rs. 1,00,000 paid to the suppliers of automatic kitchen appliances because of termination of the contract after receipt of 50% of appliances.*

e. *Wines and liquor imported in financial year 2007-08 for Rs. 20 lakh and were available in the stock on April 1, 2008 for Rs. 5 lakh were confiscated by the Government authority and therefore were written off.*

f. *Expenses of Rs.20 lakh incurred on replacement of carpets in the foyer, lounge and bar.*

2. *Out of amount credited to the reserve created under section 80HHD(1) in the financial year 2002-03, an amount of Rs. 15 lakh could not be utilized for the purposes as per section 80HHD(4) till March 31, 2009.*

3. *Amount of Rs. 4 lakh equal to U.K. £5000 was remitted and paid to a travel agent resident of U.K. as commission for the booking of international tourists in the hotel. Tax at source was not deducted out of such payment.*

4. *Amount of Rs. 40,000 each was paid in cash to the suppliers of vegetables, milk products and eggs on February 11, 2009 because of suspension of banking operations due to strike of bank employees.*

5. *Amount of Rs. 5 lakh written off in the financial year 2006-07 as irrecoverable from a travel agent; an amount of Rs. 2 lakh out of it was recovered on March 13, 2009 and credited to a reserve account.*

Compute the income chargeable to tax for assessment year 2009-10 and give reasons in brief for treatment given to each of the items. [NOVEMBER 2007]

■

Computation of taxable income	*Rs. (in lakh)*
Net profit as per Profit & Loss A/c	200
Excess depreciation [disallowed @ 5% of Rs. 500 lakh]	25
Family planning expenses [allowable in case of corporate-assessee only]	1
Advertisement in souvenir of a political party [disallowed as per section 37(2B)]	0.5
Compensation to the supplier of kitchen appliances [disallowed as per *Swadeshi Cotton Mills Co. Ltd.* v. *CIT* [1967] 63 ITR 65 (SC)]	1
Confiscation of liquor [allowable as deduction]	-
Expenditure on replacement of carpet [allowable as deduction]	-
Amount credited to reserve under section 80HHD [taxable as business income]	15
Commission paid to a travel agent resident of UK without tax deduction at source [allowable as deduction]	-
Amount paid in cash on bank strike day [section 40A(3) not applicable as per rule 6DD, hence allowable]	-
Recovery of debt already written off [chargeable to tax under section 41(4)]	2
Total income	244.50

Problem 5.14-3 *X was a partner in a firm, representing his HUF, holding 25 per cent of the share in the firm. His wife, Ms. Y a house lady was admitted in her individual capacity in the firm for 25 per cent share. She was paid remuneration which has been proposed by the Assessing Officer to be clubbed in the hands of X HUF by invoking section 64.* [NOVEMBER 2007]

■

The salary of spouse [whose salary does not fall within the proviso to section 64(1)(*ii*)] could be clubbed with the income of the individual who is a partner of the firm. In this case, the partner is representing his HUF. Hence, the salary of wife could not be clubbed with the HUF income.

The proposal of the Assessing Officer to club the remuneration of Ms. Y in the hands of X-HUF by invoking section 64 is incorrect.

Problem 5.14-4 *X a member in two AOPs namely AOP & Co. and X & Y, provides the following details of his income for the year ending on March 31, 2009:*

1. *AOP & Co. assessed at normal rates of tax had credited in his account amount of Rs. 96,000 as interest on capital, Rs. 2,96,000 as salary and Rs. 20,000 as share of profit.*

2. *A house property located a Jaipur was purchased on July 1, 2002 with the borrowed capital in "X & Y" jointly shared equally and occupied by both of them for self residential purposes. Total interest paid for the year 2008-09 on the borrowed capital was Rs. 1,60,000.*

Compute the income and the tax liability thereon for the assessment year 2009-10 and support your answer with brief reasons and the provisions of the Act. [NOVEMBER 2007]

■

Computation of taxable income of X	*Rs.*
Income from house property	
Net annual value	*Nil*
Less: Interest on borrowed capital (1/2 of Rs. 1,60,000)	80,000
House property income (*a*)	(-) 80,000
Business income	
- Interest on capital	96,000
- Salary	2,96,000
- Share of profit	20,000
Business income (*b*)	4,12,000
Taxable income (*a*) + (*b*)	3,32,000
Note: It has been assumed that normal rates of tax in case of AOP & Co. means individual rate of tax.	
Computation of tax liability of X	
Tax on Rs. 3,32,000	21,400
Add: EC @ 2% of Rs. 21,400	428
Add: SHEC @ 1% of Rs. 21,400	214
Tax liability	22,042
Less : Rebate under section 86 [(Rs. 96,000 + Rs. 2,96,000 + Rs. 20,000) ÷ 3,32,000 × Rs. 22,042]	22,042
Tax payable	*Nil*

Problem 5.14-5 : May 2007 *Provisions governing assessment of firm & AOPs* *1340*

Problem 5.14-5 - *XYZ & Co., a firm, consisting of three partners namely, X, Y and Z, carried on the business of purchase and sale of television sets in wholesale and manufacture and sale of pens under a deed of partnership executed on April 1, 2004. X, Y and Z were partners in their individual capacity. The deed of partnership provided for payment of salary amounting to Rs. 1,25,000 each to X and Z, who were the working partners. A new deed of partnership was executed on October 1, 2008 which, apart from providing for payment of salary to the two working partners as mentioned in the deed of partnership executed on April 1, 2004, for the first time provided for payment of simple interest @ 12 per cent per annum on the balances standing to the credit of the capital accounts of partners from April 1, 2008. The firm was dissolved on March 31, 2009 and the capital assets of the firm were distributed among the partners on April 20, 2009. The net profit of the firm for the year ending March 31, 2009 after payment of salary to the working partners and debit/credit of the following items to the Profit and Loss Account was Rs. 1,50,000.*

1. *Interest amounting to Rs. 1,00,000 paid to the partners on the balances standing to the credit of their capital accounts from April 1, 2008 to March 31, 2009.*

2. *Interest amounting to Rs. 50,000 paid to the partners on the balances standing to the credit of their current accounts from April 1, 2008 to March 31, 2009.*

3. *Interest amounting to Rs. 20,000 paid to the Hindu undivided family of partners X @ 18 per cent per annum.*

4. *Payment of Rs. 25,000 towards purchase of television sets made by crossed cheque on November 1, 2008.*

5. *Rs. 30,000 being the value of gold jewellery received as gift from a manufacturer for achieving sales target.*

6. *Depreciation amounting to Rs. 15,000 on motor car bought and used exclusively for business purposes, but not registered in the name of the firm.*

7. *Depreciation under section 32(1)(ii) amounting to Rs. 37,500 of new machinery bought and installed for manufacture of pens on November 1, 2008 at a cost of Rs. 5,00,000. There was no increase in the installed capacity as a result of the installation of the new machinery.*

8. *Interest amounting to Rs. 25,000 received from bank on fixed deposits made out of surplus funds.*

The firm furnishes the following information relating to it:

a. *Closing stock-in-trade was valued at Rs. 60,000 as per the method of lower of cost or market rate consistently followed by it. The market value of the closing stock-in-trade was Rs. 65,000.*

b. *Brought forward business loss relating to the assessment year 2008-09 was Rs. 50,000.*

c. *The fair market value of the capital assets as on March 31, 2009 was Rs. 20,00,000 and the cost of their acquisition was Rs. 15,00,000.*

Compute the total income of XYZ & Co. for the assessment year 2009-10. You are required to furnish explanations for the treatment of the various items given above. [MAY 2007]

■

Computation of total income of M/s HIG for the assessment year 2009-10	*Rs.*
Net profit as per Profit & Loss A/c	1,50,000
Interest to partners on capital account balance for April 1, 2008 to September 30, 2008	(+) 50,000
Interest to partners on current account balances [not allowable, there is no provision in the partnership deed to pay interest on current account]	(+)50,000
Interest to HUF of partner H	-
Payment by crossed cheque for purchase of television set [100% of Rs. 25,000 disallowed under section 40A(3)]	(+) 25,000
Gift from manufacturer [taxable as business income]	-
Depreciation on motor car (not registered in firm name) used for business purposes [allowable as per landmark case *Mysore Minerals Ltd.* v. *CIT* [1999] 239 ITR 775 (SC)]	-
Additional depreciation on new machinery [50% of 20% of Rs. 5 lakh]	(-) 50,000
Interest from bank on fixed deposits [chargeable to tax under the head "Income from other sources"]	(-) 25,000
Valuation of closing stock	(+) 5,000
Remuneration to working partners [taken separately]	(+) 2,50,000
Book profit	4,55,000
Less: Remuneration to working partners [on first Rs. 75,000 of book profit @ 90%; on next Rs. 75,000 of book profit @ 60%; on balance Rs. 2,85,000 of book profit @ 40%]	(-) 2,26,500
	2,28,500

	Rs.
Less: Brought forward business loss	(-) 50,000
Business income	1,78,500
Income from other sources	25,000
Net income	2,03,500

Problem 5.14-6 - *XYZ, a firm consists of four partners namely, X, Y, Z and A. They shared profits and losses equally during the year ending March 31, 2008. The assessed business loss of the firm for the assessment year 2008-09 which it is entitled to carry forward amounts to Rs. 3,60,000. A new deed of partnership was executed among X, Y, Z and A on April 1, 2008 in terms of which they agreed to share profits and losses in the ratio of 15:15:20:50 respectively.*

Compute the amount of business loss relating to the assessment year 2008-09, which the firm is entitled to set off against its business income for the assessment year 2009-10. The business income of the firm for the assessment year 2009-10 is Rs. 3,30,000. Your answer should be supported by reasons. [MAY 2006]

■

For provisions of section 78, *see* para 319. In the present problem, as only the profit sharing ratio of the existing partners' is changed, section 78 is not applicable. Thus, the whole of the business loss of Rs. 3,60,000 shall be available for set off against the business income for the assessment year 2009-10. Consequently, resultant business loss of Rs. 30,000 at the end of the assessment year 2009-10 shall be carried forward to the next assessment year.

Problem 5.14-7 *T (age: 31 years) and Q (age: 35 years) are individuals, who constitute an association of persons, sharing profit and losses in the ratio 2:1. For the accounting year ended March 31, 2009, the Profit and Loss account of the business was as under:*

Figures are in Rs. '000s

Cost of goods sold	*4,250*	*Sales*	*4,900*
Remuneration to:		*Dividends from companies*	*25*
T	*130*	*Capital gains—*	
Q	*170*	*Long-term*	*640*
Employees	*256*		
Interest to:			
T	*48.3*		
Q	*35.7*		
Other expenses	*111.7*		
Sales tax penalty due	*39*		
Net profit	*524.3*		
	5,565		*5,565*

Additional information furnished:

i. *Other expenses included: (a) entertainment expenses of Rs. 35,000; (b) wrist watches costing Rs. 2,500 each were given to 12 dealers, who had exceeded the sales quota prescribed under a sales promotion scheme; (c) Employer's contribution of Rs. 6,000 to the provident fund was paid on January 14, 2009; (d) Rs. 30,000 was paid in cash to an advertising agency for publicity.*

ii. *Outstanding sales tax penalty was paid on October 15, 2009. The penalty was imposed by the Sales-tax Officer for non-filing of returns and statements by the due dates.*

T and Q had, for this year, income from other sources of Rs. 2,14,000 and Rs. 82,000 respectively.

Required to:

i. *Compute the total income of the AOP for the assessment year 2009-10;*

ii. *Ascertain the tax liability of the association for that year; and*

iii. *Ascertain the tax liability for that year of the individual members.* [NOVEMBER 2005]

■

Computation of business income of AOP	Rs.
Net profit as per Profit & Loss A/c	5,24,300
Add: Amount not allowable	
Remuneration to members	3,00,000
Interest to members	84,000
Sales-tax penalty due	39,000
Publicity expenses [100% of Rs. 30,000 disallowed under section 40A(3)]	30,000
	9,77,600

	Rs.
Less: Income not chargeable to tax under the head "Profits and gains from business or profession"	
Dividend	25,000
Long-term capital gain	6,40,000
Business income	3,12,600
Computation of total income of AOP	
Business income	3,12,600
Long-term capital gain	6,40,000
Income from other sources [exempt]	—
Total income	9,52,600
Computation of tax payable	
Long-term capital gain [Rs. 6,40,000 @ 20%]	1,28,000
Business income (Rs. 3,12,600 @ 30%*)	93,780
Tax	2,21,780
Add: Surcharge [10% of Rs. 2,21,780]	22,178
Tax and surcharge	2,43,958
Add: Education cess [2% of Rs. 2,43,958]	4,879
Add: Secondary and higher education cess (1% of income-tax and surcharge)	2,440
Tax liability	2,51,280

Computation of tax payable by members

	T Rs.	*Q* Rs.
Total income	2,14,000	82,000
Tax on total income	6,400	*Nil*
Add: Education cess	128	*Nil*
Add: Secondary and higher education cess (1% of income-tax and surcharge)	64	
Tax payable	6,590	*Nil*

Problem 5.14-8 - *X Agencies, a partnership firm constituted by three partners with equal shares is dissolved on April 1, 2006 after a search. The liability to tax finally decided against the firm outstanding to be paid is Rs. 15 lakh. Out of three partners, one is declared insolvent on March 18, 2007 by the Court. The Assessing Officer, for recovering the demand, attached the bank accounts of other two partners and could recover an amount of Rs. 6 lakh from the account of one such partner. You are asked by the partners of dissolved firm :*

(1) about the liability of each of them to pay outstanding demand; and

(2) whether the action of the Assessing Officer to attach the bank account of partners against demand of dissolved firm is justified ? [NOVEMBER 2003]

■

As per section 189(3), every person who was at the time of such discontinuance or dissolution a partner of the firm, shall be jointly and severally liable for the amount of tax, penalty or other sum payable, and all the provisions of the Income-tax Act, so far as may be, shall apply. In the present problem, in view of the aforesaid provisions, the answer is as under-

1. All the three partners are jointly and severally liable for making payment of outstanding dues of Rs. 15 lakh. After insolvency of one of the partners, the other two shall be jointly and severally liable with respect to the outstanding dues.

2. The action of the Assessing Officer to attach the bank account of partner against demand of dissolved firm is justified.

Problem 5.14-9 - *X was a partner in a firm in his capacity as the karta of his HUF. On the amounts deposited by the partners, the firm paid interest. X, in his individual capacity had made deposits in the same firm in which he was as partner. The assessee claimed that the interest paid in his individual capacity should not be disallowed. The Assessing Officer did not agree and disallowed the interest paid to X in his individual capacity. Discuss.* [NOVEMBER 2000]

■

According to *Explanation 1* to section 40(*b*), where an individual is a partner in a firm on behalf, or for the benefit, of any other person, interest paid by the firm to such individual, otherwise than as partner in a representative capacity, is not taken into account, for the purposes of section 40(*b*).

In the present problem, in view of the aforesaid provision, the action of the Assessing Officer is incorrect.

*As one of the members has total income exceeding the maximum amount not chargeable to tax, the AOP is assessed at the maximum marginal rate.

Problem 5.14-10 - *X Traders, a partnership firm consisting of three partners, A, B and C is assessed to income-tax as partnership firm. B and C retired from the partnership with effect from December 31, 2008. A took over the business and continued as proprietor. The stock-in-trade as at December 31, 2008 was valued at average purchase price for settlement of accounts, which was the system consistently followed. On these facts, you are consulted on the following issues :*

1. *Under which provisions M/s. X Traders for the period April 1, 2008 to March 31, 2009 shall be assessed for the assessment year 2009-10 ? Can the Assessing Officer dispute the stock valuation in the assessment of the firm ?*

2. *A desires to admit three partners from April 1, 2010. Amongst the partners, it is agreed that two partners, shall be the working partners and be paid remuneration, your advice is sought as to the requirements to see that the remuneration to the working partners is allowable in the hands of the firm.* [MAY 2000]

■

The answer is as under :

1. As per section 189, where any business or profession carried on by a firm has been discontinued, the Assessing Officer shall make an assessment of the total income of the firm as if no such discontinuance had taken place, and all the provisions of the Act including the provisions relating to the levy of a penalty or any other sum chargeable under any provision of the Act, shall apply, so far as may be, to such assessment. Every person who was at the time of such discontinuance is a partner of the firm, shall be jointly and severally liable for the amount of tax, penalty or other sum payable, and all the provisions of the Act, so far as may be, shall apply to any such assessment or imposition of penalty or other sum.

The *Chunilal Khushaldas Patel* v. *CIT* [1967] 66 ITR 522 (Guj.), it was held that in case a partnership firm is converted into a proprietary concern of one of the partners and closing stock is taken over by the partner (who takes over) at cost then no profit is said to accrue to the partnership firm. In the present problem, in view of the aforesaid provisions, X traders shall be assessed as a partnership firm as per section 189 for the period April 1, 2007 to March 31, 2008 since the partnership firm was discontinued on December 31, 2007 and the proprietary concern came into existence with effect from January 1, 2008. Therefore, there was a discontinuance of the firm. The Assessing Officer cannot dispute the stock valuation as per the ruling given in *Chunilal Khushaldas Patel* v. *CIT* (*supra*). Discontinuance is different from dissolution and, therefore, the principle given in *ALA Firm* v. *CIT* [1991] 189 ITR 285 (SC) is not applicable.

2. To obtain deduction of remuneration paid to partners certain conditions [as specified by sections 40(*b*) and 184] should be satisfied.

Problem 5.14-11 - *See problem 321-P1.* [NOVEMBER 1999]

■

See answer to problem 321-P1.

5.15 Taxation of companies

Problem 5.15-1 - *Discuss the following:*

X Ltd. engaged in diversified activities, earned a net profit of Rs. 14,25,000 after debit/credit of the following items to its Profit and Loss Account for the year ending on March 31, 2009:

	Rs.
Items debited to profit and loss account	
Expenses on industrial unit exempt under section 10A	*2,10,000*
Provision for loss of subsidiary	*70,000*
Provision for sales tax demand (paid before due date)	*75,000*
Provision for wealth-tax demand	*90,000*
Provision for income-tax demand	*1,05,000*
Expenses on purchases/sale of equity shares	*15,000*
Depreciation	*3,60,000*
Interest on deposit credited to buyers on March 31, 2009 for advance received from them, on which TDS was deposited on July 31, 2009	*90,000*
Item credited to profit and loss account	
Income on industrial unit exempt under section 10A	*2,70,000*
Profit from 100% EOU under section 10B	*60,000*
Long-term capital gain on sale of equity shares on which security transaction tax was paid	*3,60,000*
Income from units of UTI	*75,000*

The company provides the following additional information:

i. *Depreciation includes Rs. 1,50,000 on account of revaluation of fixed assets.*

ii. *Depreciation allowable as per Income-tax Rules is Rs. 2,80,000.*

iii. *Brought forward business loss/unabsorbed depreciation:*

Financial year	Amount as per books		Amount as per income-tax	
	Loss Rs.	Depreciation Rs.	Loss Rs.	Depreciation Rs.
2000-01	*2,50,000*	*3,00,000*	*2,00,000*	*2,50,000*
2005-06	Nil	*2,70,000*	*1,00,000*	*1,80,000*
2006-07	*3,50,000*	*3,15,000*	*1,20,000*	*2,10,000*

You are required to:

1. Compute the total income of the company for the assessment year 2009-10 giving the reasons for treatment of items and

2. Examine the applicability of section 115JB, and compute book profit and the tax credit to be carried forward. [NOVEMBER 2008]

■

Computation of total income of X Ltd for the year ended March 31, 2009 (as per normal provisions)

	Rs.	*Rs.*
Net profit as per profit and loss account		14,25,000
Add:		
Provision for loss of subsidiary		70,000
Provision for sales tax (allowable as it is actually paid before due date)		*Nil*
Provision for wealth-tax (not allowable)		90,000
Provision for income-tax (not allowable)		1,05,000
Expenditure towards purchase and sale of equity shares (not allowable in view of provisions of section 14A)		15,000
Depreciation debited in P&L a/c (considered separately)		3,60,000
Interest on deposits on which tax deduction was remitted on July 31, 2009 is allowable		*Nil*
		20,65,000
Less:		
Long term capital gain credited in P&L a/c [exempt under section 10(*38*)]	3,60,000	
Income from units of UTI [exempt under section 10(*35*)]	75,000	
Deduction in respect of unit under section 10A (net)	60,000	
Deduction in respect of 100% EOU	60,000	5,55,000
		15,10,000
Less: Current year depreciation	2,80,000	
Less: Brought forward business loss	4,20,000	7,00,000
		8,10,000
Less: Brought forward depreciation		6,40,000
Taxable income		1,70,000
Computation of income under section 115JB		
Net profit as per profit and loss account		14,25,000
Add:		
Provision for loss of subsidiary		70,000
Provision for sales tax paid before 'due date' being an ascertained liability - not liable for adjustment		*Nil*
Provision for wealth-tax — no adjustment is required		*Nil*
Provision for income tax		1,05,000

	Rs.
Expenditure towards purchase and sale of equity shares - since the income is exempt under section 10(*38*) and such exempted income is reckoned for MAT it requires no adjustment	*Nil*
Depreciation debited in P&L a/c to the extent attributable revalued fixed assets	1,50,000
Interest on deposits - irrespective of the actual date of remittance of TDS amount	*Nil*
	17,50,000
Less: Long-term capital credited in P&L a/c is exempt under section 10(*38*) but is liable for MAT (as it is credited to P&L account no adjustment is required)	*Nil*
Income from units of UTI is exempt under section 10(*35*)	75,000
	16,75,000
Brought forward depreciation or business loss whichever is less as per books of account (Rs. 2,50,000 + Rs. 3,15,000)	5,65,000
Book profit	11,10,000
Total income as per normal provisions	1,70,000
Tax @ 30.9%	52,530
Income-tax on income computed under section 115JB @ 10.3%	1,14,330

Since tax payable under the provisions of section 115JB is more than the normal tax liability, the company will have to pay income-tax of Rs. 1,14,330. The excess tax liability (*i.e.*, Rs. 1,14,330—Rs. 52,530) will be available as MAT credit in the next year.

Problem 5.15-2 - *X Ltd., transferred its fertilizers business to a new company Y Ltd., by way of demerger with effect from appointed date as April 1, 2008 after satisfying the conditions of demerger. Further information given:*

1. WDV of the entire block of plant and machinery held by X Ltd., as on April 1, 2008 is Rs. 100 crore.

2. Out of the above, WDV of block of plant and machinery of fertilizer division is Rs. 70 crore.

3. X Ltd., has unabsorbed depreciation of Rs. 50 lakh as at March 31, 2008.

On the above facts:

i. *You are required to explain the provisions of the income-tax as to the allowability of depreciation, post-merger in the hands of X Ltd., and Y Ltd., as at March 31, 2009 duly calculating the depreciation.*

ii. *State how the unabsorbed depreciation has to be dealt with for the assessment year 2009-10?* [NOVEMBER 2008]

■

(Rs. in crore)

	Fertilizer division in the hands of Y Ltd.	*Other business in the hands of X Ltd.*
WDV of plant and machinery	70	30
Unabsorbed depreciation to be allocated in the same ratio	35	15
Depreciation for current year @ 15%	10.5	4.5

Problem 5.15-3 - *X Ltd. gives the following information for year ending March 31, 2009:*

- *Net profit as per Profit and Loss account for the financial year 2007-08 Rs. 33,00,000 was included in general reserve.*
- *On August 1, 2008, the company redeemed its redeemable bonus shares for Rs. 9,09,000.*
- *A shareholder holding 10 per cent equity shares of the company borrowed Rs. 3,00,000 from the company @ 18 per annum on August 31, 2008.*
- *The company declared dividend of Rs. 14,00,000 at its annual general meeting held on September 30, 2008. But the dividend remained unpaid up to March 31, 2009.*

Compute the tax liability of the company under section 115-O (tax on distributed profits) for the assessment year 2009-10. Also give reasons for treatment of each item. [NOVEMBER 2008]

■

	Rs.
Redemption of bonus shares is dividend under section 2(*22*)(*a*) and, consequently, liable for dividend tax	9,09,000
Loan given to a shareholder holding 10% equity shares in the assessee-company is deemed as dividend under section 2(*22*)(*e*), in the hands of shareholder, if the assessee-company is a company in which public are not substantially interested. Consequently, it is not liable for dividend tax. It will be taxable in the hands of the shareholder. Even if the company is a company in which the public are substantially interested, it is not liable for dividend tax	*Nil*

	Rs.
Dividend declared in annual general meeting	14,00,000
Total dividend liable for dividend tax	23,09,000
Dividend tax liability under section 115-O (16.995% of Rs. 23,09,000)	3,92,415

Note: Dividend tax rate is 15%. It shall be increased by surcharge of 10% of 15% (surcharge is applicable even if taxable income of the company is Rs. 1 crore or less than Rs. 1 crore). It will be further increased by 3% (of dividend tax *plus* surcharge) on account of education cess.

Problem 5.15-4 - *The net profit for the year ending March 31, 2009 of A Biotech Ltd. engaged in the business of biotechnology works out at Rs. 45 lakh after debit/credit of the following items:*

1. Profit of Rs. 2,50,000 from a hedging contract entered into for meeting out the loss in foreign currency payments towards an imported machinery of Rs. 80 lakh installed on February 1, 2009.

2. Incidental charges of Rs. 20 lakh paid to a financial institution for taking short-term loan of Rs. 25 crore repayable in 18 months.

3. Commission of Rs. 25,000 paid to a recovery agent for getting realisation of an old outstanding.

4. Registration fees of Rs. 20,000 and listing fees of Rs. 30,000 paid to the Registrar of Companies and the Stock Exchange respectively on the issue of bonus shares.

5. Amount of Rs. 1,00,000 towards carry forward losses for assessment year 1998-99 of X Ltd., which got merged with the company during the financial year 2004-05.

6. Interest received from banks of Rs. 90,000 net of TDS of Rs. 10,000.

7. Amount of Rs. 1,50,000 incurred towards reconditioning of generator.

8. Employees' share to the EPF for the month of March 2009 of Rs. 40,000. The amount was deposited with the PF Commissioner on April 22, 2009.

Compute the total income of the company for assessment year 2009-10 and give brief reasons for the treatment given to each of the items. [MAY 2008]

■

Computation of income of A Biotech Ltd.—

	Rs.
Net profit as per profit and loss account	45,00,000
Adjustments—	
Less: Profit on hedging contract for import of machinery (it will be deducted from actual cost of the asset, it is not separately chargeable to tax)	(-) 2,50,000
Add: Depreciation on machinery [since actual cost will be reduced by Rs. 2,50,000 on account of hedging contract for import, normal depreciation and additional depreciation on Rs. 2,50,000 will be reduced and, consequently, the difference will be added (normal depreciation: 15% × 1/2 × Rs. 2,50,000; additional depreciation: 10% of Rs. 2,50,000)]	(+) 43,750
Add: Commission paid to agent for recovery of receivables (it is an expenditure which is deductible under section 37, no adjustment is required)	—
Add: Registration fees for issue of bonus shares (it is a revenue expenditure, no adjustment is required)—***CIT*** v. ***General Insurance Corpn.*** [2006] 156 Taxman 96 (SC)	—
Add: Brought forward loss of amalgamating company (by virtue of section 72A, it will become loss of the amalgamated company of the previous year in which amalgamation takes place, assuming that conditions of section 72A are satisfied it will be taken as loss of the assessee for the previous year 2004-05 and deductible for the current year)	—
Add: Interest received from bank (amount chargeable to tax is Rs. 1,00,000, since only Rs. 90,000 is credited to profit and loss account, the difference is added back)	(+) 10,000
Add: Expenditure towards reconditioning of generator (it is for the purpose of preserve and maintain an already existing asset, it is revenue expenditure and no adjustment is required)	—
Add: Employees share of PF contribution (it is supposed to be paid within 15 days after the close of every month, even payment within 5 grace days is eligible for deduction under section 36(1)(*va*), since the payment was made on April 22, 2009 it is not eligible for deduction)	(+) 40,000
Business income	43,43,750
Any other income	*Nil*
Gross total income	43,43,750
Less: Deduction under section 80JJA (not available on the assumption that 5 year time-limit has been expired)	*Nil*
Net income	43,43,750

Problem 5.15-5 - *Discuss the following:*

1. X Ltd. incurred expenditure amounting to Rs. 3,00,000 in connection with the issue of rights shares and Rs. 2,00,000 in connection with the issue of bonus shares during the year ending March 31, 2009. The company seeks your opinion in the matter of eligibility for deduction of the expenditure incurred from its business profits for the assessment year 2009-10.

2. The directors of a private company are personally liable to pay the income-tax due from the company. Discuss. [MAY 2007]

■

Pointwise answer:

1. See para 141.8-11. In view of these provisions, the answer is as under-

Issue expenditure of Rs. 2,00,000 relating to issue of bonus shares is revenue expenditure as per ***CIT*** v. ***General Insurance Corpn.*** [2006] 156 Taxman 96 (SC).

Issue expenditure of Rs. 3,00,000 relating to issue of right shares is capital expenditure as per *Brooke Bond India Ltd.* v. *CIT* [1997] 91 Taxman 26/225 ITR 798 (SC).

2. The provisions of section 179 relate to liability of directors of a private company in liquidation. As per section 179, notwithstanding anything contained in the Companies Act, 1956, where any tax due from a private company in respect of any income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of the private company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

Where a private company is converted into a public company and the tax assessed in respect of any income of any previous year during which such company was a private company cannot be recovered, then, nothing contained in section 179 shall apply to any person who was a director of such private company in relation to any tax due in respect of any income of such private company assessable for any assessment year commencing before April 1, 1962.

Problem 5.15-6 - *X Ltd. is engaged in the manufacture and sale of drugs and pharmaceuticals. Its net profit for the year ending March 31, 2009 after debit/credit of the following items to the profit and loss account was Rs. 28,00,000.*

1. Income-tax paid on non-monetary perquisites provided to the employees Rs. 1,00,000.

2. Legal fees incurred in defending title to factory premises Rs. 2,00,000.

3. Expenditure on scientific research (not in respect of cost of land or building) on in-house research and development facility approved by the prescribed authority Rs. 10,00,000.

4. Interest paid on arrears of sales tax Rs. 1,00,000.

5. Cash payment of Rs. 20,000 made on October 10, 2008 to a supplier towards purchase of raw material.

6. Rent received from letting out vacant land Rs. 1,00,000.

7. Arrears of rent received in respect of a house property, which was let out in the earlier years and which was not charged to tax in any earlier year Rs. 2,00,000. The said property was sold during the year ending March 31, 2007.

The company had paid royalty in India to a foreign company amounting to Rs. 3,00,000 on May 1, 2007, which was disallowed by the Assessing Officer for the assessment year 2008-09 since tax was not deducted thereon. The company deducted and paid tax at source on the said amount of royalty on January 1, 2009.

The company has brought forward loss from property relating to the assessment year 2007-08 amounting to Rs.40,000.

Compute the total income of X Ltd. for the assessment year 2009-10. [NOVEMBER 2006]

■

Computation of total income of X Ltd.	*Rs.*
Net profit as per Profit & Loss A/c	28,00,000
Adjustments:	
Income-tax paid on non-monetary perquisites provided to the employees [disallowed under section 40(*a*)(*v*)]	(+) 1,00,000
Legal fees incurred in defending title to factory premises [not allowable]	(+) 2,00,000
Expenditure on approved in-house scientific research and development facility [1.5 times of Rs. 10,00,000 is allowable]	(-) 5,00,000
Interest paid on arrears of sales tax [allowable, *see* para 141.8-13]	-
Cash payment of Rs. 20,000 made on October 10, 2008 to a supplier towards purchase of raw material [allowable, *see* para 148.1]	-

	Rs.
Rent received from letting out vacant land [taxable under the head 'Income from other sources']	(-) 1,00,000
Arrears of rent received in respect of a house property which was let out in the earlier years and which was not charged to tax in any earlier year [taxable under the head 'Income from house property']	(-) 2,00,000
Payment of royalty in India to a foreign company disallowed earlier due to non-deduction of tax at source [allowable in the previous year of payment of TDS, *see* para 143]	(-) 3,00,000
Business income	20,00,000
Income from house property (*i.e.*, Rs. 2,00,000 - 30% of Rs. 2,00,000 - Rs. 40,000)	1,00,000
Business income	20,00,000
Income from other sources	1,00,000
Net income	22,00,000

Problem 5.15-7 - *X Ltd. is engaged in the manufacture and sale of textiles. It's net profit for the year ending March 31, 2009 after debit/credit of the following items to the profit and loss account was Rs. 75,00,000.*

Payment to two employees of Rs. 2,50,000 each in connection with their voluntary retirement.

Fringe benefit tax paid Rs. 1,00,000.

Charges of Rs. 2,00,000 paid for advertisement in souvenir published by a political party registered with the Election Commission of India.

Retrenchment compensation paid to employees of one of the units closed down during the year Rs. 10,00,000.

Capital expenditure incurred for the purpose of promoting family planning amongst its employees Rs. 3,00,000.

Banking cash transaction tax paid Rs. 10,000.

Interest paid under section 234B for short payment of advance tax pertaining to the assessment year 2008-09 Rs. 1,10,000.

Loss incurred in transactions of purchase and sale of shares of various companies Rs. 3,00,000.

Compensation received from supplier for delay in supply of raw materials Rs. 1,00,000.

Dividend received from a foreign company Rs. 2,00,000.

The total sales of X Ltd. for the year was Rs. 30 crores out of which export sales amounted to Rs. 10 crores. Compute the total income of X Ltd. for the assessment year 2009-10. [MAY 2006]

■

Pointwise answer :

Computation of total income of X Ltd.	*Rs.*
Net profit as per Profit & Loss Account	75,00,000
Payment of Rs. 2,50,000 to 2 employees on voluntary retirement (4/5 of Rs. 5,00,000 disallowed under section 35DDA)	(+) 4,00,000
Fringe benefit tax [disallowed under section 40(*a*)(*ic*)]	(+) 1,00,000
Advertisement charges in souvenir of registered political party [disallowed under section 37(2B)]	(+) 2,00,000
Retrenchment compensation on closure of one of the units (allowable as deduction)—*Sasson J. David & Co. (P) Ltd.* v. *CIT* [1979] 118 ITR 261 (SC)	
Capital expenditure incurred for promoting family planning amongst employees [4/5 of Rs. 3,00,000 disallowed under proviso to section 36(1)(*ix*)]	(+) 2,40,000
Banking cash transaction tax [allowable under section 36(1)(*xiii*)]	—
Interest paid under section 234B [disallowed under section 40]	(+) 1,10,000
Loss incurred in transactions of purchase and sale of shares [disallowed as speculation loss]	(+) 3,00,000
Dividend received from foreign company [considered separately as income from other sources]	(-) 2,00,000
Business income	86,50,000
Income from other sources [dividend from foreign company]	2,00,000
Total income	88,50,000

Note : Speculation loss of Rs. 3,00,000 is carried forward under section 73 to be set off against speculation income of next assessment year.

Problem 5.15-8 - *The net profits of XYZ Ltd. for the year ended March 31, 2009, after debiting/crediting the following items, were Rs. 9 lakh:*

1. *The company had taken on lease an old building for the purposes of locating its business. Due to old age of the building, it was demolished and a new building put up, which was used for purposes of XYZ's business from September, 2008.*

The cost of the new building Rs. 10 lakh was written off as revenue expenditure. The lessor permitted the company to have an extension of the lease by another twenty years.

2. *Rs. 1 lakh was paid as an annual fee for technical services to a foreign collaborator under an agreement approved by the Government.*

3. *The company collected Rs. 3 lakh from its customers by way of sales tax in the year 1986-87 and had remitted it to the State Government in due time. On the levy being challenged in the High Court, the Court held the collection as illegal and the State Government in February, 2009 refunded the amount to the company.*

4. *Land development charges of Rs. 1.5 lakh were paid to the State Industrial Development Corporation on allotment of a commercial plot.*

5. *A criminal case was filed against a director of the company, in his official capacity. The company spent legal expenses of Rs. 50,000 defending him in the proceedings. The director was acquitted of the charges at the end.*

6. *The company issued in the year bonus shares to its shareholders and for that purpose had to enhance the authorised capital. Fees of Rs. 1.5 lakh were paid to the Registrar of Companies in this regard. These have been written off in the accounts as revenue expenses.*

7. *The company paid Rs. 70,000 as interest on deposits to some of the non-resident buyers on advances received from them. No tax at source was deducted on the payment.*

8. *Overdraft interest of Rs. 40,000 was paid to the company's bank to enable the company to pay its income tax dues.*

9. *The opening the closing stocks of the year were Rs. 90,000 and Rs. 1,17,000 respectively and were undervalued by 10 per cent on cost.*

10. *Some investment were held by the company (not as stock in trade), which had to be depreciated by Rs. 4.8 lakh due to a directive from the Government.*

The balance on April 1, 2008 to the Profit and Loss Account, shown separately in the Balance Sheet, was a debit of Rs. 2 lakh.

The company had the following claims brought forward from the prior years:

Business losses relating to :	
Assessment year 1995-96	*Rs. 8 lakh*
Assessment year 2006-07	*Rs. 4 lakh*
Losses under the head capital gains—	
Long-term	
Assessment year 2007-08	*Rs. 3 lakh*
Unabsorbed depreciation (as per IT records as well as the books of the company)	*Rs. 12.50 lakh*

Required to:

(a) *Calculate the total income of XYZ Ltd. for the assessment year 2009-10. [Your answer should clearly indicate the reasons for the treatment of the individual items given above]*

(b) *Examine the applicability of section 115JB to the company for the same assessment year.* [NOVEMBER 2005]

■

A.1 *Computation of total income of XYZ Ltd.*

	Rs.
Net profit as per Profit & Loss A/c	9,00,000
Cost of new building written off as revenue expenditure [as per *Explanation 1* to section 32, cost of constructing in case of a leasehold property is to be capitalized and depreciation to be provided for]	(+) 10,00,000
Depreciation on building constructed taken on lease [10% of Rs. 10,00,000]	(-) 1,00,000
Annual fee to a foreign collaborator for technical services [allowable]	—
Sales tax refund [taxable as earlier allowed as deduction]	—
Land development charges [capital expenditure not allowable as deduction]	(+) 1,50,000
Legal expenses [allowable]	—
Enhancement of authorised capital [capital expenditure not allowable as deduction]	(+) 1,50,000
Interest on deposits to non-residents without tax deduction at source [as per section 40(*a*), it is not allowable as deduction]	(+) 70,000
Overdraft interest paid to bank account [not allowable as deduction in view of *East India Pharmaceutical Ltd.* v. *CIT* [1997] 224 ITR 627 (SC)]	(+) 40,000
Adjustment on account of under valuation of stock [1/9th Rs. 27,000 (*i.e.*, Rs. 1,17,000 – Rs. 90,000)]	(+) 3,000
Loss on account of depreciation of investment not held as stock-in-trade [not allowable as it is a capital loss]	(+) 4,80,000
Total income	26,93,000

Computation of tax liability [normal provisions]	*Rs.*
Business income	26,93,000
Less : Brought forward business loss [business loss of assessment year 1995-96 is not available for set off as 8 year time limit has already expired]	(-) 4,00,000
Less : Unabsorbed depreciation	(-) 12,50,000
Business income	10,43,000
Other income	—
Taxable income	10,43,000
Tax on Rs. 10,43,000 @ 30.9%	3,22,290
Computation of tax liability under MAT [section 115JB]	
Book profit [Rs. 9,00,000 - Rs. 2,00,000 *i.e.*, brought forward business loss or unabsorbed depreciation, whichever is lower]	7,00,000
Tax on Rs. 7,00,000 @ 10.3%	72,100

Tax payable as computed under normal provisions (*i.e.*, ignoring provisions of section 115JB) is higher than the amount determined as tax payable under section 115JB. Therefore, section 115JB is not applicable.

Notes:

1. Brought forward long-term capital loss of assessment year 2007-08 of Rs. 3,00,000 shall be carried forward to the next assessment year.

2. For the purpose of application of MAT, net profit as per Profit & Loss A/c is taken and the only adjustments permitted are those specified in section 115JB.

3. In computation of MAT, the lower of brought forward business loss or unabsorbed depreciation is taken. Since brought forward business loss as per books of account is *nil*, no adjustment is needed.

Problem 5.15-9 - *A Ltd., engaged in the business of manufacturing, shows a net profit of Rs. 65 lakh for the financial year ending March 31, 2009. A scrutiny of the Profit & Loss Account revealed the following:*

1. Rent of Rs. 2.40 lakh from a commercial property owned by the company and let to a bank was included as profit.

2. Loss of Rs. 5 lakh due to non-realisation of advances given to a wholly owned subsidiary company engaged in the business of hire-purchase financing charged to Profit & Loss Account.

3. The company used to include interest cost in valuation of its finished stock up to the financial year 2007-08. During the financial year 2008-09, the company changed its accounting policy to adopt AS-2 (Valuation of Inventories) issued by the ICAI and excluded interest cost in valuation of finished stock. This has resulted in a decrease in the year's profit by Rs. 15.40 lakh.

4. Municipal taxes, on commercial property debited Rs. 22,000, which were ultimately paid on December 1, 2009.

5. The company has received equity share of AB Ltd. valued at Rs. 1.25 lakh in exchange of equity shares of CD Ltd. in a scheme of amalgamation during the year. The shares in CD Ltd. were acquired in 1998-99 at a cost of Rs. 40,000. The surplus has been credited to Profit & Loss account. Both AB and CD are Indian companies.

6. An executive, while on business trip abroad, died and gratuity paid voluntarily amounted to Rs. 6 lakh.

7. As restructuring of its debt, the company has converted arrears of interest of Rs. 5 lakh on term loan into a new term loan with a revised repayment schedule. The company has paid Rs. 50,000 towards such funded interest during the year.

8. Legal charges in connection with alteration of the Articles of Association Rs. 1.50 lakh and for issue of bonus shares Rs. 5 lakh.

9. The company has purchased scrap materials amounting to Rs. 60,000 lakh, the payment for which was made in cash on August 15, 2008.

10. The profit, as shown above includes Rs. 5 lakh received from a foreign government for use of company's product. This was, however, not brought into India.

Compute the net income of the company for the assessment year 2009-10 clearly indicating the basis of treatment of each item. [NOVEMBER 2004]

■

Computation of net income	*Rs. in lakh*
Net profit as per Profit & Loss A/c	65
Adjustments	
Rent from commercial property (taxable under the head "Income from house property")	(–) 2.40

Loss due to non-realisation of advances relates to carrying on business; as business of the 100 per cent subsidiary company relates to financing of subsidiary companies and is allowable as deduction—*CIT* v. *Gillanders Arbuthnot & Co. Ltd.* [1982] 9 Taxman 76 (Cal.).

	Rs. in lakh
Decrease in profit due to change in method of valuation of finished stock is allowable—***Punjab Communications Ltd.*** v. ***CIT*** [2003] 84 ITD 505 (Chd.)	-
Municipal taxes of commercial property given on rent (not allowable)	(+) 0.22
Surplus on exchange of equity shares in a scheme of amalgamation [exempt under section 47(*vi*)]	(-) 0.85
Payment of gratuity on account of commercial expediency is deductible even if there is no express contract or there is no past practice, as it will engender confidence of employees in management—*CIT* v. *Laxmi Cement Distributors (P.) Ltd.* [1976] 104 ITR 711 (Guj.)	-
Restructuring of business debt (allowable)	-
Legal charges in connection with alteration of Articles of Association are deductible—*CIT* v. *Utkal Machineries Ltd.* [1981] 6 Taxman 288 (Ori.)	-
Legal charges for issue of bonus shares are deductible — ***CIT*** v. ***General Insurance Corporation*** [2006] 156 Taxman 96 (SC)	—
Purchase of scrap material for cash [disallowance under section 40A(3) not applicable in case an expenditure is covered by exception given under rule 6DD]	—
Amount received from a foreign government for use of company's product, included in profit (taxable; no adjustment required)	-
Business income	61.97
Property income [Rs. 2,40,000 - 30%; municipal tax paid on December 1, 2009 not deducible]	1.68
Net income	63.65

Problem 5.15-10 - *Discuss the following :*

1. *A domestic company is liable to pay minimum alternate tax under section 115JB for the assessment year 2008-09. While computing book profit under section 115JB, the company claims provision for deferred tax charged to Profit & Loss account in accordance with Accounting Standard-22 of the Institute of Chartered Accountants of India, which is sought to be disallowed by the Assessing Officer. On what grounds you can contest such disallowance?*

2. *X (P.) Ltd. has share capital in the form of equity share capital. The shares were held uptil March 31, 2007 by four members A, B, C and D equally. The company made losses/profits for the past three assessment years as follows:*

Assessment year	Business loss Rs.	Unabsorbed depreciation Rs.	Total Rs.
2005-06	*Nil*	*15,00,000*	*15,00,000*
2006-07	*Nil*	*12,00,000*	*12,00,000*
2007-08	*9,00,000*	*9,00,000*	*18,00,000*
Total	*9,00,000*	*36,00,000*	*45,00,000*

The above figures have been accepted by the tax department.

During the previous year ending March 31, 2008, A sold his shares to Y and during the previous year March 31, 2009, B sold his shares to Z. The profits for the past two previous year are as follows:

For the year ending March 31, 2008: Rs. 18,00,000 (before charging depreciation Rs. 9,00,000)

For the year ending March 31, 2009: Rs. 45,00,000 (before charging depreciation Rs. 7,50,000)

Compute taxable income for assessment year 2009-10. Workings must form part of your answer. [NOVEMBER 2004]

■

Point-wise answer:

The scheme of minimum alternate tax has been modified with effect from the assessment year 2001-02, to provide that the amount of deferred tax and provision therefor, if debited to profit and loss account, shall be added back to the net profit to convert it into book profit. Conversely, the amount of deferred tax, which is credited to the profit and loss account, shall be deducted from the net profit to find out book profit.

In the present problem, in view of the aforesaid provisions, the action of the Assessing Officer is correct.

2. A,B,C and D are four shareholders in X(P.) Ltd. The shareholding pattern of the company on March 31, 2007, March 31, 2008 and March 31, 2009 are as follows:

	A	*B*	*C*	*D*	*Y*	*Z*
March 31, 2007	25%	25%	25%	25%	-	-
March 31, 2008	-	25%	25%	25%	25%	-
March 31, 2009	-	-	25%	25%	25%	25%

As is evident from the data given above, shareholders having at least 51% of voting power on March 31, 2007 and March 31, 2008 are the same. Consequently, the restriction imposed by section 79 is not applicable. Income for the assessment year 2008-09 will be determined as under :

	Rs.
Business profit	18,00,000
Less: Current depreciation	9,00,000
Balance	9,00,000
Less : Brought forward business loss of the assessment year 2007-08	9,00,000
Net income	*Nil*

The assessee can carry forward the unabsorbed depreciation (*i.e.*, Rs. 36,00,000) of earlier years.

Shareholders holding 51 per cent of the voting right on March 31, 2007 and March 31, 2009 are not the same. Consequently, the restriction imposed by section 79 is applicable and business loss of the assessment year 2006-07 cannot be set off against profit of the assessment year 2009-10. However, in the given problem unabsorbed depreciation of Rs. 36,00,000 pertaining to the assessment year 2007-08 and earlier years can be set off against the income of the assessment year 2009-10, as section 79 is not applicable in the case of carry forward of unabsorbed depreciation. Consequently, income of the assessment year 2009-10 will be determined as under :

	Rs.
Business profit	45,00,000
Less: Current depreciation	7,50,000
Balance	37,50,000
Less : Unabsorbed depreciation	36,00,000
Net income	1,50,000

Problem 5.15-11 - *A domestic company, ABC Ltd. has an undertaking newly established for export of computer software in a free trade zone, the profits of which have been merged in the net profit of the company as per Profit and loss account prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act. It furnishes the following particulars in respect of assessment year 2009-10 and seeks your opinion on the application of section 115JB. You are also required to compute the total income and tax payable.*

	Rs.
Net profit as per Profit and Loss a/c as per Schedule VI	*200 lakh*
Credit side of Profit and Loss a/c includes-	
Dividend income	*20 lakh*
Excess realized on sale of land held as investment	*30 lakh*
Net profit of the undertaking for export of computer software	*100 lakh*
Debits side of Profit and Loss a/c includes-	
Depreciation on straight line method basis	*100 lakh*
Provision for losses of subsidiary company	*60 lakh*
Depreciation allowable as per income-tax law	*150 lakh*
Capital gains as computed as per income-tax law	*40 lakh*
Losses brought forward as per books of account-	
Business loss	*50 lakh*
Unabsorbed depreciation	*60 lakh*

The company has represented to you that the excess realized on sale of land cannot form part of the book profit for purposes of section 115JB. You will have to deal with this issue. [MAY 2004]

■

Book profit	*Rs. in lakh*
Net profit as per Profit and Loss a/c	200
Add: Provision for loss of subsidiary company	(+) 60
Add : Depreciation debited to P&L a/c	(+) 100
Less :	
Dividend income (being exempt under section 10)	(-) 20
Brought forward loss or depreciation, whichever is lower	(-) 50
Depreciation debited	(-) 100
Book profit	190

Computation of income under normal provisions	*Rs.*
Net profit as per Profit and Loss a/c	200
Less: Dividend (being exempt under section 10)	(-)20
Less: Capital gain	(-) 30
Less: Income exempt under section 10A	(-) 100
Add: Depreciation as per books of account	(+)100
Less: Depreciation under section 32	(-)150
Add: Provision for loss of subsidiary company	(+) 60
Business income	60
Capital gain	40
Net income	100
Tax on net income [20% of Rs. 40 lakh +30% of Rs. 60 lakh *plus* education cess @ 2% *plus* secondary and higher education cess @ 1%]	26.78
Minimum alternate tax [10% of Rs. 190 lakh *plus* education cess @ 2% *plus* secondary and higher education cess @ 1%]	19.57
Tax payable	26.78

Notes :

1. It is assumed that capital gain is long-term capital gain.

2. It is further assumed that the company does not have any brought forward unadjusted loss under the income-tax provisions.

3. Capital profit is part of book profit [*see* Accounting Standard 13]. *See* also *CIT* v. *Veekaylal Investment Co. (P.) Ltd.* [2001] 249 ITR 597 (Bom.)

Problem 5.15-12 - *X (P) Ltd. goes into liquidation on June 1, 2008. The company has the following funds prior to the distribution of assets to the shareholders:*

	Rs.
Share capital	*5,00,000*
Reserves prior to June 1, 2008	*3,00,000*
Excess realization in the course of liquidation	*5,00,000*
Total	*13,00,000*

There are 5 shareholders, each of whom gets Rs. 2,60,000 from the liquidator in full settlement. The shareholders desire to invest the resultant element of capital gains in long-term specified assets as defined in section 54EC. You are required to examine the various issues and advice the shareholders about their liability of income-tax [MAY 2004]

■

Tax treatment in the hands of one of the shareholders	*Rs.*
Amount received from liquidator	2,60,000
Less: Deemed dividend under section 2*(22)(c)* [accumulated profits of X (P.) Ltd. up to June 1, 2008 is Rs. 3,00,000, distribution to the extent of Rs. 3,00,000 will be deemed as dividend on which X (P.) Ltd. will pay dividend tax ; share of one of the shareholders in Rs. 3,00,000 is 1/5 of Rs. 3,00,000]	60,000
Balance which is treated as full value of consideration on transfer of shares in X (P.) Ltd.	2,00,000
Less: Indexed cost of acquisition [*see* Note 2]	1,90,820
Long-term capital gains	9,180
Less: Exemption under section 54EC [*see* Note 3]	9,180
Long-term capital gain taxable	*Nil*

The above tax treatment shall be applicable to each of the five shareholders.

Notes :

1. A sum of Rs. 2,60,000 is paid to each of the five shareholders. It is assumed that the company has paid tax on capital gains and dividend tax before distributing Rs. 2,60,000 to shareholders.

2. In the absence of information regarding date of acquisition of shares, it is assumed that shares in X (P.) Ltd. were acquired by the shareholders at the face value in the financial year 1996-97 and, accordingly, indexation will be done (*i.e.*, Rs. 1,00,000 × 582÷305).

3. In order to avail the exemption under section 54EC, the shareholders should invest the capital gain in long-term specified assets within 6 months from the date of transfer of the asset.

Problem 5.15-13 - *X Ltd., a domestic company holds 50 per cent of share capital of Y Ltd., which is another domestic Co. Y Ltd. paid total dividend during the year ending on March 31, 2009 of Rs. 50 lakh. Out of the dividends received from Y Ltd., X Ltd. has distributed dividend of Rs. 15 lakh. Explain with reasons the amount of dividend chargeable to tax in the hands of X Ltd.* [NOVEMBER 2003]

■

Y Ltd. will pay dividend tax @ 16.995% (15% *plus* surcharge of 1.5% *plus* education cess of 0.33% *plus* secondary and higher education cess of 0.165%) of Rs. 50 lakh.

X Ltd. will also pay dividend tax @ 16.995% of Rs. 15 lakh.

No deduction is available either to Y Ltd. or X Ltd. in respect of payment of dividend.

Problem 5.15-14 - *Under section 115JB, in the case of company, the book profit is deemed as the total income under certain circumstances. Discuss the concept of book profit (exclusive of adjustments as per explanation) in the context of the power of the Assessing Officer to examine its correctness.* [NOVEMBER 2002]

■

See paras 336.2-1 and 336.2-2.

Problem 5.15-15 - *The accounts of a public company have been prepared in accordance with provisions of Parts II and III of Schedule VI to the Companies Act and its Profit and Loss Account laid before the annual general meeting for the previous year ending March 31, 2009 shows a net profit of Rs. 15 lakh. The following information relevant for the purpose of computing its assessable income has been extracted from a scrutiny of the Profit and Loss Account :*

Credits in Profit and Loss Account	*Rs.*
Profit from a new industrial undertaking qualifying for deduction under section 80-IA (net)	*17,00,000*
Profits from a new industrial undertaking qualifying for deduction under section 10A (gross)	*10,00,000*
Long-term capital gains	*3,00,000*
Debits in Profit and Loss Account	
Expenditure relating to industrial undertaking qualifying for deduction under section 10A	*7,00,000*
Depreciation relating to 2005-06 brought forward	*10,00,000*
Business loss relating to 2005-06 brought forward	*12,00,000*
Current year's depreciation	*10,00,000*
Penalty for infraction of law	*1,00,000*
Provision for sales-tax	*3,00,000*
Dividend proposed	*2,00,000*

Depreciation admissible under the Income-tax Act and Rules for the previous year is Rs. 19,50,000. The capital gain has been invested in specified assets under section 54EC. Sales tax provided in the accounts has been remitted before the due date. There is no loss or unabsorbed depreciation to be carried forward and adjusted as per income-tax assessment.

You are required to compute the total tax liability of the company for the assessment year 2009-10. [NOVEMBER 2001]

■

Profit and Loss Account
for the year ending March 31, 2009
(on the basis of extracts given)

	Rs.		*Rs.*
Expenditure relating to industrial undertaking qualifying for deduction under section 10A	7,00,000	Profit from a new industrial undertaking qualifying for deduction under section 80-IA (net)	17,00,000
Depreciation relating to 2005-06 brought forward	10,00,000	Profit from a new industrial undertaking qualifying for deduction under section 10A (gross)	10,00,000
Business loss relating to 2005-06 brought forward	12,00,000	Long-term capital gains	3,00,000
Current year's depreciation	10,00,000	Other undisclosed items	30,00,000
Penalty for infraction of law	1,00,000		
Provision for sales tax	3,00,000		
Dividend proposed	2,00,000		
Net profit	15,00,000		
	60,00,000		60,00,000

In *Apollo Tyres Ltd.* v. *CIT* [2002] 255 ITR 273, the Supreme Court held that the Assessing Officer has no power to scrutinise net profit in profit and loss account prepared in accordance with Parts II and III of Schedule VI of the Companies Act, 1956 (certified by relevant authorities) except as provided in *Explanation* to section 115JB.

In view of the aforesaid case, since it appears that the above profit and loss account has not been prepared as per Parts II and III of Schedule VI of the Companies Act, 1956, the Assessing Officer should rewrite the profit and loss account as under :

Profit and Loss Account
for the year ending March 31, 2009

	Rs.		Rs.
Expenditure relating to industrial undertaking qualifying for deduction under section 10A	7,00,000	Profit from a new industrial undertaking qualifying for deduction under section 80-IA (net)	17,00,000
Current year's depreciation	10,00,000	Profit from a new industrial undertaking qualifying for deduction under section 10A (gross)	10,00,000
Penalty for infraction of law	1,00,000	Long-term capital gains	3,00,000
Provision of sales tax	3,00,000	Other undisclosed items	30,00,000
Net profit	39,00,000		
	60,00,000		60,00,000

	Rs.	*Rs.*
COMPUTATION OF TAXABLE INCOME		
Net profit as per profit and loss account (as submitted by the taxpayer)		15,00,000
Add :		
Expenditure relating to income not chargeable to tax under section 10A	7,00,000	
Depreciation relating to 2005-06 brought forward	10,00,000	
Business loss relating to 2005-06 brought forward	12,00,000	
Penalty for infraction of law	1,00,000	
Dividend proposed	2,00,000	32,00,000
		47,00,000
Less :		
Profit from a new industrial undertaking qualifying for deduction under section 10A		10,00,000
Long-term capital gain		3,00,000
Depreciation allowable under the Income-tax Act (Rs. 19,50,000 – Rs. 10,00,000)		9,50,000
Business income		24,50,000
Capital gains [*see* Note]		*Nil*
Gross total income		24,50,000
Less : Deduction under section 80-IA @100%		17,00,000
Net income		7,50,000
Tax on net income (including education cess and secondary and higher education cess)		2,31,750
BOOK PROFIT UNDER SECTION 115JB		
Net profit as per profit and loss account (as prepared by the Assessing Officer)		39,00,000
Adjustments :		
Add: Depreciation		(+)10,00,000
Less: Depreciation or loss brought forward, whichever is lower		(-)10,00,000
Less: Depreciation		(-)10,00,000
Book profit		29,00,000
Tax, education cess and secondary and higher education cess on book profit		2,98,700
Since tax liability is higher under minimum alternate tax provisions, tax liability of the company will be Rs. 2,98,700.		
Note : Computation of income under the head "Capital gain".		
Long-term capital gains (given)		3,00,000
Less : Exemption under section 54EC		3,00,000
Long-term capital gains chargeable to tax		*Nil*

Problem 5.15.16 - *Discuss carry forward and set off of losses in the event of change in shareholdings of companies in which public are not substantially interested.* [NOVEMBER 2000]

■

See para 335.

Problem 5.15-17 - *See problem 336.6-1a* [MAY 2000]

■

See answer to the problem 366.1-1a.

Problem 5.15-18 - *A foreign company has put forth the following arguments amongst the others to say that the provisions of section 115JB regarding minimum alternate tax are not applicable to it :*

i. *the company does not prepare the accounts in accordance with the provisions of Part II and Part III of Schedule VI to the Companies Act, 1956;*

ii. *it does not lay its accounts before the general meeting in accordance with section 210 of the Companies Act, since no meeting is held in India; and*

iii. *it does not declare any dividend in India.*

Discuss the validity or otherwise of the above arguments. Give reasons. [MAY 1999]

■

In *Advance Ruling P. No. 14 of 1997, In re* [1998] 100 Taxman 1 (AAR - New Delhi), it was held that there is no reason to confine section 115JB to Indian companies alone. It will also apply to foreign enterprises.

In the present problem, in view of the aforesaid case, the provisions of section 115JB are applicable to the foreign company. The validity of the arguments is judged as under :

1. As a result of section 115JB, every company is required to prepare its financial statements according to Part II and Part III of Schedule VI to the Companies Act, 1956 to ascertain its book profits. Therefore, the argument of the foreign company is not sustainable.

2. Section 210 of the Companies Act does not apply to a foreign company. A foreign company's accounts are prepared pursuant to section 594 of the Companies Act. However, for the purpose of application of section 115JB, it is not necessary that each and every provision of section 115JB must apply. The profit and loss account prepared in accordance with the provisions of Part II and Part III of Schedule VI to the Companies Act will have to be placed at the annual general meeting of the company. Therefore, the argument of the foreign company is not sustainable.

3. Applicability of section 115JB does not depend on whether any dividend has been paid or not. In other words, non-payment of dividend does not make any difference. Therefore, the argument of the foreign company is not sustainable.

Hence, section 115JB will be applicable to the foreign company and none of its arguments is valid.

5.16 Assessment of co-operative societies

Problem 5.16-1 - *X Co-operative Bank, a co-operative society, having its area of operation confined to Gubbi Taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities, has received the following amounts during the year ending March 31, 2009.*

1. Interest amounting to Rs. 1,00,000 from its members on loans advanced to them.

2. Interest amounting to Rs. 1,50,000 on deposits with other co-operative societies.

3. Rent amounting to Rs. 2,00,000 from letting out its godowns for storage of commodities.

X Co-operative Bank seeks your advice in the matter of taxability of the above amount and the eligibility for deduction, if any, in respect thereof for the assessment year 2009-10. [MAY 2007]

■

For provisions relating to income of banking business of a co-operative society, *see* para 341.1

In view of these provisions, the answer is as under:

1. Interest of Rs. 1,00,000 received by X Co-operative Bank from its members on loans advanced to them is income of X Co-operative Bank. However, the same qualifies for deduction under section 80P(2)(*a*)(*i*).

2. Interest of Rs. 1,50,000 on deposits with other co-operative societies is also income of X Co-operative Bank. The same qualifies for deduction under section 80P(2)(*d*) (*see* para 341.10).

3. Rent of Rs. 2,00,000 received by X Co-operative Bank from letting out its godowns for storage of commodities is income of the bank, but it qualifies for deduction under section 80P(2)(*e*), *see* para 341.11.

Problem 5.16-2- *A co-operative society engaged in the business of banking seeks your opinion in the matter of eligibility of deduction under section 80P on the following items of income earned by it during the year ending March 31, 2009.*

1. Interest on investment in Government securities made out of statutory reserves.

2. Hire charges of safe deposit lockers. [MAY 2006]

■

Deduction under section 80-P is not available to a co-operative bank other than primary agricultural credit society or primary co-operative agricultural and rural development bank.

Problem 5.16-3 - *The assessee, a co-operative society, earned interest income out of the reserve funds, which had been invested with SBI/RBI in compliance with statutory provisions in order to carry on banking business and claimed deduction under section 80P(2)(a). The Assessing Officer declined to allow the claim, but restricted its claim to that part of interest income derived from working or circulating capital. Examine the validity of action of the Assessing Officer.* [NOVEMBER 2002 (New)]

■

The action of the Assessing Officer is not justified. For detailed discussion *see* para 341.1-1.

Problem 5.16-4 - *X Co-operative Society Ltd., markets agricultural produce supplied to it by its members. Its profit and loss account for the year ended March 31, 2009 showed a profit of Rs. 10 lakh on sales of Rs. 100 lakh. (It can be assumed that profits accrued uniformly on sales). The society's claim for exemption of income from tax was examined by Assessing Officer who found that the sales composed of:*

Rs. 70 lakh of produce raised by the society's own members in their agricultural fields; and

Rs. 30 lakh of produce brought by the members from the open market and supplied to the society.

The Assessing Officer wants to deny exemption under section 80P(1) in regard to profits on bought out goods supplied by members to the society. Is the Assessing Officer's view correct in law? Discuss [NOVEMBER 1999]

■

According to section 80P(2)(*a*)(*iii*), the whole of the amount of profits attributable to the marketing of agricultural produce grown by the members of a co-operative society is deductible. Therefore, only Rs. 70 lakh is qualified for deduction under section 80P(1).

5.17 Assessment of charitable and other trusts

Problem 5.17-1 - *X Charitable Trust created on January 1, 2004 applied for registration of trust under section 12A before the Commissioner of Income-tax on July 1, 2008 and requested for condonation of delay.*

1. Explain with reasons the period for which the trust is eligible to get exemption under sections 11 and 12.

2. Can the exemption under sections 11 and 12 for assessment year 2009-10 be denied if the trust is holding investments in equity shares of a public sector company since April 1, 2006.

3. The trust has also applied for granting exemption under section 80G. But the approval for the same has been rejected by the Commissioner of Income-tax under section 80G (5)(vi) *on September 30, 2008.*

The trust seeks your advice whether it can file an appeal against the said rejection before the higher authorities. [NOVEMBER 2008]

■

The answer is as under:

1. In view of section 12A(2), the Commissioner of Income-tax cannot condone the delay and give retrospective registration to the trust. The trust will, therefore, be eligible for registration only from the assessment year 2009-10.

2. No. The trust cannot be denied exemption under sections 11 and 12 in respect of shares held in public sector company as per the specific exclusion given in section 13(1)(*d*)(*iii*).

3. The trust can make an appeal directly to Tribunal in view of section 253(1)(*c*).

Problem 5.17-2 - *Hundi superscribing "contributions in this hundi form part of corpus of trust fund" kept at Lord Venkteshwara Temple, Tirumala, was opened on March 30, 2009. Cash of Rs. 100 lakh and valuable articles worth Rs. 250 lakh were found to have been contributed by the devotees.* [MAY 2008]

■

Any contribution to corpus of a religious trust is not chargeable to tax. This rule is applicable whether the donation is in cash or in kind.

Problem 5.17-3 - *A trust created for charitable purposes also derived income by letting out halls for functions. The Director of Income-tax (Exemptions) cancelled the registration on the ground that the trust was carrying on commercial activity.* [NOVEMBER 2007]

■

The action of Director of Income-tax (Exemptions) is incorrect as per the decision in ***Sanjeevamma Hanumanthe Gowda Charitable Trust*** v. ***Director of Income-tax (Exemptions)*** [2006] 285 ITR 327 (Kar.). In this case it was held that the authorities used to satisfy themselves that the activities of the trust or institution are genuine and that the income derived from the trust property is applied to charitable or religious purpose. It is not necessary to go into the nature of the activity by which the income was derived by the trust.

However, the definition of "charitable purpose" under section 2(*15*) has been modified with effect from the assessment year 2009-10 so as to provide that "the advancement of any other object of general public utility" shall not be a charitable purpose if it involves the carrying on of any activity in the nature of trade, commerce or business or any activity of rendering of any service in relation to any trade, commerce or business, for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity, or the retention of such income, by the concerned entity. However, the above amendment will not affect the application of section 11 in respect of property held in a trust for religious purposes or for other charitable purposes (being relief of poor, education or medical relief).

Problem 5.17-4 - *The following trusts claim that anonymous donations received by them during the financial year 2008-09 are not liable to tax under section 115BBC:*

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

2. A trust established wholly for religious purposes which applied 75 per cent of the amount of anonymous donations for purposes of the trust during the relevant financial year.

Examine the validity of the claim made by the trusts. [MAY 2007]

■

As per section 13(7), anonymous donation will not be eligible for deduction under sections 11 and 12. *See* also para 349.7.

1. In the present problem, in view of these provisions, the charitable trust is liable to tax under section 115BBC even if the entire amount of anonymous donations have been applied for purposes of the trust.

2. As per section 115BBC(2), donations received by any trust or institution created or established wholly for religious purposes is not covered by the provisions of section 115BBC(1). *See* also para 349.7-4.

Problem 5.17-5 - *A charitable trust is registered under section 12AA. It has income of Rs. 3,90,000 for the year ending March 31, 2009 Besides, sale proceeds of a capital asset held by it for less than 36 months amounts to Rs. 9,60,000. It purchases a building during the year ending March 31, 2009 for Rs. 13,50,000. The capital asset is sold during the year ending March 31, 2009. The building is held only for charitable purposes. The trust claims that the purchase of the building amounts to application of its income for charitable purposes and that the capital gain arising on the sale of the capital asset is deemed to have been applied to charitable purposes. Are the claims made by the charitable trust valid in law?* [MAY 2006]

■

As per the Supreme Court ruling given in *S.R.M.M.C.T.M Tiruppani Trust* v. *CIT* [1998] 230 ITR 636, where the object of the charitable trust was to carry out repairs to old Hindu temples, building new ones, giving aid to or establishing hostels, educational and industrial institutions, etc., the amount spent in purchasing a building (to be used as hospital) would be entitled to exemption under section 11(1).

In the present problem, in view of the aforesaid case, the claim of the trust is correct that purchase of building amounts to application of income for charitable purposes.

Problem 5.17-6 - *A charitable trust, whose income can be exempt under section 11 was formed on March 1, 2008. For the accounting year ending March 1, 2009, it earned an income of Rs. 60,000. It filed with the Commissioner of Income-tax its application for registration on March 30, 2009 explaining that for good and sufficient reasons, it was prevented from filing the application by the due date.*

State:

i. *by which date the application for registration should have been filed;*

ii. *whether such an application could have been filed before the formation of the trust;*

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

iv. *the steps to be taken by the trust to secure exemption from Income-tax;*

v. *whether a certificate of registration once granted can be cancelled and if so, the conditions therefore.*

[NOVEMBER 2005]

■

The answer is as under:

i. February 28, 2009 (*i.e.*, within 1 year from the date on which the trust is created). Any application made after June 1, 2008 for registration is eligible for the application of section 11 and section 12 from the assessment year following

the financial year in which such application is made. In other words, for the delay in seeking registration there is no power vested with the Commissioner for condonation of delay and for grant of retrospective registration to the trust.

ii. No application under section 12A can be filed prior to the creation of trust.

iii. The order granting or refusing registration has to be passed within six months from the end of the month in which the application for registration is received by the Commissioner and a copy of such order shall be sent to the applicant. On failure on part of the Commissioner to pass an order on assessee's application for registration within a period of 6 months, a presumption should be raised that registration has been granted—***Karnataka Golf Association*** v. ***DIT*** [2004] 91 ITD 1 (Bang.).

iv. *See* para 346.

v. Section 12AA has been amended (with effect from October 1, 2004) to provide that if the Commissioner is satisfied that the activities of any trust or institution are not genuine (or are not carried out in accordance with the objects of the trust or institution, he shall pass an order in writing (after providing an opportunity of being heard to the concerned trust or institution), cancelling the registration granted under section 12AA.

Problem 5.17-7 - *X Public Charitable Trust runs a hospital, which derived income of Rs. 250 lakh, from its operational activities. Expenses incurred to earn such income are Rs. 55 lakh. Depreciation on various assets used in the hospital is Rs. 15 lakh. Out of income of Rs. 250 lakh, the amount accrued but non received as on March 31, 2009 is Rs. 20 lakh. The institution earmarked and set apart Rs. 30 lakh in March, 2009 to give as advance for a building intended to be taken on lease for expansion of the hospital, but the amount was paid on April 7, 2009, as the lease agreement could not be signed by March 31, 2009. The trust has got an ERP package developed and installed by an IT company during the year. The total cost to the trust on account of the ERP package was Rs. 85 lakh. Advice the trust on its total income, if the trust has incurred Rs. 12 lakh for purchase of a number of desktop and laptop computers for use in the hospital.* [MAY 2005]

■

Computation of total income of trust	*Rs. (in lakh)*
Income derived from property held under trust	250
Less: Expenses incurred in earning income	55
Less: Depreciation on used assets	15
Business income	180
Less: 15% to be set apart (15% of Rs. 180)	27
	153
Less: Income not received during the year [Note III]	20
	133
Less: Non-application of income resulting from not-signing lease agreement [*see* Note I]	30
Available amount	103
Less: Development and installation expenses of ERP package [*see* Note II]	85
Less: Purchase of desktop and laptop computers [*see* Note II]	12
Taxable income	6

Notes:

I. In *CIT* v. *Trustees of H.E.H. The Nizam's Charitable Trust* [1981] 131 ITR 497 (AP), it was held that in order to secure exemption under section 11, it is sufficient if the assessee provides or sets apart the funds for a charitable purpose and it is not necessary that the assessee must have spent the amount specified for a charitable purpose during the relevant assessment year.

II. In *S.RM.M.CT.M. Tiruppani Trust* v. *CIT* [1998] 230 ITR 636 (SC), it was held that for the purpose of claiming exemption under section 11, a trust can utilize an amount either on capital or on revenue nature of expenditure.

III. Income not received during the current year may be spent in the year of receipt or in the immediately following year. For this purpose, the option has to be exercised in writing before the expiry of due date of submission of return of income.

Problem 5.17-8 - *A public charitable trust registered under section 12A, for the previous year ending March 31, 2009, derived gross income of Rs. 16 lakh, which consists of the following:*

	(Rs. in lakhs)
Income from properties held by trust (net)	*5*
Income (net) from business (incidental to main objects)	*4*
Voluntary contributions from public	*7*

The trust applied a sum of Rs. 11.60 lakh towards charitable purposes during the year, which includes repayment of loan taken for construction of orphan home Rs. 3.60 lakh.

Determine the taxable income of the trust for the assessment year 2009-10. [MAY 2003]

■

	Voluntary contributions are received with a specific direction to form part of the corpus of trust	*Such contributions are received without any direction*
	Rs.	*Rs.*
Income from property	5,00,000	5,00,000
Income from business	4,00,000	4,00,000
Voluntary contribution	—	7,00,000
Total	9,00,000	16,00,000
Less: 15% of income	1,35,000	2,40,000
Application of income	11,60,000	11,60,000
Income chargeable to tax	*Nil*[1]	2,00,000

1. The excess application of Rs. 1,60,000 can be set off against deficiency of subsequent year— *CIT* v. *Matriseva Trust* [2000] 242 ITR 20 (Mad.)

Problem 5.17-9 - *X Charitable Trust has filed return of income for the assessment year 2009-10 within the stipulated time under section 139(1) and applied only 50 per cent of its income to specified purposes. It intends to accumulate the balance 35 per cent of income to be spent in future years. While completing the assessment, the Assessing Officer disallowed the accumulated income of 35 per cent and taxed the same on the ground that the trust has not made any application under section 11(2) alongwith return of income or even before the completion of assessment. Discuss the validity of the action of the Assessing Officer in this case.* [NOVEMBER 2002]

■

See para 348 and judgment of the Supreme Court given in Foot Note.

Problem 5.17-10 - *The income from property held under trust wholly for charitable or religious purposes will not be excluded from total income only if any part of such income is not used or applied for the benefit of certain specified persons. Who are these persons?* [NOVEMBER 2002]

■

See para 349.3-1.

Problem 5.17-11 - *Indicate the circumstances under which the income of a public charitable and religious trust will be subjected to income-tax at maximum marginal rate.* [MAY 2001]

■

See para 350.1.

Problem 5.17-12 *X Public Charitable Trust (registered under section 12A) furnishes the following data for the financial year ending March 31, 2009 :*

	(Rs. in lakh)
Income from engineering college affiliated to university (gross receipts Rs. 100 lakh)	*10*
Income from properties held in trust (out of this Rs. 2 lakh was not received during the year and Rs. 2 lakh was received only on the last day of the year)	*26*
Net income from business held under trust (as incidental to the main objects) as per books	*2*
Amount spent on free scholarship, free meals and free medical relief	*9*
Repayment of loan taken for construction of Health Care Centre	*3*

You are required to :

(a) *Compute the taxable income of the trust for the assessment year 2009-10. Assume that option is exercised under* Explanation *to section 11(1).*

(b) *Advise how the taxability on the computed income could be minimised or reduced.* [NOVEMBER 2000]

■

For the assessment year 2009-10 (previous year 2008-09)

(Rs. in lakh)

	In case the engineering college does not exist solely for educational purposes or exists for the purpose of profit (Rs. in lakh)	*In case the engineering college exists solely for educational purposes (not for the purpose of profit) (Rs. in lakh)*
Income from Engineering College affiliated to University	10	*Nil**
Income from property held under trust for charitable purposes	26	26
Net income from business held under trust	2	2
Total income	38	28
Less : 15% set apart for future	5.7	4.2
Balance	32.3	23.8
Less : Amount spent during the previous year	12	12
Shortfall	20.3	11.8
Less : Amount not realised during the previous year	2	2
Taxable income	18.3	9.8

Rs. 2 lakh of income from properties held in trust is received on the last day of the previous year 2008-09. Therefore, X Public Charitable Trust can apply such income during the previous year immediately following the previous year in which income is derived [*Explanation* to section 11(1)]. As per section 11(2), where 85% of income is not applied to charitable or religious purposes in the aforesaid manner, the charitable trust or institution may accumulate or set apart either the whole or part of its income for future application for such purposes in India. Such income so accumulated or set apart will not be included in the total income of the trust or institution in the year of receipt of income, provided such trust or institution has specified, by means of a notice to the Assessing Officer in Form No. 10 [which shall be delivered before the expiry of time allowed under section 139(1)], the purposes and period (which in no case can exceed 10 years) for which the income is accumulated or set apart. Further, the money so set apart or accumulated should be invested/deposited in any one or more of modes or forms specified in section 11(5).

In the present problem, in view of aforesaid provisions, X Public Charitable Trust can minimise its tax liability to *nil* by accumulating or setting apart the taxable income for future application as per section 11(2).

Problem 5.17-13 - *X Charitable Trust, a charitable trust registered under section 12A, has sold the plot acquired two years back. The purchase price was Rs. 2,00,000. The sale consideration was Rs. 3,60,000. A sum of Rs. 10,000 was incurred in connection with the sale. The trust acquired English mortgage (worth Rs. 3,10,000) of an immovable property utilising the sale proceeds. Is the trust entitled to exemption under section 11(1A)?* [NOVEMBER 1999]

■

In *Bafna Charitable Trust* v. *CIT* [1998] 230 ITR 864 (Bom.), it was held that, mortgage is a transfer of interest in specific immovable property for the purpose of securing the payment of money advanced. The definition of mortgage in section 58 of the Transfer of Property Act, 1882, also clearly says so. In an English mortgage, the mortgagor binds himself to repay the mortgage money on a certain date, and transfers the property absolutely to the mortgagee, subject, however, to a proviso that he would retransfer it to the mortgagor upon payment of the mortgage money as agreed. Thus, in an English mortgage, there is an absolute transfer of the mortgaged property from the mortgagor to the mortgagee.

In the present problem, in view of the aforesaid case, the investment of the net consideration or any part thereof in acquiring the English mortgage, has to be regarded as utilisation for acquisition of another capital asset within the meaning of section 11(1A) and, consequently, the trust is entitled to exemption under section 11(1A).

*Exempt under section 10(*23C*)(*iiiad*), *see* para 38.53-2.

5.18 Return of income and assessment

Problem 5.18-1 - *An order for assessment year 2008-09 was passed by the Assessing Officer as per section 143(3), but the typist wrongly typed in the order assessment year as 2007-08 and the relevant previous year ending on March 31, 2007. Assessee claimed in appeal that the same is an invalid order which was not accepted by the CIT(A) on the ground of error of clerical nature. What do you say about the correctness of the order of the CIT(A)?* [MAY 2008]

■

The Assessing Officer under section 154 can rectify such arithmetical or clerical mistake. In this case, Commissioner (Appeals) has not agreed with the contention of the assessee that the order as invalid, the Commissioner (Appeals) can correct errors in the order under section 251 while disposing the appeal — *CIT* v. *Mcmillan & Co.* [1958] 33 ITR 182 (SC).

Even if the Commissioner (Appeals) has not corrected these errors while disposing of the appeal, *vide* section 292B an order of assessment cannot to be treated as invalid merely by reason of any mistake in the assessment order if such assessment is in substance and in conformity with the provisions of the Act.

Problem 5.18-2 - *"Proceedings cannot be initiated under the Act, unless a proper notice to this effect has been served upon." In this context answer:*

i. *What are the prescribed modes of service of such notice?*

ii. *On whom the notice be addressed and served upon in the cases where the assessee is a company, a dissolved firm, a deceased person and a portioned HUF.* [MAY 2008]

■

As per section 282, a notice or requisition under the Act may be served on the person therein named either by post or as if it were a summons issued by a court under the Code of Civil Procedure, 1908.

Any such notice or requisition may be addressed—

a. in the case of a firm or a Hindu undivided family, to any member of the firm or to the manager or any adult member of the family ;

b. in the case of a local authority or company, to the principal officer thereof ;

c. in the case of any other association or body of individuals, to the principal officer or any member thereof ;

d. in the case of any other person (not being an individual), to the person who manages or controls his affairs.

Problem 5.18-3 - *Examine the correctness of the statement 'that the jurisdiction of an Assessing Officer cannot be objected by the Assessee".* [MAY 2008]

■

The statement is wrong. The assessee can question the jurisdiction of Assessing Officer in which case the question shall be determined by DGIT or CCIT or CIT.

Problem 5.18-4 - *The Assessing Officer within the powers vested in him under section 142(2A), while examining the accounts of PNF Ltd., had ordered to get the same audited. The company challenges this order on the ground "that the opportunity was not provided to them by the Assessing Officer prior to passing of such an order".* [MAY 2008]

■

By virtue of proviso to section 142(2A), inserted by the Finance Act, 2007, the Assessing Officer shall not direct the assessee to get the accounts so audited unless the assessee has been given a reasonable opportunity of being heard.

Problem 5.18-5 - *Discuss the following:*

1. X, an individual, filed his return of income for the assessment year 2008-09 on June 15, 2008. He later discovered that he had not claimed deduction under section 80C in the said return. He claimed the said deduction through a letter addressed to the Assessing Officer. The Assessing Officer completed the assessment without allowing the deduction claimed by X. Is the Assessing Officer justified in doing so?

2. State briefly the provisions relating to furnishing of annual information return under the Income-tax Act, 1961. What are the consequences of not furnishing the annual information return?

3. X Ltd. filed its return of loss for the assessment year 2008-09 on January 10, 2009 beyond the time prescribed under section 139(3) declaring a total loss of Rs. 15,00,000. It approaches you for advice regarding the course of action to be taken to secure the benefit of carry forward of the business loss for set off against future profits. Advise the company suitably in the matter.

4. X, an individual, has got his books of account for the year ending March 31, 2009 audited under section 44AB. His total income for the assessment year 2009-10 is Rs. 1,90,000. He desires to know if he can furnish his return of income for the assessment year 2009-10 through a Tax Return Preparer.

5. T, an individual, filed his return of income for the assessment year 2008-09 on June 15, 2008 declaring a total income of Rs. 1,20,000. He later discovered that he had not claimed a particular deduction amounting to Rs. 2,10,000 while computing his business income in the said return. He filed a revised return on January 3, 2009 declaring a total loss of Rs. 90,000. The Assessing Officer proposes to disallow the claim of T for carry forward of the business loss amounting to Rs. 90,000 for the reason that the revised return declaring loss for the first time was filed beyond the time prescribed under section 139(3). Examine the validity of the proposed action of the Assessing Officer. [MAY 2007]

■

Pointwise answer:

1. In ***Goetze (India) Ltd.*** v. ***CIT*** [2006] 284 ITR 323 (SC), it was held that the assessing authority does not have the power to entertain a claim for deduction made after filing of return of income in a way other than by way of a revised return under section 139(5). In the present problem, the Assessing Officer is justified in his action.

2. For provisions of section 285BA, *see* para 372A.

3. For provisions of section 119(2)(*b*), *see* para 446.3. In the present problem, in view of the aforesaid provisions, X Ltd. should apply under section 119(2)(*b*) to the CBDT which is authorised to issue orders giving extension of time-limit.

4. For provision of section 139B, *see* para 359. For the purpose of section 139B, "specified class or classes of persons" means any person, other than a company or a person, whose accounts are required to be audited under section 44AB or under any law who is required to furnish a return of income under the Act. In the present problem, X cannot furnish his return of income for the assessment year 2009-10 through a Tax Return Preparer.

5. The original return was filed within the 'due date' prescribed in section 139(1). The revised return filed subsequently dates back to the date of filing original return and hence the loss returned in the revised return is eligible for carry forward. *See* also ***CIT*** v. ***Periyar District Co-operative Milk Producers Union Ltd*** [2004] 266 ITR 705 (Mad).

Problem 5.18-6 - *Discuss the following:*

1. *State whether the following persons have to mandatorily furnish their return of income for the assessment year 2009-10.*

a. A, an individual, aged 50 years, whose gross total income before deduction under section 80C is Rs. 1,90,000 and total income after deduction under section 80C is Rs. 95,000.

b. XYZ, a firm, which has incurred a loss.

2. *Can an order of assessment, which was in accordance with the law as it stood on the date, when it was passed, be rectified by the Assessing Officer under section 154, on account of a subsequent amendment of the law with retrospective effect?* [NOVEMBER 2006]

■

Pointwise answer:

1. The answer is as under: *a.* Yes, *see* para 353; *b.* Yes, *see* para 353.

2. See para 369.6-4.

Problem 5.18-7 - *X, an individual filed his return of income for the assessment year 2008-09 erroneously offering for taxation interest received from notified Relief Bonds exempt under section 10(15)*(iic) *in the said return. The Assessing Officer completed the assessment under section 143(3) on April 20, 2009 accepting the income returned by X.X had furnished complete particulars relating to the interest income in the return of income. X approaches you for advice regarding the steps to be taken to secure exemption of the income. Advise X about the various remedies available under the Income-tax Act for the redressal of his grievance.* [MAY 2006]

■

The following remedies are available to X under the Act in the sequence given below :

Submit a petition for rectification of mistake under section 154 [*see* para 369]. If petition under section 154 is negatived by Assessing Officer, the following alternatives are available :

Alternative 1 - Seek revision under section 264 [*see* para 438.2].

Alternative 2 - Prefer appeal before CIT (Appeals) [*see* para 437.1].

Problem 5.18-8 - *A company submitted the return of income for assessment year 2006-07 on October 10, 2006. The Assessing Officer served a notice under section 143(2) on the company on August 14, 2007 in order to make assessment under section 143(3). Thereafter on September 1, 2007 the Assessing Officer issued intimation under section 143(1). Such intimation shows a demand for Rs. 10,500 towards tax and interest. The company argues that the issue of intimation under section 143(1) is bad in law. Discuss.* [MAY 2005]

■

A notice under section 143(2) can be issued after issue of intimation under section 143(1). In case intimation is issued under section 143(1), the authority is entitled to proceed under section 143(2) as the proceedings do not become final. Conversely, however, if the Assessing Officer issues notice under section 143(2), he ceases to hold jurisdiction under section 143(1). Hence, the contention of the company is correct. *See* also ***CIT*** v. ***Gujarat Electricity Board*** [2003] 260 ITR 84 (SC).

Problem 5.18-9 - *X Pvt. Ltd.'s assessment for assessment year 1998-99 was completed under section 143(3) on December 31, 2002. The company went in appeal to the Commissioner (Appeals) and the appeal was decided on August 16, 2007 and the appeal effect was duly given by the Assessing Officer on August 25, 2007. Thereafter, on September 1, 2008 the Assessing Officer noticed a mistake in calculation of depreciation on a particular block of assets, which reduced the income by Rs. 1.10 lakh. The Assessing Officer issued notice under section 154 for the purpose of rectifying the mistake. Is such rectification permissible?* [MAY 2005]

■

For time-limit under section 154, *see* para 369.4. The rectification order can be passed by the Assessing Officer at any time before the expiry of 4 years from the end of financial year in which the order sought to be amended is passed. As the order to give appeal effect was passed on August 25, 2007 (*i.e.*, during the financial year 2007-08), rectification can be done at any time up to March 31, 2012.

Problem 5.18-10 - *On whom and when section 139(4C) casts responsibility to file a return of income. What will be the effect on failure to comply with the provisions of this section?* [MAY 2003]

■

Section 139(*4C*) is applicable if the following conditions are satisfied—

1. The taxpayer is —

a. scientific research association referred to in section 10(*21*);

b. news agency referred to in section 10(*22B*);

c. association or institution referred to in section 10(*23A*);

d. institution referred to in section 10(*23B*);

e. fund or institution referred to in sub-clause (*iv*) or trust or institution referred to in sub-clause (*v*) or any university or other educational institution referred to in sub-clause (*vi*) or any hospital or other medical institution referred to in sub-clause (*viia*) of section 10(*23C*);

f. trade union referred to in section 10(*24*)(*a*)/(*b*).

2. The total income of the aforesaid taxpayers exceeds the maximum amount not chargeable to tax without giving effect to the provisions of section 10.

If the aforesaid conditions are satisfied, then these taxpayers will have to submit return of income in the prescribed form and all the provisions of the Act shall, so far as may be, apply as if it were a return required to be furnished under section 139(1).

If any person fails to furnish the return of income which he is required to furnish under section 139(4C) or to furnish it within the time allowed and in the manner required, he shall pay, by way of penalty, a sum of Rs. 100 for every day of such default.

Problem 5.18-11 - *In an order of assessment for the assessment year 2008-09 the assessee noticed a mistake for which application under section 154 was moved and the order was rectified. Subsequently, the assessee moved further application for rectification under section 154, which was rejected by the Assessing Officer on the ground that the order once rectified, cannot be rectified again. Is the contention of the Assessing Officer correct?* [MAY 2003]

■

The Assessing Officer is not legally correct— *see* para 369.

Problem 5.18-12 - *The return for assessment year 2007-08 was filed in time as per section 139(1). The assessee during the course of assessment proceeding under section 143(2), noticed certain omissions and, therefore, filed a revised return on April 18, 2009. The Assessing Officer ignoring the revised return so filed framed the order on April 27, 2009. Is the action of Assessing Officer correct?* [MAY 2003]

■

Revised return in this case can be filed up to March 31, 2009. Since the revised return is filed after the said date, it is not a valid revised return. The action of the Assessing Officer is legally correct.

Problem 5.18-13 - *Can the Assessing Officer complete the assessment under section 144 of the Income-tax Act, 1961 even though there is no failure on the part of the assessee under section 139(1), (4), (5), 142(1), 142(2A) or 143(2) of the Act? If so, under what situation ?* [NOVEMBER 2002 (New)]

■

See para 18.5.

Problem 5.18-14 - *The return of income for assessment year 2007-08 filed on February 1, 2008 was selected for scrutiny assessment for which first notice under section 143(2) was issued on February 27, 2009. Examine whether the action initiated/taken by the Income-tax Authorities are proper and valid under the provisions of the Act.* [NOVEMBER 2002 (New)]

■

Such notice shall be served on the assessee before the expiry of 12 months from the end of the month in which return is furnished. Notice under section 143(2) can be served on the assessee up to February 28, 2009. If such notice is issued on February 28, 2009, but is received by the assessee after February 28, 2009, it is not a valid notice.

Problem 5.18-15 - *The assessment completed under section 143(3) for assessment year 2002-03 was found to have been based on wrong information given by the assessee and accordingly the income of Rs. 1,32,500 earned on May 3, 2001 escaped assessment for which notice under section 148 to reopen the assessment was issued on March 11, 2009. Examine whether the action initiated/taken by the Income-tax Authorities are proper and valid under the provisions of the Act.* [NOVEMBER 2002 (New)]

■

Notice can be issued up to March 31, 2009 as income escaping assessment is more than 1 lakh [*see* para 368.1].

Problem 5.18-16 - *X, filed his return of income for the assessment year 2006-07 on March 15, 2008. The Assessing Officer completed the assessment on December 25, 2008 and served the order on December 31, 2008. However the notice of demand under section 156 was served on January 10, 2009. X claims that the demand of tax is invalid, since the notice of demand was served beyond time. Examine the issue.* [NOVEMBER 2002]

■

See para 370.1.

Problem 5.18-17 - *Discuss the following :*

1. In respect of the taxes due from a private limited company, which could not be recovered from it, the Tax Recovery Officer attached the properties of an erstwhile director for recovery thereof. It was contended by the director that a notice under section 156 had not been served on him and, therefore, the proceedings for recovery were not valid. What is the correct legal position ?

2. What do you understand by the expression protective assessment? Illustrate your answer. [NOVEMBER 2001]

■

Pointwise answer :

1. In *Mohan Wahi* v. *CIT* [2001] 116 Taxman 63(SC), it was held that service of notice of demand on the assessee under section 156 is mandatory before taking steps for recovery under the Second Schedule. Non-service of notice of demand goes to the root of the validity of subsequent proceedings for recovery.

In the present problem, in view of the aforesaid provisions, the contention of the director is correct and the recovery proceedings are invalid.

2. See para 365.1 under the caption "protective assessment".

Problem 5.18-18 - *"An assessment reopened under section 147 cannot be dropped". Discuss.* [MAY 2001]

■

As per section 152(2), where an assessment is reopened under section 147, an assessee may claim that the proceedings be dropped on his showing that he has been assessed on an amount not lower than what he would rightly be liable for even if the income alleged to have escaped assessment had been taken into account or the assessment or computation had been properly made.

The following two conditions have to be satisfied for this purpose.

1. The assessee should not have impugned any part of the original assessment order for that year either under sections 246 to 248 or under section 264.

2. The assessee shall not be entitled to reopen matters concluded by an order under section 154, 155, 260, 262 or 263.

Therefore, the statement given in the problem is incorrect.

Problem 5.18-19 - *A return of income was filed within the statutory time provided under the Act, without making the payment of self-assessment tax due as per return. The same was paid before completion of assessment. The Assessing Officer wants to declare the return as invalid. Is the Assessing Officer justified ?* [NOVEMBER 2000]

■

For defective return, *see* paras 358 and 358.1. For invalid return, *see* para 358.2.

In the present problem, in view of the aforesaid provisions, the return of income filed is a defective return. But a defective return is not *ipso facto* to be regarded as an invalid return. The Assessing Officer shall intimate the defect to the assessee and in case the assessee does not rectify the same within 15 days or such further period as the Assessing Officer may (in his discretion), on an application made in this behalf, allow, then the return is an invalid return. In case, the assessee rectifies the defect within the prescribed time, then the Assessing Officer will not be justified to declare the return as invalid.

The Delhi High Court has held in the case of *Sudhir Sareen* v. *CIT* [1999] 239 ITR 440 that a return of income filed under section 139(1) on self-assessment basis must be preceded by payment of the tax payable on self-assessment, and accompanied by proof of payment having been made, failing which it would be a defective return within the meaning of section 139(9) and if the defect is not removed on its being pointed out by the Assessing Officer, the return would be invalid and *non est.*

It is submitted, with due respect, that the aforesaid decision require re-consideration. When the assessee does not claim to have paid the tax, he cannot be expected to furnish a proof of payment and that the provision cannot be interpreted to mean that the assessee must pay the tax payable on self-assessment and attach proof of such payment with the return. In other words, he has to furnish evidence of payment of tax along with the return only if he pays the tax and claims to have paid it.

Problem 5.18-20 *The assessment of X Ltd. for the assessment year 2006-07 was completed under section 143(3) on June 30, 2008. There was an audit objection that interest on borrowals ought to have been disallowed partly as there was diversion of borrowed funds to sister concerns without charge of interest. X Ltd. did not accept the audit objection. On these facts—*

1. *What are the options open to revenue to deal with audit objection.*

2. *Can the assessment be reopened ?* [MAY 2000]

■

Pointwise answer :

1. For section 263, see para 438.1. In *CIT* v. *Shree Manjunathesware Packing Products & Camphor Works* [1999] 231 ITR 53, the Supreme Court held that the revisional power conferred on the Commissioner under section 263 is of wide amplitude. It enables the Commissioner to call for and examine the record of any proceeding. It empowers the Commissioner to make or cause to be made such enquiry as he deems necessary in order to find out if any order passed by the Assessing Officer is erroneous insofar as it is prejudicial to the interests of the revenue. After examining the record and after making or causing to be made an enquiry, if he considers the order to be erroneous, then he can pass the order thereon as the circumstances of the case justify.

In the present problem, in view of the aforesaid missions, the Commissioner can call for the records of the case and analyse if there is any error in not partly disallowing the interest on borrowed funds under section 36(1)(*iii*). In case he finds such an error has been committed, he can issue a notice to the assessee and pass appropriate orders.

2. For section 147, *see* para 367. In *Garden Silk Mills (P.) Ltd.* v. *CIT* [1999] 237 ITR 668 (Guj.), it was held that mere change of opinion does not confer jurisdiction on the Assessing Officer to initiate proceedings for reassessment merely by resorting to *Explanation 1* to section 147. For applying *Explanation 2* to section 147, it must be on material and it should have nexus for holding such opinion contrary to what has been expressed earlier.

In the present problem, in view of the aforesaid provisions, the assessment cannot be reopened under section 147 on the basis of an audit objection — *see Rajnath Leasing & Finance Ltd.* v. *Asstt. CIT* [1995] 129 CTR (Guj.) 377.

Problem 5.18-21 - *On finding that the assessee had claimed excessive depreciation for the year 2003-04, the Assessing Officer initiates action under section 147 and completes the reassessment. Subsequently, the Assessing Officer having reason to believe that the assessee had failed to disclose certain other income, proceeds on May 14, 2008 to recompute the income under section 147. The assessee on receipt of the second notice, contends that the Assessing Officer is not empowered to initiate reassessment proceedings for the second time. Discuss the validity or otherwise of the action of Assessing Officer. Discuss the position, if the earlier assessment proceeding had remained pending with the Assessing Officer.* [MAY 1999]

■

According to section 147, if the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153, assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section, or recompute the loss or the depreciation allowance or any other allowance, as the case may be, for the relevant assessment year.

In *CIT* v. *S.S.R.G. Arthanariswamy* [1982] 136 ITR 147 (Mad.), it was held that section 147 does not place any limit on number of times an Assessing Officer may invoke his power in respect of an assessment order. The same view was also upheld in *CIT* v. *Surendra Kumar Bhadani* [1987] 164 ITR 323 (Pat.).

In the present problem, in view of the aforesaid provisions, the contention of the assessee that the Assessing Officer is not empowered to initiate reassessment proceedings for the second time is incorrect. The action of the Assessing Officer is valid.

If the earlier reassessment proceeding had remained pending with the Assessing Officer then, as per section 147, the Assessing Officer can assess or reassess income escaping assessment which comes to his notice in the course of the proceedings under this section and complete the reassessment. In other words, if the earlier assessment proceeding had remained pending with the Assessing Officer, he cannot issue a second notice and make separate reassessment. He will have to complete the pending reassessment taking into consideration the income which has escaped the regular assessment.

5.19 Penalties and prosecutions

Problem 5.19-1 - *A notice to levy penalty under section 271(1)(c) was issued on June 11, 2008. The assessee in response thereto filed on July 13, 2008 a written submission requesting to decide the matter. The Assessing Officer before whom this reply was filed retired on July 31, 2008 and the officer, who succeeded him passed the penalty order without providing any further opportunity, but by taking into cognizance the reply filed by the assessee. Whether the order by the Assessing Officer is valid?* [MAY 2008]

■

As per section 129 an income-tax authority when succeeded by another, the authority so succeeding may continue with proceedings from the stage at which the proceeding was left by his predecessor. The assessee may demand an opportunity of hearing before any order of assessment is passed against him. The Assessing Officer cannot be compelled for offering a fresh hearing to the assessee due to change of incumbent — *K. Venkata Ramana and Budha Appa Rao* v. *CIT* [1987] 168 ITR 747 (AP), *Pradip Lamps Works* v. *CIT* [2001] 249 ITR 797 (SC).

Problem 5.19-2 - *Examine the following cases and state whether the same are liable for penalty as per provisions of Income-tax Act:*

1. X & Associates had made payment in excess of the limits prescribed to the contractors for carrying out labour job work at various sites, but had not deducted tax at source as per section 194C.

2. Hotels and Hotels were asked by Income-tax Officer (CIB) to furnish details of all such tourists who stayed in their hotels and had paid bill amount in excess of Rs. 10,000. They have not furnished the requisite information inspite of various reminders

3. An assessee whose turnover in the previous year was of Rs. 20 lakh had neither opted to be taxed as per section 44AF of the Act nor had kept and maintained books of account. [MAY 2008]

■

Pointwise answer—

1. For failure to deduct tax at source under section 194C, the assessee is liable for penalty under section 271C.

2. The assessee is liable for penalty of Rs. 10,000 under section 272A(1). However, it is eligible for non levy/waiver under section 273B.

3. For failure to maintain books of account in the case of assessee who has not opted for section 44AF (which is applicable to him), penalty under section 271A is leviable. A sum of Rs. 25,000 would be the amount of penalty.

Problem 5.19-3 *What is the quantum of penalty that could be levied in each of the following cases:*

1. *Failure to get books of account audited as required under section 44AB within the time prescribed.*

2. *Failure to get books of account audited in response to the notice issued under section 142(2A).*

3. *Failure to furnish audit report as required under section 92E.* [NOVEMBER 2007]

■

Pointwise answer:

1. As per section 271B, failure to get accounts audited under section 44AB or furnish such report as is required under section 44AB results in a minimum penalty of 1/2% of the total sales, turnover or gross receipts and a maximum penalty of Rs. 1,00,000.

2. As per section 271(1)(*b*), failure to comply with a notice under section 142(1) or section 143(2) or with a direction issued under section 142(2A) results in a penalty of Rs. 10,000 for each failure.

3. As per section 271BA, failure to submit report under section 92E results in a penalty of Rs. 1,00,000 [maximum penalty: no limit].

Problem 5.19-4 - *The Assessing Officer lodged a complaint against XYZ, a firm, under section 276CC for failure to furnish its return of income for the assessment year 2007-08 within the prescribed time. The tax payable on the assessed income, as reduced by the advance tax paid and tax deducted at source, was Rs. 60,000. The appeal filed by the firm against the order of assessment was allowed by the Commissioner (Appeals). The Assessing Officer passed an order giving effect to the order of the Commissioner (Appeals). The tax payable by the firm as per the said order of the Assessing Officer was Rs. 1,000. The Assessing Officer has accepted the order of the Commissioner (Appeals) and has not preferred an appeal against it to the Tribunal. The firm desires to know of the maintainability of the prosecution proceedings in the facts and circumstances of the case.* [MAY 2007]

■

In ***Guru Nanak Enterprises*** v. ***Income-tax Officer*** [2005] 149 Taxman 565, the Supreme Court held that in case the assessee fails to furnish the return of income of a particular assessment year and the tax liability finally determined by the Income-tax Department is less than Rs. 3,000 as envisaged under proviso (*ii*)(*b*) of section 276CC, prosecution under section 276CC read with section 278B is liable to be quashed.

In the present problem, in view of the aforesaid case the prosecution proceedings against XYZ are not maintainable.

Problem 5.19-5 - *X, an individual whose total sales in the business of food grains for the year ending March 31, 2008 was Rs. 66 lakh did not maintain books of account. The Assessing Officer levied penalties under section 271A for non-*

maintenance of books of account and section 271B for not getting the books audited as required by section 44AB. Is the Assessing Officer justified in levying penalty under section 271B? [MAY 2006]

■

The Assessing Officer is not justified in levying penalty under section 271B as audit of books of account presupposes the existence of books of account. When there are no books of account maintained by the assessee, audit is not possible at all. *See* also *Surajmal Parasuram Todi* v. *CIT* [1996] 222 ITR 691 (Gau.)

Problem 5.19-6 - *Can penalty under section 271(1)(c) for concealment of income or particulars thereof be imposed on "intangible" additions to income made by the Assessing Officer. Can these additions be utilised by the assessee to explain investments made in the subsequent years? Is there any time-limit for initiation of penalty proceedings in such cases? Discuss.* [NOVEMBER 2005]

■

No penalty can be levied. However, if these additions were used for explaining the subsequent investments, *Explanation 2* to section 271 would apply to deem concealment of income and for levy of penalty in that subsequent assessment year [*see* para 374 for details].

Problem 5.19-7 - *X Ltd. files its return of income for the assessment year 2005-06 on April 1, 2006. The Assessing Officer levied a penalty of Rs. 5,000 under section 271F. The assessee makes a submission to the CIT (Appeals) that he has furnished the return of income within the due date specified in section 139(4) and hence no penalty should be levied under section 271F. Discuss.* [MAY 2005]

■

For provisions of section 271F, *see* para 373. In *Pradip Lamps Works* v. *CIT* [2001] 169 CTR (SC) 1, it was held that merely because section 139(4) enables the assessee to file his return at any time before the assessment is made, it does not mean that his liability to pay penalty is erased. In the present problem, in view of the aforesaid provisions, the assessee is liable for penalty for late filing of the return.

Problem 5.19-8 - *State the conditions, if any to be satisfied by the assessee in order to get relief under section 273A(4) regarding the waiver of penalty. Can the Commissioner of Income-tax refuse to grant relief, when the conditions laid down in the section are compiled by the assessee ?* [NOVEMBER 2002 (New)]

■

See para 376.

Problem 5.19-9 - *An appeal against an assessment order for assessment year 1993-94 is decided by the Income-tax Appellate Tribunal against the assessee and the order is served on the Commissioner on December 27, 2008. The Assessing Officer levies penalty under section 271(1)(c)* vide *his order dated June 27, 2009 for the aforesaid assessment year for which the appeal has been decided against the assessee. The assessee seeks your advice on the following :*

i. Is the Assessing Officer empowered under the Act to impose penalty after a period of ten years ?

ii. What remedial action can be taken against the order and prescribed time-limit thereof ? [NOVEMBER 2002 (New)]

■

Penalty can imposed in this case within 6 months from the end of December 2008. For detailed discussion, *see* para 378.

Problem 5.19-10 - *Write short note on period of limitation for levy of penalties under Chapter XXI.* [NOVEMBER 2002]

■

See para 378.

Problem 5.19-11 - *A trust, set up wholly for charitable purposes, furnishes its return of income in respect of assessment year 2008-09 on November 15, 2008, declaring an income of Rs. 1 lakh. The Assessing Officer on scrutiny of the return finds that the income of the trust is exempt from tax. Are there any penal consequences for the trust's failure to furnish the return of income within the prescribed time ?* [November 2001]

■

Submission of return by charitable trust is essential even if its income is exempt—*Lala Gopi Mal Kuthiala Trust* v. *ITO* [1962] 46 ITR 436 (Punj.). If the total income of a charitable trust (without claiming exemption under sections 11, 12 and 13A) exceeds the maximum amount not chargeable to tax, then submission of return by the trust is essential.

As per section 272A(2), failure to furnish return of income under section 139(4A) results in levying of minimum penalty of Rs. 100 for every day during which the default continues.

Problem 5.19-12 - *X traders, a partnership firm, for the assessment year 2007-08, filed its return of income on an income of Rs. 40,000. The assessment was completed on an income of Rs. 1,20,000 in the month of June 2008. The additions included (a) profit on suppressed sales of Rs. 40,000, (b) disallowances in expenses of Rs. 40,000. The assessment became final as no appeal was preferred. Penalty proceedings were initiated on the charge of concealment of income of suppressed profits. After considering the explanation to the notice to penalty, penalty was levied on the charge that inaccurate particulars were furnished. X traders contends that the order of penalty is bad in law. Is the contention justified ?* [MAY 2001]

■

In *A.M. Shah & Company* v. *CIT* [1999] 238 ITR 415 (Guj.), it was held that the basis for issue of notice and for imposition of penalty should be the same.

In the present problem, in view of the aforesaid case, the penalty order is bad in law since the penalty proceedings were initiated on the basis of concealment of income of suppressed profits and penalty was levied on charge of furnishing of inaccurate particular of income. The contention of X traders is justified.

5.20 Interest

Problem 5.20-1 - *X filed return of income for assessment year 2008-09 claiming a refund of Rs. 45,000. The said refund was granted and paid to the assessee on March 1, 2009 after processing the return under section 143(1). Later on, the case was taken up for regular assessment by issue of notice under section 143(2) and the said assessment was completed on August 16, 2009 resulting in demand of Rs. 2,500. Is the assessee liable to interest on the amount of refund already granted to him and if so, what is the amount of such interest?* [NOVEMBER 2004]

■

Yes the assessee is liable to interest on the amount of refund already granted to him under section 234D. The amount of such interest is Rs. 1,350 (*i.e.*, Rs. 45,000 × 0.005 × 6). For details, *see* para 385.5.

Problem 5.20-2 - *Under what circumstances can interest levied under section 220(2) of the Income-tax Act be reduced or waived and by whom is the power exercisable? Can the interest be waived, after the taxes have been paid belatedly?* [NOVEMBER 2002]

■

See para 385.6-1.

Problem 5.20-3 - *Interest levied under section 220 can be waived. Discuss.* [MAY 2001]

■

See para 385.6-1.

5.21 Advance payment of tax

5.22 Tax deduction or collection at source

Problem 5.22-1 - Discuss the following:

1. *X Ltd. is engaged in manufacture of a product. It paid a lump-sum deposit and obtained 50 mobile phone services so that the employees of the assessee can be contracted immediately. The company paid Rs. 45,000 every month towards the service and call charges to the mobile phone franchise. On these facts:*

i. *Whether X Ltd., has to deduct tax at source on the payment?*

ii. *If so under which provisions of the Act?*

2. *Y Ltd., paid Rs. 5 lakh as sales commission to X (non-resident) who acted as its agent for booking orders from various customers who are outside India. The assessee has not deducted tax at source on the commission payment for the year ended March 31, 2009. On these facts:*

i. *Decide whether the commission is chargeable to tax in the hands of X in India?*

ii. *Decide about the deductibility of the commission payment in the assessment of X Ltd.* [NOVEMBER 2008]

■

Point-wise answer:

1. The provisions of section 194J would not apply as has been held in *Skycell Communications Ltd* v. *Dy. CIT* [2001] 251 ITR 53 (Mad.).

2. Commission income is not taxable in the hands of non-resident recipient in India. Consequently, section 195 is not applicable and tax is not deductible at source—Circular No. 23, dated July 23, 1969 and Circular No.786, dated February 7, 2000.

Problem 5.22-2 - *X Ltd. took on sub-lease a building from J, an individual, with effect from September 1, 2008 on a rent of Rs. 10,000 per month. It also took on hire machinery from J with effect from October 1, 2008 on hire charges of Rs. 9,000 per month. X Ltd. entered into two separate agreements with J for sub-lease of building and hiring of machinery. The rent of building and hire charges of machinery for the financial year 2008-09 amounting to Rs. 70,000 and Rs. 54,000 respectively were credited by X Ltd. to the account of J in its books of account on March 31, 2009. Examine the obligation of X Ltd. to deduct tax at source in respect of the rent and hire charges.* [MAY 2007]

■

For provisions of section 194-I, *see* para 418. In case of two separate agreements (one for building and another for furniture/fittings), the composite rent is considered to find out whether payment exceeds Rs. 1,20,000. Therefore X Ltd. is required to deduct tax at source @ 15%† of Rs. 70,000 and 10%† of Rs. 54,000 up to March 31, 2009 and deposit the same on or before May 31, 2009.

Problem 5.22-3 - *X, an individual, had let out his building on a monthly rent of Rs. 12,000. The tenant deducted tax under section 194-I from the rent paid to X, but did not remit such tax to the credit of the Central Government. X filed his return of income for the assessment year 2009-10 including therein the rental income from the said building and paid the balance tax on his total income after taking credit for tax deducted at source by the tenant. The Assessing Officer has called upon X to pay the tax to the extent of tax deducted at source. Is the Assessing Officer justified in doing so?* [NOVEMBER 2006]

■

The Assessing Officer is not justified in seeking the assessee to pay tax to the extent of tax deducted at source — *see* paras 428.7 and 428.8.

Problem 5.22-4- *Examine the obligation of the person responsible for paying income to deduct tax at source and indicate the due date for payment of such tax wherever applicable in respect of the following items:*

1. *X Ltd., the employer credited salary due for the financial year 2008-09 amounting to Rs. 2,40,000 to the account of Q, the employee, in its books of account on March 31, 2009. Q has not furnished any information about his income/loss from any other head or proof of investments/payments qualifying for deduction under section 80C.*

2. *Y, an individual whose total sales in business during the year ending March 31, 2008 was Rs. 1.20 crore, paid Rs. 9 lakh by cheque on January 1, 2009 to a contractor for construction of his business premises in full and final settlement. No amount was credited earlier to the account of the contractor in the books of Y.*

3. *X Ltd. credited Rs. 18,000 towards fees for professional services and Rs. 12,000 towards fees for technical services to the account of HG in its books of account on October 6, 2008. The total sum of Rs. 30,000 was paid by cheque to HG on December 18, 2008.* [MAY 2006]

■

Pointwise answer:

1. Under section 192 (which governs tax deduction from salary) tax is deductible only at the time of payment of salary and not when salary is credited to the account of an employee in the books of account of employer.

2. For provisions of section 194C(1), *see* para 411.1-2. Accordingly, Y must deduct tax at source as his total sales/gross turnover exceeds the limits specified in section 44AB during the financial year immediately preceding the financial year in which the sum is credited or paid to the contractor.

3. For provisions of section 194J, *see* para 419. X Ltd. is not liable to deduct tax at source as payment to HG in each of the two categories, *i.e.*, professional services and technical services does not exceed Rs. 20,000, even though the aggregate amount credited with respect to rendering both category of services exceeds Rs. 20,000.

Problem 5.22-5 - *X Ltd. has made payments on various dates in financial year 2008-09 to Y Ltd. towards work done under different contracts as follows:*

Contract Number	*Date of payment*	*Amount (Rs.)*
1.	*May 5, 2008*	*13,000*
2.	*June 6, 2008*	*16,000*
3.	*August 8, 2008*	*20,000*
4.	*September 10, 2008*	*2,000*
5.	*October 10, 2008*	*10,000*

X Ltd. claims that it is not liable to deduction of tax at source under section 194C. Examine the correctness of the claim made by the company. What would be the position if the value of the contract No. 5 is Rs. 1,000 only and there is no other contract during the year. [MAY 2005]

■

For provisions of section 194C, *see* para 411. In the present problem, X Ltd. is liable to deduct tax @ 2% (*plus* education cess *plus* secondary and higher education cess) of Rs. 61,000, as the total payment in the financial year exceeds Rs. 50,000. In case value of contract No. 5 is Rs. 1,000, then X Ltd. is liable to deduct 2% (*plus* education cess *plus* secondary and higher education cess) of Rs. 52,000.

Problem 5.22-6 - *Discuss the liability for tax deduction at source in the following cases for the assessment year 2009-10:*

---

†*Plus* EC + SHEC.

1. *X has been running a sole proprietary business whose accounts are audited under section 44AB. He pays a monthly rent of Rs. 15,000 for the office premises to R, the owner of building and an individual. Besides, he also pays service charges of Rs. 10,000 per month to R towards the use of furniture, fixtures and vacant land appurtenant thereto.*

2. *By virtue of an agreement with a nationalised bank, a catering organisation (a sole proprietary concern) receives a sum of Rs. 50,000 per month towards supply of food, water, snacks, etc., during office hours to the employees of bank.*

3. *An Indian company pays gross salary including allowances and monetary perquisites amount to Rs. 4,80,000 to its General Manager on which the tax liability works out to Rs. 95,880 for the accounting year 2008-09. Besides, the company provides non-monetary perquisites to him for the same period whose value is estimated at Rs. 1,20,000.*

4. *A foreign company which has made prescribed arrangements for the declaration and payment of dividends within India, pays a sum of Rs. 10,000 towards dividends on equity shares to a shareholder and Rs. 2,200 towards dividends on preference shares held by another shareholder.* [MAY 2003]

■

1. X is liable to deduct tax at source under section 194-I as follows:

	Rs.
Rent to R (Rs. 15,000 × 12)	1,80,000
Service charges to R (Rs. 10,000 × 12)	1,20,000
Total	3,00,000
Tax to be deducted (@15.45%)	46,350

2. Under section 194C "works contract" includes catering services. Consequently, tax is deductible at the rate of 2.06% in respect of amount payable by the nationalised bank which comes to Rs.12,360 (being 2.06% of Rs. 50,000 × 12).

3. Tax on income of the employee will be calculated as follows:

	Rs.
Gross salary, allowances and monetary perquisites	4,80,000
Non-monetary perquisites	1,20,000
Gross salary	6,00,000
Less: Deduction	—
Taxable income	6,00,000
Tax and education cess and secondary and higher education cess	87,550
Average rate of tax (Rs. 87,550/Rs. 6,00,000)	14.59%

The employer-company can deduct Rs.87,550 as tax at source under section 192. Alternatively, the employer, out of its own pocket, can pay tax on non-monetary perquisites which shall be calculated as follows:

Tax on non-monetary perquisites (@14.59% of Rs.1,20,000)	17,510
Balance to be deducted from salary	70,040

If the employer pays Rs. 17,510 (or less) out of its pocket, the same is not deductible in the hands of the employer under section 40(*a*) and not chargeable to tax in the hands of the employee under section 10(*10CC*).

4. The foreign company which has made prescribed arrangements for the declaration and payment of dividends within India is supposed to pay dividend tax @ 15% *plus* surcharge* *plus* education cess* *plus* secondary and higher education cess*.

Problem 5.22-7 - *X is an agent selling lottery tickets of Nagaland State. His business is in the sale of these tickets and under the terms of his agency, he is forbidden to participate in any of the draws or claim any prize. In assessment year 2008-09, an amount of Rs. 10 lakh was collected by him from Nagaland State as the amount accruing on unsold and unclaimed tickets in his possession. The Assessing Officer has issued a notice, asking X to deposit tax at 30 per cent, being the tax deductible at source under section 194B on the sum of Rs. 10 lakh. How will you deal with this matter as an advisor to X?* [NOVEMBER 2002]

■

Section 194B is not applicable in respect of lottery winning from unsold and unclaimed tickets — *Director of State Lotteries* v. *CIT* [1999] 238 ITR 1 (Gau.). *See* also para 409.

Problem 5.22-8 - *The following issues arise in connection with the deduction of tax at source under Chapter XVII-B. Discuss the liability for tax deduction in these cases :*

1. *X, an employee of the Central Government receives arrears of salary for the earlier three years. He enquires whether he is liable for deduction of tax on the entire amount during the current year.*

2. *A TV channel pays Rs. 11 lakh on July 1, 2008 as prize money to the winner of a quiz programme "Who will be a Millionaire" ?*

3. *State Bank of India pays Rs. 50,000 per month as rent to the Central Government for a building in which one of its branches is situated.*

4. *A television company pays Rs. 50,000 to a cameraman for shooting of a documentary film.*

5. *A State Government pays Rs. 20,000 as commission to one of its agent on sale of lottery tickets.*

6. *A turf club awards a jackpot of Rs. 5 lakh to the winner of one of its races.* [NOVEMBER 2001]

---

*Surcharge is 10 per cent of tax, education cess is 2 per cent of tax and surcharge and secondary and higher education cess is 1 per cent of tax and surcharge for the assessment year 2009-10 in the case of a company.

■

Pointwise answer :

1. If an employee receives any portion of his salary in arrears, he can claim relief in terms of section 89 read with rule 21A. If the employee furnishes information in Form No. 10E to the employer, relief under section 89 should be given to the concerned employee while deducting tax at source under section 192.

X is liable for deduction of tax on the entire amount under section 192 during the current year but he can claim relief under section 89.

2. The TV channel is required as per section 194B, at the time of payment of Rs. 11 lakh, to deduct income-tax thereon at the rate of 30% (*plus* 10% of income-tax as surcharge if payment exceeds Rs. 10,00,000 *plus* 2% of tax and surcharge as education cess *plus* 1% of tax and surcharge as secondary and higher education cess for the financial year 2008-09). Rs. 3,73,890 (33.99% of Rs. 11,00,000) shall be tax deduction at source under section 194B.

3. As per section 196, there is no requirement to deduct income-tax, at source on income by way of 'rent' if the payee is the Government.

State Bank of India is not liable to deduct tax while paying rent to the Central Government.

4. As per section 194J, the television company shall deduct tax at source at the time of making payment to the cameraman at the rate of 5.15%.

Rs. 2,575 (5.15% of Rs. 50,000) shall be tax deduction at source under section 194J.

5. As per section 194G, the payer shall deduct income-tax at the rate of 10.3% at the time of making payment of any income by way of commission.

Rs. 2,060 (10.3% of Rs. 20,000) shall be tax deduction at source under section 194G.

6. As per section 194BB, the payer shall deduct income-tax at source at the rate of 30.9% at the time of making payment of any income by way of winnings from horse races, exceeding Rs. 2,500.

Rs. 1,54,500 (30.9% of Rs. 5,00,000) shall be tax deduction at source under section 194BB.

Problem 5.22-9 *Discuss the following :*

1. *A foreign company, who has a branch operating in India pays salary to its employees "net of tax". It declines to issue certificate under section 203 to its employees of the tax deducted at source on the ground that it had not deducted any tax at source.*

2. *A foreign company pays fees for professional and technical services rendered to it by an Indian law and accountancy firm. The foreign company does not have any branch, agent or establishment in India. Advise the foreign company as to, how it comply with provisions of section 194J.* [NOVEMBER 2000]

■

Pointwise answer :

1. In a number of cases, the payers of income agree to bear the tax on income and make payment only 'net of tax' in terms of section 195A. It has been brought to the notice of the Board that in such cases, payers, however sometimes refuse to furnish a certificate under section 203 on the ground that there is no obligation to furnish such certificate where the tax on the income is required to be borne by them under any agreement.

Section 195A provides that where under an agreement/arrangement, the tax chargeable on any income is borne by the payer of the income, then, for the purpose of deduction of tax at source, such income shall be increased to such an amount as would after deduction of tax thereon, be equal to the net amount payable under the agreement.

Any sum deducted in accordance with the provisions of Chapter XVII of the Act is deemed to be the income of the payee as per section 198. Further, section 199 provides that credit for the tax deducted at source and paid to the Central Government shall be given to the person from whose income the deduction was made on the production of certificate furnished under section 203. Section 203 requires that every person deducting tax at source shall furnish to the payee a certificate in the prescribed form within the prescribed time.

In view of the above, it is clarified by the Board, *vide Circular No. 785,* dated November 24, 1999, that in all cases of deduction of tax at source including abovementioned cases, the payer is under legal obligation to furnish a certificate for the tax deducted at source in the prescribed form to the payee within the time prescribed as per section 203.

In the present problem, in view of the aforesaid provisions, the foreign company should issue a certificate under section 203 to its employees.

2. Refer para 419.7.

Problem 5.22-10 - *Discuss the following :*

1. X won the first prize in a lottery ticket on December 15, 2008 and the prize money was a Maruti car worth Rs. 2 lakh. According to section 194B, tax has to be deducted at source from the winnings of lottery at the time of payment of the prize money. What is the procedure to be adopted before handing over the Maruti car to X ?

2. A private trust has two individuals and one HUF as beneficiaries and their shares are equal. The trust borrowed certain amounts on which interest payable to a single lender is Rs. 15,000. Is the trust obliged to deduct tax at source at the time of payment/credit of such interest to the lender ? [MAY 2000]

■

Pointwise answer :

1. As per section 194B, a person responsible for paying to any person any income by way of winnings from lotteries or crossword puzzles exceeding Rs. 5,000 is required, at the time of such payment, to deduct income-tax thereon at the

rate of 30% (*plus* surcharge *plus* education cess† *plus* secondary and higher education cess†) for the assessment year 2009-10. Where the winnings are wholly in kind, the person responsible for paying shall, before releasing the winnings in kind, ensure that tax has been paid in respect of the winnings.

In the present problem, tax liability on the prize in kind, *i.e.*, Maruti car is Rs. 61,800 (*i.e.*, 30.9% of Rs. 2,00,000) which may be received by the person responsible for tax deduction, from X and the same can be deposited with the Government on account of tax deduction.

2. A private discretionary trust has to be assessed in the status of an "individual" and, consequently, deductions to which an individual is entitled will also be available to the trust. The word "individual" does not necessarily and invariably always refer to a single natural person. A group of individuals may also be assessed as an individual—*CIT* v. *Deepak Family Trust (No. 1)* [1995] 211 ITR 575 (Guj.), *CIT* v. *Venu Suresh Sanjay Trust* [1996] 221 ITR 649 (Mad.), *Niti Trust* v. *CIT* [1996] 221 ITR 435 (Guj.).

As per section 194A, any person, not being an individual* or a Hindu undivided family*, who is responsible for paying to a resident any income by way of interest other than income chargeable as interest on securities (exceeding Rs. 5,000 in a financial year) is required to deduct income-tax thereon at the rates in force [*see* Annex 1] at the time of credit of such income to the account of payee or "interest payable account" or "suspense account" or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

In the present problem, in view of the aforesaid provisions, the private trust is not obliged to deduct tax at source at the time of payment/credit of such interest to the lender since the private trust is assessed as an individual and the provisions of section 194A are not applicable when the payer is an individual[1]. However, in case the accounts of the trust are required to be audited as per the provisions of section 44AB, then it is liable to deduct tax at source @10 per cent‡.

Problem 5.22-11 - *An employee of a company has income from house property as well as other sources, besides his salary. The income from house property is a loss. He wants to know whether his income from these two sources can be considered for the purpose of deduction of tax at source while deducting tax under section 192 on salaries.* [MAY 1999]

■

According to section 192(2B), a taxpayer, having salary income in addition to other incomes, may furnish the details of total income (including loss under the head "Income from house property" but not any other loss) from other sources and tax deducted thereon to his employer. *See* para 405.2-4.

In the present problem, in view of the aforesaid provision, the loss under the head "Income from house property" can be considered for the purpose of deduction of tax at source while deducting tax under section 192 on salaries.

Problem 5.22-12 - *Discuss the liability for tax deduction at source in the following cases :*

1. An Indian company pays dividends on preference shares to a shareholder of the amount of Rs. 10,000 on September 30, 2008.

2. A foreign enterprise enters into a contract for the fabrication and supply of components for machinery with X & Co. a firm in India on December 1, 2008. X & Co. in turn sub-contracts the work to Y & Co. and pays it Rs. 20 lakh on January 16, 2009.

3. A HUF had deposited Rs. 50,000 under the National Savings Scheme, 1987 (NSS). There was a partition in the family under which the shares of each of the two coparceners in the deposit was fixed at Rs. 25,000. The partition took place in 2007. One of the coparceners withdrew the sum from the account of the erstwhile HUF in April 2008.

4. A company pays to a doctor a monthly retainership of Rs. 1,500 for attending an outpatient clinic at its factory premises.

5. Under an agreement entered into after June 1, 2006, between an Indian company and a foreign company and approved by the Central Government, the tax on royalty payable by the former to the latter, is to be paid by the Indian company. The royalty payable is Rs. 10 lakh for the financial year 2008-09.

6. A non-resident Indian had acquired 10,000 units of the UTI of the face value of Rs. 10 each, out of the funds standing to his credit in the Non-resident (External) Account maintained in a bank. The UTI declares a dividend of Rs. 12,000 on December 20, 2008, and credit it to the account of the Non-resident Indian. [NOVEMBER 1998]

■

Pointwise answer :

1. As dividend on preference shares is covered by section 115-O, tax is not deductible under section 194A.

2. According to section 194C, in case payment is made by a contractor to a sub-contractor for carrying out the whole or any part of the work undertaken by the contractor, then tax has to be deducted at source by him (contractor) at the rate of 1% (+SC+EC+SHEC).

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†Surcharge is 10% of income-tax in case net income exceeds Rs. 10 lakh in the case of an individual *plus* 2% of tax and surcharge as education cess *plus* 1% of tax and surcharge as secondary and higher education cess for the assessment year 2009-10.

*However, with effect from June 1, 2002, an individual/HUF is liable to deduct tax at source, if during the immediately preceding financial year the gross turnover exceeds Rs. 40 lakh (or in case of a profession gross receipts exceed Rs. 10 lakh).

‡Surcharge is 10% of income-tax in case net income exceeds Rs. 10 lakh in case of an individual *plus* 2% of tax and surcharge as education cess *plus* 1% of tax and surcharge as secondary and higher education cess.

In the present problem, in view of the aforesaid provision, X & Co. is liable to deduct tax at source of Rs. 20,600 [*i.e.*, @ 1.03% of Rs. 20 lakh] in respect to payment to Y & Co.

3. According to section 194EE, the person responsible for paying any amount (*i.e.*, principal and interest) out of National Savings Scheme, 1987 should deduct tax at the rate of 20% (+SC+EC+SHEC). Tax is deductible at the time of payment. It may be noted that the payment out of National Savings Scheme, 1992 is not subject to tax deduction at source.

In the present problem, in view of the aforesaid provision, the person responsible for paying Rs. 25,000 is liable to deduct tax at source of Rs. 5,150 [*i.e.*, 20.6% of Rs. 25,000] at the time of making payment to one of the coparceners in April 2008.

4. According to section 194J, any person (not being an individual[1] or a Hindu undivided family[1]) who is responsible for paying to a resident any sum by way of fees for professional services or technical services shall deduct tax at source at the rate of 5 per cent (*plus* surcharge* *plus* education cess* *plus* secondary and higher education cess) on total payment. However, no tax shall be deducted where the amount of such sum or, as the case may be, the aggregate of the amount of such sums credited or paid or likely to be credited or paid during the financial year by the aforesaid person to the account of, or to, the payee, does not exceed Rs. 20,000 in case of fees for professional services or technical services.

In the present problem, in view of the aforesaid provision, since the total fee for professional services paid by the company to the doctor is Rs. 18,000 (*i.e.*, Rs. 1,500 × 12), no tax shall be deducted at source.

5. According to section 195, a person responsible for making payment to a non-corporate non-resident assessee or to a company other than a domestic company, of any interest (other than interest on securities) or any other sum (not being salary) is required, at the time of payment or at the time of credit to the account of payee, interest payable account, or suspense account, whichever is earlier, to deduct income-tax thereon at the prescribed rates.

According to section 115A(1)(*b*), royalty received by a foreign company from an Indian concern or Government in pursuance of an agreement approved by the Central Government and made after May 31, 1997 shall be taxable at the rate of 20%.

According to section 10(*6A*), if the undermentioned conditions are satisfied, the tax so paid shall not be chargeable in the hands of foreign company —

a. income is derived by a foreign company by way of royalty received from the Government or an Indian concern in pursuance of an agreement made by the foreign company with Government or the Indian concern after March 31, 1976, but before June 1, 2002;

b. the tax on such income (under the terms of agreement) is payable by the payer of royalty (*i.e.*, by the Government or the Indian concern).

Section 195A is not applicable in this case. According to Circular No. 495, dated September 22, 1987, section 195A provides for grossing up of the tax only if it forms part of the income. Since tax exempted under section 10(*6A*) does not form part of the total income, there will be no grossing up of such tax for the purposes of tax deduction at source.

In the present problem, in view of the aforesaid provisions, the Indian company shall pay Rs. 2 lakh (*i.e.*, 20% of Rs. 10 lakh) as tax out of its pocket and deposit the same in accordance with section 195.

6. Tax is not deductible.

5.23 Refund of excess payments

Problem 5.23-1 - *X files a return of income for the assessment year 2003-04, in due time disclosing a total income of Rs. 4 lakh. The taxes due on the income were covered by taxes deducted at source, advance tax and self-assessment tax.*

The return is taken for scrutiny by the Assessing Officer, who makes large additions to the income disclosed by X. On appeal, the High Court sets aside the order of assessment and directs a fresh assessment to be made after hearing the parties. The court order has become final since neither party has preformed an appeal against it.

The Assessing Officer does not make any fresh assessment with the result that the assessment becomes barred by time.

X has filed a petition that since no assessment of his income has been made by the Assessing Officer the entire taxes paid, including the pre-assessment payments, must be refunded to him.

Is he justified in making this claim? Discuss. [NOVEMBER 2004]

■

In *Chandra Mohan* v. *Union of India* [2000] 241 ITR 484 (MP), it was held that section 240 shall apply only where refund becomes due as a result of an order passed in appeal or other proceeding under Income-tax Act. In case no order of assessment has been passed within the period of limitation, the amount of tax paid cannot be refunded. *See* also *Saurashtra Cement and Chemical Industries Ltd.* v. *ITD* [1992] 194 ITR 659 (Guj.). In the present case, X is not justified in claiming refund of tax paid. *See* also *CIT* v. *Shelly Products* [2003] 261 ITR 367 (SC).

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1. *See* footnote on page 1373.

5.24 Appeals and revisions

Problem 5.24-1 - Discuss the following:

1. *Discuss the correctness or otherwise of the following propositions:*

a. *A fresh claim before the Assessing Officer can be made only by filing a revised return and not otherwise.*

b. *The powers of the Commissioner (Appeals) to enhance the assessment are plenary and quite wide.*

c. *At the time of hearing of rectification application, the Tribunal can re-appreciate the evidence produced during the proceedings of the appeal hearing.*

d. *The High Court cannot interfere with the factual finding recorded by the lower authorities and the Tribunal, without any valid reasons.*

2. *The Commissioner of Income-tax issued notice to revise the order passed by an Assessing Officer under section 143(1)(A). During the pendency of proceedings before the Commissioner on the basis of material gathered during survey action under section 133A, the Commissioner issued a second notice the contents of which were different than the contents of the first notice. State with reasoning whether the action of the Commissioner is justified as to the second notice?*

3. *State the circumstances where the appellant shall be entitled to produce additional evidence oral or documentary before the Commissioner (Appeals) other than the evidence produced during the proceedings before the Assessing Officer?* [NOVEMBER 2008]

■

Point-wise answer:

1. The answer is as under:

a. Once a return is filed, the only option available to the assessee to make any amendment in the return is by way of filing a revised return—*Goetze India Ltd.* v. *CIT* [2006] 284 ITR 323 (SC). Hence, the proposition is correct.

b. The Commissioner has all the powers which are co-terminus with that of the Assessing Officer. He can do what the Assessing Officer can do and also direct the Assessing Officer to do what he has failed to do previously [*see* also para 437.5]—*CIT* v. *Kanpur Industrial Syndicate* [1964] 53 ITR 225 (SC), *CIT* v. *Nirbheram Daluram* [1997] 224 ITR 610 (SC).

c. The Tribunal having heard the matter earlier, in the rectification proceedings it cannot go in to merits of the appeal again and re-appreciate the evidence produced during the original hearing [*see* also para 439.3-6]—*Niranjan & Co Ltd.* v. *ITAT* [1980] 122 ITR 519 (Cal.), *CIT* v. *Ballabh Prasad Agarwalla* [1997] 90 Taxman 283 (Cal.), *CIT* v. *Vardhaman Spinning* [1997] 226 ITR 296 (Punj. & Har.).

d. In exercise of powers under section 260A the findings of fact of the tribunal cannot be disturbed by the High Court. Hence, only if the issue has substantial question of law an appeal shall lie before the High Court - *M. Janardhana Rao* v. *Joint CIT* [2005] 273 ITR 50 (SC), ***CIT*** v. ***Mohanakala*** [2007] 291 ITR 278 (SC).

2. The material on the basis of which the notice under section 263 was issued could not be said to be the record available at the time of examination as per clause (*b*) of section 263.

3. See para 437.4-1.

Problem 5.24-2 - *An assessee, who is aggrieved from all or any of the following orders is desirous to know the available remedial recourse and the time-limit against each under the Income-tax Act, 1961:*

i. *passed under section 143(3) by the Assessing Officer.*

ii. *passed under section 263 by the CIT.*

iii. *passed under section 272A by the Director General.*

iv. *passed under section 254 by the ITAT.* [MAY 2008]

■

Section under which order is passed	*Available remedy*	*Time-limit for availing remedy*
143(3)	Appeal before Commissioner (Appeals)	30 days from the date on which intimation of the order sought to be appealed against is served.
263	Appeal before Tribunal	60 days from the date on which the order sought to be appealed against is communicated to the assessee.
272A	Appeal before Commissioner (Appeals)	Within 30 days where the order is made by Deputy Commissioner or Deputy Director.
272A	Appeal before Tribunal	Within 60 days where an order is passed by CCIT or DGIT or DIT.

Section under which order is passed	*Available remedy*	*Time-limit for availing remedy*
254	High Court	Within 120 days from the date on which the order is served on the assessee and only in respect of question of law. Where the issue relates to facts, no further appeal is possible.

Problem 5.24-3 - *Assessment for assessment year 2003-04 was completed as per section 143(3) considering the various claims so made by the assessee on December 23, 2004. Subsequently this was reopened under section 147 on certain issues, but excluding the claim of the assessee as to "Lease Equalisation Fund". The order of reassessment was passed on November 24, 2007. The Commissioner within the powers vested under section 263 passed an order on January 11, 2009 rejecting the claim of assessee as to "Lease Equalisation Fund". The assessee challenges that the action of the CIT is not sustainable because barred by limitation.* [MAY 2008]

■

The assessee can challenge the revision under section 263, as it is barred by limitation reckoned from the date of assessment. Since the issue in reassessment does not cover the aspect proposed in section 263, the time limit is to be computed from the date of original assessment. In other words, action can be taken by the Commissioner in this case on or before March 31, 2007—***CIT*** v. ***Alagendran Finance Ltd.*** [2007] 293 ITR 1 (SC).

Problem 5.24-4 - *Write a brief note on filing of memorandum of cross-objections before the Income-tax Appellate Tribunal.* [NOVEMBER 2006]

■

See paras 439.2-5 and 439.2-6.

Problem 5.24-5 - *An assessee's case is pending in appeal before the Income-tax Appellate Tribunal for assessment year 2003-04. Since the appeal is pending, the assessee wishes to file an application to the Settlement Commission for disclosing additional income, the income tax on which is Rs. 15 lakh. Is it possible to make such application? Will your answer be different if the Tribunal sets aside the case and restores the matter to Commissioner (Appeals)?* [MAY 2005]

■

For provisions of sections 245A and 245B, *see* paras 458 and 459.

In the present problem, in view of the aforesaid provisions, the assessee cannot make an application to the Settlement Commission in case appeal is pending to the Income-tax Appellate Tribunal.

In case the Tribunal sets aside the case and restores the matter to the Commissioner (Appeals), then the assessee can make an application to the Settlement Commission.

Problem 5.24-6 - *The assessment of X for assessment year 2005-06 was completed under section 143(3) on January 15, 2008. The Commissioner acting under section 263 directed the Assessing Officer to add certain amount appearing in the balance sheet in total income of X. X did not challenge the order of the Commissioner under section 263 by filing appeal to the Tribunal. The Assessing Officer passed a fresh assessment order on October 1, 2008 including the said amount in total income of X pursuant to the order of the Commissioner. X disputed the fresh assessment order in appeal to Commissioner (Appeals) under section 246A. The Commissioner (Appeals) dismissed the appeal on the ground that the Assessing Officer only complied with direction of the Commissioner under section 263, which was not disputed by X in appeal to Tribunal. Examine the correctness of the stand taken by the Commissioner (Appeals).* [MAY 2005]

■

For provisions of section 263, *see* para 438.1. In the present problem, the stand taken by the Commissioner (Appeals) is incorrect as under section 246A, the assessee has a right to dispute fresh assessment order by filing appeal to Commissioner (Appeals). Any order of fresh assessment is appealable under section 246A.

Problem 5.24-7 - *Discuss the following propositions—*

1. *The Income-tax Appellate Tribunal cannot admit additional evidence during the hearing of the appeal.*

2. *The Commissioner of Income-tax can revise an order during the pendency of an appeal before the first appellate authority.*

3. *The Commissioner of Appeals cannot admit an appeal filed beyond 30 days from the date of receipt of order by an assessee.* [NOVEMBER 2003]

■

Point-wise answer :

1. See para 439.3-2.

2. As held in *CIT* v. *Shri Arbuda Mills Ltd* [1998] 231 ITR 50 (SC), the Commissioner has jurisdiction and the power to make revision under section 263 in respect of issues which are not subject matter of appeal. Also, *see* para 438.1-4.

3. See para 437.2-3b.

Problem 5.24-8 - *In the assessment made on a firm, the Assessing Officer made two specific additions, namely, (i) unexplained cash credit of Rs. 1 lakh; and (ii) disallowance under section 43B. The assessee filed an appeal before the CIT (Appeals) contesting the addition of cash credit and being unsuccessful, filed a further appeal before the Appellate Tribunal. In respect of the disallowance under section 43B, it did not file any appeal, but made a revision petition under section 264, to the CIT, who dismissed it on the ground that the assessment was the subject-matter of an appeal to the Appellate Tribunal. The assessee relied on a Board's circular under which the CIT was empowered to accept such a petition. Discuss the correctness of the view taken by the CIT.* [NOVEMBER 2002]

■

See para 438.2-2a.

Problem 5.24-9 - *Discuss the following :*

1. An assessee is aggrieved by the order of the Assessing Officer and requests you to contest the same by filing an appeal before the Commissioner of Income-tax (Appeals) as well as by filing a revision petition before the Commissioner under section 264. Can the assessee invoke both the remedies against the order of the Assessing Officer simultaneously?

2. An appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal if the High Court is satisfied that the case involves a substantial question of law. Under what circumstances does a question become a substantial question of law? [MAY 2002]

■

Pointwise answer :

1. The assessee cannot file an appeal and simultaneously seek revision under section 264 - *see* para 438.2-2.

The assessee cannot invoke both the remedies against the order of the Assessing Officer simultaneously.

2. See para 440.

Problem 5.24-10 - *In the assessment of a firm, the Assessing Officer made two additions - (i) unexplained cash credits Rs. 1 lakh; (ii) disallowance under section 43B. The firm filed an appeal before the CIT and being unsuccessful before the Appellate Tribunal only on the addition of unexplained cash credits. It was not successful in either forum. With regard to the disallowance under section 43B, it did not file any appeal, but preferred a revision petition before the CIT under section 264, who dismissed it on the ground that the assessment was the subject-matter of an appeal to the Appellate Tribunal. The assessee relies on the Board's circular under which the CIT is empowered to accept such a petition. Is the petition maintainable ?* [NOVEMBER 2001]

■

The Commissioner does not have the power to revise an order under section 264 if the same order has been made subject to an appeal to the Tribunal, even though the relief claimed in revision is different from the relief claimed in appeal before the Tribunal irrespective of fact whether the appeal is by the assessee or by the department—*Hindustan Aeronautics Ltd.* v. *CIT* [2000] 110 Taxman 311/243 ITR 808 (SC). In the aforesaid case, it was also held that the circulars or instructions given by the Board are no doubt binding in law on the authorities under the Act but when the Supreme Court or the High Court has declared the law on the question arising for consideration it will not be open to a court to direct that a circular should be given effect to and not the view expressed in the decision of the Supreme Court or the High Court.

In the present problem, in view of the aforesaid case, the petition is not maintainable.

Problem 5.24-11 - *Discuss the following :*

1. Commissioner (Appeals) has no power to decide a matter that was not raised before him.

2. The Income-tax Appellate Tribunal cannot amend its order.

3. A case before the Appellate Tribunal cannot be dealt when there is a difference of opinion amongst the members of the Bench.

4. An appeal shall lie to the High Court against the order of the Tribunal. [MAY 2001]

■

Pointwise answer :

1. According to *Explanation* to section 251, in disposing of an appeal, the Commissioner (Appeals) may consider and decide any matter arising out of the proceedings in which the order appealed against was passed, notwithstanding that such matter was not raised before the Commissioner (Appeals) by the appellant.

In view of the aforesaid provision, the Commissioner (Appeals) has power to decide a matter that was not raised before him.

2. See para 439.3-6. In view of the aforesaid provision, the Tribunal can amend any order passed by it.

3. As per section 255(4), if the members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority, if there is a majority, but if the members are equally divided, they shall state the point or points on which they differ, and the case shall be referred by the President of the Appellate Tribunal for hearing on such point or points by one or more of the other members of the Appellate Tribunal, and such point or points shall be decided according to the opinion of the majority of the members of the Appellate Tribunal who have heard the case, including those who first heard it.

In view of the aforesaid provision, the above procedure is to be adopted when there is a difference of opinion amongst the members of the Tribunal.

4. See para 440. In view of the aforesaid provisions, an appeal shall lie to the High Court against the order of the Tribunal if the case involves a substantial question of law.

Problem 5.24-12 - *The First Appellate Authority has the power to stay demand. Discuss.* [NOVEMBER 2000]

■

See paras 437.3-1 and 437.3-2.

5.25 Settlement of cases

Problem 5.25-1 - *Does the Settlement Commission have the power to reduce or waive interest levied under sections 234A, 234B and 234C? Discuss.* [NOVEMBER 2005]

■

The Settlement Commission does not have the power to reduce or waive interest levied under sections 234A, 234B and 234C. [*see* para 390].

Problem 5.25-2 - *The Settlement Commission does not have the power under section 245D to reduce or waive the interest payable by an assessee under the provisions of section 234A, 234B or 234C. Discuss.* [MAY 2002]

■

The Settlement Commission in exercise of its power under section 245(4) and (6) does not have the power to reduce or waive interest statutorily payable under sections 234A, 234B and 234C except to the extent of granting relief under the Circulars issued by the Board under section 119—*CIT* v. *Anjum M.H. Ghaswala* [2001] 119 Taxman 352 (SC).

Problem 5.25-3 - *Write short notes on :*

(a) *Does the Settlement Commission have jurisdiction to entertain an application made under section 245C(1) in respect of a case covered by Chapter XIV-B (Search and seizure case).*

(b) *Power of Settlement Commission to grant immunity from prosecution and penalty is limitless.* [NOVEMBER 2000]

■

Pointwise answer :

(*a*) With effect from June 1, 2007, the Settlement Commission cannot entertain an application for settlement of the case where the case is subject to search and seizure.

(*b*) With effect from June 1, 2007, the Settlement Commission can give immunity only from prosecution under the Income-tax Act and Wealth-tax Act. It cannot grant immunity under other laws such as Indian Penal Code or any other Central Act.

5.26 Tax planning

Problem 5.26-1 *An individual resident in India, having income earned outside India in a country with which no agreement under section 90 exists asks you to explain whether the credit of the tax paid over the income in that country will be allowed to him in India.* [NOVEMBER 2007]

■

See para 530.1.

Problem 5.26-2 - *X sought voluntary retirement from a Government of India undertaking and received compensation of Rs. 40 lakh on January 31, 2009. He is planning to use the money as capital for a business dealership in electronic goods. The manufacturer of the product requires a security deposit of Rs. 15 lakh, which would carry interest at 8 per cent per annum. X's wife is a graduate and has worked as marketing manager in a multinational company for 15 years. She now looks for a change in employment. She is willing to join her husband in running the business. She expects an annual income of Rs. 3 lakh. X would like to draw a monthly remuneration of Rs. 40,000 and also interest @10 per cent per annum on his capital in the business. X has approached you for a tax efficient structure of the business.*

Discuss the various issues, which are required to be considered for formulating your advice. Computation of income or tax liability is not required. [MAY 2005]

■

X has the option of choosing the form of organization to be sole proprietary or partnership firm. The following emerging issues need to be examined closely:

Sole proprietorship form

1. Interest on capital and remuneration paid to the proprietor is not allowable as deduction under section 37(1).

2. The salary paid to Mrs. X as an employee shall be eligible for deduction under section 37(1). However, the provisions of section 40A(2) have to be kept in mind, *see* para 147.3.

3. The clubbing provisions of section 64(1)(*ii*) are not applicable as Mrs. X has 15 years of experience of working as a marketing manager which may reasonably be considered as a technical or professional qualification for this purpose.

4. Remuneration received by Mrs. X as an employee in the sole proprietor organization of X shall be taxable in her hands under the head "Salaries" and the related provisions shall duly apply.

5. The profit of the sole proprietary business shall be taxable as business income in the hands of X at the prescribed tax rates.

Partnership firm

1. Interest on capital and remuneration payable are deductible in computation of taxable income of the partnership firm subject to the provisions of sections 37(1) and 40(*b*).

2. Share of partner in the profits of the firm is not taxable in his hand as per section 10(*2A*).

3. Salary paid to Mrs. X as partner in the firm is taxable in her hands under the head business "Profits and gains of business or profession" to the extent such remuneration is allowable in the hands of the firm under section 40(*b*).

4. The taxable income of a partnership firm will be taxable @ 30% (*plus* surcharge *plus* education cess *plus* secondary and higher education cess).

It would be better to commence a proprietary concern in the name of X and pay salary to wife in which case optimal tax benefit can be obtained.

5.27 Transfer pricing

Problem 5.27-1 - *In the context of transfer pricing provisions, read with rules, what are the factors to be considered while selecting the most appropriate method?* [NOVEMBER 2008]

■

See para 509.3.

Problem 5.27-2 - *X Motors Ltd., an Indian company declared income of Rs. 300 crore computed in accordance with Chapter IVD but before making any adjustments in respect of the following transactions for the year ending March 31, 2009 :*

i. *10,000 cars sold to B Ltd. which holds 30 per cent shares in X Motors Ltd. at a price which is less by $ 200 each car than the price charged from Y Ltd.*

ii. *Royalty of $ 1,20,00,000 was paid to Z Ltd. for use of technical know-how in the manufacturing of car. However, Z Ltd. had provided the same know-how to another Indian company for $90,00,000.*

iii. *Loan of Euro 1000 crore carrying interest @ 10 per cent per annum advanced by A Ltd., a German company, was outstanding on March 31, 2009. The total book value of assets of X Motors Ld. on the date was Rs. 90,000 crore. The said German company had also advanced a loan of similar amount to another Indian company @ 9 per cent per annum. Total interest paid for the year was EURO 100 crore.*

Explain in brief the provisions affecting all these transactions and compute the income of the company chargeable to tax for assessment year 2009-10 keeping in mind that the value of 1$ and of 1 EURO was Rs. 50 and Rs. 55, respectively, throughout the year. [NOVEMBER 2007]

■

For meaning of deemed associated enterprises, *see* para 507.1-2a. In the present problem, in view of the aforesaid provisions, B Ltd., Z Ltd., and A Ltd. are associated enterprises. Accordingly, the following adjustments are needed to calculate the correct income of X Motors Ltd.

Computation of total income	*Rs. (in crore)*
Income (given)	300
Add: Differences on account of adjustments required in the value of an international transactions:	
Adjustment in transaction with B Ltd. ($200 × 10,000 × 50)	(+) 10

Point-wise answer:

	Rs. in lakh
1. Computation of net wealth	
Land in urban area [held for more than 10 years as stock in trade]	81
Motor cars [excluding one car kept for running on hire]	20
Agricultural land (250 acre) acquired for construction of residential and commercial complex (land for development of residential and commercial complex in the hands of a construction company is stock-in-trade and not liable for wealth-tax)	*Nil*
Residential flat occupied by employee whose annual salary exceeds Rs. 5 lakh [Rs. 36 lakh × 1/3]	12
Farm house at remote village [not an asset on the assumption that it is situated beyond 25 kms. from the local limits of a municipality]	*Nil*
Cash-in-hand as per cash book [not an asset]	*Nil*
Gross wealth	113
Less: Debt owed	
Loan for purchase of land in urban area	(-) 30
Loan for purchase of stock in trade in Greater Noida - not deductible	*Nil*
Wealth tax liability - not deductible	*Nil*
Loan for construction of residential flats - attributable to one flat charged to wealth tax (Rs. 9 lakh × 1/3)	(-) 3
Net wealth	80

2. Section 4(7) is applicable if a plot of land or a house property is allotted to a member by a co-operative society. In this case, since X is not a member of the society, section 4(7) is not applicable—***Ram Saran Das Tandon*** v. ***CWT*** [2007] 292 ITR 546 (All.). Therefore, by invoking section 4(7) the Assessing Officer cannot tax the value of asset in the hands of X.

If, however, X had not received any consideration from Mrs. X for the transfer of property, then the Assessing Officer can be justified to include the asset in the hands of X under the provisions of section 4(1)(*a*)(*i*).

Problem 5.29-2 - *Discuss the following—*

1. State with reasons whether the following constitute assets chargeable to Wealth tax on the valuation date March 31, 2009:

i. *Agricultural farm house situated 26 kms. outside the municipal limits of Jaipur, but within 22 kms. of Niwai Municipal Corporation.*

ii. *Factory building and godowns leased out on rent.*

iii. *Silver and gold in the jewellars shop.*

iv. *Aircraft held by a shipping company having turn over of Rs. 800 crore for exclusive use of its managing director.*

v. *A cash balance of Rs. 1,50,000.*

2. X, a married coparcener having, no son but two minor daughters gets a commercial property on disruption of the HUF on March 17, 2009. He, therefore seeks your advice to know to whose hands the value of this property be subject to Wealth-tax on valuation date March 31, 2009.

3. How can the arrear demand of Wealth-tax be recovered by the department where the assessee dies prior to making payment thereof? [MAY 2008]

■

Pointwise answer —

1. Assets chargeable/not chargeable to wealth-tax—

Farm house - Since the agricultural farm house is falling within 22 kms. of Niwai Municipal Corporation it is an asset under section 2(*ea*).

Factory building - Factory building and godowns are "assets" under section 2(*ea*), as these are let out properties.

Gold - Silver and gold in a jewellery shop, being stock-in-trade, are not assets.

Aircraft - Aircraft held by a shipping company meant for managing director (not for personal use) is not an "asset" under section 2(*ea*)—*see* para 545.4.

Cash balance - In the case of individual/HUF, cash in hand in excess of Rs. 50,000 is chargeable to wealth-tax. However, in the case of a company, cash in hand is chargeable to wealth-tax if it is not recorded in the books of account.

2. HUF property - There is no condition that there must be two male co-parceners to constitute a HUF—*Gowli Buddanna* v. *CIT* [1966] 60 ITR 293 (SC).

3. Recovery - The tax liability of the deceased person must be paid out of his estate to the extent to which the estate is capable of meeting the charge [sec. 19]. Section 34C could be invoked by the Assessing Officer which means provisional attachment of property which in any case shall not exceed beyond 2 years.

Problem 5.29-3 *Discuss the following:*

1. *X gives the particulars of various assets held by him on March 31, 2009 and requests you to compute his net wealth by explaining in brief that why the same was dealt with like that:*

i. *Jewellary gifted to wife from time to time in total of Rs. 1 lakh and were available with her on the valuation date having market value of Rs. 5 lakh.*

ii. *A flat in Mumbai purchased under instalment scheme in 1986 for Rs. 6 lakh and used for own residence since then. The market value of it was Rs. 20 lakh on March 31, 2009 and instalment of Rs. 1 lakh was also outstanding.*

iii. *He is a qualified engineer and was in possession of instruments used for his professional activity. The value of all such instruments was Rs. 1 lakh.*

iv. *Urban land purchased for Rs. 2 lakh in August 2006 located at Jaipur, in the name of his son who is suffering from a disability specified under section 80U. The age of his son on March 31, 2009 was 10 years and value of land was Rs. 5 lakh.*

v. *House located in NOIDA shown in wealth tax return for assessment year 2008-09 at Rs. 40 lakh was sold on March 20, 2009 for Rs. 45 lakh, but the sale deed thereof was executed on April 3, 2009.*

2. *Examine the correctness of the statement that "All types of land held by an assessee on the valuation date are treated as 'Urban land' under the Wealth Tax Act".* [NOVEMBER 2007]

■

Pointwise answer:

1. The answer is as under:

i. In view of the provisions of section 4(1)(*a*)(*i*) [*see* para 546.1-1], Rs. 5 lakh shall be included in the net wealth of X.

ii. In view of the provisions of section 5(*vi*) [*see* para 547.6], the flat is qualified for exemption.

iii. Instruments used for professional activity are not assets as per section 2(*ea*) and consequently, Rs. 1 lakh is not chargeable to tax.

iv. In view of the provisions of section 4(1)(*a*)(*ii*) [*see* para 546.2] the value of urban land is not includible in the wealth of X as the minor child suffers from a disability specified under section 80U.

v. In view of the provisions of section 4(8) [*see* para 546.12], in case the conditions referred to in section 53A of the Transfer of Property Act, 1882 are satisfied, the house will not be included in the wealth of Mr. X as on valuation date March 31, 2009.

2. The statement is incorrect. *See* para 545.5-2 for details.

Problem 5.29-4 - *Discuss the following:*

1. X gifted Rs. 2,00,000 to his wife on April 10, 2008. His wife bought gold jewellery on January 31, 2009 out of the said sum of Rs. 2,00,000. The fair market value of the gold jewellery as on March 31, 2009 was Rs. 2,50,000. X claims that since his wife has not held on March 31, 2009 the sum of Rs. 2,00,000 which he gifted to her, no amount is includible in his net wealth for the assessment year 2009-10. Examine the claim of X.

2. Wealth tax is not payable by an assessee in respect of any property held under trust or other legal obligation for any public purpose of a charitable or religious nature in India. Do you agree with the statement?

3. Compute the net wealth of X Ltd. (carrying on the business of running cars in hire and also dealing in jewellery) which furnishes the following particulars of its assets and liabilities as on March 31, 2009.

Assets	*Book value*	*If valued as per Schedule III*
Fixed assets:	*Rs. (in crore)*	*Rs. (in crore)*
Plant and machinery	*10*	*15*
Factory building	*25*	*10*
Urban land (450 sq. meters)	*40*	*100*
Motor cars	*5*	*10*
Investments:		
Jewellery	*15*	*30*
Plot of land in Mumbai (480 sq. meters)	*10*	*50*
Equity shares in subsidiary companies	*20*	*25*
Current assets		
Inventories (jewellery)	*150*	*150*

	Book value Rs. (in crore)	If valued as per Schedule III Rs. (in crore)
Sundry debtors	*10*	*10*
Cash and bank balances (includes cash balance of Rs. 1,00,000)	*5*	*5*
Liabilities		
Current liabilities	*40*	*40*
Loans secured on fixed assets (urban land)	*30*	*30*

[MAY 2007]

■

Pointwise answer:

1. For provisions of section 4(1)(a)(*i*), *see* para 546.1. *See* also *CWT* v. *Kishan Lal Bubna* [1993] 204 ITR 600 (SC) in para 546.1-3 (point 7).

In the present problem Rs. 2,50,000 (*i.e.*, fair market value of the gold jewellary as on March 31, 2009) is includible in the net wealth of X.

2. The statement is correct, *see* para 550.1.

3. Computation of net wealth of X Ltd. for the assessment year 2009-10

Fixed assets	*Rs. (in crore)*
Plant and Machinery [not an asset under section 2(*ea*)]	-
Factory building [not an asset under section 2(*ea*)]	-
Urban land [it is an asset under section 2(*ea*) as plot of land not exceeding 500 sq. meters is exempt only in the hands of individual or HUF and not in the case of a company]	100
Motor car [not an asset under section 2(*ea*) on the assumption that cars are used for business of running on hire]	-
Investments	
Jewellary [it is an asset under section 2(*ea*) as it is not held as stock-in-trade]	30
Plot of land in Mumbai [it is an asset under section 2(*ea*)]	50
Equity shares in subsidiary companies [not an asset under section 2(*ea*)]	-
Current assets	
Inventories (jewellery) [not an asset under section 2(*ea*) as it is held as stock-in-trade)	-
Sundry debtors [not an asset under section 2(*ea*)]	-
Cash and bank balances (includes cash balance of Rs. 1,00,000) [bank balance is not taken as an asset under section 2(*ea*) and cash balance is not treated as an asset under section 2(*ea*) in case the amount is recorded in the books of account]	-
Less: Liabilities	
Current liabilities [not allowable as deduction]	-
Loans secured on fixed assets (urban land) [allowable as deduction as the loan is taken in relation to an asset which is part of net wealth]	30
Net wealth	150

Problem 5.29-5 - *X, an individual furnishes the following particulars of his assets and liabilities as on March 31, 2009:*

Assets :	*Rs. (in lakh)*
Residential house at New Delhi	*25*
Residential house at Agra	*15*
Plot of land comprising an area of 450 square metre at Mumbai	*60*
House at New Delhi exclusively used for carrying on his business	*15*
Commercial complex at Agra	*20*
Residential house at Chennai let out for 335 days during the relevant previous year	*10*
Motor cars used in business of running them on hire	*20*
Shares in private limited companies	*25*
Cash in hand	*3*
Gold jewellery	*12*
Liabilities:	

	Rs. (in lakh)
Loan borrowed for purchase of land at Mumbai	*20*
Loan borrowed for purchase of shares in private limited companies	*10*
Loan borrowed for purchase of gold jewellery	*6*

Amounts stated against assets, except cash in hand are the values determined as per section 7 of the Wealth-tax Act, read with Schedule III thereto. Compute the net wealth of X for the assessment year 2009-10. State the reasons for inclusion or exclusion of the various items. [MAY 2006]

■

Computation of net wealth of G	*Rs.*
Residential house at New Delhi	25,00,000
Residential house at Agra	15,00,000
Plot of land in Mumbai [exempt under section 5(*vi*)]	-
House at New Delhi used for business (not an asset)	-
Commercial complex at Agra (not an asset)	-
Residential house in Chennai (not an asset as let out for over 300 days)	-
Motor cars used for business of living (not an asset)	-
Shares in private limited companies (not an asset)	-
Land (in excess of Rs. 50,000 is an asset)	2,50,000
Gold jewellery	12,00,000
Gross wealth	54,50,000
Less : Loan borrowed for purchase of gold jewellery	6,00,000
Net wealth	48,50,000

Note: Loan borrowed for purchase of land at Mumbai and for shares of private limited companies are not deductible as exemption has been claimed w.r.t. land and shares are not asset under wealth tax.

Problem 5.29-6 - *See Problem 555-P14* [NOVEMBER 2005]

■

See answer to Problem 555-P14

Problem 5.29-7 - *X, Y and Z are partners in a firm engaged in the business of running a manufacturing unit in the municipal town of Siliguri having a population of more than 10,000 located in the State of West Bengal. Given below is the balance sheet of the firm as on March 31, 2009 :*

				(Rs. in lakh)
Partner's capital :			*Urban land*	*300*
X	*300*		*Urban land (construction not allowed)*	*700*
Y	*400*		*Factory land*	*200*
Z	*300*	*1,000*	*Residential house*	*300*
Cash credit from bank (secured by hypothecation of stock and debtors)		*100*	*Plant (WDV)*	*120*
Term loan taken from bank (secured by charge on gold and silver)		*1,200*	*Factory shed*	*400*
Creditors		*1,000*	*Lorry (WDV)*	*100*
Other liabilities		*600*	*Stocks*	*300*
			Gold and silver	*800*
			Sundry debtors	*180*
			Advance tax	*200*
			Cash at banks	*300*
		3,900		*3,900*

Two urban lands are valued by independent valuer at Rs. 550 and Rs. 50 lakh respectively. The market value of gold and silver on the balance sheet Rs. 1,100 lakh. The value of residential house as per rule 3 of Schedule III is Rs. 350 lakh.

Term loan was taken for purchase of: (a) plant and machinery Rs. 300 lakh; (b) lands the plots are of equal size Rs. 700 lakh.

The residential house is occupied by partner X, who looks after the production activity of the firm.

Partner Y is a non-resident for income-tax purposes.

The partners share the profits in the ratio of 2 : 2 : 1.

Details of personal assets of the partners as on March 31, 2009 are as follows:

(Rs. in thousands)

	X	Y	Z
Shares of companies	*40*	*Nil*	*Nil*
Cash in hand (in India)	*Nil*	*0.75*	*Nil*
Fixed deposit and other deposits with banks	*35*	*32*	*40*
Loan taken for making investment in the firm	*30*	*Nil*	*Nil*
Residential house in Nairobi, Kenya	*Nil*	*400*	*Nil*

You are required to determine the assessable wealth of each partner as at March 31, 2009 stating clearly the reason for inclusion or exclusion of each item. [MAY 2005]

■

Valuation of assets of the firm

(Rs. in lakh)

Urban land [asset under section 2(*ea*)]	550
Urban land [not an asset under section 2(*ea*) as construction is not allowed]	—
Residential house (as Schedule III valuation does not exceed written down value by more than 20%, balance sheet value is taken)	300
Lorry (WDV) [*Southern Railways Ltd.* v. *CWT* [2002] 122 Taxman 126 (Mad.)]	*Nil*
Gold and silver	1,100
Gross wealth	1,950
Less: Loan for urban land [50% of Rs. 700 lakh]	350
Net wealth	1,600

Note : Factory land, plant, factory shed, lorry, stocks, debtors, advance tax and cash at bank are not assets as per section 2(*ea*) and hence excluded from wealth.

Allocation of the net wealth among the partners *(Rs. in lakh)*

	X Rs.	Y Rs.	Z Rs.
Net wealth to the extent of share capital	300	400	200
Remaining net wealth (*i.e.*, 700 lakh) in the ratio of 2 : 2 : 1	280	280	140
Share of partners in the net wealth of firm (*a*)	580	680	340
[Out of which proportionate value of residential house (*i.e.*, 300/1600 of (*a*)]	(108.75)	(127.5)	(63.75)
Computation of net wealth of partners:			
Share in net wealth of firm (excluding share in residential house of the firm)	471.25	552.25	276.25
Cash in hand	—	0.25	—
Gross wealth	471.25	552.50	276.25
Less: Loan taken for making investment in firm	(30)	—	—
Net wealth	441.25	552.50	276.25

Problem 5.29-8 *Discuss the following :*

1. *X Ltd. is engaged in the construction of residential flats. For the valuation date March 31, 2009, it furnishes the following data and requests you to compute the taxable wealth:*

Land in urban area (construction is not permitted as per municipal laws in force) : Rs. 35,00,000.

Motor-cars (not owned but used on hire by the company) : Rs. 7,00,000.

Jewellery (investment) : Rs. 15,00,000, Loan taken for purchasing the same : Rs. 10,00,000.

Cash balance (as per books) : Rs. 1,75,000.

Bank balance : Rs. 2,50,000.

Guest house situated in a place which is 30 km. away from the local limits of the municipality: Rs. 6,00,000.

Residential flats occupied by the managing director : Rs. 10,00,000. The managing director is on whole time appointment and is drawing remuneration of Rs. 2,00,000 per month.

Residential house were let out on hire for 200 days : Rs. 8,00,000.

The computation should be supported with proper reasoning for inclusion or exclusion.

2. *What are the various circumstances under which an assessee will be deemed to have concealed the particulars of his net wealth or furnished inaccurate particulars thereof?* [NOVEMBER 2004]

■

Point-wise answer :

1. Taxable wealth of X Ltd. shall be determined as under:

	Assets (*Rs. in lakh*)
Land in urban area (not an asset)	-
Motor-cars (in use of company)	-
Jewellery (investment)	15
Cash balance as per books (not an asset)	-
Bank balance as per books (not an asset)	-
Guest house in rural area	6
Residential flats occupied by managing director	10
Residential house let out for 200 days in the financial year	8
Gross wealth	39
Less : Loan taken to purchase jewellery	10
Taxable wealth	29

2. The various circumstances under which an assessee will be deemed to have concealed the particulars of his net wealth or furnished inaccurate particulars thereof are as under :

❑ According to *Explanation 2* of section 18(1), where in respect of any facts material to the computation of the net wealth of any person under the Act —

a. such person fails to offer an explanation or offers an explanation which is found by the Assessing Officer or the Commissioner (Appeals) to be false, or

b. such person offers an explanation which he is not able to substantiate and fails to prove that such explanation is *bona fide* and that all the facts relating to the same and material to the computation of his net wealth have been disclosed by him.

❑ According to *Explanation 3* of section 18(1), where any person who has not previously been assessed under the Act, fails, without reasonable cause, to furnish within the period specified in section 17A(1), and the Assessing Officer or the Deputy Commissioner (Appeals) or the Commissioner (Appeals) is satisfied that in respect of such assessment year such person has assessable net wealth.

❑ According to *Explanation 4* of section 18(1), where the value of any asset returned by any person is less than 70% of the value of such asset as determined in an assessment under section 16 or section 17, such person shall be deemed to have furnished inaccurate particulars of such asset unless he proves that the value of the asset as returned by him is the correct value.

❑ According to *Explanation 5* of section 18(1), where in the course of a search under section 37A, the assessee is found to be the owner of any money, bullion, jewellery or other valuable article or thing and the assessee claims that such assets represent or form part of his net wealth,—

a. on any valuation date falling before the date of the search, but the return in respect of the net wealth on such date has not been furnished before the date of the search or, where such return has been furnished before the said date, such assets have not been declared in such return ; or

b. on any valuation date falling on or after the date of the search, then notwithstanding that such assets are declared by him in any return of net wealth furnished on or after the date of the search, he shall be deemed to have concealed the particulars of such asset.

Problem 5.29-9 - *A company incorporated outside India is not liable to wealth-tax in India. Discuss.* [MAY 2004]

■

A foreign company is liable for wealth-tax in India in respect of net wealth situated in India [*see* para 544]

Problem 5.29-10 - *A co-operative society formed for the purpose of construction of residential flats for its members acquired a large area of urban land for Rs. 3 crore. The society had membership, all having equal share. The Assessing Officer proposes to tax urban land in the hands of the society.*

1. What is meant by urban land ?

2. Is the action of the Assessing Officer correct ?

3. Can the members of the society be assessed on their share in the value of the urban land ? [MAY 2004]

■

Point-wise answer :

1. Urban land - *See* para 545.5.

2. Action of Assessing Officer - By virtue of section 45, no wealth-tax is chargeable in respect of net wealth of any co-operative society. *See* also Problem 555-P9.

3. Liability of members - In case the co-operative society allots flats/houses to the individual members as per the house building scheme, the individual members are then liable to be assessed in respect of the flat/house allotted to them by the society. Till the time no allotment is made, the members are not liable to be assessed on their share in the value of the urban land.

Problem 5.29-11 - *State, with reasons, whether the following constitute "assets" chargeable under Wealth-tax Act in the hands of X, a former ruler? (assume that there is taxable wealth as on valuation date March 31, 2009) :*

1. *Jewellery transferred to a minor handicapped daughter on December 31, 2008.*

2. *50 per cent of palace (occupied by him and declared by Government as his official residence) is rented out throughout the previous year ending March 31, 2009.* [NOVEMBER 2003]

■

Pointwise answer :

1. Jewellery transferred to minor handicapped daughter shall not be included in the income of X because clubbing provision under section 4(1)(*a*)(*ii*) is not applicable in case of a minor child suffering from any disability referred to in section 80U of the Income-tax Act.

2. According to section 5(*iii*), value of any one building used for the residence by a former ruler of a princely State is totally exempt from tax. However, the Supreme Court has held in *Mohd. Ali Khan* v. *CWT* [1997] 224 ITR 672, that where the assessee, a former ruler, owned a palace which is declared by the Central Government as his official residence and the palace consists of a number of buildings out of which some are actually occupied by the assessee and quite a few of them are let out to various tenants, the assessee is entitled to exemption only in respect of those buildings or palaces which are occupied by the ruler and not in respect of the buildings let out to tenants.

In the present problem, in view of the aforesaid provisions, 50 per cent of the palace rented out by X, will constitute assets chargeable under Wealth-tax Act.

Problem 5.29-12 - *State the circumstances in which the Wealth-tax Officer can refer valuation of an asset to the Valuation Officer.* [NOVEMBER 2003]

■

See answer to problem 555-P13.

Problem 5.29-13 - *Discuss the following—*

1. *X executed a will during his life time. His uncle A was appointed as executor, under the will. X died on June 13, 2008. The executor could complete the distribution of assets after the valuation date March 31, 2009. The wealth-tax records of X reveal that (a) the return of wealth for the valuation date March 31, 2008 has not been filed, (b) wealth-tax demands for the assessment years 2006-07 and 2007-08 are payable. On these facts, A approached you to advise him on his obligations under Wealth-tax Act.*

2. *In respect of defaults committed under Wealth-tax Act, penalty proceedings are initiated against the deceased prior to his death. Can the Wealth-tax Officer continue the proceedings and levy penalty on the legal representative?*

3. *X enters into an agreement on March 13, 2009 to sell the house property for Rs. 50 lakh purchased by him for Rs. 20 lakh and receives an advance of Rs. 10 lakh. Further amount of Rs. 15 lakh is received by him on March 22, 2008 but the sale deed is executed on April 21, 2009. Whether in the hands of X the house constitutes an asset on the valuation date March 31, 2009.* [MAY 2003]

■

Pointwise answer

1. A can file belated return for the assessment year 2008-09 up to March 31, 2009. Likewise, return for the assessment year 2009-10 should be submitted by A, as executor. Moreover, under section 19(1), A is liable to pay outstanding liabilities for the assessment years 2006-07 and 2007-08 out of the estate of X.

2. No penalty can be levied on legal representative for the default of deceased assessee — *see CWT* v. *H.S. Chauhan* [2000] 113 Taxman 630 (Delhi).

3. If the possession of the property is transferred to the purchaser on or before March 31, 2009, then it is not taxable in the hands of X for the assessment year 2009-10. Conversely, if the possession is transferred after March 31, 2009 then it is taxable in the hands of X for the aforesaid assessment year. For the detailed discussion, *see* para 169.3.

Problem 5.29-14 - *Explain the procedure for adoption of the value of jewellery for the valuation date as at March 31, 2009, and subsequent 3 years assuming the value of jewellery has been determined by Valuation Officer as at March 31, 2009.* [NOVEMBER 2002 (New)]

■

See para 549.6.

Problem 5.29-15 - *X, a not ordinarily resident, in India, seeks your advice with regard to the furnishing of his wealth-tax return. The value of assets held on March 31, 2009 is indicated below. You are requested to compute the taxable wealth of X giving justification for the inclusion or exclusion of each item. The valuation date as indicated above is March 31, 2009:*

	Rs.
Motor cars of foreign made held as fixed assets	*9,50,000*
Gold bonds under Gold Deposit Scheme, 1999	*15,00,000*
Residential house property at Pune let out with effect from June 5, 2008	*11,00,000*
Jewellery held	*9,00,000*
Land purchased for industrial purpose:	
- *on January 1, 2005*	*5,50,000*
- *on March 25, 2008*	*7,50,000*
Loan against the purchase of land:	
- *on January 1, 2005*	*2,75,000*
- *on March 25, 2008*	*3,50,000*
Wealth-tax liability	*9,000*
Cash in hand	*75,000*
Cash at bank	*1,25,000*
Fixed assets located in USA	*50,00,000*
Value of assets held by Mrs. X acquired out of the gifts received from her husband:	
- *Shares and securities*	*2,00,000*
- *Residential house property at Mumbai*	*9,00,000*

[NOVEMBER 2002 (New)]

■

	9,50,000
Car	*Nil*
Pune house (not an "asset" as it is let out for 300 days)	9,00,000
Jewellery	
Land for industrial use	5,50,000
- purchased on January 1, 2005	*Nil*
- purchased on March 25, 2008 (not an "asset")	25,000
Cash in hand	*Nil*
Residential house in the name of Mrs. X [exempt under section 5(*vi*)]	
Total	24,25,000
Less : Debt owed	2,75,000
Net wealth	21,50,000
Wealth-tax	6,500

Problem 5.29-16 - *Rule 3 of Part B of Schedule III to the Wealth-tax Act governs the valuation of immovable property. In which cases does this rule not apply and how would the value of such properties be determined?*[NOVEMBER 2002]

■

See para 549.1-6.

Problem 5.29-17 - *Enumerate the entities to which the provisions of the Wealth-tax Act do not apply.* [NOVEMBER 2002]

■

See para 540.

Problem 5.29-18 - *Discuss the following :*

1. Under the Wealth-tax Act, what is the scope of taxation of an individual who is not residing in India?

2. How is the assessment made on such a person and what are the provisions for recovery of tax from him?

3. X Ltd. is a company engaged in the construction and sale of buildings. It has the following assets as on March 31, 2009. You are required to compute the net wealth of the company, in respect of assessment year 2009-10.

	(Rs. in lakh)
Flats—residential ready for sale	*200*
Commercial properties ready for sale	*500*

	(Rs. in lakh)
Guest house situated 30 km. away from Delhi	*25*
Two residential houses occupied by :	
- An officer having an annual salary of Rs. 4 lakh	*10*
- An officer having an annual salary of Rs. 5 lakh	*15*
Cars used for company's business	*20*
Aircraft used by the officers for business purposes	*400*
Urban land held from March 31, 1994, on which no building could be built due to dispute of title	*50*
Cash in hand	*5*

[MAY 2002]

■

Pointwise answer :

1. See para 544.

2. Section 22 of the Wealth-tax Act provides assessment of persons residing outside India. The procedure of assessment of such persons is as under :

❑ Where the person liable to tax under the Wealth-tax Act resides outside India, the tax may be levied upon and recovered from his agent, and the agent shall be deemed to be, for all the purposes of this Act, the assessee in respect of such tax [sec. 22(1)].

❑ Any person employed by or on behalf of a person referred to in section 22(1) or through whom such person is in the receipt of any income, profits or gains, or who is in possession or has custody of any asset of such person and upon whom the Assessing Officer has caused a notice to be served of his intention of treating him as the agent of such person shall, for the purposes of section 22(1), be deemed to be the agent of such person [sec. 22(2)].

❑ No person shall be deemed to be the agent of any person residing outside India unless he has had an opportunity of being heard by the Assessing Officer as to his being treated as such [sec. 22(3)].

❑ Any agent, who, as such, pays any sum under the Act, shall be entitled to recover the sum so paid from the person on whose behalf it is paid or to retain out of any money that may be in his possession or may come to him in his capacity as such agent, an amount equal to the sum so paid [sec. 22(4)].

❑ Any agent, or any person who apprehends that he may be assessed as an agent, may retain out of any money payable by him to the person residing outside India on whose behalf he is liable to pay tax (hereinafter in this section referred to as the principal), a sum equal to his estimated liability under this section, and in the event of any disagreement between the principal and such agent or person, as to the amount to be so retained, such agent or person may secure from the Assessing Officer a certificate stating the amount to be so retained pending final settlement of the liability, and the certificate so obtained shall be his warrant for retaining that amount [sec. 22(5)].

❑ The amount recoverable from such agent or person at the time of final settlement shall not exceed the amount specified in such certificate, except to the extent to which such agent or person may at such time have in his hands additional assets of the principal [sec. 22(6)].

❑ Notwithstanding anything contained under section 27, any arrears of tax due from a person residing outside India may be recovered also in accordance with the provisions of the Act from any assets of such person which are or may at any time come within India [sec. 22(7)].

3. Computation of net wealth

	(Rs. in lakh)
Flats (residential ready for sale) [stock-in-trade not treated as "asset"]	-
Commercial properties ready for sale [stock-in-trade not treated as "asset"]	-
Guest house situated 30 km. away from Delhi	25
Residential house occupied by an officer having an annual salary of Rs. 4 lakh	*Nil*
Residential house occupied by an officer having an annual salary of Rs. 5 lakh	15
Cars used for company's business	20
Aircraft used by officers for business purposes	400
Urban land held from March 31, 1992, on which no building could be built due to dispute of title	50
Cash in hand (assuming that it is recorded in books of account)	*Nil*
Net wealth	510

Problem 5.29-19 - *Discuss the following :*

1. *X Co-operative Housing Society Ltd. owns a building in Mumbai, which stands on freehold land. There is no unbuilt area. It has 10 members, each of whom has contributed Rs. 10 lakh towards the shares in the co-operative society. The building was completed and occupied exclusively for residential purposes by its members before March 31, 2009. It was financed partly by the shares contributed by members and partly by bank finance. The annual value fixed by the*

municipality for the building is Rs. 20 lakh, the taxes amount to Rs. 1 lakh. X is a member of the society owning one of the flats. The cost of flat to X has been fixed by the society at Rs. 20 lakh and the amount outstanding by way of instalment loan payable to the society by X is Rs. 2 lakh. You are required to determine the net wealth of X as on March 31, 2009.

2. *How is the value of the interest of a person in a firm of which he is a partner determined under the Wealth-tax Act ?*

3. *The concept of a partial partition is alien to the Wealth-tax Act. Discuss.*

4. *X is aged 45 years. His father settled a property in trust giving whole life interest therein to X. The income from the property for the years 2005-06 to 2008-09 was Rs. 60,000, Rs. 64,000, Rs. 70,000 and Rs. 76,000 respectively. The expenses incurred each year were Rs. 2,000, Rs. 4,000, Rs. 5,000 and Rs. 6,000 respectively. Calculate the value of life interest of X in the property so settled on the valuation date March 31, 2009 with the help of the factor of 9.267.* [NOVEMBER 2001]

■

Pointwise answer :

	Rs.
1. Gross maintainable rent	
Annual value (being municipal value)(*a*) [Rs. 20,00,000 ÷ 10]	2,00,000
Annual rent (*b*)	*Nil*
Gross maintainable rent [(*a*) or (*b*), whichever is higher]	2,00,000
Less :	
Municipal taxes	10,000
15% of Rs. 2,00,000	30,000
Net maintainable rent	1,60,000
Capitalised value if property is constructed on freehold land (*i.e.*, Rs. 1,60,000 × 12.5)	20,00,000
Less : Instalment due	2,00,000
Net wealth	18,00,000

X can claim exemption under section 5(*vi*) in respect of net wealth of Rs. 18,00,000.

2. See para 549.4.

3. See para 550.3.

4. X has a life interest in the property which has been settled by his father. The value of the life interest has to be determined under rule 17 of Schedule III to Wealth-tax Act. The multiplier at the age of 45 is given as 9.267. The value of life interest, therefore, comes to Rs. 6,16,256 (*i.e.*, Rs. 66,500 × 9.267) (*see* Note).

Note: The average annual income from one property for the years 2006-07 to 2008-09 is determined as under :

Years	*2006-07* Rs.	*2007-08* Rs.	*2008-09* Rs.
Income	64,000	70,000	76,000
Less : Expenses (maximum 5% of income)	3,200	3,500	3,800
Net income	60,800	66,500	72,200

Average annual income is Rs. 66,500 (*i.e.*, Rs. 1,99,500 ÷ 3).

Problem 5.29-20 - *Discuss the following :*

1. *X, a person of Indian origin, was working in Kenya from 1987. He returned to India for permanent settlement in May 2007, when he remitted money into India. For the valuation date March 31, 2009, the following particulars were furnished. You are required to compute the taxable wealth for the assessment year 2009-10. The reason for inclusion or exclusion should be stated.*

	Rs.
Building owned and let out for 270 days for residence : net maintainable rent (Rs. 40,000) and the market value Rs. 10 lakh (excess of unbuilt area over specified area is 20 per cent of aggregate area)	*10,00,000*
Jewellery :	
(a) *purchased in April 2007, out of money remitted to India from Kenya*	*5,00,000*
(b) *purchased in April 2008, out of sale proceeds of motor car brought from abroad and sold*	*4,00,000*
Value of interest in urban land held by a firm in which he is a partner	*7,00,000*
Bonds held in companies	*5,00,000*
Motor car used for own business	*2,50,000*
Vacant house plot of 400 sq. mts. (purchased in December 1998) market value Rs. 9 lakh	*9,00,000*

	(Rs. in lakh)
Cash in hand	*80,000*
Urban land purchased in the year 2007 out of withdrawals from NRE account	*10,00,000*

2. *X is the legal heir of C. C had delayed filing of the returns of wealth for the assessment years 2003-04 to 2005-06. Penalty proceedings under section 18(1)*(a) *were initiated by the Assessing Officer against C when he was alive and were continued against X. Penalties were levied against X who contends that no penalty for delay in the filing of return of wealth could be levied. Is the contention correct ? Discuss.* [MAY 2001]

■

Pointwise answer :

1. Computation of taxable wealth	*Rs.*
Building [*see* Note I]	7,00,000
Jewellery purchased in April 2007 [*see* Note II]	-
Jewellery purchased in April 2008 [*see* Note III]	-
Value of interest in urban land	7,00,000
Bonds (not an "asset")	-
Motor car	2,50,000
Vacant plot [exempt under section 5(*vi*)]	-
Cash in hand (Rs. 80,000—Rs. 50,000)	30,000
Urban land purchased within one year prior to his return out of NRE account [exempt from the assessment years 2008-09 to 2014-15 under section 5(*v*)]	-
Net wealth	16,80,000

Note :

I. Since complete information is not available, the following assumptions have been made :

a. the building is constructed on a freehold land ; and

b. the building was acquired before April 1, 1974.

	Rs.
Net maintainable rent	40,000
Capitalised value (Rs. 40,000 × 12.5)	5,00,000
Add : 40% premium as excess of unbuilt area over specified area is 20% of the aggregate area	2,00,000
Total	7,00,000

II. Jewellery is purchased in April 2007, *i.e.*, within one year before his return, out of money remitted from abroad. It is, therefore, exempt from tax under section 5(*v*) for the assessment years 2008-09 to 2014-15.

III. Jewellery purchased out of sale proceeds of car brought from abroad, is qualified for exemption under section 5(*v*). Even if assessee has converted assets, which were brought by him from outside India, into money, and has used full money for acquisition of other assets, the asset which is acquired with sole considerations of original asset, is also eligible for exemption—***CWT*** v. ***K.O. Mathews*** [2003] 133 Taxman 418 (Ker.).

2. In *CWT* v. *H.S. Chauhan* [2000] 113 Taxman 630 (Delhi) it was held that the provisions of section 18 of the Wealth-tax Act, 1957 are outside the ambit of section 19 dealing with liability to assessment in special cases and, therefore, section 19 has no application to a proceeding in relation to imposition of penalty. Under section 159 of the Income-tax Act, 1961, there is a clear prescription for continuance of proceedings, *inter alia*, for imposing penalty against legal representative. Sub-section (2) of section 159 of the Income-tax Act is contextually different from sub-section (3) of section 19 of the Wealth-tax Act. The position is not similar so far as the proceedings under section 18 are concerned. Hence no penalty could be levied on legal representative for default of the deceased assessee.

In the present problem, in view of the aforesaid case, the contention of X is correct.

Problem 5.29-21 - *Discuss the following :*

1. Y Ltd. is engaged in the construction of residential flats. For the valuation date March 31, 2009, it furnishes the following data and requests you to compute the taxable wealth :

	(Rs. in lakh)
Land in urban area (construction is not permitted as per municipal laws in force)	*20*
Motor-cars (in the use of company)	*5*
Jewellery (investment)	*10*
Cash balance (as per books)	*2*
Bank balance (as per books)	*3*

	(Rs. in lakh)
Guest house (situated in rural area)	*4*
Residential flat occupied by managing director (annual remuneration of whom is Rs. 6 lakh excluding perquisites)	*8*
Residential house let out for 100 days in the financial year	*7*
Loans obtained	
For purchase of motor-car	*2*
For purchase of jewellery	*2*

The reason for inclusion or exclusion should be stated in the computation.

2. What are the conditions to be satisfied before the Assessing Officer is statutorily required to refer the valuation of the Valuation Officer under section 16A of the Wealth-tax Act ?

3. The assessee was a trust, whose objects were wide-ranging including imparting education, running free library, to raise the status of humanity and also advancement of general public utility. The trust was also conducting chits and collection of deposits from the public, but it was not its predominant or primary object. Is the trust exempt from wealth-tax ?

4. Mrs. X wife of a coparcener, unilaterally executed a release deed stating that she relinquished her status as a member of the HUF, but still maintaining her marital status. It was claimed by the HUF, that in view of this unilateral declaration by Mrs. X, her wealth should not be included in the wealth of the HUF. Discuss the validity of the claim. [NOVEMBER 2000]

■

Pointwise answer :

1. Taxable wealth of Y Ltd. shall be determined as under :

	Assets *(Rs. in lakh)*
Land in urban area (not an asset)	—
Motor-cars (in use of company)	5
Jewellery (investment)	10
Cash balance as per books (not an asset)	—
Bank balance as per books (not an asset)	—
Guest house in rural area	4
Residential flat occupied by managing director	8
Residential house let out for 100 days in the financial year	7
Gross wealth	34
Less : Loan taken to purchase motor-car and jewellery	4
Net wealth	30

2. For section 16A, refer Problem 555-P13.

3. In *Trustees of K.B.H.M. Bhiwandiwalla Trust* v. *CWT* [1977] 106 ITR 709 (Bom.) it was held that where the objects of the trust are primarily or predominantly of charitable nature, the corpus of the trust would qualify for exemption. Under section 5(1)(*i*), all the objects need not fall within the expression "public purpose of a charitable or religious nature in India". It would be sufficient if the objects considered as a whole are charitable.

In the present problem, in view of the aforesaid case, the trust property is exempt from wealth-tax.

4. In *CWT* v. *M.A.R. Rajkumar* [1997] 226 ITR 804 (AP) it was held that the wife of the karta cannot relinquish her status as a member of HUF by a unilateral declaration while retaining her marital tie.

In the present problem, in view of the aforesaid case, the contention of the HUF is invalid.

Problem 5.29-22 - *Discuss the following :*

1. The net wealth of a firm consisting of three partners X, Y and Z having equal shares and a capital contribution of Rs. 7,00,000, Rs. 3,00,000 and Rs. 2,00,000 respectively is as under :

	Rs.
Value of assets located outside India	*20,00,000*
Value of assets located in India	*50,00,000*
Debts incurred in relation to assets in India	*10,00,000*

Determine the value of interest of the partners in the firm under the Wealth-tax Act, 1957.

2. X assessed to wealth-tax furnished the following particulars as on valuation date March 31, 2009 :

a. *His father Y, who had both immovable and movable assets and assessed to wealth-tax executed a will during his life-time appointing executors, related to Y as uncles. Y died on September 30, 2008.*

b. *The executors of the will pointed out that late Y did not file his returns of wealth for the valuation date March 31, 2007 and March 31, 2008.*

c. *The executors had completed partial distribution of estate by March 31, 2009 and as a consequence he was in receipt of immovable and movable assets valued at Rs. 20 lakh.*

On these facts, you are consulted as to —

i. *how X should proceed for filing his return of wealth as on March 31, 2009 ;*

ii. *what is his liability in respect of his late father's wealth-tax assessment, under the provisions of the Act ;*

iii. *in the above facts, what would be the position under the Wealth-tax Act, if Y has not executed any will ?*[MAY 2000]

■

Pointwise answer :

1. Value of assets of the firm

	Rs.
Value of assets located outside India	20,00,000
Value of assets located in India [*i.e.*, Rs. 50,00,000 *less* debts]	40,00,000
Net wealth of the firm	60,00,000

Allocation of the net wealth among the partners

	X Rs.	Y Rs.	Z Rs.
Net wealth to the extent of share capital	7,00,000	3,00,000	2,00,000
Remaining net wealth (*i.e.*, Rs. 48 lakh) in the ratio of 1 : 1 : 1	16,00,000	16,00,000	16,00,000
Share of partners in the net wealth of firm	23,00,000	19,00,000	18,00,000

2. The answer is as under :

i. As per section 19 of the Wealth-tax Act, 1957, where a person dies, his executor, administrator or other legal representative shall be liable to pay out of the estate of the deceased person, to the extent to which the estate is capable of meeting the charge, the wealth-tax assessed as payable by such person, or any sum, which would have been payable by him under this Act if he had not died.

Where a person dies without having furnished a return under the provisions of section 14 or after having furnished a return which the Assessing Officer has reason to believe to be incorrect or incomplete, the Assessing Officer may make an assessment of the net wealth of such person and determine the wealth-tax payable by the person on the basis of such assessment, and for this purpose may, by the issue of the appropriate notice which would have had to be served upon the deceased person if he had survived, require from the executor, administrator or other legal representative of the deceased person any accounts, documents or other evidence which might under the provisions of section 16 have been required from the deceased person [sec. 19(2)].

The provisions of sections 14, 15 and 17 shall apply to an executor, administrator or other legal representative as they apply to any person referred to in those sections [sec. 19(3)].

In the present problem, in view of the aforesaid provisions, X should proceed for filing his return of wealth as on March 31, 2009 as per section 19, *i.e.*, Rs. 20 lakh shall be included in his wealth for the assessment year 2009-10.

ii. The liability of X in respect of his late father's wealth-tax assessment is limited to the extent to which the estate is capable of meeting the charge, the wealth-tax assessed as payable by such persons or any sum, which would have been payable by him if he had not died. Up to March 31, 2009, X has received Rs. 20 lakh as a result of partial distribution of estate. Therefore, his liability is limited to Rs. 20 lakh. On the balance estate, the executors shall be assessed to wealth-tax and X has no responsibility as a legal representative.

iii. Section 19A of the Wealth-tax Act, 1957, provides assessment in the case of executors. The provisions of this section are as under :

a. The net wealth of the estate of a deceased person shall be chargeable to tax in the hands of the executor or executors.

b. The executor or executors shall for the purposes of this Act be treated as an individual.

c. The status of the executor or executors shall for the purposes of the Act as regards residence and citizenship be the same as that of the deceased on the valuation date immediately preceding his death.

d. The assessment of an executor under this section shall be made separately from any assessment that may be made on him in respect of his own net wealth or on the net wealth of the deceased under section 19.

e. Separate assessments shall be made under this section in respect of the net wealth as on each valuation date as is included in the period from the date of the death of the deceased to the date of complete distribution to the beneficiaries of the estate according to their several interests.

f. In computing the net wealth on any valuation date under the section, any assets of the estate distributed to, or applied to the benefit of, any specific legatees of the estate prior to that valuation date shall be excluded, but the assets so excluded shall, to the extent such assets are held by the legatee on any valuation date, be included in the net wealth of such specific legatee on that valuation date.

It may be noted that in this section, "executor" includes an administrator or other person administering the estate of a deceased person.

In the present problem, the executors shall be responsible to file the return of wealth in respect of the valuation date March 31, 2007 and March 31, 2008 for which returns of wealth were not filed by Y. X has no liability. In case Y had died *intestate*, to the extent of share of wealth is succeeded by X as per the Succession Act will be considered as X's wealth on the valuation date.

Problem 5.29-23 - *See problems 549.1-P1 and 549.1-P2* [NOVEMBER 1999]

■

See answer to problems 549.1-P1 and 549.1-P2

Problem 5.29-24 - *X and his wife are partners in a firm X & Co., engaged in manufacturing of footwear. Their minor son Y has been admitted to the benefits of partnership. The profit-sharing ratios are :*

	Profit	Loss
X	*40%*	*50%*
Mrs. X	*30%*	*50%*
Y	*30%*	-

The abridged balance sheet of the firm as on March 31, 2009 is as under :

Liabilities	Rs.	Assets	Rs.
Capital Accounts :		*Urban house plot*	*19,60,000*
X	*15,00,000*	*Jewellery*	*3,80,000*
Mrs. X	*10,00,000*	*Housing complex*	*34,20,000*
Y	*10,00,000*	*Cash-in-hand*	*40,000*
Bank loan	*4,58,000*	*Cash at bank*	*4,30,000*
Income-tax payable	*44,000*	*Stock-in-trade*	*1,68,000*
Loan creditors	*18,00,000*		
Trade creditors	*5,96,000*		
	63,98,000		*63,98,000*

As regards the above balance sheet, the following further information is available:

1. The urban house plot is of area 980 sq. metres. The bank loan is in respect of this plot. The market value as on March 31, 2009 is Rs. 5,000 per sq. metre.

2. The housing complex consists of 3 houses of identical area in Delhi, constructed two years back on leasehold land, the lease to expire on January 20, 2046.

The firm carries on business in one of the above three units (i.e., Unit 3). The other two residential units have been let out. The pertinent details are :

	Unit 1	Unit 2
Let out during the year ended March 31, 2009	*10 months*	*9 months*
Rent per month	*Rs. 18,000*	*Rs. 18,000*
Repair expenses borne by tenant	*Rs. 28,000*	*Rs. 18,000*
Deposits received from tenants (interest paid thereon @ 9% per annum)	*Rs. 6,00,000*	*Rs. 6,00,000*

The tenant in Unit 2 was running a taxi hire concern and the firm had entered into an agreement with the tenant that he shall provide 2,000 km. (per annum) of free taxi travel to the firm for its business use. The normal taxi fare charged is around Rs. 4 per km. The firm has utilised 2,000 km.

The municipal taxes levied for the whole complex are Rs. 12,000 per annum.

3. Loan creditors of Rs. 18,00,000 relate to the above complex.

4. The market value of the jewellery is Rs. 6,20,000.

Compute the interest of the adult partners and Y in the firm X & Co. as on March 31, 2009 for the purpose of computation of net wealth in their respective individual hands. In whose hands will Y's net wealth be assessed. [MAY 1999]

■

Computation of net wealth of X & Co.

	Rs.	Rs.
Urban house plot		49,00,000
Jewellery		6,20,000
Housing complex -		
Unit 3 (not treated as "asset" because it is used for business purposes)	*Nil*	
Unit 1 (not treated as an "asset" as it is let out for 300 days)	*Nil*	
Unit 2 (*see* Note 1)	18,99,200	18,99,200
Gross wealth of the firm		74,19,200
Less : Debt owned —		
Loan taken for housing complex	6,00,000	
Bank loan	4,58,000	10,58,000
Net wealth of the firm		63,61,200

Allocation of the net wealth among the partners :

	X Rs.	Mrs. X Rs.	Y Rs.
Net wealth to the extent of share capital	15,00,000	10,00,000	10,00,000
Remaining net wealth (*i.e.*, Rs. 28,61,200) in the ratio of 4 : 3 : 3	11,44,480	8,58,360	8,58,360
Less : Exemption under section 5 in respect of house property on the assumption that partners do not own a house property of their own	(-) 5,19,680	(-) 3,89,760	(-) 3,89,760

Notes :

1. Computation of value of Unit 2 —

Computation of "actual rent" for 9 months

		Rs.
Rent of 9 months (Rs. 18,000 × 9)		1,62,000
Add : Expenses for repair (1/9 of Rs. 1,62,000)		18,000
Interest on deposits (6% of Rs. 6,00,000 for 9 months)		27,000
Value of benefit in respect of free taxi travel (2,000 km. for one year, for 9 months it will be 1,500 km., value of the benefit for 9 months will be 1,500 km. × Rs. 4)		6,000
Actual rent (after adjustment) for 9 months		2,13,000
Annual rent (*i.e.*, Rs. 2,13,000 ÷ 9 × 12)		2,84,000
Gross maintainable rent		2,84,000
Less :	Rs.	
15% of Rs. 2,84,000	42,600	
Municipal tax	4,000	46,600
Net maintainable rent		2,37,400
Capitalisation of net maintainable rent (Rs. 2,37,400 × 8)		18,99,200

2. Net wealth of minor child Y will be included in the wealth of his parents X or Mrs. X whose net wealth from all other sources (including their value of interest in the partnership firm) before clubbing, is higher.

Problem 5.29-25 *Discuss the following —*

1. *X Ltd., a widely held company, owns the following assets as on March 31, 2009 :*

a. *land at Bangalore, purchased in 2005, on which a residential complex consisting of 24 flats, to be sold on ownership basis, is under construction for last 18 months ;*

b. *two office flats at Calcutta purchased for resale in the year 2006 ;*

c. *shares of group companies, break-up value of which is Rs. 6,40,000 ;*

d. *cash at construction site Rs. 3,20,000 ; and*

e. *residential flat in occupation of company's wholetime director drawing a salary of Rs. 1,80,000 per annum.*

Which of the above assets will be liable for wealth tax. Give reasons in brief.

2. *Y. Ltd. has let out a premises with effect from October 1, 2008 on monthly rent of Rs. 1 lakh. The lease is valid for 10 years and the tenant has made a deposit equivalent to 3 months rent. The tenant has undertaken to pay the municipal taxes of the premises amounting to Rs. 1 lakh. What will be the value of the property under Schedule III of the Wealth-tax Act for assessment to wealth-tax ?*

3. *What are the circumstances under which the Wealth-tax Officer is not required to follow the procedure laid down for valuation of house property in Rule 3 of Schedule III of the Wealth-tax Act?* [NOVEMBER 1998]

■

Pointwise answer :

1. Assets owned by X Ltd. - The tax treatment of different assets owned by X Ltd. is as follows—

Land of Bangalore - Land at Bangalore cannot be treated as any building or land appurtenant thereto under section 2(*ea*)(*i*) as the house is under construction. It is an "urban land" which is held by the assessee as stock-in-trade. It is not chargeable to tax for 10 years from the date of its acquisition [*Explanation* to section 2(*ea*)].

In the present problem, in view of the aforesaid provision, land at Bangalore (being stock-in-trade of X Ltd.) was acquired in 2005 and, therefore, it shall not be treated as urban land chargeable to wealth-tax for the assessment year 2009-10. Thus, land at Bangalore shall not be included in the net wealth of X Ltd.

Office flats at Calcutta - According to section 2(*ea*)(*i*)(*2*), any house for residential or commercial purposes which forms part of stock-in-trade, shall not be included in assessee's net wealth. Accordingly, two office flats at Calcutta purchased for resale constitute the stock-in-trade of X Ltd. and, therefore, it will not be included in the net wealth of X Ltd.

Shares of group companies - Shares of group companies do not constitute "asset" for the purpose of wealth-tax.

Cash at construction site - According to section 2(*ea*)(*vi*), cash-in-hand in excess of Rs. 50,000 (in case of individuals and Hindu undivided families) and in case of other persons any amount not recorded in the books of account shall be included in the net wealth of the assessee. Assuming that cash at construction site is recorded in the books of account, it is not included in the net wealth of X Ltd.

Residential flat in occupation of X Ltd.'s wholetime director - According to section 2(*ea*)(*i*)(*1*), a house meant exclusively for residential purposes and which is allotted by a company to an employee or an officer or a director who is in wholetime employment, having a gross annual salary of less than Rs. 5 lakh shall not be included in the net wealth of the assessee. Therefore, in the present problem, residential flat in occupation of X Ltd.'s wholetime director drawing a salary of Rs. 1,80,000 per annum shall not be included in the net wealth of X Ltd.

2. Valuation of house property owned by Y Ltd. —

	Rs.	*Rs.*
Gross maintainable rent		
Annual rent (being actual rent paid by tenant)		12,00,000
Add :		
Municipal taxes borne by tenant		1,00,000
Gross maintainable rent		13,00,000
Less :		
Municipal taxes	1,00,000	
15% of 13,00,000	1,95,000	2,95,000
Net maintainable rent		10,05,000
Capitalised value (Rs. 10,05,000 × 12.5)		1,25,62,500

Note : If the property is constructed on leasehold land, then the value should be determined as follows —

If the unexpired period of lease on the valuation date is —

a. 50 years or more (Rs. 10,05,000 × 10) : Rs. 1,00,50,000

b. less than 50 years (Rs. 10,05,000 × 8) : Rs. 80,40,000

3. Rule 3 of Schedule III to the Wealth-tax Act is not applicable in some cases [*see* para 549.1-6].

5.30 Search and seizure

Problem 5.30-1 - *Discuss the following:*

1. *The business premises of X Ltd. and the residence of two of its directors at Delhi were searched under section 132 by the Deputy Director (Investigation), Delhi. The search was concluded on August 9, 2009 and following were also seized besides other papers and records:*

i. *Papers found in the drawer of an accountant relating to Y Ltd., Mumbai indicating details of various business transactions. However, X Ltd. is not having any direct or indirect connection of any nature with these transactions and Y Ltd., Mumbai and its directors.*

ii. *Jewellery worth Rs. 5 lakh from the bed room of one of the directors, which was claimed by him to be of his married daughter.*

iii. *Papers recording certain transactions of income and expenses having direct nexus with the business of the company for the period from April 16, 2006 to date of search. It was admitted by the director that the transactions recorded in such papers have not been incorporated in the books.*

You are required to answer on the basis of aforesaid and the provisions of Act, following questions:

a. *What action the Deputy Director (Investigation) shall be taking in respect of the seized papers relating to Y Ltd., Mumbai?*

b. *Whether the contention raised by the director as to jewellery found from his bed room will be acceptable?*

c. *What presumption shall be drawn in respect of the papers which indicate transactions not recorded in the books?*

d. *Proceedings for how many years shall now be taken up and within which time-limit the assessment thereof be completed by the Assessing Officer?*

e. *Can the company move an application for settlement of case as per Chapter XIX-A?* [NOVEMBER 2007]

■

1. The answer is as under:

a. As DDI Delhi does not have any jurisdiction over Y Ltd., Mumbai, he shall hand over to the Assessing Officer having jurisdiction section 132(9A), *see* para 493.11.

b. In view of the provisions of section 132(4A)(*i*) it cannot be claimed [*see* para 493.8].

c. The presumption to be drawn is that the transactions belong to the company as per section 132(4A), [*see* para 493.8].

d. Proceeding for six assessment years immediately preceding the relevant assessment year (*i.e.*, assessment year relevant to the previous year in which search is conducted) shall be taken up as per section 153A, [*see* para 499]. For time-limit for completion of assessment under section 153A [*see* para 499.5].

e. No, *see* para 458.

Problem 5.30-2 *The Assessing Officer issued notices under section 133 to four banks requiring particulars relating to a customer in a specific format duly verified in a prescribed manner. One of the banks refused to part with the information on the ground that the letter did not specify about any proceeding pending against the said customer. Examine and state in the context of provisions in the Act as to correctness of the following actions of the Income Tax Authorities or of others.* [NOVEMBER 2007]

■

The letter need not specify that the proceedings are pending against the customer. The second proviso to section 133(6) says that information can be sought even when no proceeding is pending before the Assessing Officer. Only statutory safeguard is the approval of Director or Commissioner as the case may be. Hence, the refusal by one of the banks is not tenable—*see* also *Karnataka Bank Ltd* v. *Secretary, Government of India* [2002] 255 ITR 508 (SC).

Problem 5.30-3 - *An Assessing Officer entered a hotel run by a person, in respect of whom he exercises jurisdiction, at 8 p.m. for the purpose of collecting information, which may be useful for the purposes of the Act. The hotel is kept open for business every day between 9 a.m. and 9 p.m. The hotelier, claims that the Assessing Officer could not enter the hotel after sunset. The Assessing Officer wants to take away with him the books of account kept at the hotel. Examine the validity of the claim made by the hotelier and the proposed action of the Assessing Officer with reference to the provisions of section 133B.* [NOVEMBER 2006]

■

For provisions of section 133B, *see* para 498. In view of these provisions, the claim made by the hotelier is not maintainable. Moreover, the Assessing Officer cannot take away the books of account of the hotelier.

Problem 5.30-4 - *Discuss the following:*

1. *In the course of search operations under section 132, a taxpayer makes a declaration under section 132(4) on the earning of income not disclosed. Can the statement save the taxpayer from a levy of penalty under section 271(1)(c).*

2. *State whether the information regarding possession of unexplained assets and income received from the Central Bureau of Investigation, a Government agency, can constitute "information" for action under section 132. Discuss.* [NOVEMBER 2005]

■

Pointwise answer:

1. For provisions of section 132(4), *see* para 493.7. For provisions of *Explanation 5* to section 271(1)(*c*), *see* para 374.1-5.

2. It is not "information" in *Ajit Jain* v. *Union of India* [2001] 117 Taxman 295 (Delhi), it was held that undisclosed money found by CBI without something more, would not constitute information under section 132(1) and the search based on such informed would be invalid. *See* also para 493.1.

Problem 5.30-5 - *A search was initiated in the premises of an assessee on November 11, 2008 and it was concluded on November 14, 2008. What is the period of limitation for issue of notice for making assessment of preceding six assessment years? In case assessment under section 143(3) for assessment year 2006-07 and appeal before CIT(A) for assessment year 2004-05 are pending on November 11, 2008, what would be the fate of such pending assessment and appeal?* [NOVEMBER 2004]

■

As per section 153B, the time-limit for completion of assessment in respect of each assessment year falling within six assessment years under section 153A, is within a period of 21 months from the end of the financial year in which the search was executed. Consequently, the period of limitation for issue of notice for making assessment of preceding six assessment years is, at any time before the aforesaid time-limit for completion of assessment ends.

Further as per section 153A, in case any assessment or reassessment relating to any assessment year falling within the period of six assessment years is pending on the date of search, such pending assessment or reassessment shall abate. However, this rule is not applicable in case of pending appeal. For details, *see* para 500.

Problem 5.30-6 - *In the course of search on March 25, 2009, assets were seized. State the procedure laid down to deal with such assets seized under the Act.* [NOVEMBER 2003]

■

1. The assets seized under section 132 shall be dealt in the following manner —

a. any existing liability under Income-tax Act, Wealth-tax Act, Expenditure-tax Act, Gift-tax Act, Interest tax Act may be recovered out of such assets;

b. liability determined on completion of block assessment under section 153A and liability in respect of previous year in which the search is initiated (including any penalty and/or interest payable in connection with such assessment) may be recovered out of such assets.

2. If assets seized consists partly of money and partly other assets, or where assets seized consist solely of money, Assessing Officer may first apply such money in discharge of liabilities referred in point 1 above. Liability remaining undischarged after application of money shall be discharged by applying other assets. For this purpose, other assets shall be deemed to be under distraint as if such distraint was affected by the Assessing Officer, or Tax Recovery Officer under authorisation from CCIT/CIT as per provisions of section 226(5). Thereafter recovery from other assets shall be made by affecting sale of such assets in a manner laid down in the third schedule.

3. However, if the concerned person makes an application to the Assessing Officer, within 30 days from the end of the month in which assets are seized, for release of asset, the amount of existing liability referred to in point *1* above may be recovered out of such assets and remaining portion, if any, may be released with the prior approval of CCIT/CIT to the person from whose custody assets were seized if the person concerned explains the nature and source of acquisition of such assets to the Assessing Officer.

4. The Assessing Officer is duty bound to release the assets seized (if any asset is left after applying them for discharging existing liability referred to in point 1 above) within 120 days from the date on which the last authorisations for search under section 132 (or for requisition under section 132A) was executed.

Problem 5.30-7 *The director of income-tax received information that X has unaccounted cash exceeding Rs. 50 lakh. Can the director pass orders for seizure of the cash invoking his powers under section 131(1A)? Does the director have any other course open to him for the seizure of cash ?* [NOVEMBER 2003]

■

See para 492.2.

Problem 5.30-8 - *During the course of survey operations under section 133A, carried on March 5, 2008, the income-tax authority, impounded the books of account and other documents inspected by him, relating to the assessee and retained in his custody. Is the action of the officer justified under law ?* [MAY 2003]

■

Section 133A empowers the income-tax authority to impound and retain in his custody books of account or other documents inspected by him during survey, after recording his reasons for doing so. Such books of account or other documents shall not be retained for more than 10 days (exclusive of holidays) without obtaining the approval of the Chief Commissioner or Director-General or Commissioner or Director therefor.

Problem 5.30-9 - *On September 1, 2008, X & Sons have been searched. During the search, papers belonging to his close friend Y indicating concealed income have been found. How the Assessing Officer should proceed in such a situation under the Act ?* [May 2003]

■

See para 499.6.

Problem 5.30-10 - *A bank draft was presented for clearing to a bank. On receipt of this information the Commissioner issued a warrant of authorisation under section 132A in favour of the Asstt. Commissioner requiring the bank to deliver the draft to the said officer on the ground that the draft represented an asset which has not been disclosed by the depositor under the Income-tax Act. Is the authorisation valid ?* [NOVEMBER 2002]

■

A bank draft, when presented by the customer for clearing to the bank, cannot be requisitioned from the bank by the Competent Authority—*Samta Construction* v. *Pawan Kumar Sharma* [1999] 107 Taxman 198 (MP.).

Problem 5.30-11 - *The Assessing Officer within his jurisdiction surveyed the residential house of an assessee, who is engaged in money lending business therefrom on May 11, 2008 (Thursday) at 4.30 PM. Examine whether the action initiated/taken by the Income-tax Authorities are proper and valid under the provisions of the Act.* [NOVEMBER 2002 (New)]

■

It is justified [*see* para 497.1-3].

Problem 5.30-12 - *An Income-tax authority in the course of exercising powers of survey under section 133A serves a summon on the assessee and impounds the books of account and other documents found in the premises visited. Discuss the legality of its action.* [MAY 2002]

■

As per section 133A, with effect from June 1, 2002, an income-tax authority may impound and retain in his custody for such period as he thinks fit any books of account or other documents inspected by him. However, books of account or other documents shall not be impounded before recording reasons in writing and where such books or other documents are retained for a period exceeding 10 days (excluding holidays), then the income-tax authority will have to obtain the approval of Chief Commissioner or Director General or Commissioner or Director therefor, as the case may be.

In the present problem, in view of the aforesaid provisions, the action of the income-tax authority shall not be legal if it is taken at any time before June 1, 2002.

Problem 5.30-13 - *Discuss the following :*

1. *State the conditions to be satisfied before a warrant of authorisation under section 132 is issued for search of a premises.*

2. *When does a deemed seizure arise?*

3. *Is the assessee entitled to a copy of the reasons recorded for issuing a search warrant?*

4. *Can the seized account books and other documents be retained beyond 30 days? If so, under what conditions?* [NOVEMBER 1999]

■

Pointwise answer :

1. See para 493.1.

2. See para 493.3-1.

3. There is no provision of law which requires reasons to be communicated to the assessee—*Kalpaka Bazar* v. *CIT* [1990] 186 ITR 617 (Ker.), *Mamchand & Co.* v. *CIT* [1970] 76 ITR 217 (Cal.). Further, in *Southern Herbals Ltd.* v. *Director of Income-tax (Investigation)* [1994] 207 ITR 55 (Kar.), it was held that disclosure of the materials or the information to the persons against whom the action under section 132(1) is taken is not mandatory, because the very disclosure would affect or hamper the investigation.

In *Dr. Partap Singh* v. *Director of Enforcement* [1985] 155 ITR 166 (SC), it was *held* that only the High Courts and the Supreme Court have jurisdiction to look into the reasons recorded and decide whether the issue of the search warrant issued was called for.

In the present problem, in view of the aforesaid cases, the assessee is not entitled to a copy of the reasons recorded for issuing a search warrant.

4. See para 493.9.

5.31 Special provisions in case of non-residents

Problem 5.31-1 *"NEPTUNE" is a shipliner used in carrying passengers and cargo owned by M/s X & X of U.K. The ship carried the passengers and cargo in June 2008 from Singapore to Mumbai and vice versa and collected charges thereof amounting to Rs. 200 lakh. It left Mumbai port on June 15, 2008 for its journey to Korea. No other journey to India was undertaken by any of the vessels of the company during the year ended on March 31, 2009. The non-resident company had authorised its Indian agent to comply with the income tax provisions.*

You are consulted by the Company to explain about the procedure as to return of income to be filed and the period within which the assessment thereof will be completed by the Assessing Officer. [NOVEMBER 2007]

■

See para 2.2-1 for provisions of section 172. Rs. 15 lakh (*i.e.*, 7.5% of Rs. 200 lakh) shall be deemed as income of X & X of U.K. The return of income may be submitted by July 14, 2008 (*i.e.*, 30 days of departure of ship). 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.

Problem 5.31-2- *Discuss the following:*

1. *The Income-tax Act, 1961 provides for taxation of a certain income earned by X. The Double Taxation Avoidance Agreement, which applies to X excludes the income earned by X from the purview of tax. Is X liable to pay tax on the income earned by him? Discuss.*

2. *What is the circumstance in which it is not necessary for a non-resident Indian, whose total income is above the taxable limit to file his return of income under section 139(1)?* [MAY 2006]

■

Pointwise answer:

1. For provisions of section 90, *see* para 530.1-1. In the present problem, as provisions of the DTAA prevail area the provisions of the Act, X is not liable to pay tax on the income earned by him.

2. For provisions of section 115G, see para 162.13.

Problem 5.31-3 - *A foreign company, ST, has entered into an agreement with an Indian Company KN for supply of know-how and the agreement is within the industrial policy conditions laid down by the Central Government. In the year 2008-09, Rs. 50 lakh is paid, under the agreement, to ST by KN.*

ST claims to have spent Rs. 14 lakh as expenses in India to be recognised as a deduction.

In the following situations, what will be your decision on the tax liability of the parties:

i. *The agreement having been entered into before June 1, 2001 and approved by the Government, KN pays to the Indian Income-tax Authorities the tax payable by ST;*

ii. *There is no agreement as to KN bearing the tax liability. The royalty payable is decided to be Rs. 59 lakh net of taxes.* [NOVEMBER 2005]

■

For provisions of section 10(*6a*), *see* para 38.12.

Case I: The agreement has been entered before June 1, 2002 and is approved by the Government. Also KN undertakes to pay tax of ST.

Taxable income of ST	Rs. 50,00,000
Tax payable @ 20.6% of Rs. 50,00,000 by KN	Rs. 10,30,000
Tax payable by ST	*Nil*

Case II: No agreement as to the tax of ST being paid by KN.

Taxable income (net of taxes)	Rs. 59,00,000
Gross taxable income (Rs. 59,00,000 $\times \frac{100}{79.4}$)	74,30,730
Tax payable @ 20.6% of Rs. 74,30,730 by ST	15,30,730

Problem 5.31-4 *X, a resident both in India and Malaysia in previous year 2008-09, owns immovable properties (including residential house) at Malaysia and India. He has earned income of Rs. 50 lakh from rubber estates in Malaysia during the financial year 2008-09. He also sold some property in Malaysia resulting in short-term capital gain of Rs. 10 lakh during the year. X has no permanent establishment of business in India. However, he has derived income of Rs. 10 lakh from property let out in India and he has a house in Lucknow where he stays during his visit to India. The Article 4 of the Double Taxation Avoidance Agreement between India and Malaysia provides that where as individual is a resident of both the Contracting States, then he shall be deemed to be resident of the Contracting State in which he has permanent*

home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests).

You are required to state with reasons whether the business income of X arising in Malaysia and the capital gains in respect of sale of the property situated in Malaysia be taxed in India. [MAY 2005]

■

The facts of the problem are taken from ***CIT*** v. ***PVAL Kulandagan Chettiar*** [2004] 267 ITR 654 (SC). For provisions of section 90, *see* para 530.1. X has permanent home in both India and Malaysia. However, he does not have any permanent establishment of business in India. But he has rubber estates in Malaysia. In view of DTAA provisions given in the question, X's personal and economic relations with Malaysia are closer. Hence X shall be deemed to be resident of Malaysia even though he may satisfy conditions of section 6 of the Income-tax Act, 1961 in India. It may be noted that DTAA provisions are more beneficial to X and these provisions override the provisions of Indian law. Thus, X is not liable to pay income-tax in India on business income and capital gains arising in Malaysia for the assessment year 2009-10.

Problem 5.31-5 - *A non-resident Indian (28 years) has the following sources of income in India. Compute his total income and determine his tax liability.*

	Rs.
Dividend from an Indian company	*50,000*
Interest on debentures of an Indian company invested out of remittances in convertible foreign exchange	*75,000*
Interest paid on money borrowed in India for investment in the debentures	*(-) 25,000*
Long-term capital gains on sale of shares on May 5, 2008 subscribed in convertible foreign exchange: (securities transaction tax is paid) :	
Cost in 2005-06	*(-) 2,00,000*
Sale in 2008-09	*3,00,000*
Brokerage	*(-) 10,000*
Property income in India (net)	*2,00,000*
TDS	*30,000*

The property was acquired partly out of a loan from HDFC. The repayment of loan made during the year amounted to Rs. 20,000. The assessee also claim deductions of Rs. 10,000 by way of donation to the Prime Minister's Relief Fund and of Rs. 50,000 towards repayment of loan taken for higher education in India in 1999 before his migration. [MAY 2004]

■

Computation of income of X	*Rs.*
Income from house property [*see* Note 1]	1,40,000
Capital gains [*see* Note 2]	*Nil*
Income from other sources [Rs. 75,000 -- Rs. 25,000]	50,000
Gross total income	1,90,000
Less: Deductions	
Under section 80C	20,000
Under section 80E [not available with respect to principal repayment]	—
Under section 80G	10,000
Net income	1,60,000
Tax	1,030

Notes :

1. It is given in the problem that property income (net) is Rs. 2,00,000. One fails to understand whether it is rent received *minus* TDS or whether it is rent received *minus* expenses. As the information is not clear, it is assumed that rental income is Rs. 2,00,000 (before TDS) and there is no municipal tax and interest liability.

	Rs.
Gross annual value	2,00,000
Less: Municipal tax	*Nil*
Net annual value	2,00,000
Less: Standard deduction	60,000
Income from property	1,40,000

2. X is a non-resident and shares were acquired out of foreign exchange remitted from abroad. Foreign exchange rate is not given. It is assumed that the foreign exchange rate on the date of acquisition is Rs. 43 per US Dollor (buying rate : Rs. 42, selling rate : Rs. 44) and on the date of transfer is Rs. 46 (buying rate: Rs. 45 and selling rate : Rs. 47).

	US Dollor	*INR*
Sale consideration [Rs. 3,00,000÷ Rs. 46]	6,521.74	3,00,000
Less:		
Cost of acquisition [Rs. 2,00,000÷ Rs. 43]	4,651.16	2,00,000
Expenses on transfer [Rs. 10,000÷ Rs. 46]	217.39	10,000
Long-term capital gain [US $ 1,653.16×45]	1,653.19	74,393

However, long-term capital gain is exempt from tax as securities transaction tax is applicable.

Problem 5.31-6 - *X Ltd., a non-resident foreign company, had entered into a collaboration agreement on February 21, 2008 with an Indian company and is in receipt of the following payments during the previous year ending March 31, 2009. How do you deal with them for computation, in the case of X Australia Ltd. ?*

1. *Interest on 8 per cent debentures for Rs. 50 lakh issued by an Indian company on July 1, 2008 in consideration of providing of technical know-how, manufacturing process and designs (date of payment of interest: March 31 every year).*

2. *Service charges @ 2.5 per cent of the value of plant and machinery for Rs. 500 lakh leased out to Indian company payable each year before March 31.* [NOVEMBER 2003]

■

If conditions of section 115A are satisfied, *i.e.*, agreement between the Indian company and X Ltd. (non-resident foreign company) relates to a matter included in the industrial policy of the Government of India or the agreement is approved by the Central Government, then income by way of fees for technical services is taxable @ 20% (*plus* surcharge *plus* education cess *plus* secondary and higher education cess). Consequently the tax liability of X Ltd. will be determined as follows :

	Rs.
Business income	
Debentures of Rs. 50 lakh in consideration of providing of technical know-how	50,00,000
Service charges @ 2.5 per cent of Rs. 500 lakh	12,50,000
Business income	62,50,000
Interest on debentures	3,00,000
Taxable income	65,50,000
Tax @ 20% on fees for technical services by virtue of section 115A (*i.e.*, Rs. 62,50,000 @ 20%)	12,50,000
Tax @ 40% on other income	1,20,000
Total	13,70,000
Add : Surcharge @ 2.5% in case net income exceeds Rs. 1 crore	*Nil*
Tax and surcharge	13,70,000
Add: Education cess (@ 2% of tax and surcharge)	27,400
Add : Secondary and higher education cess (1% of income-tax and surcharge)	13,700
Tax liability	14,11,100

Alternatively, if the agreement between Indian concern and X Ltd. (non-resident foreign company) does not relate to matters included in the industrial policy of the Government of India and the agreement is not approved by the Central Government, then provisions of section 115A is not applicable and by virtue of section 44D, no deduction of any expenditure shall be allowed while computing income by way of fees for technical services.

The entire income of X Ltd. will be taxed @ 40% (+ EC + SHEC)

In such a case, tax liability will be Rs. 26,98,600 (*i.e.*, Rs. 65,50,000 × 41.2%*).

Problem 5.31-7 - *When a transaction shall be considered as international transaction ? In what circumstances a transaction entered into with a person other than an associated enterprise shall be deemed to be a transaction between two associated enterprises ?* [MAY 2003]

■

See paras 507.1-3 and 507.1-3a.

Problem 5.31-8 - *Write short note on international transaction under section 92B.* [NOVEMBER 2002]

■

*Tax @ 40 per cent *plus* education cess @ 2 per cent of tax and surcharge *plus* secondary and higher education cess @ 1 per cent of tax and surcharge for the assessment year 2009-10.

See para 507.1-3.

Problem 5.31-9 - *A foreign company has entered into an agreement with an Indian company on June 1, 2002 under which industrial equipment belonging to the foreign company has been leased to the latter on an annual lump sum payment of $ 50,000. How will the lease rent be taxed in the hands of the foreign company in respect of assessment year 2009-10 ?* [MAY 2002]

■

As per section 9(1)(*vi*), royalty means consideration for the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB.

As per section 44D, notwithstanding anything to the contrary contained in sections 28 to 44C in the case of an assessee, being a foreign company, no deduction in respect of any expenditure or allowance shall be allowed under any of the said sections in computing the income by way of royalty received from an Indian company in pursuance of an agreement made after March 31, 1976.

In the present problem, in view of the aforesaid provisions, $ 50,000 shall be chargeable to tax as royalty in the hands of the foreign company for the assessment year 2009-10.

Problem 5.31-10 - *X, a tennis professional and a non-Indian citizen, participated in India in a tennis tournament and won the prize money of Rs. 1,50,000. He contributed articles on the tournament in a local newspaper for which he was paid Rs. 10,000. He was also paid Rs. 50,000 by a soft drink company for appearance in a television advertisement. Although his expenses in India were met by the sponsors, he had to incur Rs. 30,000 towards his travel costs to India. He was a non-resident for tax purposes in India. What would be his tax liability in India for assessment year 2009-10? Is he required to file his return of income under section 139(1) ?* [NOVEMBER 2001]

■

X will be governed by the provisions of section 115BBA.

Computation of tax liability of X	*Rs.*
Tax on income of Rs. 2,10,000 under section 115BBA (*i.e.*, Rs. 1,50,000 + 10,000 + 50,000 @ 10%)	21,000
Add : Surcharge (not applicable in case net income does not exceed Rs. 10 lakh for the assessment year 2009-10)	*Nil*
Tax and surcharge	21,000
Add : Education cess (@ 2% of tax and surcharge)	420
Add : Secondary and higher education cess (1% of income-tax and surcharge)	210
Tax liability	21,630

It is not necessary for X to furnish his return of income under section 139(1) by virtue of section 115BBA(2).

Problem 5.31-11 - *A foreign company has the following two options before it for negotiation with an Indian company. It seeks your advice as to the incidence to tax to exercise the better option :*

1. *Receiving royalty for the user of rights of manufacturing process.*

2. *Outright sale of manufacturing process.* [MAY 2000]

■

The answer is as under :

1. As per section 115A, royalty received by a foreign company under an agreement (approved by Central Government) made after March 31, 1976 with an Indian company, shall be chargeable to tax at the rate of 20 per cent for the assessment year 2009-10. In case the agreement is not approved by the Central Government or is not as per the industrial policy of the Government of India, royalty received by a foreign company shall be chargeable to tax at the rate of 40 per cent (*plus surcharge* plus* education cess* *plus* secondary and higher education cess*) for the assessment year 2009-10.

In any of the above cases, deduction under sections 28 to 44D and 57 is not available. However, the foreign company can claim deduction under sections 80C to 80U. It may be noted that the tax rate applicable to royalty income under the Indian ADT Agreement shall have to be referred in case such an agreement exists.

2. Outright sale of manufacturing process shall result in long-term/short-term capital gain/loss in the hands of the foreign company. The long-term capital gain in case of a foreign company is chargeable to tax at the rate of 20 per cent* for the assessment year 2009-10. The short-term capital gain in case of a foreign company is chargeable to tax at the rate of 40 per cent* for the assessment year 2009-10.

Problem 5.31-12 - *A, a resident Indian (28 years), has derived the following income for the previous year relevant to the assessment year 2009-10 :*

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*Surcharge is 2.5% of tax in case of a foreign company in case net income exceeds Rs. 1 crore, education cess is 2% of tax and surcharge and secondary and higher education cess is 1% of tax and surcharge.

	Rs.
Income from profession	*94,000*
Share income from a partnership firm in country X (tax paid in country X for this income in equivalent Indian rupees : Rs. 8,000)	*40,000*
Commission income from concern in country Y (tax paid in country Y at 20%) converted in Indian rupees	*30,000*
Interest from scheduled banks	*18,000*

He wishes to know whether he is eligible to any double taxation relief and if so, its quantum. India does not have any double taxation avoidance agreement with countries X and Y. [NOVEMBER 1999]

■

	Rs.
Indian income	1,12,000
Foreign income	70,000
Gross total income	1,82,000
Less : Deduction under section 80L	—
Net income	1,82,000
Tax on net income	3,200
Add : Surcharge (not applicable in case net income does not exceed Rs. 10 lakh for the assessment year 2009-10)	*Nil*
Tax and surcharge	3,200
Add : Education cess (@ 2% of tax and surcharge)	64
Add : Secondary and higher education cess (1% of income-tax and surcharge)	32
Tax liability in India	3,296
Rate of tax in India [*i.e.*, Rs. 3,296 ÷ Rs. 1,82,000]	1.81%
Rate of tax in foreign country X and Y [*i.e.*, Rs. 8,000 ÷ Rs. 40,000]	20%
Doubly taxed income	70,000
Rebate under section 91 on Rs. 70,000 @ 1.81%	1,268
Tax payable in India [Rs. 3,296—Rs. 1,268]	2,030

Problem 5.31-13 - *Discuss the following :*

1. *X Ltd., an Indian company, entered into an agreement with Y Ltd., a company registered in the United Kingdom for rendering technical services in India for exploration and extraction of ores. The consideration fixed was £ 5,00,000 and was arrived at as follows :*

Drawings, designs, prepared in U. K.	*£ 1,00,000*
Engineering services rendered in India	*£ 2,00,000*
Salary and allowances paid to staff deputed for work in India	*£ 2,00,000*

Discuss the taxability of above payments in the hands of Y Ltd. (the company registered in U. K.) in view of section 115A.

2. *The total income of a non-resident Indian 66 years includes :*

	Rs.
Investment income (net) received on December 31, 2008	*49,625*
Long-term capital gains	*25,000*
Other income	*75,000*
Total income	*1,49,750*

What will be the tax payable by him in respect of assessment year 2009-10 on the above income under Chapter XIIA of the Income-tax Act ? In what manner can the tax liability be reduced in this case. [MAY 1999]

■

Pointwise answer :

1. As per section 9(1)(*vii*), income by way of fees for technical services payable by a resident to a non-resident for services which are utilised in a business carried on in India shall be deemed to accrue or arise in India. The fact that some of the services are rendered outside India is irrelevant. The salary and allowances paid to staff of the non-resident do not fall under the head "Salaries" as there is no employer-employee relationship between the Indian company and the staff deputed to work in India.

---

*Surcharge is 10% of tax in case net income exceeds Rs. 10 lakh, education cess is 2% of tax and surcharge and secondary and higher education cess is 1% of tax and surcharge for the assessment year 2009-10.

According to section 115A, royalties and technical services fees received under agreement made on or after April 1, 1976, are chargeable to tax @ 30% (or 20% if received under an agreement made after May 31, 1997) in certain specified cases.

According to section 44D, while calculating the aforesaid income no deduction under sections 28 to 44C shall be allowed to foreign companies having income by way of royalties or fees for technical services received from Indian concern.

Withholding tax rates under Indo-UK ADT Agreement - Royalties and fees for technical services would be taxable in the country of source at the following rates :

a. 10 per cent in case of rental of equipment and services provided along with know-how and technical services ;

b. any other case—

i. during first five years of the agreement —

- 15 per cent if the payer is Government or specified organisation;
- 20 per cent in other cases ;

ii. subsequent years, 15% in all cases.

In the present problem, in view of the aforesaid provisions, the taxability of the consideration of £ 5,00,000 in the hands of Y Ltd. will be as under :

a. fees for technical services would be taxable @ 20% in India during the first five years of the agreement ;

b. in all subsequent years, it would be taxable @ 15%.

2. The provisions under sections 115C to 115-I are applicable only in respect of certain incomes derived by a non-resident Indian, *see* para 287.1-2.

In the present problem, in view of the aforesaid provisions, the tax payable by the non-resident Indian shall be as under :

Computation of tax

	Rs.
Investment income [*see* Note 1]	12,500
Long-term capital gains [10% of Rs. 25,000]	2,500
Other income [*see* Note 2]	—
Tax	15,000
Add : Education cess (@ 2% of tax and surcharge)	300
Add : Secondary and higher education cess (1% of income-tax and surcharge)	150
Tax liability	15,450

Notes :

1. Non-resident Indians are chargeable to tax on investment income (gross) at the rate of 20%. Tax is deductible @ 20% (*i.e.*, 20% income-tax + EC + SHEC). Gross income before tax deduction is Rs. 62,500 (*i.e.*, Rs. 49,625 ÷ 0.794). Tax on Rs. 62,500 @ 20.6% is Rs. 12,875.

2. The other income of the non-resident Indian is chargeable to tax according to normal tax rates.

3. The tax on long-term capital gains can be saved by fully investing the net consideration on sale of assets in any specified asset under section 115F or 54EC.

The aforesaid calculations are based upon the special provisions of sections 115C to 115-I. If the taxpayer opts under section 115-I (*i.e.*, not to be governed under these provisions), then tax liability shall be calculated as under —

	Rs.
Gross total income (*i.e.*, Rs. 62,500 + Rs. 25,000 + Rs. 75,000)	1,62,500
Less : Deduction under section 80L	*Nil*
Net income	1,62,500
Tax [20% of Rs. 25,000 + normal tax in respect of the balance]	7,750
Add : Surcharge (not applicable in case net income exceeds Rs. 10 lakh for the assessment year 2009-10)	-
Tax and surcharge	7,750
Add : Education cess (@ 2% of tax and surcharge)	156
Add : Secondary and higher education cess (1% of income-tax and surcharge)	78
Tax	7,980

5.32 Miscellaneous

Problem 5.32-1 - Discuss the following:

1. *X (India) Ltd. a non-resident company dealing in consumer products and having their employee base in India has furnished following information for the year ending on March 31, 2009:*

i. Expenditure on foreign travelling Rs. 1,80,000.

ii. Expenditure on display of its products Rs. 3,60,000.

iii. Expenditure on distribution on free samples Rs. 2,40,000.

iv. Expenditure on providing transport facility for movement of offshore employees from their residence in home countries (outside India) to place of work (rigs in India) and back Rs. 6,30,000.

v. The company granted to its 300 employees options to buy 200 sweat equity shares of the company over a period of two years at Rs. 100 per share on June 1, 2008. Out of which 250 employees exercised their option to buy 50 per cent shares by December 31, 2008 and balance 50 per cent shares after June 1, 2009. The fair market price of shares as on June 1, 2008 was Rs. 200 per share.

Calculate the fringe benefit tax liability of the company for assessment year 2009-10 along with due dates and amount of advance fringe benefit tax payable under section 115WJ. Reasons for treatment of each of the above items should form part of your answer. [NOVEMBER 2008]

■

Computation of fringe benefit tax

	Expenditure Rs.	Value as per section 115WC Rs.	Value of fringe benefits Rs.
Travelling (foreign)	1,80,000	5%	9,000
Expenditure on display of products (advertisement)	3,60,000	Exempt	*Nil*
Distribution of free samples	2,40,000	Exempt	*Nil*
Expenditure on providing transport facility	6,30,000	Exempt	*Nil*
Employees stock option			
Fair market value on the date of vesting Rs.200 per share (Rs. 200 × 200 shares × 250 employees × 50%)	50,00,000		
Less: Amount recovered	25,00,000	100%	25,00,000
			25,09,000
Taxable value of fringe benefits			7,94,663
Fringe benefit tax [@ 30% + surcharge@ 2.5% + EC & SHEC@ 3%]			
Advance fringe benefit tax payable (liability after rounded off given below)—			
On or before June 15, 2008 @ 15%			1,19,200
After June 15, 2008 but on or before September 15, 2008 @ 30%			2,38,400
After September 15, 2008 but on or before December 15, 2008 @ 30%			2,38,400
After December 15, 2008 but on or before March 15, 2009 @ 25%			1,98,670

Note: In ***R & B Falcon (A) (P.) Ltd.*** v. ***CIT*** [2008] 169 Taxman 515, the Supreme Court observed that the transport facility between office and residence is not subject to fringe benefit tax even if the concerned employee is not based in India and the transport facility is provided from residence of an employee in his home country (outside India) to the place of work in India.

Problem 5.32-2 - *State the circumstances under which a certificate can be issued by the Assessing Officer to the Tax Recovery Officer?* [NOVEMBER 2008]

■

Notice of demand issued under section 156 specifying the tax due must be paid by the assessee within 30 days of the service of notice. If the amount is not paid within the specified period it could be recovered in accordance with the provisions of sections 222 to 227, 229 and 232. Where the assessee has not paid the tax due within 30 days nor preferred appeal before Commissioner (Appeals) or Tribunal, the Assessing Officer in the absence of any request for extension of time for payment of tax may issue a certificate to Tax Recovery Officer for initiating tax recovery proceedings.

Problem 5.32-3 - *Tax Recovery Officer, can recover the arrears of demand from the assessee in default by sale of the attached property after making a proclamation. How can such proclamation be made by the Tax Recovery Officer?*[MAY 2008]

■

Mode of making proclamation is given by rule 54 of Schedule II to the Act.

According to it, every proclamation for the sale of immovable property shall be made at some place on or near such property by beat of drum or other customary mode, and a copy of the proclamation shall be affixed on a conspicuous part of the property and also upon a conspicuous part of the office of the Tax Recovery Officer. Such proclamation shall also be published (if the Tax Recovery Officer so directs) in the Official Gazette or in a local newspaper, or in both; and the cost of such publication shall be deemed to be costs of the sale.

Where the property is divided into lots for the purpose of being sold separately, it shall not be necessary to make a separate proclamation for each lot, unless proper notice of the sale cannot, in the opinion of the Tax Recovery Officer, otherwise be given.

Problem 5.32-4 - *Examine whether the following items of expenditure incurred/payments made by a company in the course of its business during the year ending March 31, 2009 are liable to fringe benefit tax for the assessment year 2008-09:*

1. Reimbursement to employees of expenditure on food and beverages consumed by them in the office.

2. Sales commission paid to agents.

3. Advance towards travelling expenses to be incurred during April 2009.

4. Distribution of free samples of medicines to hospitals.

5. Get-together of employees on Diwali and on Republic Day.

6. Contribution to approved superannuation fund in respect of two employees A and B amounting to Rs. 90,000 and Rs. 20,000 respectively. [MAY 2007]

■

The answer is as under:

1. Chargeable to fringe benefit tax, *see* para 535.4-4.

2. Not covered under fringe benefit tax, *see* para 535.4-6.

3. As fringe benefit tax is payable in the previous year in which the expenditure is incurred, it will not be payable on the advance paid towards travelling expenses to be incurred during April 2009.

4. Not chargeable to fringe benefit tax, *see* para 535.4-6 (Note 2).

5. Get together of employees on Diwali is liable to fringe benefit tax. However, expenditure on get together of employees on Republic Day is not treated as festival expenditure and is, therefore, not covered by fringe benefit tax [*see* also para 535.4-14].

6. Not covered under fringe benefit tax as contribution amount does not exceed Rs. 1,00,000, *see* para 535.4.

Problem 5.32-5 - *Discuss the following:*

1. State whether the following persons are liable to pay fringe benefit tax in respect of the fringe benefits provided to their employees:

i. Hindu undivided family having 30 employees on its rolls in its textile business.

ii. Charitable trust running a hospital registered under section 12AA.

2. Examine the liability to fringe benefit tax in respect of the following items of expenditure incurred by a private limited company:

*i. Transport allowance paid to employees exempt under section 10(*14*) read with rule 2BB.*

ii. Expenditure on conference of dealers.

iii. Free medical samples distributed to doctors by its pharmaceutical manufacturing unit.

■

Pointwise answer:

1. For provisions of section 115W, regarding definition of employer, *see* para 535.1. Hindu undivided family and the charitable trust are not required to pay fringe benefit tax as they do not come within the preview of definition of employer given under section 115W.

2. The liability to fringe benefit tax is as under:

i. Transport allowance - It is governed by section 10(*14*) and is outside the preview of fringe benefit tax.

ii. Conference expenditure - It is subject to fringe benefit tax as per section 115WB(2)(C) [*see* para 535.4].

iii. Free medical samples to doctors - Expenditure on distribution of free samples to any person is not subject to fringe benefit tax [*see* para 535.4].