disturbance; or (*iii*) accidental fire explosion; or (*iv*) action by an enemy or action taken in combating an enemy (whether with or without a declaration of war).

If the aforesaid two conditions are satisfied, then section 45(1A) is attracted.

176.15-1a CONSEQUENCES WHERE SECTION 45(1A) IS APPLICABLE - Where a person receives at any time during the previous year any money or other assets under any insurance from an insurer and the above two conditions are satisfied, then the following three consequences, one should note —

1. Taxability of income - Any profits or gains arising from receipt of such money or other assets shall be chargeable to income-tax under the head "Capital gains".

2. Year - It shall be deemed to be the income of such person for the previous year in which such money or other asset is received.

3. Full value of consideration - 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.

176.15-2 *WHEN SECTION 45(1A) IS NOT APPLICABLE* - In case section 45(1A) is not applicable, the tax treatment is as follows—

- *When insurance compensation is a capital receipt* - If the two conditions mentioned in para 176.15-1 are not satisfied, then section 45(1A) is not applicable and, consequently, insurance compensation (if it is a capital receipt) will not be chargeable to tax as per ruling given by the Supreme Court in *Vania Silk Mills (P.) Ltd.* v. *CIT* [1991] 59 Taxman 3. Consider a case where a road accident takes place in which vehicles and machinery or furniture being carried are destroyed. A ship, being overweight, is sunk and assets are lost. The receipt of insurance compensation in such circumstances is not chargeable to tax under section 45(1A). The reasons for destruction being other than those mentioned in the *condition. two* (*supra*). The compensation received will have to be dealt with as per the Supreme Court's judgment in the case of *Vania Silk Mills (P.) Ltd.* v. *CIT* [1991] 191 ITR 647/59 Taxman 3.
- *When insurance compensation is a revenue receipt* - If the two conditions mentioned in para 176.15-1 are not satisfied and insurance compensation is a revenue receipt, then section 45(1A) is not applicable but the receipt may be taxable as trading receipt under section 28 or 56. For instance, insurance compensation for theft of stock-in-trade is not taxable under section 45(1A) but it will be taxable as business income under section 28.

176.15-P1 *X Ltd. is a manufacturing company. On April 1, 2008, it owns Plant A and Plant B (depreciation rate : 15 per cent; depreciated value of block being Rs. 2,40,000). Plant C (new) (depreciation rate 15 per cent) is purchased by the company on June 10, 2008 for Rs. 60,000. It is put to use on the same day. Find out the tax consequences in the following different situations—*

1. Plant B is destroyed by fire on January 25, 2009. Rs. 10,000, being the compensation is paid by the insurance company on February 10, 2009.

2. Suppose insurance compensation in situation (1) is Rs. 3,70,000.

3. Plants A, B and C are destroyed by fire on January 25, 2009. Compensation paid by insurance company on February 10, 2009 is Rs. 20,000.

4. Suppose in situation (3) insurance compensation is Rs. 4 lakh.

SOLUTION :

	Situation 1 Rs.	Situation 2 Rs.	Situation 3 Rs.	Situation 4 Rs.
Depreciation				
Depreciated value of block (consisting of Plants A and B) on April 1, 2008	2,40,000	2,40,000	2,40,000	2,40,000
Add : Cost of Plant C purchased during 2008-09	60,000	60,000	60,000	60,000
Less : Money payable in respect of assets destroyed during 2008-09 (subject to maximum of Rs. 3,00,000)	(-) 10,000	(-) 3,00,000	(-) 20,000	(-) 3,00,000
Written down value on March 31, 2009	2,90,000	*Nil*	2,80,000	*Nil*

	Situation 1 Rs.	Situation 2 Rs.	Situation 3 Rs.	Situation 4 Rs.
Depreciation for the previous year 2008-09 (*no depreciation as the block ceases to exist)	43,500	*Nil*	*Nil**	*Nil*
Additional depreciation (20% of Rs. 60,000)	12,000	12,000	12,000	12,000
Depreciated value of the block on April 1, 2009 (*block ceases to exist)	2,34,500	*Nil*	—*	—*
Capital gain [Sec. 45(1A) read with sec. 50]				
Sale consideration (being the amount of compensation)	10,000	3,70,000	20,000	4,00,000
Less : Cost of acquisition as per section 50 (*section 50 is not applicable as the block does not cease to exist or written down value of the block is not reduced to zero)	NA*	3,00,000	3,00,000	3,00,000
Short-term capital gain/loss for the assessment year 2009-10	—	70,000	(-) 2,80,000	1,00,000

176.15-P2 *Suppose in problem 176.15-P1, insurance compensation is paid by the insurance company on April 14, 2009.*

SOLUTION : As per section 45(1A), capital gain arising on account of receipt of insurance compensation is chargeable to tax in the year in which such compensation is received by the taxpayer. Consequently, the amount of capital gains computed in problem 176.15-P1 is chargeable to tax in the assessment year 2010-11 (other computation including depreciation for the assessment year 2009-10 will remain the same).

176.15-P3 *X Ltd. owns two plants—Plant A and Plant B (depreciation rate 15 per cent). The depreciated value of the block on April 1, 2008 is Rs. 14,30,000. Till June 30, 2008, Plant B is installed in a foreign branch of the company. When Plant B is in transit to India on a ship in Indian Ocean, the ship drowns on July 7, 2008 due to engine failure and Plant B is completely destroyed. A compensation of Rs. 26,80,000 is paid by the insurance company. Find out the tax consequence in the following situations—*

1. Out of insurance compensation, the company purchases Plant C (new) for Rs. 5,00,000 on October 10, 2008 and remaining amount of compensation is transferred to profit and loss account.

2. Out of insurance compensation, the company purchases Plant C (new) for Rs. 5,00,000 on April 1, 2009 and the remaining amount is transferred to capital reserve account.

SOLUTION :

	Situation 1 Rs.	Situation 2 Rs.
Depreciated value of the block (consisting of Plants A and B) on April 1, 2008 (a)	14,30,000	14,30,000
Add : Cost of Plant C acquired during 2008-09 (b)	5,00,000	—
Less : Money payable in respect of Plant B destroyed during 2008-09 [but subject to a maximum of (a) + (b)]	(-) 19,30,000	(-) 14,30,000
Written down value on March 31, 2009	*Nil*	*Nil*
Less : Depreciation for the previous year 2008-09	*Nil*	*Nil*
Less : Additional depreciation @ 10% of Rs. 5,00,000	50,000	*Nil*
Depreciated value of the block on April 1, 2009	*Nil*	*Nil*
Add : Cost of Plant C acquired during the previous year 2009-10	—	5,00,000
Written down value on March 31, 2010	*Nil*	5,00,000
Less : Depreciation for the previous year 2009-10	*Nil*	75,000
Less : Additional depreciation @ 20% of Rs. 5,00,000	*Nil*	1,00,000
Depreciated value on April 1, 2011	*Nil*	3,25,000
Capital gains		
Sale consideration being the compensation received	26,80,000	26,80,000
Less : Cost of acquisition as per section 50	19,30,000	14,30,000
Short-term capital gain	*Nil**	*Nil**

*Section 45(1A) is not applicable. Condition two mentioned in para 176.15-1 is not satisfied. Insurance compensation will not be chargeable to tax as per ruling given by the Supreme Court in *Vania Silk Mills (P.) Ltd.* v. *CIT* [1991] 59 Taxman 3.

176.15-P4 *X Ltd. owns two plants—Plant A and Plant B (depreciation rate 30 per cent). Depreciated value of the block on April 1, 2008 is Rs. 3,90,000. Find out the amount of depreciation and capital gains in the following situations—*

1. Plant B is destroyed by fire on May 31, 2008. Insurance company pays Rs. 50,000 as compensation. The company purchases Plant C (new) on September 2, 2008 for Rs. 50,000. It is put to use on the same day.

2. Suppose under situation 1, insurance compensation as well as cost of Plant C is Rs. 4,60,000.

3. Plant B is destroyed by fire on May 31, 2008. Insurance compensation is determined at Rs. 60,000. Instead of paying Rs. 60,000 as compensation the insurance company gives Plant C (new) whose market value is Rs. 60,000. It is put to use on October 16, 2008.

4. Suppose under situation 3 insurance compensation and fair market value of Plant C is Rs. 4,90,000.

SOLUTION :	Situation 1 Rs.	Situation 2 Rs.	Situation 3 Rs.	Situation 4 Rs.
Depreciated value of the block on April 1, 2008	3,90,000	3,90,000	3,90,000	3,90,000
Add : Cost of Plant C acquired during 2008-09 [*as per *Explanation 10* to sec. 43(*1*) amount reimbursed/met by any person shall not be included in actual cost]	50,000	4,60,000	—*	—*
Less : Money payable in respect of Plant B destroyed during 2008-09 [*as per ruling of the Supreme Court in *CIT* v. *Kasturi Sons Ltd.* [1999] 103 Taxman 342 the expression "money payable" includes only actual money received/receivable and not other things/benefits which can be converted in terms of money]	(-) 50,000	(-) 4,60,000	—*	—*
Written down value on March 31, 2009	3,90,000	3,90,000	3,90,000	3,90,000
Less : Depreciation for the previous year 2008-09	1,17,000	1,17,000	1,17,000	1,17,000
Less : Additional depreciation @ 20%	10,000	92,000	*Nil*	*Nil*
Depreciated value of the block on April 1, 2009	2,63,000	1,81,000	2,73,000	2,73,000
Capital gains				
Sale consideration of Plant B (being compensation received in cash or kind)	50,000	4,60,000	60,000	4,90,000
Less : Cost of acquisition as per section 50 [*section 50 is not applicable as sale consideration does not exceed opening balance of the block of assets *plus* new purchase made during the year)	—*	—*	—*	3,90,000
Short-term capital gain	—	—	—	1,00,000

176.15-P5 *On April 1, 2008, X Ltd. owns the following assets :*

Asset	Rate of depreciation	Actual cost Rs.	Depreciated value on April 1, 2008 Rs.
Plant A	*15%*	*8,00,000*	*5,15,600*
Plant B	*15%*	*4,10,000*	*2,05,400*
Plant C	*15%*	*6,00,000*	*3,10,000*
Plant D	*15%*	*2,18,000*	*1,85,300*

The aforesaid assets are covered by insurance against loss by fire. Plant A is partly damaged on June 2, 2008 by fire and X Ltd. receives Rs. 6,40,000 as compensation in respect of loss. It, however, spends Rs. 1,60,000 and restores the plant to working condition. The Assessing Officer wants to tax Rs. 4,80,000 (i.e., Rs. 6,40,000—Rs. 1,60,000) either as revenue receipt under section 28 or as capital receipt under section 45. Alternately, he wants to reduce the written down value of block of assets by Rs. 4,80,000 for determining depreciation for the previous year 2008-09. Does it make any difference if the amount of compensation is Rs. 16,40,000 ?

SOLUTION : Written down value of block of assets, as per definition given under section 43(6)(c), is depreciated value of all assets at the beginning of the previous year. However, the following adjustments would be made :

1. Cost of an asset acquired during the previous year (if the asset falls in that block) will be added [sec. 43(6)(c)(A)].

2. Moneys payable (together with scrap) in respect of that asset (falling within that block) which is sold, discarded, demolished or destroyed during the previous year will be deducted [sec. 43(6)(c)(B)].

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. Since, in this case, Plant A is only partly damaged by fire and after repairing the damage, the plant is 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).

Depreciation allowance for the assessment year 2009-10, in this case, will be determined as under :

	Rs.
Block of assets : Plant (rate of depreciation : 15 per cent)	
Depreciated value of Plants A, B, C and D on April 1, 2008 (Rs. 5,15,600 + Rs. 2,05,400 + Rs. 3,10,000 + Rs. 1,85,300)	12,16,300
Add : Cost of asset acquired during the previous year	*Nil*
Less : Money payable in respect of assets sold, discarded, demolished or destroyed during the previous year	*Nil*
Written down value for the previous year 2008-09	12,16,300
Less : Depreciation for the previous year 2008-09 (15% of Rs. 12,16,300)	1,82,445
Depreciated value of the block on April 1, 2009	10,33,855

Capital gains

	If compensation is Rs. 6,40,000 Rs.	*If compensation is Rs. 16,40,000* Rs.
Sale consideration (being the compensation received)	6,40,000	16,40,000
Less : Cost of acquisition as per section 50	Not applicable [Note 1]	12,16,300
Short-term capital gain	*Nil*	4,23,700

Notes—

1. Section 50 is applicable in two cases. If sale consideration exceeds, the opening balance *plus* cost of assets purchased during the year *plus* expenses on transfer, then the excess shall be taken as short-term capital gain [sec. 50(1)]. Further, it is applicable if the block of assets ceases to exist [sec. 50(2)]. In the given problem, if insurance compensation is Rs. 6,40,000, then section 50(1)/(2) is not applicable and, consequently, the capital gain is not chargeable.

2. The expenditure incurred to restore the plant to working condition is not taken into consideration while calculating written down value or capital gain. The answer given above will remain the same even if (*a*) no expenditure is incurred or (*b*) the expenditure incurred exceeds the insurance compensation.

176.16 ***Capital gain on purchase by a company of its own shares/securities [Sec. 46A]*** - Any consideration received by a shareholder (or a holder of other specified securities) from any company on purchase of its own shares (or other specified securities) held by such shareholder (or holder of other specified securities) shall be chargeable to tax on the difference between the cost of acquisition and the value of consideration received by the holder of shares (or securities), as capital gains. The computation of capital gains shall be made in accordance with the provisions of section 48.

"Specified securities" includes employees' stock option or other securities as may be notified by the Central Government.

176.16-P1 *On June 6, 1984, X purchases 1,000 shares in A Ltd. for Rs. 12,000. Under a scheme of buy-back of its own shares, A Ltd. purchases these shares on October 10, 2008 for a consideration of Rs. 4,60,000. On October*

10, 2008, A Ltd. has an accumulated profit of Rs. 50,00,000. Find out the income chargeable to tax for the assessment year 2009-10. Is there any dividend income under section 2(22) ?

SOLUTION : Nothing is taxable on account of dividend under section 2(22). The amount of capital gains chargeable to tax for the assessment year 2009-10 is as follows:

	Rs.
Sale consideration	4,60,000
Less: Indexed cost of acquisition (Rs. 12,000 × 582 ÷ 125)	55,872
Long-term capital gains	4,04,128

176.17 ***Computation of capital gain on transfer of stock option or sweat equity [Sec. 49(2AA)/(2AB)]*** - The provisions of section 49(2AA)/(2AB) and other related issues are given below—

Different situations	*Allotment of shares/securities by the employer-company to its employees without charging anything or at concessional rate*
Tax on perquisite in respect of allotment of shares/securities by the employer in the employer-company without charging anything or at concessional rate	It is not chargeable to tax. If the option is exercised by the concerned employee during 1999-2000, then the perquisite is chargeable to tax (the value of being fair market value *minus* acquisition cost paid by the employee).
Transfer of these shares/securities by the employees	Capital gains would be taxable in the year in which shares/securities are transferred. Cost of acquisition will be as follows— - if shares are allotted during 1999-2000, market value on the date of exercise of option - if shares are allotted before April 1, 2007 (not being during 1999-2000), the amount actually paid to acquire shares - if shares are allotted on or after April 1, 2007, fair market value on the date of vesting of option (purchase price paid to the employer or FBT paid to employer shall not be considered)
Transfer of these shares/securities by the employees by gift or under an irrevocable transfer	Capital gains would be taxable in the year in which these shares/securities are gifted (how to calculate sale consideration is not specifically given in the law, fair market value on the date of making gift may be taken as sale consideration). Cost of acquisition would be taken as given above.

Notes :

1. If equity shares are allotted by the employer and are transferred by the employees on or after October 1, 2004 in a stock exchange, long-term will not be chargeable to tax and short-term capital gain will be taxable @ 15 per cent (+SC + EC + SHEC). The concerned employee will have to pay securities transaction tax.

2. Loan is taken from an associate company of the employer to finance allotment to stock option shares. Later on the loan is waived by the associate company. The amount of loan so waived shall be reduced from cost of acquisition—***Ravi Kumar Sinha*** v. ***CIT*** [2007] 15 SOT 555 (Delhi).

176.18 ***Computation of capital gain on transfer of shares allotted in the scheme of demerger [Sec. 49(2C)/(2D)]*** - *See* para 517.3-2.

176.19 ***Capital gain in the case of slump sale [Sec. 50B]*** - *See* para 520.3.

176.20 ***Capital gain on transfer of equity share allotted at time of corporation of a recognised stock exchange [Sec. 55(2)(ab)]*** - The following special provisions are applicable if a stock exchange is converted into company and member of the old stock exchange are allotted (*a*) equity shares and (*b*) right to trade in the newly formed stock exchange as a corporate entity—

1. Cost of acquisition shall be determined as following—

Capital asset	*Cost of acquisition*
■ Allotment of equity share in newly formed stock exchange	Cost of acquisition of membership ticket in the old stock exchange
■ Right to trade in the new exchange	*Nil*

2. The period of holding of the aforesaid assets should be determined from the date of holding of membership ticket in the old exchange.

176.20-P1 *X is a member of DEL Stock Exchange. He purchased the membership ticket on March 2, 1956 for Rs. 5,000. The Stock Exchange is converted into a company on November 1, 2008. Consequently, on November 1, 2008, X is allotted 1,000 shares in DEL Stock Exchange Ltd. and a ticket to trade in DEL Stock Exchange Ltd. X transfers 1,000 shares in DEL Stock Exchange Ltd. on December 1, 2008 for Rs. 2,00,000 and the ticket to trade in DEL Stock Exchange Ltd. on April 10, 2009 for Rs. 45,000, find out the amount of capital gains chargeable to tax.*

SOLUTION :

	Shares	Right to trade in stock exchange
Period of holding	March 2, 1956 to December 1, 2008 Rs.	March 2, 1956 to April 10, 2009 Rs.
Sale consideration	2,00,000	45,000
Less: Indexed cost of acquisition (Rs. 5,000 × 582 ÷ 582)	5,000	*Nil*
Long-term capital gains	1,95,000	45,000

Notes -

1. The benefit of indexation is available only from the year in which the asset (*i.e.*, shares) was first held by the assessee.

2. If the above shares are transferred in a stock exchange in India, then long-term capital gain on transfer of shares will be exempt from tax (STT being 0.125% of Rs. 2,00,000).

176.21 ***Computation of capital gains in the case of land and building [Sec. 50C]*** - The provisions of section 50C are given below—

176.21-1 *CONDITIONS* - Section 50C is applicable if the following conditions are satisfied—

Condition 1	There is a transfer of land or building or both. The asset may be long-term capital asset or short-term capital asset. It may be depreciable or non-depreciable asset.
Condition 2	The sale consideration is less than value adopted (or assessed) by any authority of a State Government for the purpose of payment of stamp duty (hereinafter referred to as "Stamp duty Authority") in respect of such transfer.

Unless property transferred has been registered by a sale deed and for that purpose value has been assessed and stamp duty has been paid by parties, section 50C cannot come into operation. If a property is transferred under a power of attorney transaction and value has not been assessed for the purpose of stamp duty, section 50C has no application—***Navneet Kumar Thakkar*** v. ***ITO*** [2008] 110 ITD 525 (Jodh.).

176.21-2 *CONSEQUENCES IF THE ABOVE CONDITIONS ARE SATISFIED* - If the above conditions are satisfied, the value adopted by the stamp duty authority shall be taken as full value of consideration for the purpose of computation of capital gains. The table given below highlights the meaning of "full value of consideration" in different situations—

Different situations	*Full value of consideration for the purpose of capital gains*
Where the assessee accepts the value adopted by stamp duty authority.	Value adopted by stamp duty authority is taken as full value of consideration.
Where the assessee has disputed value adopted by stamp duty authority under the Stamp Act (*i.e.*, stamp duty proceedings).	The stamp duty valuation as finally accepted for stamp duty purpose is taken as full value of consideration.

Different situations	*Full value of consideration for the purpose of capital gains*
Where the assessee claims that value adopted by stamp duty authority is more than the fair market value (but he has not disputed such valuation in stamp duty proceedings).	■ Fair market value determined by the Department Valuation Officer * (if it is less than the stamp duty valuation) is taken as full value of consideration. ■ Stamp duty valuation (if the fair market value determined by the Department Valuation Officer* is more than the stamp duty valuation) is taken as full value of consideration.

*While valuing property the Department Valuation Officer cannot blindly base his valuation on circle rates—***Ravi Kant** v. ***ITO*** [2007] 110 TTJ (Delhi) 297.

176.21-P1 *X owns a piece of land situated in Noida (date of acquisition: March 1, 1983, cost of acquisition: Rs. 19,291, value adopted by Stamp duty authority at the time of purchase: Rs. 45,000). On March 30, 2009, the piece of land is transferred for Rs. 4 lakh.*

Find out the capital gains chargeable to tax in the following situations—

1. The value adopted by Stamp duty authority is Rs. 5.5 lakh. X does not dispute it.

2. The value adopted by the Stamp duty authority is Rs. 5.75 lakh. X files an appeal under the Stamp Act and Stamp duty valuation has been reduced to Rs. 4.90 lakh by the Allahabad High Court.

3. The value adopted by the Stamp duty authority is Rs. 5.60 lakh. X does not challenge it under the Stamp Act. However, he claims before the Assessing Officer that Rs. 5.60 lakh is more than the fair market value of the land. The Assessing Officer referred it to the Valuation Officer who determines Rs. 5.25 lakh as fair market value.

4. In situation (3), suppose the value adopted by the Valuation Officer is Rs. 6.10 lakh.

SOLUTION :

	Situations			
	(1) Rs.	(2) Rs.	(3) Rs.	(4) Rs.
Full value of consideration	5,50,000	4,90,000	5,25,000	5,60,000
Less: Indexed cost of acquisition [Rs. 19,291 × 582 ÷ 109]	1,03,003	1,03,003	1,03,003	1,03,003
Long-term capital gains	4,46,997	3,86,997	4,21,997	4,56,997

Note - Value adopted by the Stamp duty authority at the time of acquisition cannot be taken as cost of acquisition.

Reference to Valuation Officer [Sec. 55A]

177. With a view to ascertaining the fair market value of a capital asset, the concerned Assessing Officer may refer the valuation of the capital asset to a Valuation Officer appointed by the Income-tax Department in the following cases :

■ Where the value of the asset as claimed by the assessee is in accordance with the estimate made by a registered valuer (who works in a private capacity under a licence issued by the Board and his valuation is not binding on the Assessing Officer), but the Assessing Officer is of opinion that the value so claimed is less than its fair market value [sec. 55A(*a*)].

■ Where the Assessing Officer is of opinion that the fair market value of the asset exceeds the value of the asset by more than Rs. 25,000 or 15 per cent of the value claimed by the assessee, whichever is less [sec. 55A(*b*)(*i*), read with rule 111AA].

■ Where the Assessing Officer is of opinion that, having regard to nature of an asset and relevant circumstances, it is necessary to make a reference to the Valuation Officer [sec. 55A(*b*)(*ii*)].

It can be seen that in a case where the assessee has opted for substitution of the cost of acquisition of an asset by its fair market value as on April 1,1981, the fair market value as claimed by him may be higher than its actual fair market values. The provisions of section 55A(*a*) and (*b*)(*i*) are, therefore, not applicable to such a case. It is, however, open to the Assessing Officer to make a reference to the Valuation Officer under section 55A(*b*)(*ii*). The Central Government have appointed a large number of Valuation Officers under section 12A of the Wealth-tax Act and these Valuation Officers exercise their functions in relation to the categories of assets for which they have been appointed. The

jurisdiction of the Valuation Officers has been defined in rule 3A of the Wealth-tax Rules. The Valuation Officer exercises the same jurisdiction for income-tax purposes also.

In cases covered by section 55A(*a*) and (*b*)(*i*), it will be incumbent on the Assessing Officer to refer the valuation of the asset in question to the Valuation Officer and it will not be open to him to decide the question of the valuation on his own.

Capital gains exempt from tax

178. The Act grants total/partial exemption from capital gains tax in terms of sections 54, 54B, 54D, 54EC, 54F, 54G, 54GA and 54H. These provisions are explained in paras 179 to 185. In order to understand these provisions, it is advised that one should first refer to the table given below which summarises these provisions.

Different questions	*Section 54*	*Section 54B*	*Section 54D*	*Section 54EC*	*Section 54F*	*Section 54G*	*Section 54GA*
1. Who can claim exemption under these sections	Individual/ Hindu undivided family	Individual	Any person	Any person	Individual/ Hindu undivided family	Any person	Any person
2. Which capital asset — short-term or long-term is eligible for exemption	Long-term	Short-term/ long-term	Short-term/ long-term	Long-term	Long-term	Short-term/ long-term	Short-term/ long-term
3. Which specific asset is eligible for exemption	A residential house property	Agricultural land if it was used by the individual or his parents for agricultural purposes for at least 2 years immediately prior to transfer	Land or building forming part of an industrial undertaking which is compulsorily acquired by the Government and which is used for 2 years for industrial purposes prior to its acquisition	Any long-term capital asset	Any long-term capital asset (other than a residential house property) provided on the date of transfer the taxpayer does not own more than one residential house property[1] from the assessment year 2001-02 (except the new house as stated in *4 infra*).	Land, building, plant or machinery in order to shift an industrial undertaking from urban area to rural area	Land, building, plant or machinery in order to shift an industrial undertaking from urban area to any special economic zone
4. Which asset the taxpayer should acquire to get the benefit of exemption	Residential house property	Agricultural land (maybe in rural area or urban area)	Land or building for industrial purposes	Bonds of National Highways Authority of India or Rural Electrification Corpn.	A residential house property	Land, building, plant or machinery in order to shift an undertaking to rural area.	Land, building, plant or machinery in order to shift an undertaking to any special economic zone
4.1 What is time-limit for acquiring the new asset	*Purchase* : 1 year backward or 2 years forward *Construction*: 3 years forward	2 years forward	3 years forward	6 months forward	*Purchase* : 1 year backward or 2 years forward *Construction:* 3 years forward	1 year backward or 3 years forward	1 year backward or 3 years forward
4.2 From which date the time-limit shall be determined	From the date of transfer of house property but in case of compulsory acquisition from the date of receipt of compensation	From the date of transfer of agricultural land	From the date of receipt of compensation	From the date of transfer of long-term capital asset but in the case of compulsory acquisition from the date of receipt of compensation	From the date of transfer of capital asset but in case of compulsory acquisition from the date of receipt of compensation	From the date of transfer	From the date of transfer
5. How much is exempt	Investment in the new asset	Investment in the new	Investment in the new	Investment in the new	Investment in the new	Investment in the new	Investment in the new

1. Any residential house other than the new house (up to the assessment year 2000-01).

Different questions	*Section 54*	*Section 54B*	*Section 54D*	*Section 54EC*	*Section 54F*	*Section 54G*	*Section 54GA*
	or capital gain, whichever is lower	asset or capital gain, whichever is lower	asset or capital gain, whichever is lower	asset or capital gain, whichever is lower	asset/net sale consideration × capital gain	asset or capital gain, whichever is lower	asset or capital gain, whichever is lower
6. Is it possible to revoke the exemption in a subsequent year	If the new asset is transferred within 3 years of its acquisition	If the new asset is transferred within 3 years of its acquisition	If the new asset is transferred within 3 years of its acquisition	If the new asset is transferred or it is converted into money or a loan is taken on security of the new asset within 3 years of its acquisition	(*a*) If the new asset is transferred within 3 years of its acquisition, (*b*) if another residential house is purchased within 2 years of transfer of original asset, or (*c*) if another residential house is constructed within 3 years of the transfer of original asset	If the new asset is transferred within 3 years of its acquisition	If the new asset is transferred within 3 years of its acquisition
6.1 When the exemption is revoked it is taxable in the year in which the default is committed. What will be status of the notional income	Short-term capital gain	Short-term capital gain	Short-term capital gain	Long-term capital gain	Long-term capital gain	Short-term capital gain	Short-term capital gain
7. Whether scheme of deposit is applicable	*Yes*	*Yes*	*Yes*	*No*	*Yes*	*Yes*	*Yes*
7.1 What is the scheme of deposit	*See* Note *infra*	*See* Note *infra*	*See* Note *infra*	—	*See* Note *infra*	*See* Note *infra*	*See* Note *infra*

Note - Scheme of deposit - If the new asset is not acquired up to the due date of submission of return of income, then the taxpayer will have to deposit the money in "Capital gain deposit account scheme" with a nationalised bank. The proof of deposit should be submitted along with return of income. On the basis of actual investment and the amount deposited in the deposit account, exemption will be given to the taxpayer.

The taxpayer can acquire a new asset by withdrawing from the deposit account. But the new asset should be acquired within the time-limit mentioned in 4.1 *supra*. If the deposit account is not fully utilised for acquiring the new asset, the unutilised amount [but in case of section 54F it is unutilised amount/net sale consideration × capital gain] will become chargeable to tax in the previous year in which the specified time-limit [as mentioned in para 4.1 *supra*] expires [in case of sections 54 and 54F when the 3-year time limit expires]. It will be taxable as short-term/long-term capital gain depending upon the original capital gain. The unutilised amount can be withdrawn by the taxpayer after the expiry of the aforesaid time-limit.

Capital gains arising from transfer of residential house [Sec. 54]

179. Section 54 provides exemption to capital gains arising from the transfer of a residential house property (being building or lands appurtenant thereto, the income of which is chargeable under the head "Income from house property").

179.1 ***Conditions*** - The exemption can be availed if the following conditions are satisfied—

179.1-1 *WHO CAN CLAIM EXEMPTION* - Under section 54, only an individual or a Hindu undivided family can claim exemption. In other words, no other person is eligible for claiming exemption under section 54.

179.1-2 *WHICH ASSET IS QUALIFIED FOR EXEMPTION* - Under section 54, exemption is available only if the capital asset which is transferred is a residential house property (*i.e.*, building or land appurtenant thereto)† whose income is taxable under the head "Income from house property". The

†The 'land appurtenant to the building' does imply that the ownership of the building and the land appurtenant should be of the same person. If the building is owned by one person and the land is owned by another person, then it will be a case of land adjoining the building and by no stretch of imagination can it be called land appurtenant to the said building—***P.K. Lahiri*** v. ***CIT*** [2005] 275 ITR 17/146 Taxman 349 (All.).

appurtenant is available whether the residential house property is self-occupied (in such a case income of house property is *nil* or negative) or let out.

179.1-3 *IT SHOULD BE LONG-TERM CAPITAL ASSET* - The house property which is transferred should be a long-term capital asset.

179.1-4 *WHICH NEW ASSET SHOULD BE PURCHASED OR ACQUIRED* - To claim the exemption the taxpayer will have to purchase a residential house property (old or new) or construct a residential house property (hereinafter referred to as "new residential property"). The new residential house property should be purchased or constructed within the time-limit given below—

	Time-limit
For purchasing a new residential property	It should be purchased within one year before, or within 2 years after, the date of transfer of the residential house property
For constructing a new residential property	The construction should be completed within 3 years from the date of transfer of residential house property.

The following points should be noted:

- *Construction may commence before transfer* - Construction of the house should be completed within 3 years from the date of transfer. Date of commencement of construction is irrelevant. Construction may be commenced even before the transfer of house.
- *Construction by a third party* - For claiming exemption under section 54(1), construction of house need not be made by the assessee himself, as it can be constructed by a third party for the assessee—***CIT*** v. ***Uma Budhia*** [2004] 141 Taxman 39 (Kol.)(Mag.)
- *Construction by co-operative societies* - Case of allotment of flat under the self-financing scheme of DDA (or similar scheme of co-operative societies or other institutions) is treated as construction of house for this purpose—Circular No. 471, dated October 15, 1986 and Circular No. 672, dated December 16, 1993.
- *Legal title is not necessary* - Holding of legal title is not necessary. If the taxpayer pays full consideration or substantial portion of it (in terms of the purchase agreement) within the period given above, the exemption under section 54 is available. This rule is applicable even if possession is handed over after the stipulated period or the sale deed is registered later on.
- *Not limited to one house only* - Exemption is not limited to acquisition of one house property. For instance, a taxpayer may purchase two houses, or he can purchase a house and construct first floor of the house so purchased or a person can construct two or more houses, etc. Similarly a taxpayer may sell two house properties and may purchase one house property for the purpose of availing exemption.
- *Time-limit in case of compulsory acquisition* - In the case of capital gain arising on the compulsory acquisition of a residential house by the Government, the aforesaid time-limit of 1 year, 2 year or 3 year shall be determined from the date of receipt of compensation whether initial or additional [*see* para 185].
- *Purchase of property while residing* - If there is a *bona fide* purchase, the revenue cannot be permitted to say that the assessee is not entitled to exemption under the provisions of section 54 merely because the assessee was residing in the house which was purchased by the assessee—*CIT* v. *Chandanben Maganlal* [2002] 120 Taxman 38 (Guj.). The word 'purchase' for the purpose of section 54, must be interpreted in its ordinary meaning, as buying for a price or equivalent of price—***CIT*** v. ***Uma Budhia*** [2004] 141 Taxman 39 (Kol.)(Mag.).
- *Live-link between capital gain and investment not necessary* - There is nothing in provisions of section 54 to warrant establishing a direct nexus or live-link between the amount of capital gain and the cost of new asset. For instance, if an assessee utilises long-term capital gain on sale of house for purchasing and selling shares in between before depositing the capital gain in 'Capital gains account scheme' and subsequently purchases a house, it is qualified to claim exemption under section 54—*Ajit Vaswanit* v. *CIT* [2001] 117 Taxman 123 (Delhi) (Mag.).
- *Property in foreign country* - The new house may be in India or outside Indian—***Prema P. Shah*** v. ***ITO*** [2006] 100 ITD 60/101 TTJ 849 (Mum.).

179.2 ***Amount of exemption*** - The amount of exemption is equal to—

a. the amount of capital gain generated on transfer of residential house property; or

b. the amount invested[1] in purchasing or constructing (including the amount deposited in the deposit scheme as given in para 179.4) new residential property,

whichever is lower.

■ For purpose of claiming exemption under section 54, investment in residential house would not only include cost of purchase of house but also cost incurred for making house habitable—***Saleem Fazelbhoy*** v. ***CIT*** [2006] 9 SOT 601 (Mum.).

179.3 ***Consequences if the new residential property is transferred within 3 years*** - If the new residential property is transferred within a period of 3 years from the date of its acquisition (or completion of construction), the amount of exemption given earlier would be taken back. In such a case, the capital gain on transfer of the new residential property will be calculated as follows—

	Rs.
Sale consideration of the new residential property	xxxxxx
Less: Cost of acquisition (original cost of acquisition of the new residential property *minus* exemption given earlier under section 54 which is going to be taken back because the new residential property is transferred within 3 years)	xxxxxx
Short-term capital gain	xxxxxx

179.4 ***Scheme of deposit in respect of exemption under section 54*** - The provisions are given below—

■ *What is the scheme of deposit* - Under section 54, the new residential property can be purchased/constructed within the time-limit given above (*i.e.*, 2 years/3 years from the date of transfer of original asset). The taxpayer has to submit his return of income on or before the due date of submission of return of income (*i.e.*, generally July 31 or September 30 of the assessment year)[£]. If the amount is not utilised for purchase/construction of the new property till the due date of submission of return of income, then it should be deposited in "Capital gains deposit account scheme" (hereinafter referred to as deposit account). On the basis of amount utilized in acquiring the new property and amount deposited‡ in the deposit account, the Assessing Officer will give exemption under section 54.

■ *How the deposit account should be utilised* - By withdrawing from the deposit account, new residential property can be purchased/constructed within the period given above.

■ *What happens if the deposit account is not fully utilised* - If the amount deposited is not utilised fully for purchase or construction of new residential property within the stipulated period, then the amount not so utilised shall be treated as long-term capital gain of the previous year in which the period of three years from the date of transfer of original asset expires†. In such a case, the assessee can withdraw the unutilised amount at any time after the expiry of 3 years from the date of the transfer of the original asset in accordance with the aforesaid scheme.

Unutilised amount will be taxable in the year in which the 3 year time-limit expires even if the amount is actually withdrawn by the taxpayer in a subsequent year or even if the taxpayer could not withdraw the amount in the year in which the 3 year time-limit expires because of a fault of the Assessing Officer—***Monisha H. Patel*** v. ***ITO*** [2008] 22 SOT 330 (Mum.).

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1. It includes cost of land — Circular No. 667, dated October 18, 1993.

£ *See* para 353.3.

‡The evidence can be furnished during the course of assessment proceedings—*Ajit Vaswanit* v. *CIT* [2001] 117 Taxman 123 (Delhi)(Mag.).

† If the assessee dies before the expiry of stipulated period (for purchasing the new asset), and later on the unutilised amount is refunded to the legal heirs, the Board is of the opinion that in such cases the said amount cannot be taxed in the hands of the deceased. This amount is not taxable in the hands of legal heirs also as the unutilised portion of the deposit does not partake the character of income in their hands but is only a part of the estate devolving upon them—Circular No. 743, dated May 6, 1996.

179.5 *Whether exemption is limited to acquisition of one house property* - To claim deduction under section 54, there is no bar on acquiring more than one residential house out of proceeds of one residential house—***D. Anand Basappa*** v. ***ITO*** [2004] 91 ITD 53 (Bang.), ***ITO*** v. ***P.C. Ramakrishna*** [2007] 108 ITD 251 (Chennai), ***Prem Prakash Bhutani*** v. ***CIT*** [2007] 110 TTJ (Delhi) 440.

179-P1 *X gives the following information—*

Residential house property situated at Kolkata

	Rs.
Date of transfer	*December 30, 2008*
Date of purchase	*June 30, 1992*
Sale consideration	*35,00,000*
Cost of acquisition	*2,00,000*
Expenses on transfer	*40,000*
Amount deposited in capital gains deposit account scheme on July 20, 2009	*21,00,000*
To get the exemption under section 54, the following residential house property is purchased at Chennai by X by withdrawing from the deposit account—	
Date of purchase	*June 20, 2010*
Cost of acquisition	*15,00,000*

Find out the following—

a. capital gain chargeable to tax for different assessment years;

b. X does not want to purchase or construct another property, what is the earliest date when he can withdraw the unutilised amount from the deposit account; and

c. is it possible to take back the exemption given under section 54 in a subsequent year.

SOLUTION : *Assessment year 2009-10*

	Rs.
Sale consideration	35,00,000
Less:	
Indexed cost of acquisition [Rs. 2,00,000 × 582 ÷ 223]	5,21,973
Expenses on transfer	40,000
Balance	29,38,027
Less: Exemption under section 54 [amount deposited in capital gain deposit account scheme, i.e., Rs. 21,00,000 or amount of capital gain, i.e., Rs. 29,38,037, whichever is lower]	21,00,000
Long-term capital gains chargeable to tax for the assessment year 2009-10	8,38,027
Assessment year 2012-13	
Amount deposited in capital gains deposit account scheme	21,00,000
Less: Amount utilised by purchasing a new residential property at Chennai	15,00,000
Unutilised amount	6,00,000

Notes :

1. In this case, X can purchase a new residential property, by withdrawing from the deposit account, up to December 29, 2010 or he can complete construction of a residential property up to December 29, 2011. If he does not want to purchase or complete construction of another property, he can withdraw the unutilised amount of Rs. 6,00,000 in the deposit account at any time after December 29, 2011.

2. Rs. 6,00,000 would be taxable as long-term capital gains of the previous year 2011-112, i.e., the assessment year 2012-13.

3. The new residential property purchased at Chennai should not be transferred before 3 years from the date of its purchase (in other words, the new residential property should not be transferred up to June 19, 2013). If the new

residential property is transferred before June 20, 2013, then the exemption given under section 54 (i.e., Rs. 21,00,000 *minus* Rs. 6,00,000) would be taken back.

179-P2 *X, an individual, owned a house property in Delhi and resided therein with his family for more than 25 years. He sold the house on April 10, 2008 for Rs. 5,80,000 (cost of acquisition Rs. 70,000, fair market value on April 1,1981 : Rs. 1,00,000) and moved down to Agra where he purchased on May 5, 2008 a vacant site for residential accommodation, after paying an advance of Rs. 5,000. However, before executing the sale deed in his favour, X expired on December 10, 2008. The sale deed for Rs. 32,000 was eventually executed on June 1, 2009 in favour of his son Y who completed the construction of the house on April 4, 2010, and resided therein with his family. The cost of building including the price of the site aggregated to Rs. 2,00,000. For the assessment year 2009-10, Y as X's legal heir wants to claim exemption under section 54 in respect of capital gain arising from the sale of house property in Delhi. Is the claim of Y tenable ?*

SOLUTION : In the aforesaid case, it is not in dispute that (a) there was a transfer of house property, (b) the income of Delhi house was dealt under the head "Income from house property", (c) X was using the house property as his own residence, and (d) X paid an advance for acquiring the property to use as a residential accommodation for him, but because of his death, the relevant conveyance deed could be executed only by Y. Further, as X was the seller, the amount of capital gains is chargeable in his hands. The assessment of Y is only as his legal representative who cannot be differentiated from the assessee for this purpose. If Y is liable to pay tax, he cannot be denied the benefit of section 54, which forms part of the scheme of taxation of capital gains and does not expressly stipulate that the vendor and the purchaser must be the same. Therefore, section 54 can be invoked for making the assessment on Y as legal heir of X— *C.V. Ramanathan* v. *CIT* [1980] 4 Taxman 432 (Mad.).

179-P3 *X is eldest of four brothers belonging to a Hindu family. They partitioned family properties, barring a common house in the occupation of their mother. On June 1, 2008, X sells his residential house and earns a capital gain of Rs. 2,40,000. Within a year from June 1, 2008, he acquires the common house, each of his three brothers releasing in favour of X their respective shares in the property by executing three separate release deeds for a consideration of Rs. 80,000 each which is adjusted towards the extra share agreed to be given to X by his three brothers. Can X claim exemption under section 54 ?*

SOLUTION : Under section 54, exemption can be availed if the assessee purchases or constructs a residential house within a certain period. The word "purchase" should be taken in its ordinary meaning of buying for a price or equivalent of price, by payment in kind or adjustment towards an old debt or for monetary consideration. Each release in the given problem constitutes a transfer for consideration of Rs. 80,000. The transaction is purchase by X who is, accordingly, entitled to claim relief under section 54—*CIT* v. *T.N. Aravinda Reddy* [1979] 2 Taxman 541 (SC).

179-P4 *X sells a residential house property at a long-term capital gain of Rs. 70,000. He invests Rs. 80,000 within 3 years in construction of the first floor and barsati (to be used for residence) to another house owned by him since 1949. Is Rs. 70,000 exempt from tax under section 54 ?*

SOLUTION : The words "house property" in section 54 do not mean an independent and completed house. They have the same meaning as the concept of house property in sections 22 to 27 and it includes an independent unit such as the first floor of house. In fact, there can be no doubt that the section takes into account all independent residential units, particularly in the days when multi-storeyed flats are becoming the order of the day. The amount of capital gain is invested by X in the construction of a house property within the meaning of section 54, which is completed within a period of 3 years after the date of the sale. Further, the house property so constructed is admittedly used for the purpose of residence. Hence, X is entitled to the exemption under section 54.

179-P5 *X sells a residential house property on April 3, 2008 at a long-term capital gain of Rs. 7,86,000. He invests Rs. 5,00,000 on March 10, 2009 in purchase of a house property and Rs. 3,00,000 in construction of the first floor to the house purchased in March 2009 (construction is completed by December 31, 2010). The property will be used by him for residential purposes. The Assessing Officer wants to restrict the exemption under section 54 to investment on purchase only holding that section 54 is applicable either for purchase or for construction of a house but not for both. Is the Assessing Officer right ?*

SOLUTION : If an assessee is entitled to relief on fulfilment of either of the two conditions, *i.e.*, either purchasing a house property within two years or constructing the house within three years, it would be improper to read that on fulfilment of both the conditions, he would be disentitled to that relief. Section 54 does not contemplate two kinds of relief; it only contemplates fulfilment of two alternative conditions. If both the conditions are satisfied within the

time stipulated, the assessee does not become disentitled to the relief if the other conditions are fulfilled. If a floor is added to the new house, or if it is renovated, it remains as one house only. The Assessing Officer is, therefore, not justified in restricting exemption to investment on purchase only holding that the exemption under section 54 is admissible either for purchase or for reconstruction but not for both—*B.B.Sarkar* v. *CIT* [1981] 7 Taxman 239 (Cal.).

Capital gains arising from the transfer of land used for agricultural purpose [Sec. 54B]

180. Exemption under section 54B is available on transfer of agricultural land. The provisions are given below —

180.1 ***Conditions*** - The following conditions should be satisfied —

1. The taxpayer is an individual [exemption is not available to a Hindu undivided family or any other taxpayer].

2. He transfers† an agricultural land. It may be long-term capital asset or short-term capital asset.

3. The agricultural land was used by the taxpayer or his parents, for agricultural purposes for a period of two years immediately preceding the date of transfer.

4. The taxpayer has purchased another land for agricultural purposes within a period of two years from the date of such transfer. In case capital gain arises on compulsory acquisition of agricultural land by the Government, the time-limit of 2 years shall apply from the date of receipt of compensation (whether initial or additional). The new land may be situated in an urban area or a rural area.

180.2 ***Amount of exemption*** - The amount of exemption under section 54B is equal to—

a. the amount of capital gain generated on transfer of agricultural land; or

b. the amount invested in purchasing new agricultural land (including the amount deposited in the deposit scheme as given in para 180.4),

whichever is lower.

180.3 ***Consequences if the new agricultural land is transferred within 3 years*** - If the new agricultural land is transferred within a period of 3 years from the date of its acquisition, the amount of exemption given earlier would be taken back. In such a case, the capital gain on transfer of the new agricultural land will be calculated as follows—

	Rs.
Sale consideration of the new agricultural land	xxxxxx
Less: Cost of acquisition (original cost of acquisition of the new agricultural land *minus* exemption given earlier under section 54B which is going to be taken back because the new agricultural land is transferred within 3 years)	xxxxxx
Short-term capital gain	xxxxxx

It may be noted that if the new agricultural land is situated in a rural area, the gain arising on its transfer is not chargeable to tax as an agricultural land situated in a rural area is not a "capital asset" under section 2(*14*).

180.4 ***Scheme of deposit in respect of exemption under section 54B*** - The provisions are given below—

▪ *What is the scheme of deposit* - Under section 54B, the new agricultural land can be purchased within the time-limit given above (*i.e.*, 2 years from the date of transfer of original asset). The taxpayer has to submit his return of income on or before the due date of submission of return of income (*i.e.*, generally July 31 or September 30 of the assessment year)*. If the amount is not utilised for purchase of the new agricultural land till the due date of submission of return of income, then it should be deposited in "Capital gains deposit account scheme" (hereinafter referred to as deposit

†If it is a transfer by way of compulsory requisition, one may claim exemption under section 10(*37*) [*see* para 170.2-3].
**See* para 353.3.

account). On the basis of amount utilized in acquiring the new agricultural land and amount deposited in the deposit account, the Assessing Officer will give exemption under section 54B.

▪ *How the deposit account should be utilised* - By withdrawing from the deposit account, new agricultural land can be purchased within the period given above.

▪ *What happens if the deposit account is not fully utilised* - If the amount deposited is not utilised fully for purchase of new agricultural land within the stipulated period, then the amount not so utilised shall be treated as capital gain of the previous year in which the period of 2 years from the date of transfer of original asset expires [*see* also footnote 1, para 179.4]. It will be taxable as long-term or short-term capital gains depending upon the original capital gain. In such a case, the assessee can withdraw the unutilised amount at any time after the expiry of 2 years from the date of the transfer of the original asset in accordance with the aforesaid scheme.

180-P1 *X sells agricultural land in Calcutta for Rs. 44,73,960 on July 1, 2008, which was purchased by him in 1982-83 for Rs. 6,80,000. On July 13, 2008, he purchases agricultural land of Rs. 40,000 in Delhi. On June 30, 2009, he deposits Rs. 3,90,000 in the Deposit Account. Determine the amount of exemption under section 54B.*

SOLUTION :

		Rs.
Sale proceeds		44,73,960
Less : Indexed cost of acquisition (*i.e.*, Rs. 6,80,000 × 582 ÷ 109)		36,30,826
Capital gains		8,43,134
Less : Exemption under section 54B	Rs.	
Cost of acquiring agricultural land	40,000	
Amount deposited in the Deposit Account	3,90,000	4,30,000
Long-term capital gains		4,13,134

Note : X can utilise the amount deposited in Deposit Account for acquiring agricultural land at any time before July 1, 2010. The amount not utilised before July 1, 2010 will be chargeable to tax as long-term capital gains for the assessment year 2011-12.

Capital gains on compulsory acquisition of land and buildings forming part of industrial undertaking [Sec. 54D]

181. The provisions of section 54D are given below —

181.1 ***Conditions*** - The following conditions should be satisfied to get the benefit of exemption —

1. The taxpayer may be an individual, HUF, firm, company or any other person.

2. The asset may be short-term/long-term.

3. Capital gain arises on transfer by way of compulsory acquisition of land or building which forms a part of an industrial undertaking belonging to the taxpayer.

4. Such land or building was used by the assessee for the purpose of the industrial undertaking for at least two years preceding the date of compulsory acquisition. It is, however, not necessary that such land and building should be owned by the assessee during the stipulated period of two years.

5. Assessee has purchased any other land or building within a period of three years from the date of receipt of compensation or constructed a building within such period.

6. Newly acquired land or building should be used for the purpose of shifting or re-establishing the said undertaking or setting up another industrial undertaking.

181.2 ***Amount of exemption*** - The amount of exemption under section 54D is equal to—

a. the amount of capital gains generated on transfer by way of compulsory acquisition of land or building; or

b. the amount invested in new land and building (including the amount deposited in the deposit scheme as given in para 181.4),

whichever is lower.

181.3 *Consequences if the new land and building is transferred within 3 years* - If the new land and building is transferred within a period of 3 years from the date of its acquisition (or completion of construction) the amount of exemption given earlier under section 54D would be taken back. In such a case, the capital gain on transfer of the new land and building will be calculated as follows—

	Rs.
Sale consideration of the new land and building	xxxxxx
Less : Cost of acquisition (original cost of acquisition of the new land and building *minus* exemption given earlier under section 54D which is going to be taken back because the new land and building is transferred within 3 years)	xxxxxx
Short-term capital gain	xxxxxx

181.4 *Scheme of deposit in respect of exemption under section 54D* - The provisions are given below—

- *What is the scheme of deposit* - Under section 54D, the new land and building can be purchased/ constructed within the time-limit given above (*i.e.*, 3 years from the date of receipt of compensation). The taxpayer has to submit his return of income on or before the due date of submission of return of income (*i.e.*, generally July 31 or September 30 of the assessment year)*. If the amount is not utilised for purchase/construction of the new land and building till the due date of submission of return of income, then it should be deposited in "Capital gains deposit account scheme" (hereinafter referred to as deposit account). On the basis of amount utilized in acquiring the new asset and amount deposited in the deposit account, the Assessing Officer will give exemption under section 54D.
- *How the deposit account should be utilised* - By withdrawing from the deposit account, new land and building can be purchased/constructed within the period given above.
- *What happens if the deposit account is not fully utilised* - If the amount deposited is not utilised fully for purchase or construction of new land and building within the stipulated period, then the amount not so utilised shall be treated as capital gain of the previous year in which the period of three years from the date of receipt of compensation expires [*see* also footnote 1, para 179.4]. It will be taxable as short-term or long-term capital gains depending upon the original capital gain. In such a case, the assessee can withdraw the unutilised amount at any time after the expiry of 3 years from the date of receipt of compensation in accordance with the aforesaid scheme.

181-P1 *X Ltd., a manufacturing company, purchases a factory building (constructed on a leasehold land) on May 6, 1998 for Rs. 20 lakh (prior to this the company used the same building as a tenant for about 5 years). The building is compulsory acquired by the Government on April 20, 2008 for which a sum of Rs. 60 lakh is paid as compensation on March 14, 2009. Compute the amount of capital gains chargeable to tax for the assessment year 2009-10 taking into consideration the following information —*

1. On April 1, 2008, the company owns two buildings (rate of depreciation : 10 per cent) one of which is acquired by the Government during 2008-09. The depreciated value of the block on April 1, 2008 is Rs. 21.35 lakh.

2. The company purchases a factory building (constructed on a leasehold land) on April 6, 2009 for Rs. 15 lakh.

Does it make difference if the factory building is purchased on March 31, 2009?

SOLUTION : As the compensation is received on March 14, 2009, capital gain is taxable for the assessment year 2009-10 as follows —

	Rs.
Sale consideration	60,00,000
Less : Cost of acquisition as per section 50 being the depreciated value of the block as on April 1, 2008 [see para 173.1-3]	21,35,000
Short-term capital gain	38,65,000
Less : Exemption under section 54D [as the taxpayer has purchased a factory building within 2 years from March 14, 2009, exemption is available under section 54D, the exemption being Rs. 15 lakh]	15,00,000

**See* para 353.3.

	Rs.
Short-term capital gain chargeable to tax for the assessment year 2009-10	23,65,000

In this case, the amount of capital gain will be reduced if the new building is purchased in the previous year 2008-09 (*i.e.*, in the year in which the old building was acquired). Suppose, the new building is purchased on March 31, 2009, then as per section 50, the cost of acquisition of the building acquired by the Government will increase and the capital gain shall be determined as follows —

	Rs.
Sale consideration	60,00,000
Less : Cost of acquisition as per section 50 [being the depreciated value of block on April 1, 2008 and cost of building purchased during 2008-09, *i.e.*, Rs. 21.35 lakh + Rs.15 lakh]	36,35,000
Short-term capital gain	23,65,000
Less : Exemption under section 54D	15,00,000
Short-term capital gain	8,65,000

Capital gain not to be charged on investment in certain bonds [Sec. 54EC]

182. Section 54EC has been inserted from the assessment year 2001-02. Salient features of section 54EC are given below —

182.1 ***Conditions*** - The following conditions should be satisfied—

1. Assessee - The assessee may be an individual, firm, company or any other person.

2. Long-term capital asset - The asset transferred should be a long-term capital asset.

3. Investment in specified asset - The assessee should invest the whole or any part of the capital gain in "long-term specified assets" within 6 months† from the date of transfer of the asset.

From the assessment year 2006-07, the "long-term specified asset" means bonds issued by NHAI and REC if such bonds are redeemable after 3 years and are issued on or after April 1, 2006.

182.2 ***Amount of exemption*** - The amount of exemption under section 54EC is as follows—

a. the amount of capital gains generated on transfer of capital asset; or

b. the amount invested in specified asset as stated above,

whichever is lower.

The investment made on or after April 1, 2007 in the long-term specified assets noted above by an assessee during any financial year cannot exceed of Rs. 50 lakh.

The cost of specified asset which is considered for the purpose of section 54EC shall not be eligible for tax rebate under section 88 or deduction under section 80C.

182.3 ***Consequences if the new asset is transferred within 3 years*** - If the specified assets are transferred (or converted into money or any loan/advance is taken on the security of specified assets) within 3 years from the date of their acquisition, the amount of capital gains arising from the transfer of original asset which was not charged to tax, will be deemed to be the income by way of long-term capital gains of the previous year in which specified assets are transferred, etc.

182.4 ***Is it possible to claim exemption under section 54EC in respect of depreciable asset*** - In the case of transfer of a depreciable asset, section 50 is applicable. By virtue of section 50 (for the purpose of sections 48 and 49), capital gain on transfer of a depreciable asset shall be treated as capital gain on transfer of short-term capital asset. Section 50 nowhere says that, for the purpose

†The time limitation for making the investments under section 54EC has been extended as follows—

(*a*) up to September 30, 2006 in case of persons where the long-term capital asset was transferred between September 29, 2005 and December 31, 2005 (both dates inclusive);

(*b*) up to December 31, 2006 in case of persons where the long-term capital asset was transferred between January 1, 2006 and June 30, 2006 (both dates inclusive)—**Order F.No. 142/09/2006-TPL**, dated June 30, 2006.

of section 54EC, depreciable asset would be short-term capital asset. Section 54EC is an independent section. Section 50 does not have an overriding effect over section 54EC. Section 54EC has an application where long-term capital asset is transferred. Therefore, capital gain received by an assessee on the transfer of a depreciable asset (if conditions necessary under section 54EC are complied with by the assessee) is eligible for the benefit under section 54EC—***CIT*** v. ***Assam Petroleum Industries (P.) Ltd.*** [2003] 131 Taxman 699 (Gau.), ***CIT*** v. ***ACE Builders (P.) Ltd.*** [2005] 144 Taxman 855 (Bom.).

182-P1 *On January 2, 2009, X sells gold for Rs. 3,85,000 (cost of acquisition on March 10, 1994: Rs. 1,05,000). Expenses on purchase and transfer are Rs. 100 and 200 respectively. On May 30, 2009, he acquires bonds of National Highways Authority of India (investment being Rs. 40,000). These bonds are redeemable after 42 months. Find out the amount of exemption under section 54EC.*

SOLUTION :

	Rs.
Sale consideration	3,85,000
Less : Expenses on transfer	200
Net sale consideration	3,84,800
Less : Indexed cost of acquisition [i.e., Rs. 1,05,100 × 582/244]	2,50,689
Long-term capital gain	1,34,111
Less : Exemption under section 54EC	40,000
Capital gain chargeable to tax	94,111

Note : X should not transfer the bonds of National Highways Authority of India or take a loan on the security of these bonds or otherwise convert these bonds into money, within 3 years from May 30, 2009. If X transfers the bonds of National Highways Authority of India (or X takes any loan or advance on security of these bonds) within 3 years from May 30, 2009, then Rs. 40,000 will be deemed as income by way of long-term capital gain of the previous year in which he transfers these bonds.

182-P2 *X Ltd. sells the following assets —*

	Agricultural land	Bonus shares	House property (let out)
Date of sale	*November 30, 2008*	*January 1, 2009*	*March 25, 2009*
Date of acquisition	*May 9, 1993*	*April 4, 1983*	*June 6, 1982*
	Rs.	*Rs.*	*Rs.*
Sale consideration	*9,00,000*	*2,50,000*	*6,00,000*
Purchase consideration	*70,000*	*Nil*	*1,00,000*

The agricultural land is situated in urban area and used for agricultural purpose since 1994.

X Ltd. invests in the following assets during April 2009 —

1. Bonds of the National Highways Authority of India (redeemable on June 1, 2012) : Rs. 4,00,000.

2. Non-convertible debentures (redeemable on May 10, 2014) of the Rural Electrification Corporation : Rs. 5,00,000.

3. Agricultural land : Rs. 75,000.

Find out the capital gains chargeable to tax.

SOLUTION :

	Land Rs.	Bonus shares Rs.	House property Rs.
Sale consideration (a)	9,00,000	2,50,000	6,00,000
Indexed cost of acquisition (b)	1,66,967*	*Nil*	5,33,945**

*Rs. 70,000 ÷ 244 × 582.

**Rs. 1,00,000 ÷ 109 × 582.

	Land Rs.	Bonus shares Rs.	House property Rs.
Long-term capital gain [before any exemption] (c)	7,33,033	2,50,000	66,055
Less : Exemption under section 54EC [Note]	7,33,033	1,66,967	—
Income under the head "Capital gains"	*Nil*	83,033	66,055

Notes :

1. Total investment which is eligible for exemption under section 54EC is Rs. 9,00,000. There is no order of priority when exemption is not available under any other section. If exemption is available under any other section, then exemption should first be given under that section and thereafter under section 54EC.

2. If the bonus shares are transferred in a recognised stock exchange, long-term capital gain of Rs. 2,50,000 will be exempt under section 10(38) [see para 170.2-4].

182-P3 *X sells the following long-term capital assets on January 11, 2009 —*

	Residential house property Rs.	Gold Rs.	Silver Rs.	Diamonds Rs.
Sale consideration	*3,90,000*	*8,10,000*	*2,96,000*	*6,40,200*
Indexed cost of acquisition	*70,000*	*1,15,000*	*1,78,000*	*4,30,000*
Expenses on transfer	*10,000*	*81,000*	*6,000*	*32,000*

The due date of filing return of income for the assessment year 2009-10 is July 31, 2009. For claiming exemption under sections 54 and 54EC, X purchases the following asset —

Assets	Date of acquisition	Amount Rs.
Land (for constructing a residential house)	March 31, 2009	1,00,000
Bank deposit (for constructing house)	August 5, 2009	50,000
Rural Electrification Corporation (redeemable on July 5, 2013)	July 5, 2009	7,50,000
Bonds of National Highways Authority of India (redeemable on August 10, 2018)	July 10, 2009	3,05,000

Find out the amount of capital gain chargeable to tax for the assessment year 2009-10.

SOLUTION :

	House property Rs.	Gold Rs.	Silver Rs.	Diamonds Rs.
1	2	3	4	5
Sale consideration	3,90,000	8,10,000	2,96,000	6,40,200
Less : Expenses on transfer	10,000	81,000	6,000	32,000
Net sale consideration (a)	3,80,000	7,29,000	2,90,000	6,08,200
Less : Indexed cost of acquisition	70,000	1,15,000	1,78,000	4,30,000
Long-term capital gain (b)	3,10,000	6,14,000	1,12,000	1,78,200
Exemption under section 54 [Note 1] (c)	1,00,000	—	—	—
Exemption under section 54EC [Note 2] (d)	2,10,000	6,14,000	1,12,000	1,19,000
Capital gain chargeable to tax [(b) – (c) – (d)]	*Nil*	*Nil*	*Nil*	59,200

Notes :

1. *Exemption under section 54* - Since the due date of filing return of income is July 31, 2009, the deposit made on August 5, 2009 is not considered. Exemption under section 54 is limited to amount utilised for constructing residential house up to July 31, 2009 (*i.e.*, Rs. 1,00,000).
2. *Exemption under section 54EC* - The amount of exemption available under section 54EC is Rs. 10,55,000 (*i.e.*, Rs. 7,50,000 + Rs. 3,05,000).

Capital gain on transfer of certain listed securities/units not to be charged to tax in certain cases [Sec. 54ED]

182A. Exemption under section 54ED is not available from the assessment years 2007-08 onwards.

Capital gains on transfer of a long-term capital asset other than a house property [Sec. 54F]

183. The provisions of section 54F are given below—

183.1 ***Conditions*** - Exemption under section 54F is available if the following conditions are satisfied—

183.1-1 *WHO CAN CLAIM EXEMPTION* - Under section 54F, only an individual or a Hindu undivided family can claim exemption. In other words, no other person is eligible for claiming exemption under section 54F.

183.1-2 *WHICH ASSET IS QUALIFIED FOR EXEMPTION* - Under section 54F, exemption is available only if the capital asset which is transferred is a long-term capital asset but other than a residential house property (for instance, it may be a plot of land, commercial house property, gold, share or any asset but not a residential house property).

183.1-3 *WHICH NEW ASSET SHOULD BE PURCHASED OR ACQUIRED* - To claim the exemption under section 54F, the taxpayer will have to purchase a residential house property (old or new) or construct a residential house property (hereinafter referred to as "new house"). It may be in India or outside India. The new house should be purchased or constructed within the time-limit given below—

	Time-limit
For purchasing a new house	It should be purchased within one year before, or within 2 years after, the date of transfer of the original asset.
For constructing a new house	The construction should be completed within 3 years from the date of transfer of original asset.

The following points should be noted :

- *Time-limit in the case of compulsory acquisition* - In case of compulsory acquisition, the time-limit of 1 year, 2 years or 3 years shall be determined from the date of receipt of compensation (whether initial or additional).
- *Construction may commence before transfer of capital asset* - Construction of the house should be completed within 3 years from the date of transfer of the original asset. Date of commencement of construction is irrelevant. Construction may be commenced even before the transfer of the original asset.
- *Allotment by co-operative societies* - Case of allotment of flat under the self-financing scheme of DDA (or similar scheme of co-operative societies or other institutions) is treated as construction of house for this purpose—Circular No. 471, dated October 15, 1986 and Circular No. 672, dated December 16, 1993.
- *Holding of legal title not necessary* - Holding of legal title is not necessary. If the taxpayer pays full consideration or substantial portion of it (in terms of the agreement to sell) within the stipulated

period given in the table above, the exemption under section 54F is available, even if possession is handed over after the stipulated period or the sale deed is registered later on.

- *Residential house should be purchased/acquired (may or may not be used for residential purposes)* - The requirement of section 54F is that the property should be a residential house. The use of the property is not the relevant criterion to consider the eligibility for benefit under section 54F. What is required is investment in a residential house. Mere non-residential use would not render a property ineligible for benefit under section 54F, if it otherwise is a residential house—***Mahavir Prasad Gupta*** v. ***CIT*** [2006] 5 SOT 355 (Delhi).

183.1-4 NOT MORE THAN ONE RESIDENTIAL HOUSE PROPERTY SHOULD BE OWNED BY TAXPAYER - Under section 54F, exemption is available only if on the date of transfer of the original assets, the taxpayer does not own more than one residential house property (other than the new house). He should also not purchase within a period of two years after such date (or complete construction within a period of 3 years after such date) any residential house[1] (other than the new house).

183.2 ***Amount of exemption*** - If the above conditions are satisfied, then the exemption is available on the following basis—

$$\text{Cost of new house} \times \frac{\text{Capital gains}}{\text{Net sale consideration}}$$

Notes:

1. The amount of exemption cannot exceed the amount of capital gain.

2. Cost of the new house includes cost of land—Circular No. 667, dated October 18, 1993.

3. Net sale consideration means the full value of the consideration received or accruing as a result of the transfer of the capital asset after deduction of any expenditure incurred, wholly and exclusively, in connection with the transfer.

4. If the transferor allows the transferee to retain and apply a part of total consideration to discharge the mortgage to which the property has been subjected to, the amount so applied for discharge of mortgage would have to be excluded from the 'full value of consideration'— *CIT* v. *N.M.A. Mohammed Haniffa* [2001] 115 Taxman 181 (Mad.).

5. In case of semi-finished house, the purchaser will have to invest on flooring, wooden work, sanitary work, etc., to make it habitable. Therefore, the investment in house would be complete only when such house becomes habitable. Accordingly, the expenditure incurred on making the house habitable should be considered as investment in purchase of the house, subject to the condition that payment is made during the period specified in section 54F—***Saleem Fazelbhoy*** v. ***CIT*** [2006] 9 SOT 603 (Mum.).

183.3 ***Circumstances when exemption granted under section 54F may be withdrawn*** - In the following cases, exemption granted under section 54F can be withdrawn :

Defaults	Consequences
1. If the assessee transfers the new house within 3 years of its purchase/construction.	Capital gain which arises on the transfer of the new house will be taken as short-term capital gain. Besides, the capital gain which was exempt under section 54F shall be treated as long-term capital gain of the year in which the new house is transferred.
2. If the assessee purchases, within a period of two years of the transfer of original asset, or constructs within a period of three years of the transfer of such asset, a residential house other than the new house.	Capital gain which was exempt under section 54F shall be deemed to be income by way of long-term capital gain of the year in which another residential house is purchased or constructed.

Notes —

1. It may be noted that in *2 supra*, capital gain is chargeable to tax even if no capital asset is "transferred" during the year. It appears that the policy of the Government is to give exemption under section 54F to an individual (or HUF) who does not own more than one residential house property and who wants to purchase/construct

1. Whose income is taxable under the head "Income from house property".

(only) one residential house by converting his other assets (like gold, silver, shares, etc.). If the taxpayer purchases/constructs two or more houses within the specified time-limit, then he becomes disqualified to claim the exemption under section 54F and the exemption already allowed when the first house was purchased/ constructed will be taken back at the time of the purchase or construction of the second house. This rule is applicable only if the second house is purchased/constructed within the specified time-limit as stated above.

2. In point *2* in the Table (*supra*), the time-limit shall be determined from the date of transfer of original asset even in the case of compulsory acquisition. For instance, if a plot of land is acquired by the Government on April 10, 2007 and compensation is received on May 26, 2008, capital gain is taxable for the previous year 2008-09. The taxpayer can purchase a residential house within 2 years or construct a house within 3 years from May 26, 2008 to claim exemption under section 54F. Now he should not purchase within 2 years or construct within 3 years from April 10, 2007 another residential house. If within this limit, he purchases/constructs another house, then exemption under section 54F is not available.

183.3-1 ***OTHER POINTS*** - One should also keep in view the following—

1. If by applying section 54F, there is no income in hands of a minor child to be added under section 64(1A), the benefit under section 54F cannot be denied to minor child on the ground that father of minor child had two residential houses at the time of transfer of the capital asset—***CIT*** v. ***Madan Lal Bassi*** [2004] 88 ITD 557 (Chd.)

2. Where an assessee purchases ground floor of a house and later, when vendor builds first floor, the assessee purchases first floor by a separate sale deeds, the assessing authority is not justified in disallowing the assessee's claim for exemption of capital gains on ground that ground floor and first floor constitute two residential houses and, therefore, provisions of section 54F(2) are attracted—***Hansa Bai Sanghi*** v. ***ITO*** [2004] 89 ITD 239 (Hyd.).

183.4 *Scheme of deposit in respect of exemption under section 54F* - The provisions are given below—

■ *What is the scheme of deposit* - Under section 54F, the new house can be purchased/constructed within the time-limit given above (*i.e.*, 2 years/3 years from the date of transfer of original asset). The taxpayer has to submit his return of income on or before the due date of submission of return of income (*i.e.*, generally July 31 or September 30 of the assessment year)*. If the amount is not utilised for purchase/construction of the new house till the due date of submission of return of income, then it should be deposited in "Capital gains deposit account scheme" (hereinafter referred to as deposit account). On the basis of amount utilized in acquiring the new property and amount deposited in the deposit account, the Assessing Officer will give exemption under section 54F.

■ *How the deposit account should be utilised* - By withdrawing from the deposit account, new house can be purchased/constructed within the period given above.

■ *What happens if the deposit account is not fully utilised* - If the amount deposited is not utilised fully for purchase or construction of new house within the stipulated period, then the following amount shall be treated as long-term capital gain of the previous year in which the period of three years from the date of transfer of original asset expires [*see* also footnote 1, para 179.4].

$$\text{Unutilised amount in the deposit account in respect of which exemption was claimed under section 54F but which is not utilised within the specified time-limit for purchasing/constructing a residential house} \times \frac{\text{Amount of original capital gain}}{\text{Net sale consideration}}$$

In such a case, the assessee can withdraw the unutilised amount at any time after the expiry of 3 years from the date of the transfer of the original asset in accordance with the aforesaid scheme.

183-P1 *X sells shares in a private limited company on July 10, 2008 for Rs. 8,05,000 (cost of acquisition on June 15, 1984 : Rs. 60,000, expenses on sale : Rs. 5,000). On July 10, 2008, he owns one residential house property. To get the benefit of exemption under section 54F, X deposits on July 30, 2009 Rs. 6,00,000 in Capital Gains Deposit Account Scheme. By withdrawing from the Deposit Account, he purchases a residential house property at Delhi on July 6, 2010 for Rs. 4,80,000. Ascertain —*

a. the amount of capital gain chargeable to tax for the assessment year 2009-10;

**See* para 353.3.

b. *tax treatment of the unutilised amount ;*

c. *when can he withdraw the unutilised amount ; and*

d. *what X has to do to ensure that exemption under section 54F is never taken back.*

SOLUTION : *Assessment year 2009-10*

	Rs.
Sale consideration	8,05,000
Less :	
Expenses	5,000
Indexed cost of acquisition [Rs. 60,000 × 582/125]	2,79,360
Balance	5,20,640
Less : Exemption under section 54F [Rs. 6,00,000, being the amount deposited in Deposit Account/ Rs. 8,00,000 being net sale consideration × Rs. 5,20,640 being the amount of capital gain]	3,90,480
Long-term capital gain	1,30,160

Notes —

1. In this case, X has not fully utilised the deposit account for acquiring a residential house property. Out of Rs. 6 lakh deposited for acquiring the house, it is utilised to the extent of Rs. 4.80 lakh. Tax treatment of Rs. 1.20 lakh, being the unutilised amount, will be as follows —

	Rs.
Unutilised amount (a)	1,20,000
Net sale consideration (b)	8,00,000
Original capital gain (c)	5,20,640
Notional long-term capital gain [*i.e.*, (a)/(b) × (c)]	78,096
Effective exemption under section 54F [*i.e.*, Rs. 3,90,480 — Rs. 78,096]	3,12,384

Rs. 78,096 will be chargeable to tax as long-term capital gain after the expiry of 3 years from date of transfer of shares (*i.e.*, July 9, 2011). Consequently, it will be taxable for the assessment year 2012-13.

2. The unutilised amount of Rs. 1.20 lakh can be withdrawn by X at any time after July 9, 2011.

3. If X sells the new house at Delhi before July 6, 2013, then Rs. 3,12,384 (exemption under section 54F) will be taken as long-term capital gains of the year in which the house is sold.

4. If X purchases any other residential house before July 10, 2010 or constructs any other house (income of which is taxable under section 22) before July 10, 2011, then Rs. 3,12,384 (exemption under section 54F) will be deemed as long-term capital gain of the year in which another house is purchased or constructed.

183-P2 *X purchases 1,000 non-listed shares in Y Ltd. on August 16, 1990 for Rs. 8,000. On May 17, 1992, he gets 500 bonus shares. On October 20, 2007 he acquires 1,500 right shares at the rate of Rs. 11 per share. He sells 3,000 shares in Y Ltd. on February 12, 2009 at the rate of Rs. 110 per share (brokerage on sale : 1 per cent). He owns one residential house property. He purchases a residential house on June 29, 2009 for Rs. 2,90,000. Ascertain the amount of capital gains chargeable to tax for the assessment year 2009-10.*

SOLUTION :

	1000 original shares Rs.	500 bonus shares Rs.	1500 right shares Rs.
Sale consideration	1,10,000	55,000	1,65,000
Less : Expenses on transfer	1,100	550	1,650
Net sale consideration	1,08,900	54,450	1,63,350
Less : Indexed cost of acquisition [Rs. 8,000 × 582/182 ; 1,500 × Rs. 11 × 582/551]	25,582	*Nil*	17,428
Long-term capital gain	83,318	54,450	1,45,922
Long-term capital gain as percentage of net sale consideration	76.51%	100%	89.33%
Order of preference for claiming exemption under section 54F	3	1	2
Exemption under section 54F [see Note]	55,239	54,450	1,45,922
Capital gain	28,079	*Nil*	*Nil*

Note - The amount of exemption is determined as under—

	Investment utilised for claiming exemption Rs.	Exemption Rs.
Bonus shares [Rs.54,450/Rs.54,450 × Rs. 54,450]	54,450	54,450
Right shares [Rs.1,63,350/1,63,350 × Rs. 1,45,922]	1,63,350	1,45,922
Original shares [Rs.72,200/1,08,900 × Rs. 83,318]	72,200	55,239
Total [any other order of preference will give lower exemption]	2,90,000	2,55,611

Capital gains on transfer of assets in cases of shifting of industrial undertaking from urban area [Sec. 54G]

184. Section 54G provides exemption on transfer of asset in the case of shifting of industrial undertaking from the urban area.

184.1 ***Conditions*** - Exemption can be availed if the following conditions are satisfied :

- A capital asset (being plant, machinery, land or building or any right in land or building) used for the purpose of an industrial undertaking situated in an urban area is transferred. For this purpose, "urban area" means any such area within the limits of a municipal corporation or municipality as the Central Government may, having regard to the population, concentration of industries, need for proper planning of the area and other relevant factors, by general or special order, declare* to be an urban area for the purposes of this section.
- The transfer is effected in the course of, or in consequence of, the shifting of such industrial undertaking (hereinafter referred to as the "original asset") to any area other than an urban area.
- The assessee has within a period of one year before or 3 years after the date on which the transfer took place :

a. purchased new machinery or plant for the purposes of business of the industrial undertaking in the area to which the said undertaking is shifted ;

b. acquired building or land or constructed building for the purposes of his business in the said area ;

c. shifted the original asset and transferred the establishment to such area ; and

d. incurred expenses on such other purpose as may be specified in a scheme framed by the Central Government for the purposes of this section.

184.2 ***Amount of exemption*** - If the above conditions are satisfied, then the amount of exemption is equal to—

a. the amount of capital gain generated on transfer of capital assets in the case of shifting of an industrial undertaking as stated above; or

b. the cost and expenses incurred in relation to all or any of the purposes mentioned in (*a*) to (*d*) *supra* (such cost and expenses being hereinafter referred to as the new asset),

whichever is lower.

184.3 ***Consequences if the new asset is transferred within 3 years*** - If the new asset is transferred within a period of 3 years from the date of its purchase/construction/acquisition, the amount of exemption given earlier under section 54G would be taken back. In such a case, the capital gain on transfer of the new asset will be calculated as follows—

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*See *Taxmann's Direct Taxes Circulars*, Vol. 1, 2006 edition.

	Rs.
Sale consideration of the new asset	xxxxxx
Less: Cost of acquisition (original cost of acquisition of the new asset *minus* exemption given earlier under section 54G which is going to be taken back because the new asset is transferred within 3 years)	xxxxxx
Short-term capital gain	xxxxxx

184.4 *Scheme of deposit in respect of exemption under section 54G* - The provisions are given below—

■ *What is the scheme of deposit* - Under section 54, the new asset can be purchased/constructed/acquired within the time-limit given above (*i.e.*, 3 years from the date of transfer of original asset). The taxpayer has to submit his return of income on or before the due date of submission of return of income (*i.e.*, generally July 31 or September 30 of the assessment year). If the amount is not utilised for purchase/construction/acquisition of the new asset till the due date of submission of return of income, then it should be deposited in "Capital gains deposit account scheme" (hereinafter referred to as deposit account). On the basis of amount utilized in acquiring the new asset and amount deposited in the deposit account, the Assessing Officer will give exemption under section 54G.

■ *How the deposit account should be utilised* - By withdrawing from the deposit account, new asset can be purchased/constructed/acquired within the period given above.

■ *What happens if the deposit account is not fully utilised* - If the amount deposited is not utilised fully for purchase/construction/acquisition of new asset within the stipulated period, then the amount not so utilised shall be treated as capital gain of the previous year in which the period of three years from the date of transfer of original asset expires [*see* also footnote 1, para 179.4]. It will be taxable as long-term or short-term capital gain, depending upon the original capital gain. In such a case, the assessee can withdraw the unutilised amount at any time after the expiry of 3 years from the date of the transfer of the original asset in accordance with the aforesaid scheme.

184-P1 *X Ltd. owns an industrial undertaking at Kanpur which is situated in urban area. As per policy of the State Government, the industrial undertaking is shifted to a rural area. In the process of shifting, the company sells the following assets :*

	Plant and machinery	Building	Furniture	Land
Rate of depreciation	15 per cent	10 per cent	10 per cent	-
Year of acquisition	1977	1978	1976	1975
Written down value of the block on April 1, 2008	9,50,000	10,75,000	25,000	-
Cost of acquisition of land (fair market value on April 1, 1981 : Rs. 60,000)	-	-	-	20,000
Sale proceeds (date of sale June 25, 2008)	47,92,000	88,90,000	17,32,000	60,00,000
Cost of assets acquired during April-May 2009 for the purpose of shifting the undertaking to a rural area	30,50,000	4,00,000	3,70,000	50,70,000

Assuming the industrial undertaking is transferred to rural area by June 15, 2009, ascertain the capital gains chargeable to tax for the assessment year 2009-10. Does it make any difference if the assets are acquired by March 31, 2009?

SOLUTION : *Computation of capital gain if the new asset is acquired during April-May 2009 —*

	Plant and machinery Rs.	*Building* Rs.	*Furniture* Rs.	*Land* Rs.
Sale proceeds	47,92,000	88,90,000	17,32,000	60,00,000
Less :				
Cost of acquisition (being written down value on April 1, 2008 of the different blocks as per section 50)	9,50,000	10,75,000	25,000	-
Indexed cost of acquisition in the case of land (*i.e.*, Rs. 60,000 × 582/100)	-	-	-	3,49,200
Short-term capital gain	38,42,000	78,15,000	17,07,000	-
Long-term capital gain	-	-	-	56,50,800
Less : Exemption under section 54G [see Note]	38,42,000	46,78,000	-	-
Short-term capital gain	*Nil*	31,37,000	17,07,000	-
Long-term capital gain	-	-	-	56,50,800

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. 3,70,000 in acquiring furniture. The qualifying investment for claiming exemption under section 54G is Rs. 85,20,000 (*i.e.*, Rs. 30,50,000 + Rs. 4,00,000 + Rs. 50,70,000). As tax incidence is higher in the case of short-term capital gain, the exemption is first utilised against short-term capital gains.

Computation of capital gain if the new asset is acquired up to March 31, 2009 —

	Plant and machinery Rs.	*Building* Rs.	*Furniture* Rs.	*Land* Rs.
Sale proceeds	47,92,000	88,90,000	17,32,000	60,00,000
Less :				
Cost of acquisition (being written down value on April 1, 2008 *plus* cost of asset purchased during 2008-09, as per section 50)	40,00,000	14,75,000	3,95,000	-
Indexed cost of acquisition in case of land	-	-	-	3,49,200
Short-term capital gain	7,92,000	74,15,000	13,37,000	-
Long-term capital gain	-	-	-	56,50,800
Less : Exemption under section 54G [see Note *supra*]	7,92,000	74,15,000	-	3,13,000
Short-term capital gain	-	-	13,37,000	-
Long-term capital gain	-	-	-	53,37,800

Exemption of capital gains on transfer of assets in cases of shifting of industrial undertaking from urban area to any Special Economic Zone [Sec. 54GA]

185. Section 54GA has been inserted to give exemption in case of shifting of an industrial undertaking from urban area to a special economic zone.

185.1 *Conditions* - Exemption can be availed if the following conditions are satisfied—

- A capital asset (being plant, machinery, land or building or any right in land or building) used for the purpose of an industrial undertaking situated in an urban area is transferred.
- The transfer is effected in the course of, or in consequence of, the shifting of such industrial undertaking (hereinafter referred to as the "original asset") to any Special Economic Zone. Such Special Economic Zone may be situated in urban area of any other area.

- The assessee has within a period of one year before or 3 years after the date on which the transfer took place:
  a. purchased machinery or plant for the purposes of business of the industrial undertaking in the Special Economic Zone to which the said undertaking is shifted;
  b. acquired building or land or constructed building for the purposes of his business in the Special Economic Zone;
  c. shifted the original asset and transferred the establishment to Special Economic Zone; and
  d. incurred expenses on such other purpose as may be specified in a scheme framed by the Central Government for the purposes of this section.

185.2 ***Amount of exemption*** - If the above conditions are satisfied, then the amount of exemption is equal to—

a. the amount of capital gain generated on transfer of capital assets in the case of shifting of an industrial undertaking as stated above; or

b. the cost and expenses incurred in relation to all or any of the purposes mentioned in (*a*) to (*d*) *supra* (such cost and expenses being hereinafter referred to as the new asset),

whichever is lower.

185.3 ***Consequences if the new asset is transferred within 3 years*** - If the new asset is transferred within a period of 3 years from the date of its purchase/construction/acquisition, the amount of exemption given earlier under section 54GA would be taken back. In such a case, the capital gain on transfer of the new asset will be calculated as follows—

	Rs.
Sale consideration of the new asset	xxxxxx
Less: Cost of acquisition (original cost of acquisition of the new asset *minus* exemption given earlier under section 54GA which is going to be taken back because the new asset is transferred within 3 years)	xxxxxx
Short-term capital gain	xxxxxx

185.4 ***Scheme of deposit in respect of exemption under section 54GA*** - These provisions have been framed on similar lines as given in section 54G [*See* para 184.4].

Extension of time-limit for acquiring new asset [Sec. 54H]

185A. The cumulative impact of section 45(5) (already discussed in para 176.4) and section 54H is given below —

1. Initial compensation - Capital gain is chargeable to tax in the previous year in which the compensation (or part thereof) is first received. For availing the benefit of exemption under sections 54, 54B, 54D, 54EC and 54F, the new asset should be acquired within time-limit specified for this purpose. But the specified time-limit shall be determined from the date of receipt of compensation. If initial compensation is received in parts, then the entire initial compensation is taxable in the year in which a part is first received, but the time-limit for acquiring the new asset under sections 54, 54B, 54D, 54EC and 54F shall be determined on the basis of dates of receipt of different parts of initial compensation.

2. Enhanced compensation - If any enhanced compensation is received, it is taxable in the year in which such compensation is received and for acquiring the new asset under sections 54, 54B, 54D, 54EC and 54F, the time-limit shall be determined from the date of receipt of additional compensation.

185A-P1 *A residential house property owned by X is acquired by the Punjab Government on April 20, 2005 (cost of acquisition on June 17, 1981 : Rs. 1 lakh). The Government awards Rs. 20 lakh as initial compensation out of*

which Rs. 5 lakh is received on March 10, 2009 and Rs. 15 lakh is received on July 19, 2009. On his appeal, the Punjab and Haryana High Court increases the compensation from Rs. 20 lakh to Rs. 28 lakh and the additional compensation of Rs. 8 lakh is paid to him on December 12, 2012. X is a businessman and the due date of filing income-tax return is September 30 every year. Ascertain the amount of investment and time of investment for availing the maximum exemption under section 54.

SOLUTION : *Assessment year 2009-10*

	Rs.
Sale consideration (being initial compensation)	20,00,000
Less : Indexed cost of acquisition [*i.e.*, Rs.1 lakh × 497/100]	4,97,000
Long-term capital gain	15,03,000

To avail the benefit of full exemption under section 54, X should acquire a residential house property for Rs. 15,03,000 (or more) within one year before the date of receipt of initial compensation or up to September 30, 2009 (being the due date of submission of return of income for the assessment year 2009-10). If it is not possible to acquire a residential house by September 30, 2009, then the amount should be deposited in the deposit account with a nationalised bank and the proof of deposit should be submitted with the return of income. By withdrawing from the deposit account, a residential house can be purchased within 2 years or constructed within 3 years from the date of receipt of initial compensation as follows —

	Rs.5 lakh received on March 10, 2009	*Rs.15 lakh received on July 19, 2009*
Minimum investment to get full exemption	Rs. 3,000	Rs.15,00,000
Date by which a house should be purchased by withdrawing from the deposit account	March 9, 2011	July 18, 2011
Date by which construction should be completed by withdrawing from the deposit account	March 9, 2012	July 18, 2013

Assessment year 2013-14 (*i.e.*, the previous year 2012-13 during which additional compensation of Rs. 8 lakh is received)

	Rs.
Sale consideration received on December 12, 2012	8,00,000
Less : Cost of acquisition	*Nil*
Long-term capital gain	8,00,000

X should purchase a new house of at least Rs. 8 lakh on or after December 13, 2011 but on or before September 30, 2013. Likewise, a house of Rs. 8,00,000 (or more) may be constructed up to September 30, 2013. If the house is not purchased or constructed by September 30, 2013, then the amount should be deposited in capital gain deposit account and by withdrawing from the deposit account, a house can be purchased by December 11, 2014 or constructed by December 11, 2015.

Short-term/long-term capital gains - How charged to tax

186. Tax will be calculated as follows—

Gross total income [excluding income given in columns (2) and (3)]	*Long-term capital gains taxable under section 112*	*Short-term capital gain taxable under section 111A*
(1)	*(2)*	*(3)*
Step A1 - Find out gross total income from all sources excluding income given in *Step B1* and *Step C1.*	*Step B1* - Find out long-term capital gain	*Step C1* - Find out short-term capital gain taxable under section 111A [*see* para 186.3]
Step A2 - Deduct, deduction permissible under sections 80C to 80U (A2 cannot exceed A1)	*Step B2* - Find out income-tax on long-term capital gain at the rate specified by section 112 [*see* para 186.1]	*Step C2* - Find out income-tax on short-term capital gain at the rate specified by section 111A [*see* para 186.3]

(1)	(2)	(3)
Step A3 - The balancing amount is "other net income"		
Step A4 - Find out income-tax on "other net income" [*see* Annex 1]		

Step D - *Add* the tax computed at *Steps A4, B2* and *C2*.

Step E - *Add* surcharge* on income-tax computed under *Step D*.

Step F - Find out *D* + *E*.

Step G - *Add:* Education cess* at the rate of 2 per cent of *Step F*.

Step H - *Add:* Secondary and higher education cess* at the rate of 1 per cent of *Step F*.

Step I - Tax liability is equal to *F* + *G* + *H*.

186.1 *How to compute tax on long-term capital gains [Sec. 112]* - Long-term capital gain is taxable at a flat rate of 20 per cent.

186-1-1 TAX RATE IS 10 PER CENT IN A FEW CASES - In case long-term capital gain is covered by section 115AB, 115AC, 115AD or 115E, it is taxable at the rate of 10 per cent (+ SC + EC + SHEC)*. Moreover, if listed shares/securities/units are transferred and the benefit of indexation is not taken, then long-term capital gain is taxable @ 10 per cent (+ SC + EC + SHEC)* [*see* para 186.2].

186.1-2 INCENTIVES UNDER SECTIONS 80C TO 80U ARE NOT AVAILABLE - Deduction under sections 80C to 80U is not available in respect of long-term capital gains and those short-term capital gains which are taxable under section 111A.

186.1-3 EXEMPTION LIMIT IN SOME CASES [PROVISO TO SEC. 112(1)(a)] - The proviso to section 112(1)(*a*) gives a relief—

■ *Conditions* - The relief is available if the following conditions are satisfied -

Condition 1	The taxpayer is a resident individual or a resident Hindu undivided family. He or it may be ordinarily resident or not ordinarily resident.
Condition 2	Taxable income *minus* long-term capital gain is less than the amount of exemption limit [Rs. 1,80,000 in the case of resident woman (below 65 years), Rs. 2,25,000 in the case of resident senior citizen (65 years or more), Rs. 1,50,000 in the case of any other individual or every HUF].

*Surcharge, education cess and secondary and higher education cess is applicable as follows:

	Assessment year 2009-10
■ *Surcharge (as a percentage of income-tax)*—	
1. If the assessee is an individual/HUF/AOP/BOI and net income does not exceed Rs. 10 lakh	*Nil*
2. If the assessee is an individual/HUF/AOP/BOI and net income exceeds Rs. 10 lakh	10%
3. If the assessee is an artificial juridical person	10%
4. If the assessee is a firm or a domestic company and net income does not exceed Rs. 1 crore	*Nil*
5. If the assessee is a firm or a domestic company and net income exceeds Rs. 1 crore	10%
6. If the assessee is a non-domestic company and net income does not exceed Rs. 1 crore	*Nil*
7. If the assessee is a non-domestic company and net income exceeds Rs. 1 crore	2.5%
8. If the assessee is a co-operative society or local authority	*Nil*
■ *Education cess (as a percentage of income-tax and surcharge)*	2%
■ *Secondary and higher education cess (as a percentage of income-tax and surcharge)*	1%

■ *Relief* - If the aforesaid conditions are satisfied, the following shall be deducted from long-term capital gain -

Exemption limit — (Net income or taxable income — Long-term capital gain)

After deducting the aforesaid amount, the balancing amount of long-term capital gain is chargeable to tax.

Provisions illustrated - X (28 years) is a resident individual. For the assessment year 2009-10, he has the following incomes—

	Rs.
Long-term capital (LT)	33,000
Other income	1,47,000
Net income (NI)	1,80,000

In this case the two conditions given above are satisfied (*i.e.*, the taxpayer is a resident individual and NI — LT is Rs. 1,47,000 which is lower than the exemption limit of Rs. 1,50,000). Consequently, from the long-term capital gain, the following shall be deducted—

Rs. 1,50,000 (exemption limit) — [Rs. 1,80,000 (NI) — Rs. 33,000 (LT)] = Rs. 3,000

In this case, the long-term capital gain chargeable to tax will be Rs. 30,000 (*i.e.*, Rs. 33,000 - Rs. 3,000).

186.1-4 ***EXEMPTION UNDER SECTION 10*** - If long-term capital gain arises on transfer on or after October 1, 2004 of equity shares or units of equity oriented mutual fund and the transaction is subject to securities transaction tax at the time of sale, such capital gain is not chargeable to tax by virtue of section 10(*38*). Exemption is also available in some cases under section 10(*33*)/(*36*)/(*37*) [*see* para 170.2 for detailed discussion].

186.2 ***Long-term capital gains in respect of shares, securities and units [Sec. 112]*** - If the following conditions are satisfied, then tax on long-term capital gain will be computed under *Option One* or *Option Two* as given below —

■ *Conditions* - The following conditions should be satisfied —

Condition 1	The taxpayer is an individual, HUF, company or any other person (maybe resident or non-resident).
Condition 2	The asset is a long-term capital asset.
Condition 3	The long-term capital asset is— *a.* a security listed in any recognised stock exchange in India; or *b.* a unit of UTI or a mutual fund (whether listed in a recognised stock exchange or not); or *c.* zero coupon bonds.

Note : As per section 2(*h*), "securities" include—(*i*) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate ; (*ii*) Government securities ; (*iii*) such other instruments as may be declared by the Central Government to be securities ; and (*iv*) rights or interest in securities.

In other words, shares, debentures, Government securities or bonds are "securities" for this purpose.

■ *Tax computation* - If the capital asset which is transferred is equity shares or units of equity oriented mutual fund and the transaction is subject to securities transaction tax, the long-term capital gain is not chargeable to tax. In other case, if the conditions given in box are satisfied, tax shall be computed as follows (*i.e.*, under *Option 1* or *Option 2*, whichever is lower) —

Option 1	Option 2
1. Find out sale consideration	*1.* Find out sale consideration
2. Deduct : Indexed cost of acquisition/improvement and expenses on transfer	*2. Deduct :* Cost of acquisition/improvement and expenses on transfer
3. The balancing amount [*i.e.*, (*1*) — (*2*)] is long-term capital gain	*3.* The balancing amount [*i.e.*, (*1*) - (*2*)] is long-term capital gain
4. 20 per cent (+ SC + EC + SHEC)* of (*3*) is the amount of tax liability	*4.* 10 per cent (+ SC + EC + SHEC)* of (*3*) is the amount of tax liability

The taxpayer has an option in respect of each transaction† to pay tax under *Option 1* or *Option 2*, whichever is lower. It is difficult to state when *Option 2* is better. However, in the case of transfer of listed bonus shares, listed debentures, listed bonds and zero coupon bonds, *Option 2* will be better as compared to *Option 1.*

The aforesaid option is also available in the case of a non-resident/foreign company whose capital gain is calculated in foreign currency in terms of proviso to section 48—***McLeod Russel India Ltd., In re*** [2008] 168 Taxman 175 (AAR - New Delhi).

186.3 ***Tax on short-term capital gain in certain cases [Sec. 111A]*** - The provisions of section 111A are given below—

186.3-1 CONDITIONS - Section 111A is applicable if the following conditions are satisfied—

1. The taxpayer is an individual, HUF, firm, company or any other taxpayer.

2. During the previous year, he has generated short-term capital gain on transfer of equity shares or units in equity-oriented mutual fund.

3. The transaction of transfer takes place on or after October 1, 2004.

4. Such transaction is chargeable to securities transaction tax at the time of transfer.

186.3-2 *CONSEQUENCES IF THE ABOVE CONDITIONS ARE SATISFIED* - If the above conditions are satisfied, short-term capital gain is taxable at the rate of 15‡ per cent (+ SC + EC + SHEC)*.

No deduction is available under sections 80C to 80U from the above-noted short-term capital gains.

186.3-3 *EXEMPTION LIMIT IN SOME CASES [PROVISO TO SEC. 111A]* - The proviso to section 111A gives a relief—

- *Conditions* - The relief is available if the following conditions are satisfied—

1. The taxpayer is a resident individual or a resident Hindu undivided family. He or it may be ordinarily resident or not ordinarily resident.

2. Taxable income *minus* short-term capital gain [given in para 186.3-1] is less than the amount of exemption limit [Rs. 1,80,000 in the case of resident woman (below 65 years), Rs. 2,25,000 in the case of resident senior citizen (65 years or more), Rs. 1,50,000 in the case of any other individual or every HUF].

- *Relief* - If the aforesaid conditions are satisfied, the following shall be deducted from such short-term capital gain—

Exemption limit — (Net income or taxable income — Such short-term capital gain)

**See* Foot Note, para 186.

†If several transactions have taken place by way of sale of shares, etc., the assessee can avail the benefit of indexation in a few transactions and avail the 10 per cent tax rate on the remaining transactions—***Devinder Prakash Kalra*** v. ***CIT*** [2005] 97 TTJ (Delhi) 372.

‡10 per cent up to the assessment year 2008-09.

After deducting the aforesaid amount, the balancing amount of such short-term capital gain is chargeable to tax at 10 per cent‡ (even for the assessment year 2009-10 the rate is 10 per cent)‡.

186.4 ***Cumulative impact of sections 10, 111A and 112*** - Section 10(*33*) gives exemptions on capital gain (if any) arising on transfer of units of US-64. Section 10(*38*) gives exemption on long-term capital gain arising on transfer of equity shares, etc., if the transaction is covered by securities transaction tax [for detailed discussion, *see* para 170.2]. If securities transaction tax is applicable and capital gain is short-term capital gain, it is taxable at the lower rate 15 per cent‡ as given by section 111A. Long-term capital gain is taxable at the rate of 20 per cent‡ (if the benefit of indexation is not taken, it is taxable at the rate of 10 per cent‡ in some cases). The cumulative impact of these provisions is given below—

Income-tax rates

(*Add* surcharge, education cess and secondary and higher education cess, *see* Foot Note, para 186)

Capital asset	If transaction is covered by securities transaction tax at the time of transfer		If it is not covered by securities transaction tax		
	Long-term	Short-term	Long-term		Short-term
			Without indexation†	With indexation†	
US-64	0%	0%	0%	0%	0%
Units (equity oriented)	0%	15%	10%	20%	Normal
Units (others)	NA	NA	10%	20%	Normal
Equity shares (listed) (any other)	0%	15%	10%	20%	Normal
Equity shares (not listed)	NA	NA	NA	20%	Normal
Preference shares (listed)	NA	NA	10%	20%	Normal
Preference shares (not listed)	NA	NA	NA	20%	Normal
Debentures (listed)	NA	NA	10%	NA	Normal
Debentures (not listed)	NA	NA	20%	NA	Normal
Government securities	NA	NA	10%	20%	Normal

NA = Not applicable

Note - Securities transaction tax is applicable in the case of transfer of equity shares and units of equity oriented mutual fund on or after October 1, 2004. It is applicable only if these assets are transferred in a recognized stock exchange in India. It is also applicable if units of equity oriented mutual fund are transferred to the mutual fund. If these assets are transferred without recording the transaction in a recognized stock exchange in India or if units of equity oriented mutual fund are transferred to a person other than the mutual fund, securities transaction tax is not applicable, even if the transfer takes place on or after October 1, 2004.

†It is at the option of the assessee.

‡*Plus* SC, EC, and SHEC. *See* Foot Note, para 186.

186-P1 *From the following data, find out the tax liability for the assessment year 2009-10 :*

	X (an individual) (32 years) Rs.	AB(HUF) Rs.	X (P.) Ltd. Rs.	Y (an individual) (69 years) Rs.
Income from house property	25,000	12,000	70,000	1,24,000
Capital gain				
- Short-term	12,000	12,000	28,000	60,000
- Long-term on sale of land	1,50,000	2,20,000	1,06,000	1,36,000
Deduction under sections 80D and 80G	4,000	8,000	4,000	12,000
Payment of life insurance premium, contribution to public provident fund	23,000	10,000	—	17,000
SOLUTION :				
Computation of net income				
Income from house property	25,000	12,000	70,000	1,24,000
Capital gain	1,62,000	2,32,000	1,34,000	1,96,000
Gross total income	1,87,000	2,44,000	2,04,000	3,20,000
Less : Deductions				
Under section 80C	23,000	10,000	—	17,000
Under sections 80D and 80G	4,000	8,000	4,000	12,000
Net income	1,60,000	2,26,000	2,00,000	2,91,000
Computation of tax				
Net income (excluding long-term capital gain)(a)	10,000	6,000	94,000	1,55,000
Income-tax on (a)	*Nil*	*Nil*	28,200	*Nil*
Income-tax on long-term capital gain *20% of [Rs. 1,50,000 — (Rs. 1,50,000 — 10,000)], **20% of [Rs. 2,20,000 — (Rs. 1,50,000 — Rs. 6,000)] ; ***20% of Rs. 1,06,000, ****20% of [Rs. 1,36,000 — (Rs. 2,25,000 — Rs. 1,55,000) (b)	2,000*	15,200**	21,200***	13,200****
Total income-tax [(a) + (b)]	2,000	15,200	49,400	13,200
Add : Surcharge	—†	—†	*Nil*‡	—†
Tax and surcharge	2,000	15,200	49,400	13,200
Add: Education cess*	40	304	988	264
Add : Secondary and higher education cess	20	152	494	132
Tax payable (rounded off)	2,060	15,660	50,880	13,600

186-P2 *X (date of birth : June 10, 1942) has income of Rs. 14,15,000 (i.e., long-term capital gain on sale of a house : Rs. 94,000, pension : Rs. 59,000 and bank interest : Rs. 12,62,000). He pays Rs. 30,000 as insurance premium annually. Find out tax liability for the assessment year 2009-10.*

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†In the case of an individual and Hindu undivided family, surcharge for the assessment year 2009-10 is applicable only if net income exceeds Rs. 10,00,000.

‡ Surcharge is 10% of tax in case of a company for the assessment year 2009-10 only if net income exceeds Rs. 1 crore.

*Education cess is 2% of tax and surcharge for the assessment year 2009-10.

SOLUTION : *Computation of net income*	Rs.
Salary	59,000
Long-term capital gain	94,000
Interest	12,62,000
Gross total income	14,15,000
Less : Deduction under section 80C	30,000
Net income	13,85,000
Tax on net income other than long-term capital gain (*i.e.*, Rs. 13,85,000 — 94,000)(*a*)	2,84,800
Tax on long-term capital gain @ 20% of Rs. 94,000 (*b*)	18,800
Computation of tax liability	
Tax on net income [*i.e.*, (*a*)+(*b*)](*c*)	3,03,600
Add : Surcharge	30,360
Tax and surcharge	3,33,960
Add : Education cess (2% of tax and surcharge)	6,679
Add : Secondary and higher education cess (1% of tax and surcharge)	3,340
Tax payable	3,43,980

186-P3 *X (29 years) has the following income for the previous year 2008-09.*

Business income	(–)1,18,000
- *Short-term capital gain*	1,13,000
- *Long-term capital gain on sale of land*	5,22,000

Find out the tax liability for the assessment year 2009-10, assuming that he pays life insurance premium of Rs. 53,000 and he is (a) resident and ordinarily resident in India (b) resident and not ordinarily resident in India, and (c) non-resident in India :

	Resident and ordinarily resident Rs.	*Resident and not ordinarily resident* Rs.	*Non-resident*
Business income (loss is adjusted against long-term capital gain)	*Nil*	*Nil*	*Nil*
Short-term capital gain	1,13,000	1,13,000	1,13,000
Long-term capital gain (after adjustment of business loss)	4,04,000	4,04,000	4,04,000
Gross total income	5,17,000	5,17,000	5,17,000
Less : Deduction under section 80C [deduction under sections 80C to 80U cannot be deducted from long-term capital gains]	53,000	53,000	53,000
Net income	4,64,000	4,64,000	4,64,000
- Long-term capital gain	4,04,000	4,04,000	4,04,000
- Other income	60,000	60,000	60,000
Tax on net income [see Note 1]	62,800	62,800	80,800
Add : Education cess (2% of tax and surcharge)	1,256	1,256	1,616
Add : Secondary and higher education cess (1% of tax and surcharge	628	628	808
Tax payable (rounded off)	64,680	64,680	83,220

Notes :

1. In the case of a resident individual, if the net income (other than long-term capital gain) is below the amount of first slab which is not taxable (*i.e.*, Rs. 1,50,000), then the long-term capital gain shall be reduced by the amount by which the total income (other than long-term capital gain) falls short of the maximum amount which is not chargeable to tax.

In the case of resident and ordinarily resident and not ordinarily resident, net income (other than long-term capital gain) is 60,000, *i.e.*, less than Rs. 1,50,000. Therefore, long-term capital gain shall be reduced by the difference between Rs. 1,50,000 and Rs. 60,000 (such difference is Rs. 90,000). Tax on long-term capital gain (Rs. 4,04,000 – Rs. 90,000) @ 20% is Rs. 62,800.

In the case of non-resident, net income (*i.e.*, Rs. 4,64,000) includes long-term capital gain of Rs. 4,04,000 and other income of Rs. 60,000. Tax on long-term capital gain @ 20% is Rs. 80,800.

186-P4 *On June 30, 2008, X (32 years) sells the following assets —*

	Equity shares in A Ltd. (listed) Rs.	Equity shares in B Ltd. (listed) Rs.	Shares in C Ltd. (non-listed) Rs.
Sale consideration	*5,00,000*	*5,80,000*	*6,89,000*
Cost of acquisition	*26,000*	*1,10,000*	*20,000*
Date of acquisition	*May 10, 1982*	*June 6, 1983*	*April 6, 1984*

Income of X from other sources is Rs. 7,86,000. X deposits Rs. 50,000 in public provident fund. Find out the net income and tax liability for the assessment year 2009-10 under the following two situations : (a) the shares are sold outside the recognised stock exchange; and (b) the shares are transferred through a recognised stock exchange.

SOLUTION : *Computation of long-term capital gain*

	Equity shares in A Ltd. Rs.	Equity shares in B Ltd. Rs.	Shares in C Ltd. Rs.
Sale consideration	5,00,000	5,80,000	6,89,000
Less : Indexed cost of acquisition	1,38,826[1]	5,51,897[2]	93,120[3]
Long-term capital gain	3,61,174	28,103	5,95,880

Computation of net income

Long-term capital gain	9,85,157
Income from other sources	7,86,000
Gross total income	17,71,157
Less : Deductions under section 80C	50,000
Net income (rounded off)	17,21,160

Computation of tax

Tax on income other than long-term capital gain (*i.e.*, tax on Rs. 7,36,000)	1,25,800
Add : Tax on long-term capital gain (see Note 1)	1,72,197
Tax	2,97,997
Add : Surcharge @ 10%*	29,800
Tax and surcharge	3,27,797
Add : Education cess (2% of tax and surcharge)	6,556
Add : Secondary and higher education cess (1% of tax and surcharge)	3,278
Tax payable (rounded off)	3,37,630

1. Rs. 26,000 ÷ 109 × 582.
2. Rs. 1,10,000 ÷ 116 × 582.
3. Rs. 20,000 ÷ 125 × 582.

* Surcharge is 10% of tax in case the net income exceeds Rs. 10 lakh.

Notes

1. Computation of tax on long-term capital gain

	Shares in A Ltd. Rs.	Shares in B Ltd. Rs.	Shares in C Ltd. Rs.
Tax on long-term capital gain as computed (after deducting indexed cost of acquisition) @ 20% (a)	72,235	5,621	1,19,176
Whether option mentioned in para 186.2 is available [*shares in C Ltd. are non-listed]	Yes	Yes	No*
Sale consideration	5,00,000	5,80,000	—
Less : Cost of acquisition	26,000	1,10,000	—
Balance (b)	4,74,000	4,70,000	—
Tax on (b) @ 10% (c)	47,400	47,000	—
Effective tax [(a) or (c), whichever is lower]	47,400	5,621	1,19,176

Computation of total income under situation (b)

	Rs.
Long-term capital gain [see Note]	5,95,880
Income from other sources	7,86,000
Gross total income	13,81,880
Less : Deduction under section 80C	50,000
Net income (rounded off)	13,31,880

Computation of tax

Tax on income other than long-term capital gain (i.e., Rs. 7,36,000)	1,25,800
Add : Tax on long-term capital gain (see Note)	1,19,176
Tax	2,44,976
Add : Surcharge @ 10% (surcharge is 10% of tax in case net income exceeds Rs. 10,00,000)	24,498
Tax and surcharge	2,69,474
Add : Education cess @ 2%	5,389
Add : Secondary and higher education cess @ 1%	2,695
Tax payable	2,77,560

Note : When listed equity shares are transferred through a recognised stock exchange, X has to pay securities transaction tax of Rs. 1,350 (0.125% × Rs. 10,80,000) and long-term capital gain is exempt from tax.

186-P5 *On April 20, 2008, X (31 years) sells the following assets —*

	Sale consideration Rs.
1. Self-generated goodwill of a business (long-term)	*14,00,000*
2. Bonus shares in A Ltd. (listed) (being long-term capital asset)	*6,00,000*
3. Bonus shares in B Ltd. (non-listed) (being short-term capital asset)	*8,00,000*
4. Listed debentures of C Ltd. (acquired on March 6, 1984 for Rs. 40,000)	*1,00,000*

Find out the tax liability of X for the assessment year 2009-10 on the assumption that his business income is Rs. 6,000 in the following two situations :

(a) When shares are transferred outside a recognized stock exchange.

(b) When shares of A Ltd. are transferred through a recognised stock exchange.

SOLUTION : *Computation of capital gain*

	Goodwill Rs.	Listed bonus shares in A Ltd. Rs.	Non-listed bonus shares in B Ltd. Rs.	Listed debentures of C Ltd. Rs.
Sale consideration	14,00,000	6,00,000	8,00,000	1,00,000
Less : Cost of acquisition [*the benefit of indexation is not available in the case of transfer of debentures/ bonds]	*Nil*	*Nil*	*Nil*	40,000*
Short-term capital gain	-	-	8,00,000	-
Long-term capital gain	14,00,000	6,00,000	-	60,000

Computation of income

	Rs.	*Rs.*
Business income		6,000
Capital gain		
- Short-term	8,00,000	
- Long-term	20,60,000	28,60,000
Net income		28,66,000

Computation of tax	Situation (a)	Situation (b)
Tax on income other than long-term capital gain (*i.e.*, tax on Rs. 8,06,000)	1,46,800	1,46,800
Tax on long-term capital gain [20% of Rs. 14,00,000 + 10% of Rs. 6,00,000 + 10% of Rs. 60,000] [long-term capital gain of Rs. 6,00,000 is not taxable in situation (b)]	3,46,000	2,86,000
Tax	4,92,800	4,32,800
Add : Surcharge @ 10%*	49,280	43,280
Tax and surcharge	5,42,080	4,76,080
Add : Education cess (2% of tax and surcharge)	10,842	9,522
Add : Secondary and higher education cess (1% of tax and surcharge)	5,421	4,761
Tax payable (rounded off)	5,58,340	4,90,360

Notes :

1. In the case of listed bonus shares and listed debentures/bonds, it is better if tax is payable under the *Option 2* mentioned in para 186.2.

2. As the shares in A Ltd. are transferred on or after October 1, 2004, X will have to pay securities transaction tax [*i.e.*, 0.125% of Rs. 6,00,000] if such shares are transferred in a recognised stock exchange and long-term capital gains will not be chargeable to tax.

186-P6 *For the assessment year 2009-10, Mrs. X (36 years), a resident individual, gives the following information -*

	Rs.
Short-term capital gain which satisfies conditions given in para 186.3 (ST)	*1,37,000*
Other income	*1,83,000*
Amount deductible under sections 80C and 80G	*7,000*
Net income (NI)	*3,13,000*

SOLUTION : In this case, the two conditions are satisfied (*i.e.*, the taxpayer is a resident individual and NI — ST is Rs. 1,76,000 (which is lower than the exemption limit of Rs. 1,80,000). Consequently, from the short-term capital gain, the following shall be deducted -

* Surcharge is 10% of tax in case the net income exceeds Rs. 10 lakh for the assessment year 2009-10.

Rs. 1,80,000 (exemption limit) — [Rs. 3,13,000 (NI) — Rs. 1,37,000 (ST)] = Rs. 4,000

Computation of net income and tax

	Short-term capital gain under section 111A Rs.	Other incomes Rs.	Total Rs.
Income	1,37,000	1,83,000	3,20,000
Less: Deduction under sections 80C and 80G	-	7,000	7,000
Net income	1,37,000	1,76,000	3,13,000
Income-tax on net income [10% of Rs. 1,33,000 (*i.e.*, Rs.1,37,000 - Rs. 4,000 calculated above)]	13,300	*Nil*	13,300
Add: Surcharge	*Nil*	*Nil*	*Nil*
Add: Education cess (2% of tax and surcharge)	266	*Nil*	266
Add : Secondary and higher education cess (1% of tax and surcharge)	133	*Nil*	133
Tax liability (rounded off)	13,700	*Nil*	13,700

186-P7 *The following information is given by X (40 years) for the assessment year 2008-09 -*

	Rs.
Sale consideration of equity shares	*2,00,000*
Indexed cost of acquisition (purchased in 1981)	*1,43,000*
Other incomes	*5,50,000*
PPF contribution	*70,000*

Find out net income and tax liability of X for the assessment year 2009-10 firstly on the assumption that equity shares are transferred on April 10, 2008 (outside a recognised stock exchange) and secondly, on the assumption that equity shares are transferred on April 10, 2008 in Bombay Stock Exchange.

SOLUTION :

	If equity shares are transferred outside stock exchange	If equity shares are transferred in Bombay Stock Exchange
	Rs.	Rs.
Sale consideration	2,00,000	2,00,000
Less: Indexed cost of acquisition	1,43,000	1,43,000
Long-term capital gains	57,000	*Nil*
Other incomes	5,50,000	5,50,000
Gross total income	6,07,000	5,50,000
Less : Deduction under section 80C	70,000	70,000
Net income	5,37,000	4,80,000
Income-tax on other income	51,000	51,000
Add: Tax on long-term capital gains	11,400	*Nil*
Total	62,400	51,000
Add: Surcharge	*Nil*	*Nil*
Add: Education cess	1,248	1,020
Add : Secondary and higher education cess	624	510
Tax liability (rounded off)	64,270	52,530

Note : If equity shares (or units of equity oriented mutual fund) are transferred and the transaction is recorded in a recognized stock exchange in India (or units are transferred to the mutual fund), then the transaction is covered by

the securities transaction tax (0.125% of the sale consideration is the amount of securities transaction tax which is payable by the seller and the same amount is payable by purchaser). It may be noted that if these conditions are satisfied, securities transaction tax is payable irrespective of the fact whether the seller has generated long-term capital gain (or loss) or short-term capital gain (or loss). If securities transaction tax is applicable, then—

a. long-term capital gains in the hands of the seller is not chargeable to tax (conversely, long-term capital loss is not taken into consideration);

b. short-term capital gains is taxable under section 111A @ 15% + surcharge, if any + education cess + secondary and higher education cess.

In the above problem, if equity shares are transferred in Bombay Stock Exchange; securities transaction tax is applicable (X has to pay securities transaction tax which is 0.125% of Rs. 2,00,000, *i.e.*, Rs. 250). Long-term capital gain is not chargeable to tax.

186-P8 *The following information is given by Mrs. X (32 years) for the assessment year 2009-10—*

	Rs.
Sale consideration of equity shares	*70,000*
Indexed cost of acquisition of equity shares	*5,45,000*
Sale consideration of gold	*8,00,000*
Indexed cost of acquisition of gold	*60,000*
Other incomes	*8,00,000*
PPF contribution	*70,000*

Find out net income and tax liability of Mrs. X for the assessment year 2009-10 firstly on the assumption that equity shares are transferred on May 31, 2008 privately to a friend and, secondly, on the assumption that equity shares are transferred on May 31, 2008 in the National Stock Exchange.

SOLUTION :

	If equity shares are transferred outside stock exchange Rs.	If equity shares are transferred in a recognised stock exchange Rs.
Long-term capital loss on equity shares	(-) 4,75,000	*Nil*
Long-term capital gain on gold	7,40,000	7,40,000
Other incomes	8,00,000	8,00,000
Gross total income	10,65,000	15,40,000
Less : Deduction under section 80C	70,000	70,000
Net income	9,95,000	14,70,000
Income-tax on other income	1,21,000	1,21,000
Add: Tax on long-term capital gains	53,000	1,48,000
Total	1,74,000	2,69,000
Add: Surcharge	*Nil*	26,900
Total	1,74,000	2,95,900
Add: Education cess	3,480	5,918
Add : Secondary and higher education cess	1,740	2,959
Tax liability (rounded off)	1,79,220	3,04,780

Note: In the above problem, if equity shares are transferred in a recognised stock exchange, securities transaction tax is applicable (Mrs. X has to pay securities transaction tax which is 0.125% of Rs. 70,000, *i.e.*, Rs. 88). Long-term capital gain in such a case is exempt from tax. Conversely, long-term capital loss is not taken into consideration.

Hints for tax planning

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

- Since long-term capital gains bear lower tax, taxpayers should so plan as to transfer their capital assets normally only 36 months* after acquisition. It is pertinent to note that if capital asset is one which became the property of the taxpayer in any of the manner specified in para 173.1-1, the period for which it was held by the previous owner is also to be counted in computing 36 months*.
- The assessee should take advantage of exemption under section 54 by investing the capital gain arising from the sale of residential house property in the purchase of another house (even out of India) within the specified period.
- In order to claim advantage of exemption under sections 54B and 54D it should be ensured that the investment in new asset is made only after effecting transfer of capital assets.
- In order to take the advantage of exemption under sections 54, 54B, 54D, 54EC, 54F, 54G and 54GA the taxpayer should ensure that the newly acquired asset is not transferred within three years from the date of acquisition. In this context, it is interesting to note that the transfer (one year in the case of section 54EC) of a newly acquired asset according to the modes mentioned section 47 is not regarded as "transfer" even for this purpose. Consequently, newly acquired assets may be transferred even within 3 years of their acquisition according to the modes mentioned in section 47 without attracting capital gains tax liability. Alternatively, it will be advisable that instead of selling or converting assets acquired under sections 54, 54B, 54D, 54F, 54G and 54GA into money, the taxpayer should obtain loan against the security of such asset (even by pledge) to meet the exigency.
- In two cases, surplus arising on sale or transfer of capital assets is chargeable to tax as short-term capital gain by virtue of section 50. These cases are : (*a*) when written down value of a block of assets is reduced to *nil*, though all the assets falling in that block are not transferred, (*b*) when a block of assets ceases to exist.

Tax on short-term capital gain can be avoided if —

a. another capital asset, falling in that block of assets, is acquired at any time during the previous year ; or

b. benefit of section 54G is availed [*see* para 184].

Taxpayers desiring to avoid tax on short-term capital gains under section 50 on sale or transfer of capital asset, can acquire another capital asset, falling in that block of assets, at any time during the previous year.

For this purpose, the following case study should be examined :

X Ltd. maintains books of account on the basis of financial year. On April 1, 2008, the depreciated value of assets is as follows :

First block : Plant (rate of depreciation : 15%)

	Rs.
Plant A	20,000
Plant B	4,10,000
Plant C	60,000

Second block : Plant (rate of depreciation : 30 per cent)

Plant P	10,65,000
Plant Q	25,00,000

During the previous year 2008-09, the company has purchased/sold the following plants :

Asset	Date of sale/purchase	Cost Rs.	Selling price Rs.	Rate of depreciation
Plant D (Office equipment)	April 20, 2008	45,000	—	25%
Plant B	May 10, 2008	—	10,60,000	25%
Plant P	May 15, 2008	—	2,00,000	40%

*12 months in some cases—*see* para 168.

		Rs.
Depreciation in respect of the First Block		
Depreciated value of Plants A, B and C on April 1, 2008		4,90,000
Add: Cost of Plant D acquired during the previous year		45,000
Total		5,35,000
Less: Sale proceeds of Plant B (*not to exceed Rs. 5,35,000)		5,35,000
Written down value		*Nil*
Depreciation		*Nil*
Capital gain on sale of Plant B:		
Sale proceeds		10,60,000
Less: Cost of acquisition	*Rs.*	
Depreciated value of the first block on April 1, 2008 [*i.e.*, Rs. 20,000 + Rs. 4,10,000 + Rs. 60,000]	4,90,000	
Cost of Plant D acquired during 2008-09	45,000	5,35,000
Short-term capital gain		5,25,000
Tax on short-term capital gain [*i.e.*, 30% of Rs. 5,25,000]		1,57,500
Add: Surcharge (10% of tax in case net income exceeds Rs. 1 crore)		—
Tax and surcharge		1,57,500
Add: Education cess (2% of tax and surcharge)		3,150
Add: Secondary and higher education cess (1% of tax and surcharge)		1,575
Tax liability (rounded off)		1,62,230

Tax liability of Rs. 1,62,230 can, however, be avoided if a plant of Rs. 5,25,000 eligible for depreciation, at the rate of 15 per cent, is acquired at any time during the previous year 2008-09. Suppose X Ltd. acquires Plant E (new) for Rs. 5,25,000 on March 31, 2009, amount of depreciation/short-term capital gain would be as follows :

		Rs.
Depreciation in respect of the first block:		
Depreciated value of Plants A, B and C on April 1, 2008		4,90,000
Add: Cost of Plants D and E acquired during the year 2008-09 (Rs. 45,000 + Rs. 5,25,000)		5,70,000
Total		10,60,000
Less: Sale proceeds of Plant B		10,60,000
Written down value		*Nil*
Depreciation†		*Nil*
Capital gains		
Sale proceeds		10,60,000
Less: Depreciated value of the first block on April 1, 2008	4,90,000	
Cost of Plants D and E acquired during the previous year	5,70,000	10,60,000
Short-term capital gain		*Nil*
Impact on cash flow due to purchase of Plant E:		
Tax saving on short-term capital gain @30.9%		(+)1,62,225
Cash outflow on account of purchase of Plant E		(–)5,25,000
Effective cash inflow/outflow on account of purchase of Plant E for Rs. 5,25,000		(–)3,62,775

■ If securities transaction tax is applicable, long-term capital gain is exempt from tax by virtue of section 10(*38*). Conversely, if the taxpayer has generated long-term capital loss, it is taken as equal to zero. Consider the case of Mrs. X in Problem 186-P8. If shares are transferred, in National Stock Exchange, securities transaction tax is applicable and as a consequence, the long-term capital loss of Rs. 4,75,000 is ignored. In such a case, tax liability can be reduced, if Mrs. X transfers shares to a friend or relative outside the stock exchange at the market price (securities transaction tax is not applicable in the case of transactions not recorded in stock exchange, long-term capital loss can be

†The company can claim additional depreciation of Rs. 52,500 if a few conditions are satisfied - *See* para 109.8

set off and the tax liability Mrs. X will be reduced to Rs. 1,25,560). Later on, the friend or relative, who has purchased shares, may transfer shares in a stock exchange.

Problems on computation of capital gains

188-P1 *X, an individual, sells a residential house at Madras on July 10, 2008 for Rs. 24,90,000 (cost of plot of land acquired in 1985-86 : Rs. 60,000, cost of construction in 1985-86 : Rs. 2,50,000). To claim exemption under section 54, X makes the following investments :*

Date of investment	Investment	Amount Rs.
December 10, 2008	*Purchase of a residential house at Delhi*	*2,60,000*
July 31, 2009	*Deposit in bank account for utilising for purchase/construction of house*	*7,75,000*
July 9, 2010	*Purchase of a residential house at Pune (amount invested by withdrawing from the bank account)*	*3,50,000*
July 9, 2011	*Construction of house at Bombay completed (amount is invested by withdrawing from deposit account)*	*3,75,000*

After March 31, 2009, X sells the following assets :

Date of sale	Assets sold	Consideration received Rs.
December 31, 2009	*Residential house at Delhi*	*6,05,000*
July 15, 2011	*Residential house at Pune*	*8,90,000*
July 10, 2014	*Residential house at Bombay*	*16,40,000*

Determine the taxable income of X for the assessment years 2009-10 to 2015-16, taking into consideration the following information :

Previous year	Other income (i.e., income taxable under section 56) Rs.
2008-09	*5,60,000*
2009-10	*6,70,000*
2010-11	*7,80,000*
2011-12	*8,95,000*
2012-13	*9,86,000*
2013-14	*10,92,000*
2014-15	*11,30,000*

SOLUTION : *Previous year 2008-09 (assessment year 2009-10)*

		Rs.
Sale proceeds of residential house at Madras		24,90,000
Less : Indexed cost of acquisition (*i.e.*, Rs. 3,10,000 × 582 ÷ 133)		13,56,541
Balance		11,33,459
Less : Exemption under section 54	Rs.	
Purchase of residential house at Delhi	2,60,000	
Amount deposited in bank account for purchase/construction of residential house in future	7,75,000	10,35,000
Capital gains		98,459
Income from other sources		5,60,000
Gross total income		6,58,459
Less : Deductions under sections 80C to 80U		*Nil*
Net income (rounded off)		6,58,460

	Rs.
Previous year 2009-10 (assessment year 2010-11)	
Sale proceeds of residential house at Delhi	6,05,000
Less : Cost of acquisition (Rs. 2,60,000 being the actual cost, *minus* Rs. 2,60,000, being the exemption availed under section 54, exemption under section 54 is to be deducted as the house is sold within 3 years)	*Nil*
Capital gain	6,05,000
Income from other sources	6,70,000
Gross total income	12,75,000
Less : Deductions under sections 80C to 80U	*Nil*
Net income	12,75,000
Previous year 2010-11 (assessment year 2011-12)	
Net income (being income from other sources)	7,80,000
Previous year 2011-12 (assessment year 2012-13)	
Sale proceeds of residential house at Pune within 3 years from the date of purchase	8,90,000
Less : Cost of acquisition (*i.e.*, Rs. 3,50,000 *minus* Rs. 3,50,000 being exemption availed under section 54)	*Nil*
Short-term capital gain (a)	8,90,000
Long-term capital gains (being the amount of bank deposit not utilised up to June 10, 2009 for purchase or construction of house), *i.e.*, Rs. 7,75,000 — Rs. 3,50,000 — Rs. 3,75,000)	50,000
Income from other sources	8,95,000
Gross total income	18,35,000
Less : Deductions under sections 80C to 80U	*Nil*
Net income	18,35,000
Previous year 2012-13 (assessment year 2013-14)	
Net income (being income from other sources)	9,86,000
Previous year 2013-14 (assessment year 2014-15)	
Net income (being income from other sources)	10,92,000
Previous year 2014-15 (assessment year 2015-16)	
Sale proceeds of residential house at Bombay	16,40,000
Less : Indexed cost of acquisition (exemption availed under section 54 is not deducted as the house is sold after 3 years, Rs. 3,75,000 × 780* ÷ 690*)	4,23,913
Capital gain	12,16,087
Income from other sources	11,30,000
Gross total income	23,46,087
Less : Deductions under sections 80C to 80U	*Nil*
Net income (rounded off)	23,46,090

188-P2 *During the previous year ending on March 31, 2009, X sells the following :*

	Date of sale	Sale proceeds Rs.	Cost of acquisition Rs.	Year of purchase	Fair market value on April 1, 1981 Rs.
Preference shares	*April 10, 2008*	*4,10,000*	*1,00,000*	*1993-94*	*1,80,000*
Agricultural land in rural area (outside the municipal limits)	*May 25, 2008*	*30,00,000*	*2,30,000*	*1973-74*	*3,40,000*

*Assumed.

	Date of sale	Sale proceeds Rs.	Cost of acquisition Rs.	Year of purchase	Fair market value on April 1, 1981 Rs.
Agricultural land in urban area	*June 10, 2008*	*27,00,000*	*6,17,250*	*1986-87*	*2,00,000*
Debentures (listed)	*April 10, 2008*	*3,17,900*	*2,30,615*	*1993-94*	*1,80,000*
Personal car	*July 1, 2008*	*1,25,000*	*70,000*	*1986-87*	*NA*

On July 31, 2009 (being the due date of furnishing return of income), X deposits Rs. 1,00,000 under section 54B for claiming exemption in future by purchasing agricultural land. By withdrawing from the deposit account, he purchases agricultural land for Rs. 70,000 till June 9, 2010. Assuming that the income of X from other sources for the previous years 2008-09 and 2010-11 is Rs. 86,000 and Rs. 1,92,000, respectively, find out taxable income for the assessment years 2009-10 and 2011-12.

SOLUTION : *Previous year 2008-09 (assessment year 2009-10)*

Capital gain	Rural agricultural land Rs.	Urban agricultural land Rs.	Shares Rs.	Debentures Rs.	Personal car Rs.
Sale proceeds	30,00,000	27,00,000	4,10,000	3,17,900	1,25,000
Less : Indexed cost of acquisition	N.A.	25,65,996[1]	2,38,525[2]	2,30,615[3]	NA
Capital gain (*agricultural land in rural area and personal car are not capital assets, surplus arising on sale of these is not taxable at all)	—*	1,34,004	1,71,475	87,285	—*
Less : Exemption under section 54B	—	1,00,000	—	—	—
Balance	—	34,004	1,71,475	87,285	—

Income under the head "Capital gains"	2,92,764
Income from other sources	86,000
Gross total income	3,78,764
Less : Deduction under sections 80C to 80U	*Nil*
Net income	3,78,760
Previous year 2010-11 (assessment year 2011-12)	
Amount deposited in bank account on July 31, 2009	1,00,000
Less : Amount utilised for purchase of agricultural land within 2 years from sale of agricultural land (*i.e.*, up to June 9, 2010)	70,000
Long-term capital gain	30,000
Income from other sources	1,92,000
Net income	2,22,000

1. Rs. 6,17,250 × 582 ÷ 140
2. Rs. 1,00,000 × 582 ÷ 244
3. The benefit of indexation is not available in the case of transfer of debentures.

188-P3 *X enters into a partnership with three other persons on July 1, 2008 to start a manufacturing business. The following capital assets are contributed by X as his capital contribution :*

	Land Rs.	Gold Rs.	Preference Shares Rs.
Fair market value on the date of transfer by X to the firm (i.e., July 1, 2008)	*19,00,000*	*9,00,000*	*4,00,000*
Amount recorded in books of the firm	*17,00,000*	*6,90,000*	*4,50,000*
Date of acquisition	*May 1, 1942*	*June 10, 2006*	*November 2, 2007*
Cost of acquisition	*1,500*	*4,40,000*	*4,70,000*
Fair market value on January 1,1981	*90,000*	-	-

On July 31, 2008, he deposits Rs. 13,00,000 in a bank account for purpose of availing exemption under section 54F (he owns one residential house). Construction of a residential house at Bombay is completed on June 21, 2011. Rs. 8,60,000, being the amount of investment, is financed by withdrawing from the deposit account. Assuming that income of X from other sources (except capital gain) for the previous years 2008-09 and 2011-12 is Rs. 80,000 and Rs. 2,40,000, respectively, determine the net income of X for the assessment years 2009-10 and 2012-13.

SOLUTION : *Assessment year 2009-10 (previous year 2008-09)*

Capital gain	Land Rs.	Gold Rs.	Preference Shares Rs.
Value of consideration received as a result of transfer of assets to firm (i.e., amount recorded in books of account)	17,00,000	6,90,000	4,50,000
Less : Indexed cost of acquisition	5,23,800[1]	4,40,000	4,70,000
Capital gain	11,76,200	2,50,000	(–)20,000
Less : Exemption under section 54F (i.e., Rs. 13,00,000 ÷ Rs. 17,00,000 × 11,76,200)	8,99,447	—	—
Balance	2,76,753	2,50,000	(–)20,000
Capital gain			5,06,753
Other income			80,000
Net income (rounded off)			5,86,753

1. Rs. 90,000 × 582 ÷ 100

Assessment year 2012-13 (previous year 2011-12) - Since X has not fully utilised the deposit account for purchase/ construction of residential house, the amount left unutilised by June 30, 2011 will be considered for calculating deemed capital gains.

	Rs.
Amount utilised out of the deposit account (a)	8,60,000
Sale proceeds of land (b)	17,00,000
Capital gain (c)	11,76,200
Amount of exemption [(a) ÷ (b) × (c)]	5,95,019
Amount of exemption availed during the assessment year 2009-10	8,99,447
Excess of exemption taxable as deemed long-term capital gain	3,04,428
Other income	2,40,000
Net income (rounded off)	5,44,430

The following points should also be noted :

1. If he sells the residential house at Bombay before June 21, 2014, the amount of exemption under section 54F (i.e., Rs. 5,95,019) will be deemed as long-term capital gain of the year in which the house is sold.

2. If X purchases (before July 1, 2010) or constructs (before July 1, 2011) any other residential house (whose income is chargeable to tax under section 22), then exemption of Rs. 5,95,019 will be deemed as long-term capital gain of the year in which another house is purchased or constructed.

188-P4 *Discuss the following :*

1.X acquired a plot of land on June 30,1981 for Rs. 1,10,000. The funds invested were borrowed at the rate of 9 per cent per annum (the amount was repaid by X on March 31,1985). X sells the plot of land on June 30, 2008 for Rs. 10,00,000. What will be the amount of capital gains for the assessment year 2009-10? Can X claim deduction of ground rent paid by him?

2. XY & Co., a partnership firm, owns a house property which is utilised by partners for their residence. On June 30, 2008, the firm sells the property at a long-term capital gains of Rs. 1,20,000. Can the firm or partners claim exemption under section 54?

SOLUTION : 1. Capital gains is computed after deducting cost of acquisition from the amount of sale consideration. The cost of acquisition may include an expenditure incurred after the date of acquisition, e.g., interest on funds borrowed for payment of purchase consideration—*CIT* v. *Mithilesh Kumari* [1973] 92 ITR 9 (Delhi). Therefore, in the given problem, long-term capital gains would be calculated as under :

	Rs.	Rs.
Sale proceeds		10,00,000
Less : Indexed cost of acquisition		
Purchase consideration (*i.e.*, Rs. 1,10,000 × 582 ÷ 100)	6,40,200	
Interest for 1981-82 (*i.e.*, Rs. 7,425 × 582 ÷ 100)	43,214	
Interest for 1982-83 (*i.e.*, Rs. 9,900 × 582 ÷ 109)	52,861	
Interest for 1983-84 (*i.e.*, Rs. 9,900 × 582 ÷ 116)	49,671	
Interest for 1984-85 (*i.e.*, Rs. 9,900 × 582 ÷ 125)	46,094	8,32,040
Long-term capital gain		1,67,960

Notes : X cannot claim deduction of ground rent from long-term capital gains as ground rent constitutes an expenditure incurred for the purpose of the maintenance of capital asset and not for the purpose of its acquisition—*CIT* v. *Mithilesh Kumari* [1973] 92 ITR 9 (Delhi).

2. Benefit under section 54 can be availed only if the house property is owned by an individual or Hindu undivided family. Therefore, the firm cannot claim deduction under section 54. Moreover, the partners of the firm also cannot claim the benefit of section 54 as the transferor of the asset is the firm and not the partners.

188-P5 *X owns 1,000 partly paid shares in a company. These shares have been forfeited by the company for non-payment of call money. X wants to claim Rs. 8,000 (i.e., amount paid at the time of application and allotment) as short-term capital loss. Is the claim of X tenable?*

SOLUTION : The forfeiture of partly paid shares because of non-payment of call money is in accordance with articles 29 to 35 in Table A of Schedule I of the Companies Act, 1956. Under rule 7 of Table A, a person becomes member of a company as soon as the shares have been allotted to him. The holder of such shares is also entitled to receive, within 3 months of allotment, relevant share certificate. Therefore, it can be said that X was legal owner of shares at the time of forfeiture. The point for consideration is whether forfeiture of shares amounts to a "transfer" under section 2(47). Transfer in relation to capital asset includes "the extinguishment of any rights therein". The Gujarat High Court in *CIT* v. *Vania Silk Mills (P.) Ltd.* [1977] 107 ITR 300 has *held* that the expression "the extinguishment of any rights therein" in section 2(47) covers every possible transaction which results in the destruction, annihilation, extinction, termination, cessation or cancellation, by satisfaction or otherwise, of all or any of the bundle of rights—qualitative or quantitative—which the assessee has in a capital asset, whether such asset is corporeal or incorporeal. In the given problem, X's rights in the shares are undoubtedly extinguished. There is, therefore, transfer of capital under section 2(47) and, accordingly X is entitled to claim short-term capital loss of Rs. 8,000.

188-P6 *X is a partner in a firm, A Co., along with three other persons. On December 31, 2008, the firm is dissolved and X takes over the following assets :*

	Plant and machinery (depreciation is claimed by the firm) Rs.	Residential house premises (no depreciation is claimed) Rs.
Fair market value of assets on December 31, 2008	*6,50,000*	*26,00,000*
Agreed value of assets taken over by X as per dissolution deed	*4,60,000*	*18,50,000*
*Cost of acquisition (*as per section 50)*	*3,10,000**	*90,000*
Year of acquisition	*1970*	*1940*
Fair market value on April 1, 1981	*—*	*4,40,000*

Discuss whether A Co. is liable for tax on any capital gains. Will X be able to claim depreciation in respect of plant and machinery on Rs. 6,50,000?

SOLUTION : With effect from April 1, 1988 (*i.e.*, the assessment year 1988-89) sub-section (4) is inserted in section 45 to provide for charging to tax on surplus arising from the transfer of capital asset by a firm to partners on dissolution of the firm or otherwise. It is taxable in the previous year in which the transfer takes place. For this purpose, fair market value of the asset on the date of such transfer is deemed to be the value of consideration received or accruing as a result of transfer.

Taxable capital gains of the firm will be determined as under :

	Plant Rs.	Residential house Rs.
Fair market value of assets on the date of transfer (agreed value is not relevant)	6,50,000	26,00,000
Less : Cost of acquisition (*as per section 50, **fair market value on April 1, 1981 × 582 ÷ 100)	3,10,000*	25,60,800**
Capital gain [*surplus arising on sale/transfer of depreciable asset is short-term capital gain, as per section 50]	3,40,000*	39,200

An assessee is entitled for depreciation on actual cost in the first year and on the written down value in the subsequent years. In the given problem X is entitled to claim depreciation in respect of plant and machinery on its actual cost, *i.e.*, Rs. 4,60,000, being the cost incurred by it on the acquisition of asset following the dissolution of the firm. Unless it is established by the Income-tax Department that the purchase price is determined amongst the partners by resorting to fraud, collusion and inflation and deflation of values for ulterior purposes, cost of the asset to a partner must necessarily be its cost to him at the time of dissolution whether mentioned in the dissolution deed or ascertain *aliunde*—*Kalooram Govindram* v. *CIT* [1965] 57 ITR 335 (SC). On the strength of this judgment, the Delhi High Court in *Raj Narain Agarwala* v.*CIT* [1970] 75 ITR 1 has held that on the dissolution of firm, if assets are divided amongst partners at a genuine valuation, the cost to the partner who utilises the assets in his business, is the valuation at which he took them over. Therefore, X is entitled for depreciation on Rs. 4,60,000.

188-P7 *X purchased in 1984-85, 42,000 (non-listed) shares of a company at the rate of Rs. 100 per share with a view to acquiring controlling interest of the company. In 2008-09, he sells the entire lot of 42,000 shares at the market value of Rs. 45 per share. On account of this sale, X wants to claim capital loss of Rs. 1,76,65,200 in the assessment year 2009-10. The Assessing Officer finds that X had purchased the shares in 1984-85 at the rate of Rs. 100 per share when the market value of the shares was Rs. 76 per share. According to the Assessing Officer, the extra price of Rs. 24 per share was paid by X to acquire the controlling rights of the company. The Assessing Officer, therefore, determines the amount of loss at Rs. 1,29,71,952, excluding the extra price of Rs. 24 per share. Is the Assessing Officer legally correct?*

SOLUTION : Controlling interest is an incidence arising from holding a particular number of shares in a company. It cannot be separately acquired or transferred. It flows from the fact that a number of shares are held by a person. If for acquiring that number of shares, a person is required to pay more than the market price and the transaction

is genuine, then the cost of acquisition is that which has actually been paid. It is not right to conclude that controlling interest is a distinct capital asset which can be acquired or transferred independently of the shares. Therefore, the view of the concerned Assessing Officer is not legally correct—*Maharani Ushadevi* v. *CIT* [1982] 8 Taxman 91 (MP).

188-P8 *A car in personal use for about 6 years is sold at a profit of about Rs. 58,000. Will the gain be taxable?*

SOLUTION : The point for consideration is whether a car used for personal purposes is a "capital asset" within the definition of the term in section 2(*14*). According to this definition, "capital asset" excludes "personal effects", that is to say, "movable property (including wearing apparel and furniture, but excluding jewellery) held for personal use by the assessee or any member of his family depending upon him". There is no court decision on the question whether a car is a "personal effect" with reference to this definition. According to *Black's Law Dictionary*, "personal effects" means "articles associated with person as property having more or less intimate relation to person of possessor". *The Random House Dictionary of the English Language* gives the meaning as "privately owned articles consisting chiefly of clothing, toilet items, etc., for intimate use by an individual". *The Cyclopaedic Law Dictionary* interprets the word as such tangible property as is carried out about the person. According to *Words and Phrases*, the term designates articles associated with the person or such tangible property as is worn or carried out by the person. In *H.H. Maharaja Rana Hemant Singhji* v. *CIT* [1976] 103 ITR 61, the Supreme Court observed that "the Legislature intended only those articles to be included in the definition which are intimately and commonly used by the assessee". Since the expression "personal effects" is imprecise and it has not been exhaustively defined in the Act, it may be taken to include a conveyance. According to this opinion, there can be no tax on the capital gain resulting from the sale of a conveyance which has been taken to cover a scooter, a car and even an aeroplane. There are at least four judgments of courts in other Commonwealth countries, which lend support to the construction of "personal" or "household" effects as including motor cars :

Australia - "I feel no difficulty about the word 'effects' being sufficient to cover a motor car, even apart from authorities,"— *Re. Tormey, Tormey* v. *Tormey* [1935] VLR 300. "If a horse-drawn carriage is a household effect, I see no reason why a motor car should not be a household effect, or why a motor car is any less a household effect than is a horse carriage"— *Re. Fortlage,* Ross v. *Fortlage* [1916] 60 Sol. Jo. 527.

Canada - Under present conditions of life, a motor car used in this fashion—as apparently the testator used his motor car in his lifetime—should be included under the word "effect"— *Re. Priadham* [1953] 1 DLR 782.

New Zealand - (A testator, by his will, bequeathed to his wife all his "household and personal furniture and effects"— The question was whether the testator's Austin A40 motor car passed under the bequest). "The phrase 'household and personal effects' can comprehend a motor car, and will, I think, ordinarily do so unless its user for business purposes has been so considerable as to exclude it from inclusion in that category"— *Re. Liverton, Liverton* v. *Liverton* [1954] NZLR 612.

In view of the aforesaid rulings, it can be said that surplus arising on sale of a car used for personal purposes is not taxable under section 45.

188-P9 *X owned 5 acres of agricultural land within the city limits of Madras which he had purchased on October 1, 1982 for Rs. 5,00,000. On October 1, 2008, he sold the agricultural land for Rs. 50,00,000. On January 1, 2009, he purchased a coffee estate for Rs. 20,00,000. The coffee estate was in a remote village and the nearest town was about 20 kilometres away from the estate. On February 28, 2010, he sold the coffee estate for Rs. 35,00,000. You are required to compute the income chargeable under the head "Capital gains" for the assessment years 2009-10 and 2010-11. What would be your answer if the coffee estate was situate within the city limits of Ooty?*

SOLUTION :

Assessment year 2009-10	*Rs.*
Sale proceeds of agricultural land	50,00,000
Less : Indexed cost of acquisition (*i.e.,* Rs. 5,00,000 × 582 ÷ 109)	26,69,725
Capital gains	23,30,275
Less : Exemption under section 54B	20,00,000
Long term capital gain	3,30,275

Assessment year 2010-11

	If coffee estate is situated in remote village Rs.	If coffee estate is situated within the city limits of Ooty Rs.
Sale proceeds	35,00,000	35,00,000
Less : Cost of acquisition (i.e., Rs. 20,00,000 – Rs. 20,00,000 being the amount of exemption under section 54B, as the coffee estate is sold within 3 years from the date of acquisition)	—	*Nil*
Income under the head "Capital gains" (*the asset is not a capital asset)	Not taxable*	35,00,000

188-P10 *X Ltd., an Indian company, had been the owner of a plot of vacant land since 1973 when it had been acquired at a cost of Rs. 10,000. The Government compulsorily acquired the plot under the Land Acquisition Act and after the Collector had given his award of compensation on January 2, 1994, took possession thereof immediately. The amount of the award was Rs. 5,00,000 and the fair market value of the plot on April 1, 1981 was Rs. 40,000. The amount was duly received by X Ltd. on June 6, 1995, but considering the amount of the compensation awarded as too meagre, it filed an appeal to Court. In the appeal decided on June 30, 2007 the High Court increased the amount of the award by Rs. 10,00,000 and also ordered payment of interest @ 6 per cent per annum on the increased amount with effect from January 2, 1994, the date of the award by the Collector. Such interest up to the date of High Court's order amounted to Rs. 4,50,000. The levy of interest was automatic in accordance with the provisions of section 34 of the Land Acquisition Act. The Government appealed to the Supreme Court against the High Court decree, but as directed by the High Court paid both the additional compensation and the interest to X Ltd. in September 2008 after taking a bond from the company promising to refund whatever sum might be held to have been received in excess on the basis of the Supreme Court's decision. X Ltd. approaches you for advise on the following issues :*

1. Was there any chargeable surplus as a result of the compulsory acquisition ? What is the nature of such surplus ?

2. On what date did the surplus arise and in which year did it become assessable ?

3. What was the amount of the chargeable surplus ?

4. What was the effect of the High Court decree in regard to the assessment already completed ? Could the additional compensation be charged to tax in any particular assessment year (to be indicated by you if the answer is in the affirmative) ?

5. How is the interest to be treated for taxation purposes ? When is it assessable ?

6. Can it be claimed that there being an appeal filed before the Supreme Court, the enhanced compensation or the interest, though actually received cannot be taxed because of the possibility of the Supreme Court reversing or modifying the High Court decree ?

7. Is there any legal provision enabling X Ltd. to reduce its liability to tax on the additional compensation or interest ?

Give your advice on all the issues stating your reasons.

SOLUTION : *(1)* to *(3)* Compulsory acquisition is treated as transfer under section 2(47). Therefore, surplus of Rs. 4,02,400 (*i.e.*, Rs. 5,00,000—Rs. 40,000 × 244 ÷ 100) will be taxable as long-term capital gains for the assessment year 1996-97.

(4) The additional compensation of Rs. 10,00,000 will be taxable, as per section 45(5) [see para 176.4] for the assessment year 2009-10. The computation of income will be on the following lines :

	Rs.
Additional compensation received	10,00,000
Less : Cost of acquisition	*Nil*
Long-term capital gain for the assessment year 2009-10	10,00,000

(5) Though interest is awarded on June 30, 2007, entire amount is not taxable in the previous year 2007-08. It accrues from year to year from January 2,1994 to June 30, 2007 [see also (6) *infra*].

(6) The decision of the High Court having been challenged before the Supreme Court by the Government, there remains a possibility that the Government's appeal may succeed (wholly or partly). Since the Government has

challenged the entire amount of enhancement, the possibility cannot be overruled that such enhancement may be scaled down or may even be wholly refused.

Capital gain - In view of the amendment made by the Finance Act, 2003 in section 45(5), capital gain on receipt of additional compensation for the assessment year 2009-10 will be computed as shown above. If in a subsequent year, the Supreme Court reduces the additional compensation, then income of the assessment year 2009-10 will be recomputed by taking into consideration the reduced compensation.

Interest - Though X Ltd. has received interest in full, it has not obtained an absolute right thereto. If compensation is reduced, interest will change accordingly.

As a result, the assessment in respect of interest cannot be presently completed— *CIT* v. *Hindustan Housing & Land Development Trust Ltd.* [1986] 161 ITR 524 (SC). The interest (to the extent sustained by the Supreme Court's order), will become assessable year-wise (from January 2, 1994 to June 30, 2007) according to the provisions of section 147.

(7) There is no exemption/deduction. Exemption under section 54EC is, however, available from additional compensation.

CHAPTER EIGHT

Income from other sources

Basis of charge [Sec. 56]

191. Income from other sources is the last and residual head of income. Sub-section (1) of section 56 covers any income which does not fall under any other head of income. However, sub-section (2) of section 56 specifies eight incomes which are always taxable under the head "Income from other sources".

191.1 ***Special provisions*** - The following eight incomes are always taxable under the head "Income from other sources"—

1. Dividend	Dividend is defined by section 2(*22*) [for definition *see* para 193]. Dividend from an Indian company is not taxable in the hands of shareholders. However, deemed dividend under section 2(*22*)(*e*) from an Indian company or any dividend from a foreign company is taxable in the hands of shareholders under the head "Income from other sources".
2. Winning from lotteries, etc.	It includes any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever. These receipts are chargeable to tax under the head "Income from other sources". For detailed discussion, refer to para 194.
3. Employees' contribution towards staff welfare scheme	Any sum received by the assessee from his employees as contributions to any staff welfare scheme is taxable in the hands of the employer under the head "Income from other sources" (if it is not taxable as business income under section 28) [*see* para 195].
4. Interest on securities	Interest on debentures, Government securities/bonds is taxable under the head "Income from other sources" (if the same is not taxed as business income under section 28). For detailed discussion, refer to para 196.
5. Rental income of machinery, plant or furniture	Rental income from machinery, plant or furniture let on hire is taxable as income from other sources (if the same is not taxed as business income under section 28) [*see* para 197].
6. Rental income of letting out of plant, machinery or furniture along with letting out of building and the two lettings are not separable	Such rental income is taxable under the head "Income from other sources" (if the same is not taxed as business income under section 28). For detailed discussion, refer to para 198.
7. Sum received under Keyman insurance policy	Any sum received under a Keyman insurance policy (including bonus) is taxable as income from other sources (if the same is not taxable as salary income or business income).
8. Gift	If any sum of money is received during a previous year without consideration by an individual or a Hindu undivided family from any person or persons exceeds Rs. 50,000, the whole of such amount is taxable in the hands of the recipient as income from other sources [*see* para 199 for detailed discussion].

191.2 ***General provisions [Sec. 56(1)]*** - "Income from other sources" is the last and residual head of income. A *source* of income which does not specifically fall under any one of the other four heads

of income (*viz.*, "Salaries", "Income from house property", "Profits and gains of business or profession" or "Capital gains") is to be computed and brought to charge under section 56 under the head "Income from other sources". In other words, it can be said that the residuary head of income can be resorted to only if none of the specific heads is applicable to the income in question and that it comes into the operation only if the preceding heads are excluded.

191.2-1 PROPOSITION ON THE BASIS OF JUDICIAL PRONOUNCEMENTS - The House of Lords in *Salisbury House Estate Ltd.* v. *Fry* [1930] AC 432 had laid the following propositions regarding the scope of Schedule D (*i.e.*, the residuary Schedule under the English income-tax law) which are equally applicable to the scope of the head "Income from other sources", as has been affirmed by the Supreme Court in *Nalinikant Ambalal Mody* v. *CIT* [1966] 61 ITR 428 :

- An income can be charged to tax under the residuary head only if none of the specific heads is applicable to the income in question.
- Where an item of income is taxable under one of the specific heads of income and charge under that head of income exhausts the chargeability of income to tax, no part of such income can be charged to tax under the residuary head.

The residuary head of income can be resorted to only if none of the specific heads is applicable to the income in question and it comes into operation only after the preceding heads are excluded—*S.G. Mercantile Corpn. (P.) Ltd.* v. *CIT* [1972] 83 ITR 700 (SC), *Bihar State Co-operative Bank Ltd.* v. *CIT* [1960] 39 ITR 114 (SC). The character or the nature of income does not cease to be income from property because of its non-chargeability under the relevant computing sections. What is crucial is the classification. Once the income is classified under a particular head, then only one has to look to the corresponding computing section for the purpose of chargeability to tax.

191.2-2 BROAD CONCLUSIONS - To sum up, it can be said that the residuary head of income can be invoked only if all the following conditions are satisfied :

- *Income* - There is an "income" [sec. 2(*24*), read with sections 4 and 5].
- *Income should not be exempt* - That income is not exempt from tax under sections 10 to 13A.
- *Not covered by other heads* - That income is neither salary income, nor rental income from house property, nor income from business/profession, nor capital gains. These four categories of incomes are not chargeable to tax under the head "Income from other sources", even if such incomes, or a part thereof, cannot be brought to tax under their respective heads.

191.2-3 INSTANCES - The following are some of the examples of income generally taxable under section 56(1) :

a. income from sub-letting;

b. interest on bank deposits and loans;

c. income from royalty (if it is not income from business or profession);

d. director's fee;

e. ground rent;

f. agricultural income received from outside India;

g. director's commission for standing as a guarantor to bankers;

h. director's commission for underwriting shares of new company;

i. remuneration received by a person from a person other than his employer, *e.g.*, examination remuneration received by a teacher;

j. rent of plot of land;

k. insurance commission;

l. mining rent and royalties;

m. interest on foreign Government securities;

n. casual income;

o. annuity payable under a will, contract, trust, deed (excluding annuity payable by employer which is chargeable under the head "Salaries");

p. salaries payable to a Member of Parliament;

q. family pension received by family members of a deceased employee;

r. in the case of retirement, interest on employee's contribution if provident fund is unrecognised;

s. income from undisclosed sources;

t. gratuities paid to director who is not employee of the company—*CIT* v. *L. Armstrong Smith* [1946] 14 ITR 606 (Bom.);

u. income from racing establishments—*Janab A. Syed Jalal Sahib* v. *CIT* [1960] 39 ITR 660 (Mad.);

v. compensation received for use of business assets—*Sultan Bros. (P.) Ltd.* v. *CIT* [1964] 51 ITR 353 (SC);

w. annuity payable to the lender of a trade mark—*CIT* v. *Lal Chand Jain* [1968] 69 ITR 65 (Delhi).

191.2-4 *JUDICIAL PRONOUNCEMENTS* - The following judicial pronouncements will give a clear idea about the scope of section 56(1) :

■ *Discontinuance of business* - Money received by an assessee from a business/profession, discontinued prior to the commencement of the previous year, is chargeable to tax under section 56—*Roma Bose* v. *ITO* [1974] 95 ITR 299 (Cal.).

■ *Liquidator* - Where the liquidator of a banking company is engaged in realising business asset, interest received on fixed deposits is chargeable under the head "Income from other sources", as the liquidator under these circumstances cannot be said to carry on the business of the banking company—*Morvi Mercantile Bank Ltd.* v. *CIT* [1976] 104 ITR 568 (Guj.).

■ *Interest on unrecognised provident fund* - Interest received by an employee at the time of retirement on his contribution to an unrecognized provident fund is taxable as income from other sources—*CIT* v. *G. Hyatt* [1971] 80 ITR 177 (SC).

■ *Interest earned before commencement of business* - Interest earned on short-term investment of funds, borrowed for setting up of factory, during construction of factory before commencement of business has to be assessed as income from other sources and it cannot be held to be non-taxable on ground that it would go to reduce interest liability on borrowed amount which would be capitalised—*Tuticorin Alkali Chemicals & Fertilizers Ltd.* v. *CIT* [1997] 93 Taxman 502/227 ITR 172 (SC).

■ *Tax on salary* - Tax on salary of the assessee borne by payer, for whom the assessee was working under a contract, under a legal obligation, was assessable as income of payee under the head "Income from other sources"—*Emil Webber* v. *CIT* [1993] 200 ITR 483 (SC).

■ *Income from let out godown* - Where the assessee-company let out godown to its subsidiary company at Rs. 37,902 per month whereas subsidiary let it out to another party at Rs. 44,794 per month, the Tribunal was justified in holding that the difference was assessable as the assessee's income from other sources—*CIT* v. *Shriram Jute Products Ltd.* [1993] 71 Taxman 293 (Cal.).

■ *Broad principles regarding interest on deposit of surplus money* - The following principles are applicable in assessing interest income under the provisions of the Income-tax Act —

1. Interest on fixed deposits and other deposits before the commencement of the business is income from other sources.

2. Income from interest on deposits of surplus money during the construction period is also to be considered/treated as income from other sources.

3. Interest income in respect of surplus money, not required for business and deposited in bank or with persons, as idle money, for safe keeping, would be assessable as income from other sources. If the income from interest is from a fund which has been brought as surplus capital, it would be assessable as income from other sources.

4. In respect of investment of surplus funds there is divergence of opinion between different High Courts and the Rajasthan High Court in the case of *Murli Investments Co.* held that if the surplus funds are invested instead of keeping them idle, the income by way of interest should be treated as income from other sources—*CIT* v. *Rajasthan Land Development Corpn.* [1995] 211 ITR 597 (Raj.).

Relevance of method of accounting

192. Income chargeable under this head is computed in accordance with the method of accounting regularly employed by the assessee. For instance, if books of account are kept on the basis of mercantile system, income is taxable and expenditure is deductible on "due" basis, whereas if books of account are kept on the basis of cash system, income is taxable on "receipt" basis and expenditure is deductible on "payment" basis. Method of accounting does not, however, affect basis of charge in the case of dividend income, though it is taxable under this head. In the case of interest on securities, income is taxable on "accrual" basis, if no method of accounting is regularly employed by the assessee.

Dividend [Sec. 56(2)(i)]

193. Dividend from an Indian company is not taxable in the hands of shareholders (company declaring dividend will have to pay dividend tax under section 115-O). However, deemed dividend under section 2(*22*)(*e*) from an Indian company or any dividend from a foreign company is taxable in the hands of shareholders under the head "Income from other sources", regardless of the fact whether shares are held by the assessee as investment or as stock-in-trade.

193.1 *Dividend in common parlance* - Dividend in its ordinary connotation means the amount paid to or received by a shareholder in proportion to his shareholding in a company, out of the total sum so distributed.

193.2 *Dividend under the Income-tax Act* - Section 2(*22*) gives the definition of "dividend". The definition laid down by section 2(*22*) is inclusive and not exhaustive. If, therefore, a particular distribution is not regarded as dividend within the extended meaning of the expression in section 2(*22*), it may still be dividend provided it is "dividend" under the ordinary meaning of the expression— *Kantilal Manilal* v. *CIT* [1961] 41 ITR 275 (SC).

▪ Under section 2(*22*), the following payments or distributions by a company to its shareholders are deemed as dividends to the extent of *accumulated profits* [*see* para 193.2-1] of the company (it may be noted that these payments may not be "dividend" under the Companies Act) :

a. any distribution entailing the release of company's assets [*see* para 193.2-2] ;

b. any distribution of debenture, debenture-stock, deposit certificates and bonus to preference shareholders [*see* para 193.2-3] ;

c. distribution on liquidation of company [*see* para 193.2-4] ;

d. distribution on reduction of capital [*see* para 193.2-5] ;

e. any payment by way of loan or advance by a closely-held company to a shareholder holding substantial interest provided the loan should not have been made in the ordinary course of business and money-lending should not be a substantial part of the company's business [*see* para 193.2-6].

▪ If dividend comes under (*a*) to (*d*) (*supra*), then the payer-company will pay dividend tax under section 115-O and in the hands of recipient shareholders, it is not chargeable to tax.

Conversely, if dividend comes under (*e*) (*supra*), then it is taxable in the hands of shareholder. In such case, the payer-company will not pay dividend tax.

▪ With effect from the assessment year 2000-01, the following shall not be treated as "dividend"—

a. any payment made by a company on purchase of its own shares in accordance with the provisions contained in section 77A of the Companies Act ; or

b. any distribution of shares made in accordance with the scheme of demerger by the resulting company to the shareholders of the demerged company whether or not there is a reduction of capital in the demerged company.

193.2-1 ***ACCUMULATED PROFITS*** - Any payment or distribution under the aforesaid clauses is treated as dividend. However, the payment or distribution under the aforesaid clauses can be treated as dividend only to the extent of accumulated profits of the company. Therefore, it is essential to discuss the meaning and scope of the expression "accumulated profits".

193.2-1a STATUTORY PROVISIONS - The following statutory provisions should be noted—

▪ *Explanation 1* - It provides that accumulated profits do not include capital gains arising before April 1,1946 and after March 31,1948 but before April 1,1956.

▪ *Explanation 2* - It provides that, in case of a company (which is not in liquidation), it includes all profits of a company up to the date of distribution or payment. However, in the case of a company in liquidation it includes all profits of the company up to the date of liquidation. Where, the liquidation is consequent on the compulsory acquisition of a company's undertaking by the Government or a Government company, accumulated profits do not include any profits of the company prior to the three successive years immediately preceding the previous year in which such acquisition took place. For instance, if accounting year of a company is financial year and compulsory acquisition takes place on March 13, 2007, its accumulated profits will exclude profits accumulated up to March 31, 2003.

▪ *Capitalised profits* - Capitalised profits (*e.g.*, issue of bonus shares by capitalising general reserve) are part of "accumulated profit" for the purposes of clauses (*a*), (*b*), (*c*) and (*d*) of section 2(*22*) [but not for the purpose of clause (*e*) of section 2(*22*)].

193.2-1b PROPOSITIONS TAKEN FROM JUDICIAL RULINGS - One should also note the following propositions taken from judicial rulings—

▪ *Whether accumulated profits include current profits* - Accumulated profits include all profits up to the date of distribution or payment (or up to the date of liquidation in the case of liquidation).

▪ *Computation of accumulated profits - Whether on the basis of commercial profits or assessed profits* - In a number of cases it has been held that accumulated profits are computed on the basis of commercial profits.

▪ *How to account for depreciation* - While calculating "accumulated profits", an allowance for depreciation and additional depreciation at the rates provided by the Income-tax Act itself has to be made by way of deduction— *Navnitlal C. Jhaveri* v. *CIT* [1971] 80 ITR 582 (Bom.).

▪ *Whether reserves are part of accumulated profit* - Accumulated profits include general reserve— *CIT* v. *K. Srinivasan* [1963] 50 ITR 788 (Mad.). Accumulated profits also include development rebate reserve, development allowance reserve and investment allowance reserve, as these reserves are not in the nature of any expenditure or outgoing— *P.K. Badiani* v. *CIT* [1976] 105 ITR 642 (SC). Building reserve fund is includible in accumulated profits, because it is a fund set apart for constructing new buildings and is not in the nature of depreciation fund— *CIT* v. *Jaldu Rama Rao* [1982] 11 Taxman 203 (AP).

▪ *Whether provisions are part of accumulated profit* - Provisions for taxation and dividends do not form part of accumulated reserve— *CIT* v. *V. Damodaran* [1972] 85 ITR 590 (Ker.).

▪ *Whether additions by Assessing Officer form part of accumulated profit* - Addition made by the Assessing Officer on account of concealed income forms part of accumulated profits. Accumulated profits do not, however, include additions made by the Assessing Officer on account of disallowance of inadmissible expenditure.

▪ *Balancing charge - Is it includible in accumulated profit* - Balancing charge under section 41(2) is not part of accumulated profit—*CIT* v. *Urmila Ramesh* [1998] 96 Taxman 533 (SC).

▪ *Whether tax free income can be included in it* - Accumulated profits include tax-free income/ revenue receipts, *e.g.*, agricultural income—*CIT* v. *Tea Estates India Ltd.* [1972] 86 ITR 705 (Cal.).

Even profits not assessable to tax form part of accumulated profits. However, capital gains/receipts of capital nature are included in accumulated profits only if such gains/receipts are chargeable to capital gains tax— *see CIT* v. *Nalin Behari Lal Singha* [1969] 74 ITR 849 (SC), *ITO* v. *Short Bros. (P.) Ltd.* [1966] 60 ITR 83 (SC), *CIT* v. *Mangesh J. Sanzgiri* [1979] 119 ITR 962 (Bom.).

▪ *Whether subsidy is part of accumulated profit* - Current profit would be part of accumulated profits but subsidy on capital account cannot be treated as accumulated profits—***CIT*** v. ***Rajasthan Wires (P.) Ltd.*** [2003] 130 Taxman 93 (Jp.) (Mag.).

▪ *Whether profit of amalgamating company is part of accumulated profit* - Strictly construed, 'accumulated profits', whether capitalised or not, held by the amalgamating companies, which are separate independent entities, cannot by any stretch of imagination be treated as accumulated profits or capitalised profits of amalgamated company—*CIT* v. *Gautam Sarabhai Trust* [2002] 81 ITD 677 (Ahd.).

▪ *Investment in real estate out of accumulated profit* - In ***ITO*** v. ***Gurdip Singh*** [2008] 19 SOT 525 (Delhi), it was held that accumulated profits for the purpose of computing deemed dividend would include profits of the company up to the date of payment of such dividend or transaction taxable as dividend. In this case, the Tribunal held that the amounts invested in real estate cannot be reduced from accumulated profit.

193.2-2 *DISTRIBUTION OF ACCUMULATED PROFITS ENTAILING RELEASE OF COMPANY'S ASSETS [SEC. 2(22)(a)]* - Under sub-clause (*a*) of section 2(*22*), any distribution by a company of its accumulated profits (whether capitalised or not) is dividend if it entails the release of company's assets. In other words, there are two conditions prescribed by this clause—

a. distribution should be from accumulated profits (not from capital); and

b. such distribution must result in the release of the assets by the company.

193.2-2a DISTRIBUTION IN KIND - As no specific mode of distribution is prescribed by the clause, distribution may be in the form of payment in cash or kind. In *Kantilal Manilal* v. *CIT* [1961] 41 ITR 275, the Supreme Court *held* that where a company (being entitled to purchase shares in another company in which it was shareholder) distributed such right among its own shareholders in proportion to their shareholdings, such distribution of the right amounted to dividend. Shah, J. in this case concluded that dividend need not be distributed in money ; it may be distributed by delivery of property or right having monetary value. When assets are distributed as dividend, amount of dividend is taken to be the market value of the property on the date on which the shareholders become entitled to receive dividend—*CIT* v. *Central India Industries Ltd.* [1971] 82 ITR 555 (SC).

193.2-2b BONUS SHARES - One of the conditions laid down in sub-clause (*a*) of section 2(*22*) is that distribution must entail the release of assets by the company to its shareholders. When, therefore, a company issues bonus shares capitalising its profits, then there is no release of assets and, consequently, bonus shares are not taken as dividend. If, however, bonus shares are issued to preference shareholders, it amounts to distribution of dividend by virtue of sub-clause (*b*) of section 2(*22*).

If bonus shares are issued to equity shareholders, it does not amount to distribution of dividend at the time of issue of bonus shares, as there is no release of assets. But if bonus shares are redeemed (redemption is possible only in case if bonus shares are in the form of redeemable preference shares), there will be release of assets and in that event these would constitute dividend— *Shashibala Navnitlal* v. *CIT* [1964] 54 ITR 478 (Guj.).

193.2-3 *DISTRIBUTION OF ACCUMULATED PROFITS IN THE FORM OF DEBENTURES, DEBENTURE STOCK [SEC. 2(22)(b)]* - Under this clause the following two distributions are treated as dividend to the extent of accumulated profits (whether capitalised or not) of the company :

a. distribution by a company to its shareholders (whether equity shareholders or preference shareholders) of debentures, debenture-stock or deposit certificates in any form, whether with or without interest ; and

b. distribution by a company to its preference shareholders of bonus shares.

It is worthwhile to note that under the aforesaid circumstances distribution amounts to dividend even if there is no release of assets at the time of distribution.

193.2-4 *DISTRIBUTION OF ACCUMULATED PROFITS AT THE TIME OF LIQUIDATION [SEC. 2(22)(c)]* - Under sub-clause (*c*), any distribution made by a company to its shareholders on its liquidation is treated as dividend to the extent to which such distribution is attributable to the accumulated profits (whether capitalised or not) of the company immediately before its liquidation.

193.2-4a PIECE MEAL DISTRIBUTION - When distribution is made by liquidator, the distribution is deemed to take place in same proportion in which share capital and accumulated profits stood immediately before the distribution in the accounts of the company.

For instance, share capital and general reserve of a company in liquidation are Rs. 2,00,000 and Rs. 3,00,000, respectively. Suppose, the company distributes Rs. 50,000, then Rs. 20,000 shall be amount received by shareholder on account of share capital and Rs. 30,000 shall be treated as dividend under section 2(22)(*c*)—*CIT* v. *Girdhardas & Co. (P.) Ltd.* [1967] 63 ITR 300 (SC) [*see* also para 176.9].

193.2-4b WHEN AMOUNT DISTRIBUTED IS LESS THAN INVESTMENT BY SHAREHOLDERS - Where a distribution in the winding up of a company is found to be out of accumulated profits, it is dividend even though the amount so distributed does not exceed the capital subscribed by the shareholders and in such a case it is incorrect to say that what exceeds the capital alone attracts tax— *Vidyutrai V. Desai* v. *CIT* [1958] 33 ITR 510 (Bom.).

193.2-4c WHEN NOT DEEMED AS DIVIDEND - Under sub-clause (*c*), the following are, however, not treated as dividend :

a. any distribution in respect of preference shares issued for full cash consideration ; and

b. any distribution insofar as such distribution is attributable to the capitalised profits of the company representing bonus shares allotted to its equity shareholders during 1964-65.

193.2-5 *DISTRIBUTION OF ACCUMULATED PROFITS ON THE REDUCTION OF ITS CAPITAL [SEC. 2(22)(d)]** - Any distribution by a company to its shareholders on the reduction of capital is treated as dividend to the extent the company possesses accumulated profits (whether capitalised or not).

■ *When not deemed as dividend* - The following are not treated as dividend under this clause :

a. any distribution out of accumulated profits which arose up to the previous year 1932-33 or up to the previous year ending during 1932-33 ;

b. any distribution in respect of preference shares issued for full cash consideration ; and

c. any distribution insofar as such distribution is attributable to the capitalised profits of the company representing bonus shares allotted to its equity shareholders after March 31, 1964, but before April 1,1965.

■ *Reorganisation of capital* - Where there is only re-organisation of capital, which results in splitting up of the capital of the company into two companies and there is no reduction of capital in the aggregate, section 2(22)(*d*) will not apply—*Ajai Choudhary* v. *CIT* [2000] 74 ITD 350/109 Taxman 281 (Delhi) (Mag.).

193.2-6 *DISTRIBUTION OF ACCUMULATED PROFITS BY WAY OF ADVANCE OR LOAN [SEC. 2(22)(e)]* - Payment by way of loan/advance to the extent of accumulated profits by a closely-held company is treated as dividend in the following two cases :

Case 1	*Case 2*
1. Loan or advance is given by a closely-held company.	*1.* Loan or advance is given by a closely-held company (say X Ltd.).
2. Such loan is given to a registered shareholder.	*2.* Such loan is given to a "concern" (say Y) [*see* Note 3].

*Section 2(22)(*d*) is constitutionally valid—*Punjab Distilling Indust. Ltd.* v. *CIT* [1965] 57 ITR 1 (SC).

Case 1	*Case 2*
3. The shareholder (getting the loan) beneficially holds 10 per cent or more of equity shares in the company (giving the loan).	*3.* One of the shareholders, beneficially holding 10 per cent equity shares capital in X Ltd., has a substantial interest [*see* Note 4] in Y.
4. Such loan or advance is treated as dividend in the hands of shareholder.	*4.* Such loan or advance is treated as dividend in the hands of Y.

Notes :

1. Such loan or advance is treated as dividend to the extent of accumulated profits (excluding capitalized profit).

2. Loan or advance for the above purpose may be given to a shareholder (in *Case 1*) directly or it may be given for the benefit of shareholder or on behalf of shareholder.

3. "Concern" for this purpose may be a HUF, sole proprietor, firm, AOP, BOI or a company.

4. A person shall be deemed to have a substantial interest in a concern, if he is (*at any time during the previous year*), beneficially entitled to at least 20 per cent of income of such concern (if such concern is a company, then he should beneficially hold at least 20 per cent equity share capital of the company). Shares held by a person in two different capacities, *i.e.*, as individual and as HUF, cannot be clubbed for purpose of deciding whether a person has substantial interest in concern—***CIT*** v. ***Kunal Organics (P.) Ltd.*** [2007] 164 Taxman 169 (Ahd.) (Mag.).

5. Where money-lending is a substantial part of the business of the company (giving loan), the above provisions are not applicable. For this purpose, the factual position as it stands during relevant previous year alone is supposed to be taken into consideration to decide issue whether lending of money is substantial part of business of concerned company—***Rekha Modi*** v. ***ITO*** [2007] 13 SOT 512 (Delhi).

6. If after giving loan or advance to a shareholder, the company declares normal dividend and such dividend is set off against outstanding loan/advance, the amount so set off will not be taken as "dividend".

193.2-6a POINTS TO BE BORNE IN MIND WHILE APPLYING SECTION 2(22)(e) - In order to understand the application and scope of sub-clause (*e*) of section 2(*22*), one should keep in mind the following propositions derived from decided cases :

- *Only registered shareholder* - Under sub-clause (*e*), the word "shareholder" refers to the registered shareholder and not merely beneficial owner of a share and hence a loan granted to a beneficial owner of shares, who is not a registered shareholder, cannot be regarded as loan or advance to a "shareholder" so as to fall within the mischief of section 2(*22*)(*e*)—*Rameshwarlal Sanwarmal* v. *CIT* [1980] 3 Taxman 1 (SC).

However, it is not necessary that payer or payee must have shareholdings in other company. If payment of any sum by way of advance or loan is made by one private limited company to another private limited company in which there is a common shareholder having sufficient holding or a beneficial interest in both companies, provisions of section 2(*22*)(*e*) can be invoked and those loans and advances shall be deemed dividend under section 2(*22*)(*e*)—***Skyline India Recruit.com. (P.) Ltd.*** v. ***ITO*** [2008] 24 SOT 402 (Mum.)(SMC).

- *No restriction on amount of deemed dividend* - There is nothing in sub-clause (*e*) of section 2(*22*) to restrict the deemed dividend to that portion of accumulated profits which corresponds to the assessee's shareholding in the capital of the company—*CIT* v. *Mayur Madhukant Mehta* [1972] 85 ITR 230 (Guj.). If a loan is given by a company to a shareholder who owns 25 per cent of share capital, the amount of loan to the extent of entire accumulated profits (and not to the extent of 25 per cent of accumulated profits) will be treated as dividend— *CIT* v. *Arati Debi* [1978] 111 ITR 277 (Cal.).
- *Accumulated profits* minus *dividend under section 2(22)(e)* - For the purpose of section 2(*22*) accumulated profits get reduced by the amount deemed as dividend under section 2(*22*) even if no adjustment is made in the books of account.

For instance, the total accumulated profit of A Ltd. is Rs. 120 lakh. It gives a loan to X of Rs. 50 lakh which is deemed as dividend under section 2(*22*)(*e*). Later on, the company advances Rs. 76 lakh to Y and such advance falls under section 2(*22*)(*e*). Now Rs. 70 lakh (*i.e.*, Rs. 120 lakh *minus* Rs. 50 lakh) only shall be treated as dividend. Suppose, A Ltd. further gives a loan to Z amounting to Rs. 10 lakh which satisfies conditions of section 2(*22*)(*e*), then nothing shall be taxable as dividend since there is no accumulated profit left [Rs. 120 lakh — Rs. 50 lakh

= Rs. 70 lakh]—*CIT* v. *P.K. Badiani* [1970] 76 ITR 369 (Bom.), *CIT* v. *G. Narasimhan* [1979] 118 ITR 60 (Mad.), *CIT* v. *G. Narasimhan* [1999] 102 Taxman 66 (SC).

▪ *Relationship of debtor and creditor* - In order to attract the provision of section 2(*22*)(*e*), the important consideration is that there should be loan/advance by a company to its shareholder. Every payment by a company to its shareholder may not be loan/advance. To be treated as loan every amount paid must make the company a creditor of the shareholder for that amount. If, however, at the time when payment is made, the company is already a debtor of the shareholder, the payment would be merely a repayment by the company towards its already existing debt. It would be a loan by the company only if the payment exceeds the amount of its already existing debt and that too only to the extent of the excess. If the shareholder has a current account with the company, the position as regards each debit will have to be considered individually, as it may or may not be a loan. In such a case, the debit balance of the shareholder with the company at any point of time cannot be taken to represent an advance/loan by the company; nor can the amount at the end of the previous year be alone taken as loan— *CIT* v. *P.K. Badiani* (*supra*).

▪ *Repayment of loan* - Section 2(*22*)(*e*) is applicable even if loan is repaid before the end of the previous year. In other words, the liability is attracted at the moment the loan is given—*Tarulata Shyam* v. *CIT* [1977] 108 ITR 345 (SC). If, however, any amount is deposited by the shareholder with the company, its repayment does not attract the provisions of section 2(*22*)(*e*) because it does not result in advancing or giving loan to the shareholder—*Mohan Anand* v. *CIT* [2002] 82 ITD 708 (Delhi).

▪ Bona fide *loan* - Even a *bona fide* loan for a short duration is treated as dividend if all the conditions of section 2(*22*)(*e*) are satisfied— *CIT* v. *Bhagwat Tewari* [1976] 105 ITR 62 (Cal.).

▪ *Overdraft* - An overdraft taken by a shareholder from the company is treated as loan and is taxable as dividend if conditions of section 2(*22*)(*e*) are satisfied—*CIT* v. *K. Srinivasan* [1963] 50 ITR 788 (Mad.).

▪ *Loan in kind* - Section 2(*22*)(*e*) is applicable even if loan is given in kind—*M.D. Jindal* v. *CIT* [1986] 28 Taxman 509 (Cal.).

▪ *Agricultural income* - Even loan obtained by the assessee-shareholder from a company from out of its accumulated profits, which are exempt in the hands of the company as agricultural income, is to be treated as deemed dividend in the hands of the assessee—*S. Kumaraswami* v. *ITO* [1961] 43 ITR 423 (Mad.).

▪ *Loan on behalf of assessee* - Where whenever the assessee, a managing director of a company, needed money he used to ask an employee to take a loan from the company and pass it on to him even without executing any pronote, it was *held* that the 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—*L. Alagusundaram Chettiar* v. *CIT* [2002] 121 Taxman 587 (SC).

▪ *Payment on behalf of shareholder* - Section 2(*22*)(*e*) covers not only advances and loans to shareholders but any other payments by the company on behalf of or for the individual shareholders, such as payments of shareholder's personal expenses, insurance premia, etc., to the extent of the accumulated profits of the company— *CIT* v. *K. Srinivasan* [1963] 50 ITR 788 (Mad.).

▪ *Debit balance* - Where the assessee-shareholder, having business of his own, was transacting business with the company and the account of the assessee in the company always showed a debit balance, it was *held* that the said debit balance would amount to a loan from the company to the assessee—*CIT* v. *Jamnadas Khimji Kothari* [1973] 92 ITR 105 (Bom.).

▪ *Call money* - The amounts due by the assessee to the company towards the first and second call moneys on the shares *held* by it in the company and which were treated as having been paid up by making book entries in running account cannot be treated as a payment by way of loan by the company to the assessee for the purpose of section 2(*22*)(*e*)—*G.R. Govindarajulu Naidu* v. *CIT* [1973] 90 ITR 13 (Mad.).

▪ *Share application money* - Share application money received by a closely-held company cannot be treated as dividend under section 2(*22*)(*e*) pending allotment of shares—*Ardee Finvest (P.) Ltd.* v. *CIT* [2001] 79 ITD 547 (Delhi).

■ *Advance rent* - X holds more than 10 per cent equity share capital in A (Pvt.) Ltd. He lets out a property to A (Pvt.) Ltd. under an agreement. On May 20, 2008, he receives Rs. 1,00,000 as advance rent under that agreement. Advance rent will be deemed as dividends even if the amount is received under the lease agreement (not as a shareholder but as a landlord) or even if it has to be adjusted against future rent—***CIT*** v. ***P.S. Abubucker*** [2004] 135 Taxman 77 (Mad.).

■ *Distribution out of share premium account* - Since section 78 of the Companies Act puts a statutory bar on share premium account being used for distribution of dividend, deeming provisions of section 2(*22*)(*e*) cannot apply and, hence, payment made by a company out of its share premium account cannot be brought to tax in hands of receiver as deemed dividend under section 2(*22*)—***CIT*** v. ***MAIPO India Ltd.*** [2008] 24 SOT 42 (Delhi).

193.2-7 *EXAMPLE ILLUSTRATING THE PROVISIONS OF SECTION 2(22)* - XYZ Ltd. is a company registered in India. The balance sheet of the company on March 31, 2008 is as under :

Liabilities		*Rs.*	*Assets*	*Rs.*
Preference share capital (issued for cash)		4,00,000	Fixed assets (before depreciation)	15,00,000
Equity share capital			Investment in share (market value Rs. 13,00,000)	4,00,000
❑ issued for cash		6,00,000	Other assets	9,20,000
❑ issued as bonus shares in 1960 and 1976 by capitalising profits		6,00,000		
General reserve		3,00,000		
Investment allowance reserve		90,000		
Depreciation reserve		1,00,000		
Profit and Loss A/c balance as on April 1, 2007 :	Rs. 2,40,000			
Add: Profit of the year ending March 31, 2008	Rs. 60,000	3,00,000		
Provision for taxation and dividend		2,30,000		
Current liabilities		2,00,000		
		28,20,000		28,20,000

Note : Profit and loss account balance on April 1, 2007 includes agricultural income of Rs. 30,000.

■ As under the provisions of section 2(*22*), a payment/distribution is treated as dividend only to the extent of accumulated profits, one has to first ascertain "accumulated profits" to apply the deeming fiction of section 2(*22*). Accumulated profit, as on March 31, 2008, is calculated as under:

	For sub-clauses (a), (b), (c) and (d) of section 2(22) Rs.	*For sub-clause (e) of section 2(22) Rs.*
Capitalise profit (*i.e.*, bonus shares issue) [*not considered under section 2(*22*)(*e*)]	6,00,000	—*
General reserve	3,00,000	3,00,000
Investment allowance reserve, etc.	90,000	90,000
Depreciation reserve (*Not taken into account)	—*	—*
Balance of P&L A/c on April 1, 2007 (agricultural income, even if tax-free, forms part of accumulated profits)	2,40,000	2,40,000
Current profit of the year ending March 31, 2008	60,000	60,000
Provisions for taxation/dividend (*not considered, if it is a provision ; may be considered if it is reserve)	—*	—*
Total	12,90,000	6,90,000

■ If the company declares and pays dividend of Rs. 10,00,000 on April 1, 2008 in cash, the entire amount would be treated as dividend as it does not exceed Rs. 12,90,000 and the company would have to pay dividend tax at the rate of 16.995 per cent, *i.e.*, Rs. 1,69,950.

■ If the company distributes investment in shares on April 1, 2008 to its shareholders, the distribution would constitute dividend. Amount of dividend would be ascertained on the basis of market value of shares on the date of distribution. If, on the date of distribution, the market value of shares so distributed is Rs. 13,00,000, the distribution would amount to dividend to the extent of Rs. 11,02,611 (*i.e.*, 100/116.995 × Rs. 12,90,000) and the company would have to pay dividend tax at the rate of 16.995 per cent, *i.e.*, Rs. 1,87,389. If X holds 10 per cent share capital and receives shares worth Rs. 1,30,000 (being 10 per cent of Rs. 13,00,000), Rs. 1,10,261 (being 10 per cent of Rs. 11,02,611) would amount to dividend which would be exempt from tax and Rs. 19,739 would be return of capital which would be taken into consideration at the time of computation of capital gains when transfer of shares take place.

■ If the company gets right shares of a company in which it holds shares and renounces its right in favour of its own shareholders on April 10, 2008, the market value of rights is "dividend" and is chargeable in the hands of the company to dividend tax, as renouncement of right to subscribe share amounts to release of asset by the company. However, market value of right on the date of renouncement, in excess of accumulated profits (*i.e.*, Rs. 12,90,000), is not chargeable to dividend tax in the hands of the company.

■ If the company issues bonus shares of Rs. 3,00,000 by capitalising general reserve to its equity shareholders, it is not treated as dividend and hence not chargeable to dividend tax in the hands of company, as it does not amount to release of asset by the company.

■ If the company issues redeemable preference shares on April 1, 2008 of Rs. 3,00,000 to its equity shareholders as bonus shares by capitalising general reserve, it will not amount to dividend. X, one of the shareholders, receives preference shares of Rs. 30,000 as bonus shares; no tax on Rs. 30,000 would be attracted at the time of issue of bonus shares. If the company redeems these preference shares and X receives Rs. 30,000 on May 10, 2008, Rs. 30,000 would be dividend (on which the company will have to pay dividend tax) as it amounts to release of assets (if the company is in possession of accumulated profits at the time of redemption).

■ If the company issues bonus shares to its preference shareholders on April 5, 2008, it amounts to dividend (to the extent of accumulated profit) and is chargeable in the hands of the company to dividend tax, even if it does not amount to release of assets, as it is specially covered by section 2(*22*)(*b*).

■ If the company issues debentures or debenture-stock to its shareholders (equity or preference) the distribution will amount to dividend and is chargeable in the hands of the company to dividend tax, so long as it does not exceed Rs. 12,90,000.

■ If the company reduces its share capital and pays Rs. 8,00,000 on May 1, 2008 to its shareholders, it will amount to dividend under section 2(*22*)(*d*), as it does not exceed Rs. 12,90,000. Consequently, on Rs. 8,00,000, the company will have to pay dividend tax.

■ Suppose XYZ Ltd. is a company in which the public are not substantially interested and X beneficially holds 10 per cent or more of equity share capital (suppose, he holds 15 per cent of share capital). If the company gives a *bona fide* loan of Rs. 8,00,000 to X on April 10, 2008 for 1.5 months at the rate of 11 per cent per annum, it will amount to dividend under section 2(*22*)(*e*) to the extent of accumulated profit (*i.e.*, Rs. 6,90,000) in the hands of X even if :

a. X repays the loan with interest within 1.5 months; or

b. X holds just 15 per cent of share capital and claims that his proportionate share in the accumulated profits is Rs. 1,03,500 (*i.e.*, 15 per cent of Rs. 6,90,000).

It may be noted that on deemed dividend under section 2(*22*)(*e*), the company giving loan or advance is not chargeable to dividend tax but the recipient will have to include it in his income from other sources. In the aforesaid case, the company is liable to deduct tax at source under section 194 and Rs. 8,00,000 will be taxable in the hands of X as dividend under the head "Income from other sources". If, however, the company declares dividend and X becomes entitled to receive Rs. 50,000 which is set off by the company against loan of Rs. 8,00,000, Rs. 50,000 is not treated as dividend. If X repays the loan of Rs. 8,00,000 (with interest) on May 25, 2008 and the company pays dividend of Rs. 50,000 on May 26, 2008, Rs. 50,000 will be treated as dividend which will be chargeable to dividend tax in the hands of company. Consequently, for the previous year 2008-09, X will be liable to include Rs. 6,90,000 as dividend in his income received on April 10, 2008 under section 2(*22*)(*e*).

In the aforesaid case, if the company advances loan to X in ordinary course of its business and lending money is substantial part of the company's business, then Rs. 6,90,000 will not be treated as dividend under section 2(*22*)(*e*).

■ Suppose XYZ Ltd. is a company in which the public are not substantially interested and money lending is not a substantial part of the company's business. The following are the shareholders of XYZ Ltd. and their interest in various concerns :

List of shareholders of XYZ Ltd.	*Share-holding in XYZ Ltd.*	*Shareholding in A Ltd. (a widely held Co.)*	*Shareholding in B Ltd. (a closely held company)*	*Share-holding in C Ltd.*	*Share of profit in D (Firm)*
X	7%	26%	8%	—	24%
Y	8%	1%	5%	10%	25%
Z (son of X)	36%	19%	17%	—	—
P	9%	21%	9%	5%	50%
Q	11%	26%	8%	18%	1%
R [shares are held on behalf of R(HUF)]	15%	—	—	—	—
Others (none of them holds above 1% share in any company)	14%	7%	53%	67%	—

❑ XYZ Ltd. gives a loan of Rs. 10,000 to R(HUF) on July 1, 2008. Since R(HUF) is not a registered shareholder of XYZ Ltd., the loan will not be treated as dividend in the hands of R(HUF).

❑ XYZ Ltd. gives a loan of Rs. 11,000 to R on July 2, 2008. Though R is a registered shareholder, since he does not beneficially hold at least 10 per cent equity shares in XYZ Ltd. [15 per cent equity shares are held on behalf of R(HUF)], the loan will not be treated as deemed dividend in the hands of R.

❑ XYZ Ltd. gives a loan of Rs. 20,000 to A Ltd. on July 5, 2008. Since Q holds 11 per cent equity shares in XYZ Ltd. and 26 per cent in A Ltd., the loan of Rs. 20,000 will be deemed as dividend income of A Ltd. (though A Ltd. is not a shareholder in X Ltd.).

❑ XYZ Ltd. gives a loan of Rs. 15,000 to B Ltd. on September 1, 2008. On September 1, 2008, Z, Q and R hold at least 10 per cent equity shares in XYZ Ltd. None of these persons, on September 1, 2008 holds 20 per cent or more equity shares in B Ltd. However, on March 10, 2009, X dies and by virtue of his will 8 per cent interest is transferred to his son Z and, consequently, shareholding of Z in B Ltd. goes above 20 per cent during the previous year 2008-09. Therefore, loan of Rs. 15,000 given by X Ltd. to B Ltd. will be treated as dividend income of B Ltd., for the previous year 2008-09.

❑ XYZ Ltd. gives a loan of Rs. 40,000 to C Ltd. on August 1, 2008. On this date, Z, Q and R (holding at least 10 per cent shares in XYZ Ltd.) do not hold 20 per cent or more equity shares in C Ltd. However, on March 31, 2009, Q purchases 2 per cent equity shares in C Ltd. Consequently, loan of Rs. 40,000 will be deemed as dividend income of C Ltd. for the previous year 2008-09.

❑ On August 5, 2008, XYZ Ltd. pays Rs. 30,000 by way of advance to D Firm. None of the shareholders of XYZ Ltd. (holding 10 per cent or more equity shares, *i.e.*, Z, Q and R) is a partner in D Firm on August 5, 2008 with 20 per cent shares. However, from January 1, 2009, P transfers 20 per cent profit share in D firm to Q for adequate consideration. Consequently, advance of Rs. 30,000 will be taken as deemed dividend of D firm for the previous year 2008-09.

■ Suppose XYZ Ltd. goes into liquidation on May 1, 2008, and accumulated profits on that date is Rs. 13,50,000 (*i.e.*, Rs. 12,90,000 computed earlier + Rs. 60,000 being profit up to the date of liquidation). On May 11, 2008, the company had distributable profit of Rs. 27,00,000 and it distributes Rs. 8,00,000 to shareholders. In this case Rs. 4,00,000 would amount to dividend. According to the ruling of the Supreme Court in *CIT* v. *Girdhardas & Co. (P.) Ltd.* [1967] 63 ITR 300, the distribution has to be apportioned between accumulated profits and capital. In this case out of Rs. 27,00,000, Rs. 13,50,000 (*i.e.*, 50 per cent of Rs. 27,00,000) represents accumulated profits. Therefore, 50 per cent of the amount distributed will be treated as dividend which will be subject to dividend tax.

193.3 *Tax treatment in the hands of shareholders if dividends are distributed after March 31, 2003* - Tax treatment of dividend is as follows—

193.3-1 *DIVIDEND RECEIVED FROM A DOMESTIC COMPANY* - If dividend is covered by section 2(*22*) [not by clause (*e*) of section 2(*22*)] and declared, distributed or paid after March 31, 2003*, then it is not

*If such dividend is declared/distributed during the financial year 2002-03, then it is taxable in the hands of shareholders.

taxable in the hands of shareholders by virtue of section 10(*34*)/(*33*). On such dividend, the company declaring dividend will pay dividend tax under section 115-O [*see* para 337].

If a loan or advance is given which is deemed as dividend under section 2(*22*)(*e*), then such loan or advance is taxable under section 56 as "dividend" in the hands of recipient.

193.3-2 *DIVIDEND RECEIVED FROM A NON-DOMESTIC COMPANY* - If dividend is received from a company other than a domestic company, it is chargeable to tax in the hands of recipient.

193.4 ***Basis of charge of dividend income [Sec. 8]*** - Method of accounting regularly employed by the assessee does not affect basis of charge of dividend income fixed by section 8.

Normal dividend - Normal dividend declared at annual general meeting is deemed to be the income of the previous year of shareholder in which it is declared. For instance, by virtue of dividend declared by a company on October 31, 2002, X is entitled to receive Rs. 3,000, Rs. 3,000 will be included in the income of the previous year 2002-03 and accordingly taxable in the hands of X for the assessment year 2003-04.

Deemed dividend - Deemed dividend under section 2(*22*) is treated as the income of the previous year in which it is so distributed or paid. Where a company declares dividend *in specie, i.e.*, shares, it will be taxable only in the year in which shares were transferred to the shareholders by execution of instrument of transfer and not in the year in which it was declared—*CIT* v. *Rampur Distillery & Chemical Co. Ltd.* 1974 Tax LR 691 (All.).

Interim dividend - Interim dividend is deemed to be the income of the previous year in which the amount of such dividend is unconditionally made available by the company to a shareholder.

Winnings from lotteries, crossword puzzles, horse races and card games, etc. [Sec. 56(2)(*ib*)]

194. Winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever, is taxable under section 56 under the head "Income from other sources".

194.1 ***Only "winning" from lottery, races, gambling, etc., is chargeable to tax*** - Under section 56(2)(*ib*) amount taxable is "winning" from lotteries, crossword puzzles, races, etc. The crucial word is "winning". Only winnings from lotteries, winnings from races, winnings from betting, etc., are chargeable to tax. If a receipt is not "winnings", then it is not taxable under section 56(2)(*ib*).

- *Winnings - Meaning of* - The word "winnings" has given the following meaning in the *Universal Dictionary of English Language* by Henry Ceicil Wyld. Rentlodge and Kagat Paul Ltd., London, 1952 Edition ; "Amount won, esp. money won in betting". In the *Oxford English Dictionary*, Volume XII, the word "winnings" is given the following meaning : "Things or sums gained, gains, profits, earning (obs. or dial) in mod, use chiefly applied to money won by gambling or betting". Income accruing to an agent/trader in respect of prizes on unsold/unclaimed lottery tickets in possession of an agent is income from business and does not constitute winnings from lotteries—*Director of State Lotteries* v. *CIT* [1999] 238 ITR 1 (Gauhati).

- *Meaning as given in the Act* - The expression "lottery" includes winnings from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called and "card game and other game of any sort" includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game.

194.2 ***Tax incidence on winnings from lotteries, etc.*** - Section 115BB provides that gross winnings from lotteries, crossword puzzles, races including horse races (other than income from the activity of owning and maintaining race horses), card games and other games of any sort or from gambling or betting of any nature whatsoever are chargeable to income-tax at a flat rate of 30 per cent

(+ SC + EC + SHEC)* on the gross winnings (without claiming any allowance or expenditure—*see* also para 201.1-7).

194.3 ***How to "gross up" if net winnings is given*** - Tax is deducted at source under sections 194B and 194BB on payments in respect of winnings from lotteries or crossword puzzle or card game and other game of any sort exceeding Rs. 5,000 (Rs. 2,500 in case of winnings from horse races) @ 30 per cent (+ SC + EC + SHEC)*.

If net amount received is given, then net amount shall be grossed up to find out the amount chargeable to tax. An example is given below to make the aforesaid position clear—

Winnings from lottery or horse race in case of X

	Rs.
Winnings on March 15, 2009	1,00,000
Tax deduction @ 30.9 per cent (including education cess)	30,900
Net amount received by X	69,100

If it is given that X receives Rs. 69,100 on account of winnings from lotteries (or on account of winnings from races), then net receipt shall be converted into gross amount as follows —

Source	*Mode of conversion*
Net winnings from lotteries or crossword puzzle or horse race or card games and other games	$\frac{\text{Net amount}}{[1 - (0.30 + SC + EC + SHEC)^*]}$
Winnings from other races, gambling or betting	As no tax is required to be deducted, there is no difference between net and gross amounts

194.4 ***In which year it is chargeable to tax*** - Where an assessee does not maintain any books of account, lottery prize won by him would accrue in the year in which it is received by the assessee and not in year in which the prize is declared—*CIT* v. *M. Ramachandran* [2000] 74 ITD 385 (Mad.).

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*Surcharge, education cess and secondary and higher education cess is applicable as follows :

[illegible]	*Financial year 2008-09 (assessment year 2009-10)*
■ *Surcharge (as a percentage of income-tax)—*	
1. If the recipient is an individual/HUF/AOP/BOI and payment or credit subject to tax deduction does not exceed Rs. 10 lakh	*Nil*
2. If the recipient is an individual/HUF/AOP/BOI and payment or credit subject to tax deduction exceeds Rs. 10 lakh	10%
3. If the recipient is an artificial juridical person	10%
4. If the recipient is a firm or a domestic company and payment or credit subject to tax deduction does not exceed Rs. 1 crore	*Nil*
5. If the recipient is a firm or a domestic company and payment or credit subject to tax deduction exceeds Rs. 1 crore	10%
6. If the recipient is a non-domestic company and payment or credit subject to tax deduction does not exceed Rs. 1 crore	*Nil*
7. If the recipient is a non-domestic company and payment or credit subject to tax deduction exceeds Rs. 1 crore	2.5%
8. If the recipient is a co-operative society or local authority	*Nil*
■ *Education cess (as a percentage of income-tax and surcharge)*	2%
■ *Secondary and higher education cess (as a percentage of income-tax and surcharge)*	1%

Sum received from employees as their contribution towards staff welfare schemes [Sec. 56(2)(*ic*)]

195. Any sum received by the assessee from his employees as their contribution to any provident fund, or superannuation fund, or any fund, set up under the Employees' State Insurance Act, 1948 or any other fund for the welfare of employees is taxable as income from other sources, if the same is not taxable under section 28 as business income [*see* also para 200.2 and para 6.2-13].

Interest on securities [Sec. 56(2)(*id*)]

196. Income by way of interest on securities is taxable under the head "Income from other sources", if the same is not taxable as business income under section 28.

196.1 ***Meaning of "security"*** - The word "security" is not defined under the Act. One has, therefore, to depend upon its natural meaning and the meaning ascribed to it under various judicial pronouncements. Lord Cave in *Singer* v. *Williams* [1921] 1 AC 41 observed : "The word (security) denotes a debt or a claim, the payment of which is in some way secured.... Where the word is used in its normal sense, some form of secured liability is postulated.... The word 'securities' must be construed in the sense above defined and accordingly does not include shares or stock in a company."

196.2 ***Interest on securities [Sec. 2(28B)]*** - Interest on securities means —

a. interest on any security of the Central Government or a State Government;

b. interest on debentures or other securities for money issued by or on behalf of a local authority or a company or a corporation established by a Central, State or Provincial Act.

196.3 ***Basis of charge*** - Income by way of interest on securities is taxable on "receipt" basis if books of account are maintained on "cash basis". It is taxable on "due" basis when a person does not maintain books of account or when a person maintains books of account on the basis of "mercantile system". No assessee shall be precluded from being charged to income-tax in respect of any interest on securities received by him in a previous year, if such interest had not been charged to income-tax for any earlier previous year.

196.4 ***Due date of interest*** - Interest on securities does not accrue every day or according to the period of holding. If one holds 7 per cent securities of a company from January 1, 2009 to February 28, 2009, it cannot be said that interest of two months has accrued to him. Generally, interest becomes due on due dates specified on securities. For instance, if specified due dates of interest of a security are March 1 and September 1 every year, interest of six months would fall due on each such date and whosoever is holder of securities on these dates will be entitled to interest of six months on each date. If X purchases Rs. 20,000, 8 per cent securities (specified due dates : March 1 and September 1) on February 25, 2009 and sells the same on March 3, 2009, he will become entitled for interest of 6 months (*i.e.*, Rs. 20,000 × ½ × 7 ÷ 100 = Rs. 700), irrespective of the fact that he holds securities for just 6 days. As, in this case, interest of 6 months will become due to X on March 1, 2009, he will be liable to tax on the whole interest of Rs. 700 in the previous year 2008-09 if he maintains books of account on "mercantile system". If, however, he maintains books of account on "cash system", then Rs. 700 is taxable in the previous year in which it is received.

An assessee has credited in its profit and loss account for the current year, interest on securities but the due date of interest falls in the next year. Such interest has been included in the current year's profit and loss account only to show what the assessee is entitled in due course to help better explanation of the financial position of the assessee. In ***CIT*** v. ***Federal Bank Ltd.*** [2008] 170 Taxman 239 (Ker.), the Court held that merely because the assessee had declared such interest as amount receivable in the course of time, it did not mean that interest on securities had in fact accrued to the assessee. Only real income is assessable under the Act. Though interest due or receivable is assessable under the mercantile system, yet since the interest on securities involved in the instant

case, was neither received nor receivable during the previous year, such interest could not be assessed.

196.5 ***Interest exempt from tax [Sec. 10(15)]*** - Interest earned from the following is exempt from tax to the extent to which amount of these certificates and deposits do not exceed, in each case, the maximum amount which is permitted to be invested or deposited therein :

■ Income by way of interest, premium on redemption or other payments on notified bonds, securities, or certificates issued by the Government and interest on notified deposits.

■ Interest on notified Capital Investment Bonds† in the case of individual and Hindu undivided families (no bond will be notified by the Central Government on or after June 1, 2002).

■ Interest on notified Relief Bonds, in the case of an individual and Hindu undivided family.

■ Interest received by a non-resident Indian from notified bonds‡ [*i.e.*, NRI Bonds and NRI Bonds (Second Series) issued by State Bank of India] or by an individual owning such bonds by virtue of being a nominee or survivor of such non-resident Indian or by an individual to whom the bonds have been gifted by the non-resident Indian. Exemption will be available only if the bonds are purchased by a non-resident Indian in foreign exchange. The interest and principal received in respect of such bonds, whether on their maturity or otherwise, is not allowable to be taken out of India. Where the individual who is a non-resident Indian in the previous year in which the bonds are acquired, becomes a resident in India in any subsequent year, the interest received from such bonds will continue to be exempt in the subsequent years as well.

If the bonds are encashed in a previous year prior to their maturity by an individual who is so entitled, the exemption in relation to the interest income shall not be available to such individual in the assessment year relevant to such previous year in which the bonds have been encashed.

■ Interest on securities held by the Issue Department of the Central Bank of Ceylon.

■ Interest* payable to any foreign bank performing central banking functions outside India (This exemption will be available from the assessment year 1985-86 where the interest is payable in respect of the deposits made by such bank with any scheduled bank in India with the approval of the Reserve Bank of India).

■ Interest* payable to the Nordic Investment Bank on loan advanced by it to a project approved by the Central Government.

■ Interest received or receivable by European Investment Bank, on a loan granted by it in pursuance of the framework-agreement for financial co-operation entered into on November 25, 1993 by the Central Government with that bank (applicable from the assessment year 2005-06).

■ Interest* payable by the Government or a local authority on money borrowed, or debt owned by it before June 1, 2001 from sources outside India.

■ Interest* payable by an industrial undertaking [*see* para 196.5-1] on moneys borrowed under a loan agreement entered into before June 1, 2001, from the following financial institutions : The International Finance Corporation, Washington ; Export Import Bank of Washington, Washington, D.C. ; Export Import Bank of Japan, Tokyo ; The Development Loan Fund, Columbia, U.S.A. ; The West German Bank for Reconstruction, West Germany and the Banque Francaise de Commerce Exterieur, Paris.

■ Interest* payable by an industrial undertaking [*see* para 196.5-1] in India on moneys borrowed or debt incurred by it before June 1, 2001 in a foreign country in respect of purchase outside India of raw material, capital plant and machinery or component. It includes purchase of capital plant and

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†Notified bond in 7 per cent Capital Investment Bonds.

‡No such bond will be notified by the Government on or after June 1, 2002.

*"Interest" includes hedging transaction charges on account of currency fluctuation. For the assessment year 2001-02, "interest" shall not include interest paid on delayed payment of loan or on default. From the assessment year 2002-03, interest shall not include interest paid on delayed payment of loan or on default if it is in excess of 2 per cent per annum.

machinery under hire-purchase agreement or a lease agreement with an option to purchase such plant and machinery. It also includes interest payable outside India by a ship-breaking unit in respect of purchase of ship from outside India.

■ Interest* payable by the Industrial Finance Corporation of India or the Industrial Development Bank of India or the Industrial Credit Investment Corporation of India, or Export Import Bank of India, or, National Housing Bank or, the Small Industries Development Bank of India on any money borrowed before June 1, 2001 from sources outside India.

■ Interest* payable by any other financial institution established in India or a banking company on any money borrowed from sources outside India under a loan agreement approved by the Central Government before June 1, 2001.

■ Interest* payable by an industrial undertaking in India [*see* para 196.5-1] on any money borrowed by it in a foreign currency from sources outside India under a loan agreement approved before June 1, 2001. Where borrowings are required to be utilised for specified industrial purposes and if these are not so utilised, withdrawal of approval for exemption will be justified—*Reliance Industries Ltd.* v. *Union of India* [2002] 124 Taxman 246 (Delhi).

■ Interest* payable by a scheduled bank to a non-resident or a person who is resident but not ordinarily resident [within the meaning of section 6(6)] on deposits (approved by RBI) in foreign currency.

■ Interest* payable by a public company formed and registered in India, and which is eligible for deduction under section 36(1)(*viii*), with the main objective of carrying on business of providing long-term finance for construction or purchase of houses in India for residential purposes on any money borrowed by it in foreign currency from sources outside India under agreement approved by the Central Government before June 1, 2003, to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government.

■ Interest* payable by public sector companies on certain specified bonds and debentures subject to such conditions, including the condition that the holder of such bonds or debentures registers his name and his holding with that company, as may be specified by the Central Government by notification in the Official Gazette.

For interest on notified debentures of public sector companies—*see Taxmann's Direct Taxes Circulars*, Vol. 1, 2006.

■ Interest on deposits, with a notified scheme, made by a retiring Government employee (or public sector employee, with effect from the assessment year 1991-92) out of his retirement benefits for a lock-in-period of three years.

■ Interest on securities held by the Welfare Commissioner, Bhopal Gas Victims, Bhopal in Reserve Bank, SGL Account No. SL/DH 048.

■ Interest on deposits for the benefit of the victims of the Bhopal gas leak disaster held in notified account with the Reserve Bank of India or with a public sector bank.

■ Interest on Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999.

■ Interest on notified bonds issued by local authority or by State Pooled Finance Entity (applicable from the assessment year 2008-09).

■ Interest received by a non-resident or resident but not ordinarily resident in India on deposit made after March 31, 2005 in an Offshore Banking Unit.

196.5-1 ***MEANING OF INDUSTRIAL UNDERTAKING*** - The term "industrial undertaking" for the purpose of section 10(*15*)(*iv*) means an undertaking which is engaged in the manufacture of processing of goods or in the business of generation or distribution of electricity or any other form of power or in mining or in the construction of ships or in the business of ship-breaking or in the operation of ships or aircrafts or construction or operation of rail system or the business of providing telecommunication services or the manufacture of computer software or recording of programme on any disc, tape, perforated media or other information device.

**See* page 568.

196.6 ***Persons exempt from tax*** - Interest on securities is exempt from tax under sections 10, 11 and 13A if securities are held by the following :

- Local authority [sec. 10(*20*)].
- Approved scientific research association [sec.10(*21*)].
- Any regimental Fund or Non-public Fund [sec. 10(*23AA*)].
- An institution existing solely for the development of khadi or village industries [sec. 10(*23B*)].
- Authority established for the development of khadi and village industries [sec. 10(*23BB*)].
- Any body or authority constituted for the administration of public religious trusts or endowments [sec. 10(*23BBA*)].
- The Prime Minister's National Relief Fund, the Prime Minister's Fund (Promotion of Folk Art), the Prime Minister's Aid to Students Fund, or any other notified institution [sec. 10(*23C*)].
- Registered trade union [sec. 10(*24*)].
- Statutory provident fund, recognised provident fund, approved superannuation fund and approved gratuity fund [sec. 10(*25*)].
- Member of a scheduled tribe [sec. 10(*26*)].
- Corporation or other body or institution established for promoting the interest of the members of scheduled castes/scheduled tribes [sec. 10(*26B*)].
- Public charitable and religious trust or institution [sec. 11].
- Political party registered with the Election Commission of India [sec. 13A].

196.7 ***Grossing up of interest*** - As gross interest [*i.e.*, net interest *plus* tax deducted at source -*see* para 406] is taxable, net interest is grossed up as follows :

Net interest received × 100 ÷ (100 — Rate of tax deduction at source†).

Grossing up is not required when tax is not deducted at source.

196.8 ***Deduction under section 80L*** - No deduction under section 80L is available.

196.9 ***Avoidance of tax by certain transactions in securities [Sec. 94]*** - Interest on securities does not accrue from day to day but on certain fixed dates. If, on the eve of due date of payment of interest, a person transfers securities to another person and re-acquires the same or similar securities after the interest has been received by the transferee, the transferor would be able to evade tax in respect of such interest. To prevent this malpractice, section 94 provides certain checks under sub-sections (1) and (2).

196.9-1 *BOND-WASHING TRANSACTIONS [SEC. 94(1)]* - A bond-washing transaction is defined as a transaction which consists of selling securities (to a friend or relative) some time before the due date of interest and acquiring back the same (or similar) securities after the due date is over. This practice is generally adopted by high-income group assessees to evade tax by transferring securities to low-income group assessees on the eve of due date of payment of interest. If this practice is not checked, interest is includible in the total income of the transferee, as interest is chargeable in the hands of the person who is legal owner of securities on the due date of payment of interest. To prevent the avoidance of tax in this manner, section 94(1) provides that where a security owner transfers the securities on the eve of the due date of interest and re-acquires them and the interest is received by the transferee, the income from such securities will be deemed as income of the transferor and, accordingly, it will be included in the total income of the transferor, and not of the transferee.

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†For rate of deduction, *see* Annex 1. Generally, tax is deducted at the rate of 10 per cent (+SC+EC+ SHEC) in the case of listed debentures and at the rate of 20 per cent (+SC+EC+SHEC)* in the case of non-listed debentures if the recipient is a resident non-corporate assessee. Tax is deductible at the rate of 20 per cent (+SC+EC+SHEC)* if the recipient is a domestic company. No tax is deductible in the case of Government securities.

*For surcharge, etc., *see* para 194.3.

196.9-2 *SALES-CUM-INTEREST* - Another method of avoiding tax is sale of securities *cum*-interest. To avoid this practice, section 94(2) provides that if assessee, having beneficial interest in securities during the previous year, sells them in such a way that either no income is received or income received is less than the sum he would have received if interest had accrued from day to day, then income from such securities for such year (not income up to the date of transfer) would be deemed as income of such person.

196.9-3 *EXCEPTIONS* - Deeming provisions of section 94(1) and (2), discussed above, are not applicable if the security owner proves to the satisfaction of the Assessing Officer that : (*a*) there has been no avoidance of income-tax ; or (*b*) the avoidance of income-tax was *exceptional* and *not systematic* and there was not any avoidance of income-tax under section 94(1) and (2) in his case during the three years preceding the previous year—*CIT* v. *Sakarlal Balabhai* [1968] 69 ITR 168 (Guj.). A single transaction of avoidance of tax is exceptional (and not systematic), and, accordingly, it will not be hit by deeming fiction of section 94, even if it is planned and tax liability is reduced or avoided—*Gurdial Singh Uppal* v. *CIT* [1972] 85 ITR 238 (P & H), ***CIT v. Vallabh Leasing & Finance Co. (P.) Ltd.*** [2004] 265 ITR 1 (MP).

Income from machinery, plant or furniture let on hire [Sec. 56(2)(*ii*)]

197. Income from machinery, plant or furniture belonging to the assessee and let on hire is taxable as income, from other sources if the same is not chargeable to tax under the head "Profits and gains of business or profession". Where the assessee-company leased out printing machinery and a distillery plant on rent and the assessee never carried on at any time either the business of printing or that of a distillery, it was held that the income received by the assessee by way of rent from leasing of printing machinery, etc., should be assessed under the head "Income from other sources"—*Dharak Ltd.* v. *CIT* [1986] 25 Taxman 196 (Ker.).

Income from composite letting of building, machinery, plant or furniture [Sec. 56(2)(*iii*)]

198. If an assessee lets on hire machinery, plant or furniture and also building and letting of building is inseparable from letting of machinery, plant or furniture, income from such letting is taxable as income from other sources. This rule is applicable only if the same is not chargeable to tax under the head "Profits and gains of business or profession".

198.1 ***Letting of building need not be incidental to letting of plant, machinery or furniture*** - Section 56(2)(*iii*) first mentions the letting of the machinery, plant or furniture and then refers to the letting of the building and further uses the word "also" in connection with the letting of the building. From this it is incorrect to conclude that the primary letting must be of the machinery, plant or furniture. All that section 56(2)(*iii*) contemplates is that the letting of machinery, plant or furniture should be inseparable from the letting of the buildings—*Sultan Bros. (P.) Ltd.* v. *CIT* [1964] 51 ITR 353 (SC).

198.2 ***It is not necessary that machinery, furniture or plant is inseparable from building*** - The language used in the Act is not that the two must be inseparably connected when let out. What is required by law is that the letting of one is inseparable from the letting of the other—*Sultan Bros. Pvt. Ltd.* v. *CIT* [1964] 51 ITR 353 (SC).

198.3 ***When letting of plant, machinery or furniture is inseparable from letting of building*** - The inseparability referred to in section 56(2)(*iii*) is an inseparability arising from the intention of the parties. That intention may be ascertained by framing the following questions :

1. Is it the intention in making the lease that the two should be enjoyed together ? It is immaterial whether there is one lease or two.

2. Is it the intention to make the letting of the two practically one letting ?

3. Would one have been let alone and a lease of it accepted by the tenant without the other ?

If the answers to the first two questions are in the affirmative, and the last in the negative, then it should be held that it is intended that the lettings would be inseparable—*Sultan Bros. Pvt. Ltd.* v. *CIT* [1964] 51 ITR 353 (SC).

198.4 *Instances* - The following instances will explain the practical application of the above stated tests :

■ *Lease of cinema building with furniture and other articles* - Where a cinema building is given on lease under a lease deed which indicates that the lease in respect of theatre as such includes furniture and other articles therein, rental income therefrom is taxable under the head "Income from other sources"—*CIT* v. *D.L. Kanhare* [1973] 92 ITR 535 (Bom.), *M. K. Dar* v. *CIT* [1982] 138 ITR 801 (All.), *CIT* v. *Khalid Mehdi* [1986] 57 CTR (AP) 110.

■ *Letting of hotel building and furniture* - In *Sultan Bros.* v. *CIT* [1964] 51 ITR 353 (SC) a company constructed a building for the purpose of running a hotel. The lease provided for a monthly rent of Rs. 5,950 for the building and a hire of Rs. 5,000 for the furniture and fixtures. It was *held* by the Supreme Court that income from letting out was taxable under section 56 since the building and fixtures/furniture were to be used for one purpose (*i.e.*, for running a hotel) all together and not one separately from the other, notwithstanding that the sum payable for their enjoyment was fixed separately.

■ *Letting out of rooms with furniture by a club* - Where the assessee-company, running a club for the benefit of its members, let out its rooms along with furniture and other facilities solely to its members, it was *held* that consolidated rent charged by the assessee was classifiable as income from other sources and not as income from house property—*CIT* v. *Cawnpore Club Ltd.* [1983] 14 Taxman 211 (All.).

■ *Letting out of building with air-conditioning plant, lifts, etc.* - In *Chitpore Golabari Co. (P.) Ltd.* v. *CIT* [1971] 82 ITR 753 (Cal.), the assessee let on hire three buildings with air-conditioning plant, tube wells, refrigerators, etc., on *rent separately fixed* for buildings and furniture, but the lease deed referred to the buildings and fixtures collectively as "demised premises", it was *held* that the entire rental income was chargeable to tax under the head "Income from other sources". In *Indian City Properties Ltd.* v. *CIT* [1978] 111 ITR 19 (Cal.), the court *held* that where the Tribunal had found that there was no letting of lift or air-conditioning plant along with the letting of the building, the income derived from letting of building would be assessable under section 22 and the lift and air-conditioning charges, shown separately in the assessment order, would have to be taxed as income from other sources under section 56, *see* also *CIT* v. *Bhakhtawar Construction (P.) Ltd.* [1986] 27 Taxman 7 (Bom.).

198.5 *Conclusions* - On the basis of the aforesaid judicial pronouncements, the following broad conclusions one can draw :

1. If there is letting of machinery, plant and furniture and also letting of the building and the two lettings form part and parcel of the same transaction or the two lettings are inseparable (in the sense that letting of one is not acceptable to the other party without letting of the other), then such income is taxable under section 56(2)(*iii*) under the head "Income from other sources" (if it is not taxable under section 28). This rule is applicable even if sum receivable for the two lettings is fixed separately.

2. If building is let out but other assets like machinery, plant or furniture are not given on rent. However, certain amenities like lift services, air conditioning, fire fighting facilities, etc., are provided, then section 56(2)(*iii*) is not applicable. The essential requirement of section 56(2)(*iii*) is that there should be letting of plant, machinery or furniture and also letting of building.

For instance, if the owner of a building only undertakes to instal, erect and fit up and operate an air conditioning and cooling plant and to instal, fit up and maintain a lift in the building for the benefit of all the tenants at a specified charge (maybe on "no profit no loss basis" or some other basis), there is no letting of air-conditioning plant and lifts to the tenants. Consequently, in such case income from letting of building is taxable under section 22 under the head "Income from house property" and

amount collected for providing different amenities shall be taxable under section 56(1) [if such charges are not taxable under section 28].

The aforesaid rule is applicable even if the assessee receives composite rent from his tenant towards building as well as services/amenities. The portion of rent attributable to the building should only be assessed as "Income from house property" and balance portion attributable to amenities must be assessed as "Income from other sources"—*CIT* v. *Kanak Investments* (*P.*) *Ltd.* [1974] 95 ITR 419 (Cal.), *CIT* v. *Model Mfg. Co.* (*P.*) *Ltd.* [1985] 21 Taxman 338 (Cal.).

Receipts without consideration to be treated as income [Sec. 56(2)(*vi*)]

199. ***If sum of money without consideration is received on or after April 1, 2006*** - The provisions in respect of gift received on or after April 1, 2006 are briefly given below -

199.1 ***Conditions*** - The following conditions should be satisfied—

a. the recipient is an individual or a Hindu undivided family;

b. any sum of money is received without consideration on or after April 1, 2006;

c. the aggregate amount of such money received by an individual/Hindu undivided family during a financial year from any person/persons exceeds Rs. 50,000.

If these conditions are satisfied the entire amount is chargeable to tax in the hands of recipient. In other words, if aggregate amount of such money received by an individual/Hindu undivided family during a financial year from any person/persons is Rs. 50,000 or less, nothing would be chargeable to tax. Conversely, if such amount is more than Rs. 50,000, the entire amount is chargeable to tax.

199.2 ***Provisions not applicable in few cases*** - While calculating the above monitory limit of Rs. 50,000, any sum of money received from the following shall not be considered -

1. Money received from a relative [*see* para 199.2-1].

2. Money received on the occasion of the marriage of the individual.

3. Money received by way of will/inheritance.

4. Money received in contemplation of death of the payer.

5. Money received from a local authority.

6. Money received from any fund, foundation, university, other educational institution, hospital, medical institution, any trust or institution referred to in section 10(*23C*).

7. Money received from a charitable institute registered under section 12AA.

199.2-1 *MEANING OF RELATIVE* - For the aforesaid purpose, the term "relative" means—

[illegible]	*If taxpayer is X*
1. Spouse of the individual	Mrs. X
2. Brother or sister of the individual	Brothers/sisters of X
3. Brother or sister of the spouse of the individual	Brothers/sisters of Mrs. X
4. Brother or sister of either of the parents of the individual	Brothers/sisters of father/mother of X
5. Any lineal ascendant or descendant of the individual	Lineal ascendant or descendant of X
6. Any lineal ascendant or descendant of the spouse of the individual	Lineal ascendant or descendant of Mrs. X
7. Spouse of the person referred to in (*2*) to (*6*)	Spouse of the aforesaid persons

199.2-2 *OTHER POINTS* - The following points should be noted—

1. It may be noted that gifts in kind are not covered by the aforesaid provision.

2. A sum of money received without consideration by a firm, a company, AOP, BOI is not taxable under section 56(2)(*vi*). The above provisions cover only a receipt by an individual or HUF. Trust would be liable to tax as courts have held the status of a trust as an individual.

3. Gift on the occasion of marriage is not chargeable to tax. Gifts on other occasions (*e.g.*, gifts on birthday, etc.) will, however, be chargeable to tax. Further, marriage gift may be received from relatives, friends or any other person.

4. The above provision is applicable whether the recipient is a resident or non-resident. Even a gift received by a non-resident in India is chargeable to tax.

5. The above provision is applicable whether the donor is resident or non-resident.

199.1-P1 X receives the following gifts on or after April 1, 2008—

1. On April 10, 2008, he gets a gift of Rs. 25,000 from his friend A.
2. On May 1, 2008, he gets another gift of Rs. 500 from his friend A.
3. On June 1, 2008, he gets a gift of Rs. 26,000 from C, who is cousin of his father.
4. On July 18, 2008, he gets a gift of Rs. 5,000 from D, who is elder brother of his grandfather.
5. On July 20, 2008, he gets a gift of Rs. 41,000 from his grandmother.
6. On the occasion of marriage of X, he gets Rs. 1,90,000 as gift on July 31, 2008 (out of which Rs. 1,00,000 is received from different relatives of X and Mrs. X and remaining amount is received from friends of X and Mrs. X).
7. A computer received from his employer (it was purchased for Rs. 40,000 by the employer on May 1, 2008 and given as gift on September 20, 2008).
8. On November 1, 2008, X purchases a house property from his friend for Rs. 35,000 (market value of the property is Rs. 6 lakh).
9. On October 1, 2008, he gets Rs. 80,000 from a notified public charitable institution.
10. X receives of Rs. 5,40,000 on October 5, 2008 under will of a person known to him.

SOLUTION :

Date of gift	Gift	Amount Rs.	Reason
April 10, 2008	Gift from A	25,000	
May 1, 2008	Gift from A	500	
June 1, 2008	Gift from cousin of X's father	26,000	Cousin of X's father is not a "relative" of X
July 18, 2008	Gift from elder brother of X's grandfather	5,000	Brother of X's grandfather is not a "relative" of X
July 20, 2008	Gift from grandmother	*Nil*	Gift from a "relative" is not taxable
July 31, 2008	Gift on the occasion of marriage of X	*Nil*	Gift from any person on the occasion of marriage of the taxpayer is not taxable
September 20, 2008	Gift from employer	*Nil*	Gift by an employer is taxable under the fringe benefit tax
November 1, 2008	Gift in kind	*Nil*	Gift in kind is not taxable
October 1, 2008	Gift from a charitable institute	*Nil*	Gift from a charitable institute is not taxable
October 5, 2008	Gift under a will	*Nil*	Gift received by taxpayer under a will of any person is not taxable
Total	Taxable	56,500	As it exceeds Rs. 50,000, it is chargeable to tax

Interest on KVP, IVP, NSC, etc.

199A. The tax treatment of interest on KVP, IVP, NSC, etc. is given below—

199A.1 ***Interest on Kisan Vikas Patras*** - The amount of interest accrued on investment in Kisan Vikas Patra by an assessee is to be calculated on the basis of following Table received from the Department of Economic Affairs wherein rate of interest and maturity amount for Rs. 100 denomination of Kisan Vikas Patras are given below :

Period from the date of certificate to the date of its encashment	Purchased from 1-3-2002 to 28-2-2001		Purchased from 1-3-2003 to 28-2-2003	
	Rate of interest	Maturity value Rs.	Rate of interest	Maturity value Rs.
1 year	7.25	1074	6.40	1065.02
2 years	7.25	1153	6.40	1134.28
2 years and 6 months	7.25	1195	6.40	1170.51
3 years	7.75	1256	6.40	1207.95
3 years and 6 months	7.75	1305	6.88	1267.19
4 years	8.25	1382	6.88	1310.80
4 years and 6 months	8.25	1439	6.88	1355.90
5 years	8.75	1534	7.36	1435.63
5 years and 6 months	8.75	1602	7.36	1488.49
6 years	8.75	1672	7.36	1543.30
6 years and 6 months	9.25	1800	7.85	1649.13
7 years	9.25	1883	7.85	1713.82
7 years and 6 months	—	2000*	7.85	1781.06
8 years	NA	NA	7.85	1850.93
8 years and 7 months	NA	NA	—	2000.00

199A.2 ***Interest on Indira Vikas Patra*** - These bonds have been discontinued.

199A.3 ***Interest on National Saving Certificates*** - *See* para 235.3.

199A.4 ***Deep Discount Bonds*** - *Vide Circular No. 2/2002*, dated February 15, 2002, the Board has issued certain clarifications.

199A.4-1 *POSITION BEFORE ISSUE OF CIRCULAR NO. 2/2002* - The Board had earlier clarified that the difference between the bid price (subscription price) and the redemption price (face value) of such bonds will be treated as interest income assessable under the Income-tax Act. On transfer of the bonds before maturity, the difference between the sale consideration and the cost of acquisition would be taxed as income from capital gains where the bonds were held as investment, and as business income where the bonds were held as trading assets. On final redemption, however, no capital gains will arise.

199A.4-2 *POSITION AFTER ISSUE OF CIRCULAR NO. 2/2002* - Substantial changes has been made *vide Circular No. 2/2002* which are given below. These are applicable only in respect of bonds issued after February 15, 2002—

1. Every person holding a Deep Discount Bond will make a market valuation of the bond as on March 31 of each financial year.

2. The difference between the market valuations as on two successive valuation dates will represent the accretion to the value of the bond during the relevant financial year and will be taxable as interest income (where the bonds are held as investments) or business income (where the bonds are held as trading assets).

3. Where the bond is transferred at any time *before the maturity* date, the difference between the sale price and the cost of the bond will be taxable as short-term capital gains in the hands of an investor or as business income in the hands of a trader. For computing such gains, the cost of the

*It is after 7 years and 8 months.

bond will be taken to be the aggregate of the cost for which the bond was acquired by the transferor and the income, if any, already offered to tax by such transferor up to the date of transfer.

4. Where the bond is redeemed by the original subscriber, the difference between the redemption price and the value as on the last valuation date immediately preceding the maturity date will be taxed as interest income in the case of investors or business income in the case of traders.

5. Investors holding Deep Discount Bonds up to an aggregate face value of Rs. 1,00,000 may, at their option, continue to offer income for tax in accordance with the earlier clarifications issued by the Board referred to in para 199A.4-1 above.

Deductions [Sec. 57]

200. The income chargeable to tax under this head is computed after making the following deductions :

200.1 ***Commission or remuneration for realising dividend† or interest on securities [Sec. 57(i)]*** - Any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realising dividend (not being dividend covered by section 115-O) or interest on securities on behalf of the assessee, is deductible. Though, unlike in section 43(*2*), the word "paid" is not defined for the head "Income from other sources", the aforesaid expenditure is deductible on "due basis" in the case of mercantile system of accounting or on "payment" basis in the case of cash system of accounting [sec. 145].

200.2 ***Deduction in respect of employees' contribution towards staff welfare schemes [Sec. 57(ia)]*** - Deduction in respect of any sum received by a taxpayer as contribution from his employees towards any welfare fund of such employees is allowable only if such sum is credited by the taxpayer to the employee's account in the relevant fund before the due date. For this purpose "due date" is the date by which the assessee is required as employer to credit such contribution to the employees' account in the relevant fund under the provisions of any law or terms of contract of service or otherwise. *See* also para 6.2-13.

200.3 ***Repairs, depreciation in the case of letting out of plant, machinery, furniture, building*** - In the case of income chargeable under section 56(2)(*ii*)/(*iii*) the following expenses are deductible :

a. current repairs in respect of building [sec. 30(*a*)(*ii*)—*see* para 107] ;

b. insurance premium in respect of insurance against risk of damage or destruction of the premises [sec. 30(*c*)—*see* para 107] ;

c. repairs and insurance of machinery, plant and furniture [sec. 31—*see* para 108] ;

d. depreciation [sec. 32—*see* para 109].

200.4 ***Standard deduction in the case of family pension [Sec. 57(iia)]*** - In the case of income in the nature of family pension, the amount deductible is Rs. 15,000 or 33⅓ per cent of such income, whichever is less.

■ For this purpose, "family pension" means a regular monthly amount payable by the employer to a person belonging to the family of an employee in the event of his death.

200.5 ***Any other expenses for earning income [Sec. 57(iii)]*** - Any other expenditure is deductible under section 57(*iii*) if the following four conditions are satisfied :

a. the expenditure must be laid out or expended wholly and exclusively for the purpose of making or earning the income ;

b. the expenditure must not be in the nature of capital expenditure ;

c. it must not be in the nature of personal expenses of the assessee ;

†Not being dividend under section 115-O which is not chargeable to tax in the hands of shareholders.

d. it must be laid out or expended in the relevant previous year and not in any prior or subsequent year—*see Virmati Ramkrishna* v. *CIT* [1981] 131 ITR 659 (Guj.).

200.5-1 *EXPENDITURE NEED NOT PRODUCE INCOME* - It is not necessary that any income should in fact have been earned as a result of the expenditure. What section 57(*iii*) requires is that the expenditure must be laid out or expended wholly and exclusively for the purpose of making or earning income—*CIT* v. *Rajendra Prasad Moody/Raghunandan Prasad Moody* [1978] 115 ITR 519 (SC).

200.5-2 *RELEVANCE OF EXISTENCE OF RELATIONSHIP BETWEEN ACTIVITY PRODUCING INCOME AND EXPENDITURE INCURRED* - The expenditure or outgoing sought to be deducted should bear a character which has a connection with or relation to the particular activity which produces the income or constitutes its source. Thus, where there is no connection or relationship between the litigation expenditure and the dividend income, the expenditure cannot be deducted from the dividend income—*CIT* v. *S. Devaraj* [1969] 73 ITR 1 (Mad.).

200.5-3 *EXPENDITURE MUST BE INCURRED IN THE YEAR OF INCOME* - To be deductible under section 57(*iii*), the expenditure in question must be incurred in the year in which the income forming the basis of the assessment arose—*CIT* v. *Basant Rai Takhat Singh* [1933] 1 ITR 197 (PC).

200.5-4 *RELEVANCE OF EXISTENCE OF SOURCE OF INCOME IN THE YEAR IN WHICH EXPENDITURE INCURRED* - If the source of income does not exist at the time when the expenditure is incurred, such expenditure is not allowable. Where the assessee-HUF claimed deduction of certain interest and expenses in respect of a block of shares which following its partition ceased to belong to it, it was *held* that as the impugned shares were not held by the assessee in the relevant previous year, the expenditure claimed was not allowable—*Seth Shiv Prasad* v. *CIT* [1972] 84 ITR 15 (All.).

200.5-5 *RELEVANCE OF CLAIM FOR DEDUCTION* - A duty is cast on the Assessing Officer to consider whether the assessee is entitled to a deduction from income falling under section 56 even though no such specific claim is made by the assessee—*CIT* v. *Archana R. Dhanwatay* [1982] 136 ITR 355 (Bom.).

200.5-6 *SECTION 57(iii) VERSUS SECTION 37(1)* - Though sections 37(1) and 57(*iii*) have a great deal in common and overlap on an extensive area and the expenditure which qualifies for deduction under section 57(*iii*) would necessarily fall within that ambit of section 37(1), the converse cannot be the case. Section 57(*iii*) is narrower in scope than section 37(1)—*CIT* v. *S. Devaraj* [1969] 73 ITR 1 (Mad.).

The test of allowability under section 57(*iii*) is that the expenditure must be for the purpose of "earning or making" the income. However, this is quite a different requirement from that laid down by section 37 which does not expect the expenditure to satisfy any condition other than that it should be incurred for the purposes of the business and wholly and exclusively for these purposes—*CIT* v. *George Polous* [1984] 146 ITR 380 (Mad.).

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

1. X purchases shares in a foreign company by investing borrowed capital. Dividend from foreign company is chargeable to tax. During the previous year 2008-09, while income of X from dividend from the foreign company is Rs. 80,000, interest on borrowed capital is Rs. 90,000. In this case, income from other sources is (-) Rs. 10,000, after deducting the entire interest liability of Rs. 90,000. Suppose in this case dividend income is zero, then income from other sources would be (-) Rs. 90,000.

2. Y purchases shares in an Indian listed company by investing borrowed capital. Dividend from this company is not chargeable to tax in the hands of shareholders. Consequently, interest on borrowed capital is not deductible.

Amounts not deductible

201. Under the Act the following are not deductible from the income chargeable under the head "Income from other sources" :

201.1 ***Amount not deductible under section 58*** - The following are not deductible by virtue of section 58 :

201.1-1 *PERSONAL EXPENSES [SEC. 58(1)(A)(I)]* - Any personal expenditure of the assessee is not deductible [*see* para 141.3].

201.1-2 *INTEREST [SEC. 58(1)(A)(II)]* - Any interest chargeable under the Act which is payable outside India on which tax has not been deducted at source is not deductible.

201.1-3 *SALARY [SEC. 58(1)(A)(III)]* - Any payment chargeable under the head "Salaries" and payable outside India is not deductible if tax has not been paid or deducted therefrom [*see* para 143.4].

201.1-4 *WEALTH-TAX [SEC. 58(1A)]* - Any sum paid on account of wealth-tax is not deductible [*see* para 143.5 for detailed discussion].

201.1-5 *AMOUNT SPECIFIED BY SECTION 40A [SEC. 58(2)]* - Any amount specified by section 40A is not deductible while calculating income under the head "Income from other sources" [*see* paras 147, 148, 151 and 153].

201.1-6 *EXPENDITURE IN RESPECT OF ROYALTY AND TECHNICAL FEES RECEIVED BY A FOREIGN COMPANY [SEC. 58(3)]* - In the case of foreign companies expenditure in respect of royalties and technical service fees as specified by section 44D is not deductible.

201.1-7 *EXPENDITURE IN RESPECT OF WINNINGS FROM LOTTERY [SEC. 58(4)]* - No deduction shall be allowed under any provision of the Act in computing the income by way of any winnings from lotteries, crossword puzzles, races including horse races*, card games and other games of any sort or from gambling or betting of any form or nature (this provision is, however, not applicable in the case of income from the activity of owning and maintaining race horses). Consequently, while computing the aforesaid income the following are not deductible—

1. No deduction is permissible under section 57.

2. Losses cannot be set off under sections 70, 71 and 72 against the aforesaid incomes. Under section 58(4) an allowance in connection with income under the head "Income from other sources" is not deductible under any provision of the Act including sections 70, 71 and 72 in computing income by way of winnings from lotteries, crossword puzzles, etc.; an allowance is appropriation for any purpose—*De Roche* v. *De Roche* 94 NW 767, 770.

3. No deduction is permissible under sections 80C to 80U.

Where, however, a certain percentage has to be foregone by the winner to the Government/agency conducting the lotteries, it is deductible (as it amounts to diversion by overriding title)— Circular No. 461, dated July 9, 1986.

201.2 ***Amounts not deductible by virtue of sections 115A, 115AB, 115AC, 115AD, 115BBA and 115D*** - No deduction is available under section 57 in the case of income referred to in sections 115A, 115AB, 115AC, 115AD, 115BBA and 115D [*see* para 162.13].

Problems on computation of income from other sources

202-P1 *Discuss whether transfer by a subsidiary company of its assets to its parent company in a scheme of amalgamation amounts to distribution of dividends to the extent of its accumulated profits under section 2(22)(a) and (c).*

SOLUTION : Under sub-clause (a) of section 2(22), "dividend" includes any distribution by a company of accumulated profits, whether capitalised or not, if such distribution entails the release by the company to its shareholder of all or any part of the assets of the company. This provision is attracted only where (a) a company distributes its accumulated profits to its shareholders, and (b) such distribution entails the release by the company to its shareholders of all or any part of its assets. However, where a company transfers its asset to another company in a scheme of amalgamation, such transfer may not be regarded as a "distribution" by the company of its accumulated profits to its shareholders even though its accumulated profits are embedded in the assets so transferred by it.

*It covers winnings from races, etc. This provision is not applicable in the case of income from the activity of owning and maintaining race horses.

Under sub-clause (c) of section 2(22), "dividend" includes any distribution made by a company to its shareholders on its liquidation to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not. This provision is attracted only in a case where a company goes into liquidation and not where it merges with another company in a scheme of amalgamation without going into liquidation.

Therefore, the provision of sub-clause (a) or (c) of section 2(22) are not attracted in a case where a company merges with another company in a scheme of amalgamation—Circular No. 5-P, dated October 9, 1967.

202-P2 *X is a shareholder in X Ltd., a closely held company. The other shareholders in the company are Mrs. X, and X's father. Seventy-five per cent of the shares in X Ltd. are held by X. During the relevant previous year 2008-09, the company gifts Rs. 50,000 to the son of X. The Assessing Officer, while completing the assessment of the assessee, wants to treat it as payments made on behalf of or for the benefit of the assessee and, therefore, considers the same under section 2(22)(e) as deemed dividend in the hands of X. X's son has invested Rs. 50,000 in his own name. Discuss whether the contention of the Assessing Officer is tenable in law.*

SOLUTION : To attract sub-clause (e) of section 2(22), three conditions have to be fulfilled, viz., (1) company should not be a company in which the public are substantially interested within the meaning of section 2(18), (2) shareholder should own benefit of at least 10 per cent of the equity capital ; and (3) company should possess accumulated profits at the time it makes a payment. If these conditions are satisfied sub-clause (e) has the effect of bringing to tax as dividend in the hands of the shareholders, three types of payments made by the company. They are : (a) any payment of any sum by way of advance or loan to a shareholder ; (b) any payment on behalf of shareholder ; and (c) the payment for the individual benefit of the shareholder. If the gift made to the son of the assessee by the company is payment on behalf of the assessee or payment for the individual benefit of the assessee, then the gift can be treated as deemed dividend in the hands of the assessee.

The fiction created for particular purpose cannot be extended beyond the purpose for which it is intended. Legal fictions are created for definite purpose and are limited to the purpose for which they are created and should not be extended.

In the instant case, there is no case that the payment has been made to discharge any liability of the assessee in the company. Apart from the assessee, his wife and father are also shareholders. Hence, there is no material that the payment in question is made to the son of X on his behalf or for his benefit. From the relationship alone a conclusion cannot be drawn to the effect that the payment is made on behalf of or for the benefit of X, a shareholder. The other shareholders are the mother and grandfather of the payee. In the circumstances, section 2(22)(e) is not applicable to the facts of the case.

The burden is on the revenue to prove that the payment is on behalf of or for the benefit of X. X has discharged his burden of proving that the gift is made to X's son and he has invested the amounts in his own name. Therefore, section 2(22)(e) is not attracted to the gift made by the company to the X's son—*CIT* v. *P.V. John* [1990] 52 Taxman 221 (Ker.).

202-P3 *Thomas Ltd. went into voluntary liquidation on December 31, 2008. The summarised balance sheet of the company as on that date was as under :*

Liabilities	Rs.	Assets	Rs.
Paid-up share capital	*25,00,000*	*Fixed assets*	*25,00,000*
Reserves and surplus	*10,00,000*	*Current assets*	*15,00,000*
Sundry liabilities	*5,00,000*		
	40,00,000		*40,00,000*

The share capital of the company consisted of 2,50,000 shares of Rs. 10 each out of which 50,000 shares had been issued in December 2008 as fully paid bonus shares in the ratio of 4 : 1 by capitalising an equal amount of reserves created out of the profits. Thomas Ltd. was a company in which the public were substantially interested and its shares were quoted on the Bombay Stock Exchange. X, one of the shareholders of the company, had purchased 10,000 shares through a recognised broker in 1988-89 at the then prevailing market price of Rs. 25 per share. The liquidator sold the fixed assets of the company on January 2, 2009 (date of liquidation being December 31, 2008) for Rs. 41 lakh and also realised the current assets of Rs. 15 lakh. After payment of the company's sundry liabilities to the tune of Rs. 5 lakh and also his fee and expenses aggregating to Rs. 1 lakh, he distributed on March 1, 2009 the balance equally amongst the shareholders of the company. How will you treat the amount received by X for income-tax

purposes ? Will your answer be different if X was an established share dealer ? In giving the calculations the capital gains tax liability of the company may be assumed to be Rs. 2 lakh.

SOLUTION : *Amount available to the liquidator*

	Payment to shareholders Rs.
Fixed assets' sale [Rs. 41 lakh — Rs. 2 lakh]	39,00,000
Current assets	15,00,000
Sundry liabilities	(–) 5,00,000
Expenses on liquidation	(–) 1,00,000
Total (out of Rs. 48 lakh, accumulated profit is Rs. 15 lakh [*i.e.*, reserves : Rs. 10 lakh + profit capitalised on issue of bonus shares : Rs. 5 lakh = 15 lakh. Profit on sale of fixed asset : Rs. 16 lakh, expenses on liquidation : Rs. 1 lakh and capital gain tax : Rs. 2 lakh are not part of accumulated profit being profit generated or expenditure incurred after the date of liquidation—*See* Note 4].	48,00,000
Dividend payable by the company	15,00,000
Less : Tax on distributed profit of Rs. 15 lakh which is treated as dividend under section 2(22) [*i.e.*, 16.995/116.995 of Rs. 15 lakh under section 115-O - see para 337]	2,17,894
Balance available [out of which accumulated profit is Rs. 12,82,106, *i.e.*, after providing dividend tax liability of Rs. 2,17,894]	45,82,106
Dividend tax payable by the company	
Dividend	12,82,106
Dividend tax (@ 15% + 10% surcharge + 2% education cess + 1% secondary and higher education cess]	2,17,894

X holds 10,000 equity shares and 2,500 bonus shares. Thus, he holds 5% paid-up equity share capital of the company (*i.e.*, 12,500 ÷ 2,50,000 × 100). Amount of dividend in the hands of X (regardless of fact whether X is share dealer or investor) would be Rs. 64,105 (*i.e.*, 5% of Rs. 12,82,106). Further X will get Rs. 1,65,000 (5% of Rs. 33 lakh) as repayment of share capital (*i.e.*, a return @ Rs. 13.20 per share, Rs. 1,65,000 ÷ 12,500).

On the basis of aforesaid computation, taxable income of X will be determined as under :

	Rs.
Dividend (exempt)	*Nil*
Capital gain	
Short-term capital gains on bonus shares (*i.e.*, Rs. 13.20 × 2,500—*Nil*)	33,000
Long-term capital gains on sale of original shares (*i.e.*, Rs. 13.20 × 10,000 —Rs. 9,03,727[1])	(–)7,71,727
Gross total income	33,000
Less : Deduction	*Nil*
Net income	33,000

Notes :

1. Indexed cost of acquisition is determined as under :

Original share acquired in 1988-89 (10,000 × Rs. 25 × 582* ÷ 161**)	9,03,727

*Cost inflation index for 2008-09

**Cost inflation index for 1988-89

2. Long-term capital loss can be set off only against long-term capital gains.

3. If X is a dealer in shares, his income will be determined as under :

Business income (Rs. 13.20 × 12,500 — Rs. 25 × 10,000)	(–) 85,000
Income from other sources (*i.e.*, dividend)	*Nil*
Gross total income	(–)85,000
Less : Deduction under section 80L [not available]	*Nil*
Net income [loss of Rs. 85,000 will be carried forward]	*Nil*

4. "Accumulated profits" includes profit up to the date of liquidation. Any profit generated after the date of liquidation does not form part of accumulated profit.

202-P4 *X holds 10 per cent of equity shares of ABC Ltd. (cost of acquisition on April 1, 1969 of 1,500 shares : Rs. 75,000 ; fair market value on April 1, 1981 : Rs. 80,000). ABC Ltd. goes into liquidation on December 31, 2008. Balance sheet of ABC Ltd. as on December 1, 2008 is given below. Determine the net income of (a) the company, and (b) X for the assessment year 2009-10.*

Capital and liabilities	Rs.	Assets and properties	Rs.
Share capital (15,000 shares of Rs. 100)	*15,00,000*	*Total assets comprising land and building on which no depreciation is claimed (amount realised on December 20, 2008 Rs. 1,21,00,000 and cost of liquidation : Rs. 45,000) (acquired on April 1, 1996 : Rs. 61,34,965)*	
P & L Account	*75,000*		
General reserve	*8,25,000*		
Sundry creditors	*26,00,000*		
			50,00,000
	50,00,000		*50,00,000*

Income of X from other sources : Rs. 62,000. Shares of ABC Ltd. are not listed.

SOLUTION : *Assessment of ABC Ltd.*	*Rs.*
Amount realised	1,21,00,000
Less : Cost of liquidation	45,000
	1,20,55,000
Less : Indexed cost of acquisition (Rs. 61,34,965 × 582 ÷ 305)	1,17,06,720
Capital gain	3,48,279
Tax on capital gain [@20%+EC+SHEC]	71,745
Amount realised	1,21,00,000
Less :	
Cost of liquidation	45,000
Tax on capital gain	71,745
Sundry creditors	26,00,000
Amount available for distribution (before dividend tax)	93,83,260
Distribution which is treated as dividend under section 2(22)(c) before dividend tax [*i.e.*, to the extent of accumulated profit up to December 31, 2008 being the date of liquidation. It is Rs. 8,25,000 + Rs. 75,000 + Rs. 71,00,000, being surplus on sale of assets — Rs. 71,745, being capital gains tax — Rs. 45,000]	78,83,255
Less : Dividend tax @ 16.995% [*i.e.*, 15% + 10% of 15% + 3% of (15% + 10% of 15%)] [16.995/116.995 × 78,83,255]	11,45,142
Balance to be treated as dividend	67,38,113
Dividend tax payable by ABC Ltd. @ 16.995%	11,45,142
Amount available for distribution after dividend tax	82,38,118
Assessment of X	
Consideration received from the liquidator (*i.e.*, 10% of Rs. 82,38,118)	8,23,812
Less : Deemed dividend under section 2(22)(c) [*i.e.*, 10% of accumulated profit of Rs. 67,38,113 (a)	6,73,811
Consideration received in respect of investment in shares	1,50,000
Less : Indexed cost of acquisition of shares (Rs. 80,000 × 582 ÷ 100)	4,65,600
Capital gain (long-term)	(–)3,15,600
Income from dividends (a)	*Nil*
Income from other sources	62,000
Gross total income	62,000
Less : Deduction under section 80L [not available]	*Nil*
Net income (rounded off) [capital loss of Rs. 3,15,600 will be carried forward]	62,000

202-P5 *C Ltd., a private limited company, in which the public are not substantially interested, is a holding company of T Ltd. T Ltd. has regular sales dealing with a unit of C Ltd. The unit has closed down due to unavoidable*

circumstances. Approximately Rs. 10 lakh of T Ltd. for the goods supplied is outstanding after adjusting the dividend payable to C Ltd. Please advise :

1. *Whether the balance of Rs. 10 lakh to the credit of T Ltd. will be treated as sundry credit for goods supplied or as deemed loan advanced by T Ltd. to C Ltd.*
2. *Whether the balance of Rs. 10 lakh to the credit of T Ltd. can be treated as deemed dividend in the hands of the shareholders of C Ltd.*

SOLUTION : The amount standing to the credit of T Ltd. is the outstanding amount for sale made to the parent company C Ltd. and as such is in the nature of sundry credit. The loan of an amount is different from the amount remaining outstanding in respect of goods supplied. The amount can also not be deemed as dividend in the hands of the shareholders of the parent company C Ltd., for it does not fall within the definition of "dividend" as contained in section 2(22) of the Act. While a loan creates a debt, there may be a debt without creating a loan. Every sale of goods on credit does not amount to a transaction of loan—*Bombay Steam Navigation Co. (1953) (P.) Ltd.* v. *CIT* [1965] 56 ITR 52 (SC), *CIT* v. *Saurashtra Cement & Chemical Industries Ltd.* [1975] 101 ITR 502 (Guj.) and *Lakhmichand Muchhal* v. *CIT* [1961] 43 ITR 315 (MP).

Moreover, if a loan is advanced by a company engaged in money-lending, in the ordinary course of its business, it does not come within the mischief of section 2(22). It will not be correct to construe section 2(22) by importing the expression "directly or indirectly" in connection with the expression "by way of advance or loan to a shareholder" appearing therein—*Nandlal Kanoria* v. *CIT* [1980] 122 ITR 405 (Cal.).

202-P6 *X, who maintains books of account on mercantile basis, holds following securities on April 1, 2008 :*

- *Rs. 50,000 7% securities of the Tamil Nadu Government ; and*
- *Rs. 61,000 14% non-listed debentures of ABC Ltd.*

Interest on both the cases is payable on December 1 every year.

On August 1, 2008, X borrows Rs. 33,000 at 7 per cent per annum and invests it in 8 per cent securities of the Central Government purchased at Rs. 110 (par rate : Rs. 100) (due date of interest January 1 and July 1 every year). On August 31, 2008, he further borrows Rs. 40,000 at 8 per cent per annum for investing it in 10 per cent listed debentures of DEF Ltd. (date of payment of interest : April 15 every year). Interest on borrowing for the period ending March 31, 2009 is, however, paid by X on April 15, 2009. He pays 2 per cent commission to his bank on net amount of interest realised. His income from other sources is Rs. 86,000. Determine the taxable income of X for the assessment year 2009-10. Can he claim deduction in respect of (a) whole of the interest payable on Rs. 33,000, borrowed for investing in Government securities, even if it exceeds income accrued, (b) interest payable on Rs. 40,000 borrowed for the purpose of investing in debentures of DEF Ltd. even if during the previous year the investment does not yield any income ?

SOLUTION :

	Amount realised Rs.	Taxable amount Rs.
Securities of Tamil Nadu Government (*i.e.* Rs. 50,000 × 7/100)	3,500[1]	3,500
Non-listed debentures of ABC Ltd. (*i.e.*, Rs. 61,000 × 14/100)	6,781[2]	8,540
Central Government securities (*i.e.*, instalment of interest due on January 1, 2009 on Rs. 30,000) (being par value of investment, *i.e.*, Rs. 33,000 ÷ 110 × 100) at the rate of 8% for 6 months	1,200	1,200
Listed debentures of DEF Ltd. (*debentures are purchased after April 15, 2008, therefore, interest due on April 15, 2008 is included in the income of seller, interest due on April 15, 2009 will, however, be included in total income of X for the assessment year 2010-11)	*Nil**	*Nil**
Gross interest	11,481	13,240
Less : Deductions		
Collection charges (2% of net amount realised, *i.e.*, Rs. 11,498)		229.62
Interest payable on Rs. 33,000 @ 7% per annum from August 1, 2008 to March 31, 2009 (*i.e.*, Rs. 33,000 × 7/100 × 8/12)	1,540.00[3]	
Interest payable on Rs. 40,000 @ 8% per annum from August 31, 2008 to March 31, 2009 (*i.e.*, Rs. 40,000 × 8/100 × 7/12)	1,866.67[4]	3,406.67
Interest on securities		9,603.71

	Amount realised Rs.	Taxable amount Rs.
Other income		86,000.00
Gross total income		95,603.71
Less : Deduction under section 80L [not available]		—
Net income		95,603.71
Net income (rounded off)		95,600.00

Notes :

1. In the case of Government securities, tax is not deducted at source.

2. In the case of non-Government securities (non-listed) tax is deducted at source @ 20%* if tax is deducted during the financial year 2008-09 in the case of resident non-corporate assessee. Therefore, the amount realised is Rs. 6,781 (being Rs. 8,540 — 20%* of Rs. 8,540).

3. Interest of Rs. 1,540 payable (even if not paid up to March 31, 2009) on amount borrowed for the purpose of investment in Government securities is fully deductible, even if it exceeds the amount of income accrued (*i.e.*, Rs. 1,200) to the assessee.

4. Interest of Rs. 1,866.67 payable on Rs. 40,000, borrowed for the purpose of investing in debentures of DEF Ltd. is deductible even if no interest is accrued to X during the previous year.

202-P7 *Find out the income chargeable to tax in the following cases—*

1. On May 5, 2008, X borrows Rs. 1,00,000 at the rate of 9 per cent per annum from a bank to invest in public issue of 10 per cent debentures of A Ltd. A Ltd. allots debentures on May 10, 2008 (as per terms of allotment interest is payable every year on November 30. However, the first interest on November 30, 2008 would be for the period commencing May 10, 2008 to November 30, 2008).

2. On April 18, 2008, Y borrows Rs. 2,00,000 at the rate of 8 per cent per annum from a bank to invest in public issue of 9.5 per cent debentures of B Ltd. B Ltd. allots debentures on April 30, 2008 (as per terms of allotment interest is payable every year on May 15; however, the first interest would be payable only on May 15, 2009 for the period commencing April 30, 2008 to May 15, 2009).

3. On June 6, 2008, Z borrows Rs. 4,00,000 at the rate of 10 per cent per annum from a bank to purchase (ex-interest) 11 per cent debentures of C Ltd. from B (purchase consideration being Rs. 4,00,000 + interest payable by C Ltd. on June 30, 2008). Interest is payable by C Ltd. every year on June 30. However, at the time of purchase of debentures from B, Z has agreed that interest received by him on June 30, 2008 would be given to B. Cost of acquisition of these debentures in the hands of B was Rs. 3,80,000 (date acquisition being June 17, 1985).

SOLUTION : *Computation of income for the assessment year 2009-10*

	X Rs.	Y Rs.	Z Rs.
Due date of interest falling in the previous year 2008-09	November 30, 2008	May 15, 2008	June 30, 2008
Amount of interest income [see Notes 1, 2 and 3]	5,589	*Nil*	44,000
Less: Interest on borrowed capital [see Note 4]	8,162	15,255	32,767
Income from other sources	(-) 2,573	(-) 15,255	11,233
Computation of income for the assessment year 2010-11			
Due date of interest falling in the previous year 2009-10	November 30, 2009	May 15, 2009	June 30, 2009
Amount of interest income [see Note 2]	10,000	19,781	44,000
Less: Interest on borrowed capital	9,000	16,000	40,000
Income from other sources	1,000	3,781	4,000

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

Notes :

1. Normally, interest is payable on the due date specified in the terms of allotment for the full period. For instance, if interest is payable once in a year, then interest of the full year is payable to the person who is the owner of debentures on that date. Likewise, if interest is payable twice in a year, then whosoever is the registered holder of these debentures will get half yearly interest on each of the due dates. However, in the case of public issue, the first interest is payable from the date of allotment till the first due date as per the terms of allotment. X has been allotted debentures of A Ltd. at the time of public issue. According to the terms of allotment, he has been paid interest by A Ltd. on November 30, 2008 for the broken period commencing on May 10, 2008 to November 30, 2008 (204 days ÷ 365 days × Rs. 10,000).

2. Y has also acquired debentures at the time of public issue from B Ltd. As per terms of allotment, no interest is paid by B Ltd. on May 15, 2008. Consequently, nothing is taxable in the hands of Y for the previous year 2008-09. For the next year income of Y will include interest for the period commencing from April 30, 2008 to May 15, 2009.

3. Z has purchased debentures from B on ex-interest basis. In simple words, the term "ex-interest" means the next interest immediately after this transaction will be given to the seller. Consequently, the interest received by Z on June 30, 2008 is given to the seller B. However, under the Income-tax Act, Z is chargeable to tax in respect of interest of Rs. 44,000 received by him on June 30, 2008, since he is the registered owner of the debentures on the said date. The cost of acquisition of these debentures in the hands of Z would be Rs. 4,44,000 (*i.e.*, Rs. 4,00,000 + Rs. 44,000). To put it differently, B, the seller, is not chargeable to tax in respect of interest of Rs. 44,000, since he is not the registered holder of these debentures on June 30, 2008. Rs. 44,000 received by B would be part of sale consideration. The capital gain in the hands of B would be calculated as follows:

	Rs.
Sale consideration (Rs. 4,00,000 + Rs. 44,000)	4,44,000
Less: Cost of acquisition (indexation benefit is not available in the case of debentures)	3,80,000
Long-term capital gains	64,000

4. Interest on borrowed capital is calculated from the date of borrowing till the end of the previous year.

CHAPTER NINE

Income of other persons included in assessee's total income

Transfer of income without transfer of assets [Sec. 60]

206. Section 60 is applicable if the following conditions are satisfied:

Condition 1	The taxpayer owns an asset.
Condition 2	The ownership of asset is not transferred by him. In other words, he has retained the ownership of the asset.
Condition 3	The income from the asset is transferred to any person under a settlement, trust, covenant, agreement or arrangement.
Condition 4	The above transfer may be revocable or may not be revocable.
Condition 5	The above transfer may be effected at any time (may be before the commencement of the Income-tax Act or otherwise).

If the above conditions are satisfied, the income from the asset would be taxable in the hands of the transferor.

Provisions illustrated - X owns 4,000, 14 per cent debentures of A Ltd. of Rs. 100 each (annual interest being Rs. 56,000). On April 1, 2008, he transfers interest income to Y, his friend, without transferring the ownership of these debentures. Although during 2008-09 interest of Rs. 56,000 will be received by Y, it is taxable in the hands of X, as he has transferred income without transferring the ownership of the asset.

206.1 ***Meaning of transfer*** - For the purpose of sections 60, 61 and 62, transfer includes any settlement, trust, covenant, agreement or arrangement.

206.2 ***No exception*** - Cases falling under section 60 do not have any exception.

206.3 ***Other points*** - Section 60 has no application where corpus itself is transferred—*CIT* v. *Grandhi Narayana Rao* [1988] 173 ITR 593 (AP).

Revocable transfer of assets [Sec. 61]

207. By virtue of section 61, if an asset is transferred under a "revocable transfer", income from such asset is taxable in the hands of the transferor. The transfer for this purpose includes any settlement, trust, covenant, agreement or arrangement.

207.1 ***What is revocable transfer*** - In any of the following cases, a transfer is a revocable transfer—

Situations	*Example*
Situation 1 - If an asset is transferred under a trust and it is revocable during the lifetime of the beneficiary.	X transfers a house property to a trust for the benefit of A and B. However, X has a right to revoke the trust during the lifetime of A and/or B. It is a revocable transfer and income arising from the house property is taxable in the hands of X.
Situation 2 - If an asset is transferred to a person and it is revocable during the lifetime of transferee.	X transfers a house property to A. However, X has a right to revoke the transfer during the lifetime of A. It is a revocable transfer and income arising from the house property is taxable in the hands of X.
Situation 3 - If an asset is transferred before April 1, 1961 and it is revocable within six years.	X transfers an asset on March 31, 1961. It is revocable on or before June 6, 1963. It is a revocable transfer.

Situations	*Example*
Situation 4 - If the transfer contains any provision to re-transfer the asset (or income therefrom) to the transferor directly or indirectly wholly or partly.	X transfers an asset. Under the terms of transfer, on or after April 1, 1998, he has a right to utilize the income of the asset for his benefit. However, he has not exercised this right as yet. On or after April 1, 1998, income of the asset would be taxable in the hands of X, even if he has not exercised the aforesaid right.
Situation 5 - If the transferor has any right to reassume power over the asset (or income therefrom) directly or indirectly wholly or partly.	X transfers an asset. Under the terms of transfer, he has a right to use the asset for the personal benefits of his family members whenever he wants. Till date he has not exercised this right. It is a revocable transfer. The entire income from the asset would be taxable in the hands of X.

Note: It may be noted that all income arising to the transferor by virtue of the aforesaid transfer shall be chargeable to income-tax in the hands of the transferor as and when the power to revoke the transfer arises (even if such power has not been exercised).

207.2 ***Revocable* - *Meaning of*** - The expression "revocable" is not qualified in any manner. The section does not speak of an absolute or unqualified power of revocation. If there is an income arising by virtue of a transfer of assets which is revocable, then that income must be deemed to be the income of the assessee. The only question that has got to be asked is whether the trust deed is capable of being revoked. Thus, where in the case of a trust created by father and mother for the benefit of their children, the trust deed provided that the father could revoke the deed with the consent of the mother and any two of his three children, it was *held* that the trust was revocable—*Behramji Sorabji Lalkaka* v. *CIT* [1948] 16 ITR 301 (Bom.).

207.2-1 *TRANSFERS HELD TO BE REVOCABLE TRANSFERS* - The following are held as revocable transfers :

1. If there is provision to reassume power, the transfer will be "revocable" ; actual exercise of power is not necessary—*CIT* v. *S. Raghbir Singh* [1965] 57 ITR 408 (SC).

2. Where the assessee can at any time reassume power over the assets or the income by just cancelling or altering the terms of the deed, trust was "revocable"—*C.T. Senthilnathan Chettiar* v. *State of Madras* [1968] 67 ITR 102 (SC).

3. Where no absolute right is given to transferee and asset can revert to transferor in certain circumstances, transfer is revocable—*V. Venugopala Varma Rajah* v. *CAIT* [1972] 84 ITR 466 (SC).

207.2-2 *TRANSFER HELD TO BE IRREVOCABLE TRANSFER* - The following are held as irrevocable transfers :

1. Where by a registered deed one G dedicated certain assets in favour of a temple and, while continuing to manage the assets as savarakar of the temple, G also borrowed money from the temple, it was *held* that in the absence of evidence to show that the aforesaid deed was not genuine, the deed had to be held as valid and irrevocable one and, therefore, income of the temple from the assets was not assessable in the hands of G—*CIT* v. *Shri Ramchandraji Maharaj Ka Bada Mandir* [1983] 15 Taxman 64 (MP).

2. The words 'right to reassume power' must mean that such a power is lawfully given under the trust deed itself. Thus, where the assessee created an irrevocable trust and, as trustee, he had powers to develop and improve the trust property and, by a supplemental deed, he increased the trustee's remuneration, it was *held* that such powers would not amount to "power to reassume" control over the trust, so as to treat the trust as revocable, and to include the trust income in the assessee's income—*CIT* v. *E. M. Gopalakrishna Kone* [1965] 57 ITR 569 (Mad.).

When an individual is assessable in respect of remuneration of spouse [Sec. 64(1)(*ii*)]

208. The provisions of section 64(1)(*ii*) are given below—

208.1 ***Conditions*** - Section 64(1)(*ii*) is applicable if the following conditions are satisfied—

Condition 1	The taxpayer is an individual.
Condition 2	He/she has a substantial interest in a concern.
Condition 3	Spouse of the taxpayer (*i.e.*, husband/wife of the taxpayer) is employed in the above-mentioned concern.
Condition 4	Spouse is employed in the concern without any technical or professional knowledge or experience.

208.2 ***Consequences if the above conditions are satisfied*** - If the aforesaid conditions are satisfied, then salary income of the spouse will be taxable in the hands of the taxpayer.

Provisions illustrated - X has a substantial interest in A Ltd. and Mrs. X is employed by A Ltd. without any technical or professional qualification to justify the remuneration. In this case, salary income of Mrs. X shall be taxable in the hands of X.

208.3 ***Other points*** - One has to keep in view the following points—

208.3-1 *REMUNERATION - MEANING OF* - Income to be clubbed in the hands of individual is limited to salary, commission, fees or any other remuneration received by the spouse, directly or indirectly, whether in cash or in kind. Any other income, not covered by the aforesaid categories, is, however, outside the scope of this section, even if it accrues to the spouse from a concern in which the individual has a substantial interest. Even where the payment is allowable as deduction under sections 30 to 43B in the hands of the employer, it can be included in the total income of the assessee.

208.3-2 *SALARY - HOW COMPUTED* - For the purpose of clubbing under section 64(1)(*ii*), salary has to be computed in accordance with the provisions of sections 15 to 17.

208.3-3 CONCERN - The expression "concern" covers both business concern and professional concern and both proprietary and non-proprietary concerns.

208.3-4 *SUBSTANTIAL INTEREST - MEANING OF* - An individual has a "substantial interest" in any of the following two situations—

1. In the case of a company - If an individual beneficially holds (individually or along with his relatives) 20 per cent or more of equity shares in a company at any time during the previous year.

2. In the case of a concern other than company - If an individual is entitled to 20 per cent profit in a concern (individually or along with his relatives) at any time during the previous year.

Beneficial ownership of equity shares, rather than legal ownership, is the criterion in the case of a company. An individual who has beneficial interest in 20 per cent or more equity shares, either independently or along with his relatives, will be covered by the concept of substantial interest even if he (and/or his relatives) is not a registered holder of any shares. Conversely, however, a registered holder of majority of shares will not fall within this concept if he, individually or along with his relatives, has no beneficial interest in at least 20 per cent equity shareholding. "Relative", in relation to an individual, means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual [sec. 2(*41*)]. It is not necessary that an individual should have substantial interest in a concern throughout the previous year. This section is applicable even if an individual has substantial interest in a concern at any time during the relevant previous year.

208.3-5 *WHEN BOTH HUSBAND AND WIFE HAVE SUBSTANTIAL INTEREST* - The provisions are given below—

Provision	*Illustration*
1. Both husband and wife have a substantial interest in a concern	X (and his relatives) beneficially holds 20 per cent equity share capital in A Ltd. Mrs. X (and her relatives) beneficially holds 20 per cent equity share capital in A Ltd.
2. Both are in receipt of the remuneration from such concern	X and Mrs. X are employed by A Ltd.
3. Remuneration is received without any technical and professional qualification.	They are employed in A Ltd. without any technical professional qualification.
4. Remuneration will be included in the total income of husband or wife whose total income, excluding such remuneration, is greater.	Salary income of X and Mrs. X will be included in the income of X (if income of X before this clubbing is higher than that of Mrs. X).

If once clubbing is done in the hands of X, salary of X and Mrs. X will be included in the income of X (in the subsequent years), even if income of X is lower than that of Mrs. X in that year. In such a case, the Assessing Officer can club the income of X and Mrs. X in the hands of Mrs. X only if the Assessing Officer is satisfied that it is necessary to do so. The Assessing Officer can take such action only after giving Mrs. X an opportunity of being heard.

208.3-6 EXCEPTION - Remuneration which is solely attributable to the application of technical or professional knowledge and experience of the spouse will not be clubbed.

Technical or professional qualification - "Professional qualification" means fitness to do a job or undertake an occupation or vocation requiring intellectual skill or requiring manual skill as controlled by intellectual skill and which is such that a person should be able to take out a living therefrom independently, though the salary does not cease to be product of professional skill merely because particular employment is accepted. It is not necessary to confine the word "technical" to qualification having technical subjects. Technical qualification may take within its fold everything connected with specialisation in particular subject, be it science, technology or commerce or business management. The words "technical or professional qualifications" do not necessarily relate to technical or professional qualifications acquired by obtaining a certificate, diploma or a degree or in any other form from a recognised body like a university or an institute—*Batta Kalyani* v. *CIT* [1985] 20 Taxman 378 (AP). However, contrary opinion expressed by some other Courts, it is respectfully submitted, requires reconsideration.

The words 'technical or professional', must receive a liberal construction as that term is not defined in the section itself or elsewhere in the Act. The word 'technical' is a term of wide import. Any task required to be performed in an orderly and methodical manner which requires some skill and knowledge for performance and which also involves some degree of complexity, can be regarded as 'technical'. The fact that ordinarily the term 'technical' is used in relation to things mechanical or electrical or anything associated with machinery does not warrant limiting the scope of the term in section 64. Similarly, the word 'professional' is again a term of wide import. The varieties of professions are endless.

It is, therefore, necessary to consider the term 'technical and professional qualifications and experience', in the context of the facts which are required to be considered in a given case. Regard must, therefore, be had to the nature of the business carried on by the concern, the nature of the technical or professional knowledge and experience in that concern and the mind of technical or professional qualifications, knowledge and experience possessed by the spouse to whom the payment is made from that concern for the services rendered by that person—*CIT* v. *R. Jayalakshmi* [1998] 101 Taxman 350 (Mad.).

208-P1 *Income of X (31 years) and Mrs. X (28 years) for the previous year 2008-09 is follows —*

	X Rs.	Mrs. X Rs.
Salary from B Ltd.	*2,60,000*	*Nil*
Business income	*90,000*	*6,000*
Income from other sources	*37,000*	*4,000*
Total	*3,87,000*	*10,000*
Less : Deduction under section 80L [not available]	—	—
Balance	*3,87,000*	*10,000*
Tax (rounded off)	*33,370*	*Nil*

X is employed by B Ltd. (salary being Rs. 20,000 per month and one month's salary as bonus) without any technical or professional qualification. Mrs. X holds 20 per cent equity share capital from March 20, 2009 in B Ltd. Find out the net income of X and Mrs. X for the assessment year 2009-10.

SOLUTION : In this case, Mrs. X has substantial interest in B Ltd. for sometime during the previous year 2008-09. Her husband X is employed by B Ltd. during 2008-09 on Rs. 20,000 per month without any professional qualification.

Rs. 2,60,000 shall be included in income of Mrs. X. It may be noted that this rule of clubbing is applicable even if it is beneficial to the taxpayer. Before clubbing tax liability of X and Mrs. X is Rs. 33,370. After applying the aforesaid rule of the clubbing, the tax liability of X and Mrs. X will be Rs. 9,270 as shown below—

	X Rs.	Mrs. X Rs.
Salary of X from B Ltd.	-	2,60,000
Business income	90,000	6,000
Income from other sources	37,000	4,000
Gross total income	1,27,000	2,70,000
Less : Deductions under section 80L [not available]	—	—
Net income	1,27,000	2,70,000
Tax	*Nil*	9.000
Add : Surcharge (not applicable in case net income does not exceed Rs. 10 lakh)	*Nil*	*Nil*
Tax and surcharge	*Nil*	9,000
Add: Education cess (2% of tax and surcharge)	*Nil*	180
Add: Secondary and higher education cess [1% of tax and surcharge]	*Nil*	90
Tax liability (total : Rs. 9,270) (rounded off)	*Nil*	9,270

If X has technical or professional qualification to justify the remuneration, then the above clubbing provisions are not applicable. If X does not have technical/professional qualification, then his salary shall be included in the income of Mrs. X (who has substantial shareholding in the employer-company for a few days during the previous year) even if the resulting tax liability is lower. In such a case it is incorrect to state that the clubbing is applicable only if it is beneficial to the revenue or income will be clubbed in the hands of that spouse whose income is higher—see Circular No. 258, dated June 14, 1979.

When an individual is assessable in respect of income from assets transferred to spouse [Sec. 64(1)(*iv*)]

209. The provisions of section 64(1)(*iv*) are given below—

209.1 ***Conditions*** - Section 64(1)(*iv*) is applicable if the following conditions are satisfied—

Condition 1	The taxpayer is an individual.
Condition 2	He/she has transferred an asset (other than a house property).
Condition 3	The asset is transferred to his/her spouse.
Condition 4	The transfer may be direct or indirect.
Condition 5	The asset is transferred otherwise than (*a*) for adequate consideration, or (*b*) in connection with an agreement to live apart.
Condition 6	The asset may be held by the transferee-spouse in the same form or in a different form.

209.1-1 *CONSEQUENCES IF THE ABOVE CONDITIONS ARE SATISFIED* - If the above conditions are satisfied, any income from such asset shall be deemed to be the income of the taxpayer who has transferred the asset.

Provisions illustrated - Mrs. X transfers 100 debentures of IFCI to her husband without adequate consideration. Interest income on these debentures will be included in the income of Mrs. X.

209.1-2 *HOW TO COMPUTE INCOME FROM TRANSFERRED ASSET* - The income from assets transferred must be regarded in the same way as it would be if the asset has not been transferred—*see CIT* v. *Maharaj Kumar Kamal Singh* [1973] 89 ITR 1 (SC). Exemption, deduction or tax incentives in respect of such income can be claimed by the transferor. *See, G.B. Banerjee* v. *CIT* [1979] 117 ITR 446 (Cal.), *R. Ganesan* v. *CIT* [1965] 58 ITR 411 (Mad.), *CIT* v. *H. L. Gulati* [1982] 138 ITR 648 (All.).

209.1-3 NON-RESIDENT - Likewise, income from assets transferred by a non-resident individual to his wife is subject to clubbing provisions of section 64 only if income from such asset is accrued and received in India —*CIT* v. *F. Y. Khambaty* [1986] 159 ITR 203 (Bom.).

209.2 ***Condition one - Asset is transferred by an individual*** - The above noted rule of clubbing is applicable if the transferor is an individual (*i.e.*, husband or wife). If the transferor is a person other than an individual than the above provisions are not applicable.

209.3 ***Condition two - Asset other than house property should be transferred*** - If a house property is transferred and the above noted conditions are satisfied, then the transferor is "deemed" as owner of the property under section 27 [*see* para 86.2-4].

209.4 ***Condition three- Relationship of husband and wife*** - The relationship of husband and wife should subsist both at the time of transfer of asset and at the time when income is accrued—*Philip John Plasket Thomas* v. *CIT* [1963] 49 ITR 97 (SC). It means that transfer of asset before marriage is outside the scope of this section. Similarly, if transferor-spouse dies, the income, though continued to be enjoyed by the transferee, cannot be included in the income of deceased transferor, heir, administrator or executor, as a widow or widower is not a spouse— *Vinodkumar Ratilal* v. *CIT* [1975] 100 ITR 564 (Guj.). The word "spouse" does not include illegal wife—*Executors of the Will of T.V. Krishna Iyer* v. *CIT* [1966] 38 ITR 144 (Ker.).

209.5 ***Condition four - Transfer*** - In section 63(*b*), the Legislature uses the words "any disposition, trust, covenant, agreement or arrangement". If the Legislature were minded to include an arrangement or agreement, not amounting to transfer, in section 64, it could have used these words. Therefore, the word "transfer" in section 64 must be treated as having been used in the strict sense and not in the sense of "including every means by which the property may be passed from one to another". Even if there is an indirect transfer, there must still be transfer of assets. The word, "indirectly" does not destroy the significance of the word "transfer"—*CIT* v. *Keshavlal Bullubhai Patel* [1965] 55 ITR 637, *CIT* v. *M. K. Stremann* [1965] 56 ITR 62 (SC).

- Allocation of property at the time of partition is not "transfer"— *T. S. Srinivasan* v. *CIT* [1965] 56 ITR 455 (Mad.).
- Renunciation of right to issue new shares is transfer—*R. N. Gupta* v. *CIT* [1972] 84 ITR 780 (Delhi).
- Transfer includes lease—*Maharao Raja Kamlaker Singh* v. *CIT* [1968] 67 ITR 351 (All.).

209.5-1 INDIRECT TRANSFERS - If the two transfers are interconnected and are parts of the same transaction in such a way that it can be said that the circuitous method has been adopted as a device to evade implications of this section, the case will fall within the section—*CIT* v. *C.M. Kothari* [1963] 49 ITR 107 (SC). For instance, if X gifts or cross transfers Rs. 10,000 to Mrs. A and A gifts property worth Rs. 10,000 to Mrs. X, the transaction would be indirect transfer without consideration by X to Mrs. X and by A to Mrs. A. What is material is not the unreality of the cross-transactions, nor whether the appearance of reality is attempted to be maintained but whether the transfers are parts of the same transaction adopted with a view to evade the implications of the section—*CIT* v. *Keshavji Morarji* [1967] 66 ITR 142 (SC).

209.6 ***Condition five - Consideration*** - Natural love and affection may be good consideration but that would not be adequate consideration for the purpose of section 64(1)—*Tulsidas Kilachand* v. *CIT* [1961] 42 ITR 1 (SC). Moreover, the Andhra Pradesh High Court in *Potti Veerayya Sresty* v. *CIT* [1972] 85 ITR 194 made the following observation in this context :

> "Good consideration to support a contract under provisions of the Indian Contract Act is one thing and 'adequate consideration' to avoid tax under the Income-tax Act is quite a different thing. Since the law insists that the consideration for transfer must be adequate, there must be some means to measure the adequacy of the consideration. That is to say, the consideration that supports the transfer should be one, the value of which can be measured in terms of money or money's worth."

Therefore, religious or spiritual benefits are not consideration which can be measured in terms of money or money's worth.

209.6-1 PAYMENT OF CONSIDERATION IN PART - As long as the consideration is not equal to or nearly equal to the value of assets transferred, section 64(1)(*iv*) will be attracted. It cannot be contended that the section will not apply where the consideration has been paid at least in part. Section 64(1)(*iv*) has to be strictly construed and only the part of the income referable to the transfer for inadequate consideration is assessable under section 64(1)(*iv*)—*V. Amirtham Ammal* v. *CIT* [1976] 102 ITR 350 (Mad.), *H. N. Patwardhan* v. *CIT* [1970] 76 ITR 279 (Bom.). The contrary view given by the Kerala High Court in *CIT* v. *Junus Haji Ummer Sait* [1988] 37 Taxman 162, it is respectfully submitted, requires reconsideration.

209.6-2 MONEY PAID TO WIFE TO OBTAIN HER CONSENT FOR ADOPTION - Since payment of any amount or other reward in consideration of adoption is prohibited under the Hindu Adoptions and Maintenance Act, the payments made by an assessee to his wife cannot be treated as consideration paid for obtaining her consent to adoption. These payments should be treated as gift to wife and, therefore, the income from such gifts was includible in the assessee's income —*Bansilal Vyas* v. *CIT* [1978] 113 ITR 537 (AP), *Potti Veerayya Setty* [1972] 85 ITR 194 (AP).

209.7 *Condition six - There may be change in the identity of transferred asset* - Where cash is gifted by an assessee to his wife and the latter deposits the same in a bank, interest income is includible in the assessee's total income—*Mohini Thapar* v. *CIT* [1972] 83 ITR 208 (SC). Similarly, if gifted money is invested by wife in house property, rental income is taxable under section 64 — *R. Ganesan* v. *CIT* [1975] 58 ITR 411 (Mad.).

209.7-1 CAPITAL GAIN ON SALE OF TRANSFERRED ASSETS - If an individual transfers an asset without consideration to his wife who sells it at a profit, capital gain arising to wife on sale of asset is chargeable to tax in the hands of the transferor—*Seventilal Maneklal Sheth* v. *CIT* [1968] 68 ITR 503 (SC).

209.7-2 APPROPRIATION WHEN TRANSFERRED ASSET IS INVESTED IN A BUSINESS - An asset (may be in cash or kind) is transferred by husband to his wife (directly or indirectly) without adequate consideration. She invests the asset in a business. How much will be clubbed in the hands of husband will be determined as follows—

Step one	Find out total investment of transferee spouse in the business on the first day of the previous year.
Step two	Find out the amount invested by the transferee-spouse out of the assets transferred to her without adequate consideration by her husband on the first day of the previous year in said business.
Step three	Find out the taxable income (exempt income is not included) of the transferee-spouse from the business. If the transferee-spouse becomes a partner of a firm by investing the aforesaid asset then only interest income from the firm is considered under *Step three*. Share of profit from the firm is not considered under *Step three*, as it is exempt under section 10(*2A*).
Step four	The amount which shall be included in the hands of transferor is determined as follows—*Step three* × *Step two* ÷ *Step one*.

209.7-2P1 *On December 27, 2007, X gifts Rs. 2,50,000 to Mrs. X. Mrs. X starts a business on January 20, 2008 by investing Rs. 8,50,000 which she has arranged as follows—*

	Rs.
Gift on December 27, 2007 from husband	*2,50,000*
Loan from husband	*1,50,000*
Gift from Mrs. A	*2,00,000*
Gift from father of Mrs. X	*1,00,000*
Loan from bank and friends	*1,10,000*
Her own funds	*40,000*

The following information is taken from the capital account by Mrs. X in the books of the business.

	Dr.	Cr.
Capital on January 20, 2008	-	*8,50,000*
Profit of the year ending March 31, 2008	-	*2,00,000*
Drawings up to March 31, 2008	*70,000*	-
Balance as on April 1, 2008	-	*9,80,000*
Fresh capital (gift is given by X) on April 10, 2008	-	*1,00,000*
Profit of the year ending March 31, 2009	-	*6,00,000*
Drawings for 2008-09	*2,15,000*	-
Balance as on April 1, 2009	-	*14,65,000*
Profit of the year 2009-10	-	*9,00,000*
Drawings of the year 2009-10	*3,70,000*	-
Balance as on April 1, 2010	-	*19,95,000*

Find out the amount taxable in the hands of X for different assessment years on the assumption that profit credited in the capital account of Mrs. X is as per audited profit and loss account. However, for the previous year 2008-09, Rs. 28,000 is not deductible (being 20 per cent of cash payment of Rs. 28,000 to a supplier). Other expenses debited to profit and loss account are as per income-tax law.

SOLUTION :

	Assessment years		
	2008-09 Rs.	*2009-10* Rs.	*2010-11* Rs.
First day of the previous year [*in the case of newly set up business previous year commences on the date of setting up of the business] (a)	January 20, 2008*	April 1, 2008	April 1, 2009
Total investment of Mrs. X in the business on the first day of the previous year (b)	8,50,000	9,80,000	14,65,000
How much of the amount given in (b) has been gifted by X (c)	2,50,000	2,50,000	3,50,000
Income of Mrs. X from business (i.e.,* Rs. 6,00,000 + disallowance of Rs. 28,000) (d)	2,00,000	6,28,000*	9,00,000
Income to be included in the hands of X [(d) × (c) ÷ (b)]	58,824	1,60,204	2,15,017

Notes -

1. It is assumed that loan of Rs. 1,50,000 from X is a *bona fide* loan. Clubbing provisions are, therefore, not attracted in respect of such loan.

2. There is no provision to club proportionate income in respect of gift from Mrs. X's father in the hands of latter.

209.7-2P2 *Suppose in problem 209.7-2P1 business is started by Mrs. X on January 20, 2008 by investing Rs. 6,00,000 (arranged from sources given in that problem but except gift from X). X gifts Rs. 2,50,000 Mrs. X on February 1, 2008 which is invested by her in the business on the same day. Other data in the problem remaining the same, find out the amount taxable in the hands of X for the assessment year 2008-09.*

SOLUTION : The business is newly started on January 20, 2008. The first day of the previous year is January 20, 2008. On this date amount invested in the business by Mrs. X out of assets transferred without consideration from X is Zero. Therefore, nothing will be included in the income of X. Amount invested after the first day of the previous year will be considered only in the next year.

209.7-3 ***WHEN TRANSFERRED ASSET IS INVESTED IN A FIRM*** - The aforesaid rule is also applicable in case transferred asset is invested by the spouse to become partner in a firm. However, from the assessment year 1993-94, clubbing provisions are not attracted in respect of share of profit from a firm where the transferred assets are invested by way of contribution of capital. Proportionate interest on capital will, however, continue to be clubbed if transferred asset is invested in a firm.

209.7-3P1 *X and Y form a partnership firm on April 1, 2008 (profit sharing ratio 2 : 3) by investing Rs. 10 lakh and Rs. 15 lakh respectively. The investment has been financed from the following sources -*

	X Rs.	Y Rs.
Gift from Mrs. X	6,60,000	-
Gift from Mrs. Y	-	8,00,000
Past savings of X and Y	3,40,000	7,00,000

For the year ending March 31, 2009, share of profit from the firm is as follows—	X Rs.	Y Rs.
interest on capital @ 12 per cent	1,20,000	1,80,000
Salary as working partner	24,000	24,000
Share of profit	1,08,000	1,62,000

Find out the income chargeable to tax in the hands of X and Mrs. X

SOLUTION :

	X. Rs.	Mrs. X Rs.
Share of profit [exempt under section 10(2A)]	Nil	-
Salary from the firm	24,000	-
Interest on capital [Rs. 1,20,000 × Rs. 6.6 lakh ÷ Rs. 10 lakh]	40,800	79,200*
Business income	64,800	79,200

209.7-4 INCOME ARISING FROM ACCRETIONS TO TRANSFERRED ASSETS - If an assessee gifts units to his or her spouse and subsequently the bonus units are issued to the spouse, interest on bonus units will not be includible in the hands of the assessee under section 64(*iv*) as there is no transfer of bonus units by the assessee to the spouse—*see CIT* v. *M. P. Birla* [1983] 142 ITR 377 (Bom.).

209.8 ***When clubbing is not attracted*** - In the following cases section 64(1)(*iv*) is not applicable :

1. If assets are transferred before marriage.

2. If assets are transferred for adequate consideration.

3. If assets are transferred in connection with an agreement to live apart.

4. If on the date of accrual of income, transferee is not spouse of the transferor.

5. If property is transferred by a karta of HUF, gifting coparcenary property to his wife—*L. Hirday Narain* v. *ITO* [1970] 78 ITR 26 (SC).

6. If property is acquired by the spouse out of pin money (*i.e.*, an allowance given to the wife by her husband for her dress and usual household expenses)—*R. B. N. J. Naidu* v. *CIT* [1956] 29 ITR 194 (Nag.) or household savings—*R. Dalmia* v. *CIT* [1982] 133 ITR 169 (Delhi).

When individual is assessable in respect of income from assets transferred to son's wife [Sec. 64(1)(*vi*)]

210. The provisions of section 64(1)(*vi*) are given below—

210.1 ***Conditions*** - One has to satisfy the following conditions—

Condition 1	The taxpayer is an individual.
Condition 2	He/she has transferred an asset after May 31, 1973.
Condition 3	The asset is transferred to his/her son's wife.
Condition 4	Transfer may be direct or indirect.
Condition 5	The asset is transferred otherwise than for adequate consideration.
Condition 6	The asset may be held by the transferee in the same form or in a different form.

210.1-1 *CONSEQUENCES IF THE ABOVE CONDITIONS ARE SATISFIED* - If the above conditions are satisfied, then income from the asset is included in the income of the taxpayer who has transferred the asset.

Provisions illustrated - X (or Mrs. X) transfers a bank deposit of Rs. 20,000 in favour of his (or her) son's wife, without adequate consideration. Income accrued to son's wife shall be included in the income of X (or Mrs. X).

210.2 *Other points* - The following points should be noted —

1. The relationship of father-in-law (or mother-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.

2. Transfer includes indirect transfer, *see* para 209.5-1.

3. For computation of income from transferred asset, *see* para 209.1-3.

4. For consequences when the identity of transferred asset is changed, *see* para 209.7.

210.2-P1 *In problem 209.7-2P1, assume that Mrs. A is mother of X, find out the amount taxable in the hands of Mrs. A for the different assessment years.*

SOLUTION : Since Mrs. A is mother-in-law of Mrs. X, the provisions of section 64(1)(*vi*) will be applicable. Consequently, proportionate income will be taxable in the hands of Mrs. A as follows -

	Assessment years		
	2008-09 Rs.	*2009-10* Rs.	Rs. *2010-11* Rs.
(*b*) [taken from problem 209.7-2P1]	8,50,000	9,80,000	14,65,000
How much is given by Mrs. A, mother in-law (c)	2,00,000	2,00,000	2,00,000
(*d*) [taken from problem 209.7-2P1]	2,00,000	6,28,000	9,00,000
Amount taxable in the hands of Mrs. A [(*d*) × (c) ÷ (b)]	47,059	1,28,163	1,22,867

When individual is assessable in respect of income from assets transferred to a person for the benefit of spouse [Sec. 64(1)(*vii*)]

211. The provisions of section 64(1)(*vii*) are given below—

211.1 *Conditions* - One has to satisfy the following conditions—

Condition 1	The taxpayer is an individual.
Condition 2	He/she has transferred an asset.
Condition 3	The transfer may be direct or indirect.
Condition 4	The asset is transferred to a person or an association of persons.
Condition 5	It is transferred for the immediate for deferred benefit of his/her spouse.
Condition 6	The transfer is without adequate consideration.

211.1-1 *CONSEQUENCES IF THE ABOVE CONDITIONS ARE SATISFIED* - If the aforesaid conditions are satisfied then income from such asset to the extent of such benefit is taxable in the hands of the taxpayer who has transferred the asset.

Provisions illustrated - X transfers Government bonds without consideration to an association of persons subject to the condition that, the interest income from these bonds will be utilised for the benefit of Mrs. X. Interest from bonds shall be included in the income of X.

Only the portion of income that is set apart for the benefit of spouse is taxable in the hands of settlor—*CIT* v. *Arvind H. Dalal* [1999] 105 Taxman 24 (Bom.).

211.2 *Consideration* - *See* para 209.6.

211.3 ***Clubbing is not attracted for "non-existent" income*** - If no income or benefit is accrued or derived by wife, directly or indirectly, out of the property transferred by the individual, then "non-existent" income or benefit cannot be included in the income of individual—*Col. H. H. Sir Harinder Singh* v. *CIT* [1972] 83 ITR 416 (SC).

211.4 ***Section 64(1)(vii) is attracted even if the transferor and trustee is the same person*** - The capacity of the declarer of trust and his capacity as trustee are different and after the declaration of trust he holds the assets as a trustee. Under the Transfer of Property Act, there can be a transfer by a person to himself or to himself and another person or persons—*Tulsidas Kilachand* v. *CIT* [1961] 42 ITR 1 (SC). For instance if an individual makes a declaration of trust in respect of certain shares for the benefit of his wife and appoints himself as trustee, provision of section 64(1)(*viii*) will be attracted.

211.5 ***Clubbing provisions cannot be avoided on the ground that assessment is made on trustee under section 161(1)*** - Where, in respect of properties settled on trust for the benefit of spouse, the spouse was assessed to tax on her share in the income of the trust under section 161(2), such assessment will not affect the validity of the inclusion of the trust income in the hands of the settlor under section 64(1)(*vii*) and all the assessments made against the spouse beneficiary must be annulled and tax recovered, if any, be refunded—*C. R. Nagappa* v. *CIT* [1969] 73 ITR 626 (SC).

When an individual is assessable in respect of income from assets transferred to a person for the benefit of son's wife [Sec. 64(1)(*viii*)]

212. The provisions of section 64(1)(*viii*) are given below—

212.1 ***Conditions*** - The following conditions should be satisfied—

Condition 1	The taxpayer is an individual.
Condition 2	He/she has transferred an asset after May 31, 1973.
Condition 3	The asset is transferred to any person or an association of persons.
Condition 4	Transfer may be direct or indirect.
Condition 5	The asset is transferred for the immediate or deferred benefit of his/her son's wife.
Condition 6	The asset is transferred otherwise than for adequate consideration.

212.1-2 CONSEQUENCES IF THE ABOVE CONDITIONS ARE SATISFIED - If the above conditions are satisfied, then income from the asset to the extent of such benefit is included in the income of the taxpayer who has transferred the asset.

Provisions illustrated - X (or Mrs. X) transfers an industrial undertaking to an association of persons subject to the condition that out of the annual income (*i.e.*, Rs. 30,00,000), a sum of Rs. 5,00,000 shall be utilised for the benefit of daughter-in-law of X (or Mrs. X). In this case, Rs. 5,00,000 shall be included in the income of X (or Mrs. X).

Income of minor child [Sec. 64(1A)]*

213. All income which arises or accrues to the minor shall be clubbed in the income of his parent.

213.1 ***Clubbing in the hand of father or mother*** - The income of minor will be included in the income of that parent whose total income [excluding the income includible under section 64(1A)] is greater.

- Where the marriage of the parents does not subsist, the income of the minor will be includible in the income of that parent who maintains the minor child in the relevant previous year.
- The minor's income, in case both the parents are not alive, cannot be assessed in the hands of the grandparent or any other relatives or even in the hands of minor—***R.P. Sarathy*** v. ***CIT*** [2006] 5 SOT 732 (Chennai).

*Provisions of section 64(1A) are not *ultra vires* entry 82, List I of Seventh Schedule, and article 14 of Constitution of India —*Syed Askari Hadi Ali Augustine Imam* v. *Union of India* [1994] 76 Taxman 170/209 ITR 746 (Pat.).

▪ Where any such income is once included in the total income of either parent, any such income arising in any succeeding year shall not be included in the total income of the other parent unless the Assessing Officer is satisfied (after giving that parent an opportunity of being heard) that it is necessary so to do. In other words, once clubbing of minor's income is done with that of one parent, it will continue to be clubbed with that parent only in subsequent years. However, if the income is to be clubbed with the income of the other parent, it can be done after giving an opportunity of being heard to the other parent—***R.P. Sarathy*** v. ***CIT*** [2006] 5 SOT 732 (Chennai).

The mere fact that in a subsequent assessment year the income of the other parent is higher than that of the parent in whose assessment the income of the minor had been included in the earlier assessment year, cannot be regarded as an event which would inevitably lead to the conclusion that it is 'necessary' to change the mode of assessment of the income of the parent within which the minor's income had been included in the earlier years, and to include the minor's income in the income of other parent in the current assessment year—*CIT* v. *Vairaprakasam Sivakasi* [1998] 150 CTR (Mad.) 454.

213.2 *When clubbing is not attracted* - In the cases given below, clubbing provision of section 64(1A) is not applicable —

1. Income of minor child (from all sources) suffering from any disability of the nature specified under section 80U [*see* para 267] is not subject to clubbing provision given above.

2. Income of minor child on account of any manual work.

3. Income of minor child on account of any activity involving application of his skill, talent or specialised knowledge and experience.

213.3 *Exemption under section 10(32)* - In case the income of individual includes the income of his or her minor child in terms of section 64(1A), such individual shall be entitled to exemption of Rs. 1,500, in respect of each minor child. Where, however, the income of any minor so includible is less than Rs. 1,500, the aforesaid exemption shall be restricted to the income so included in the total income of the individual.

213-P1 *A and B are minor sons of X and Mrs. X. Business income of X is Rs. 3,40,000. Income from house property of Mrs. X is Rs. 1,90,000. Income of A and B from stage acting is Rs. 60,000 and Rs. 70,000, respectively. Besides, interest on company deposits of A and B (deposit was made out of income from acting) is Rs. 30,000 and Rs. 1,000, respectively. A and B have received the following birthday gifts—on May 20, 2008 gift received by B from his grand father : Rs. 80,000, on September 14, 2008 gift received by A Rs. 60,000 from X's friend and Rs. 35,000 from a relative. Find out the income of X, Mrs. X, A and B for the assessment year 2009-10.*

SOLUTION :

	X Rs.	Mrs. X Rs.	A Rs.	B Rs.
Income from house property	-	1,90,000	-	-
Business income	3,40,000	-	-	-
Income from stage acting	-	-	60,000	70,000
Income from other sources				
- Gift received by B from grandfather on September 1, 2008 (gift from a relative not chargeable to tax)	-	-	-	-
- Gift received by A on September 14, 2008 from X's friend (to be clubbed in the hands of X after giving exemption of Rs. 1,500)	58,500	-	-	-
- Gift received by A on September 14, 2008 from relatives (gift from a relative is not taxable)	-	-	-	-
- Interest from company deposit received by A (to be clubbed in the hands of X)	30,000	-	-	-
- Interest from company deposit received by B (to be clubbed in the hands of X after giving exemption of Rs. 1,500, amount to be clubbed is Rs. 1,000 - Rs. 1,000)	*Nil*	-	-	-
Net income	4,28,500	1,90,000	60,000	70,000

Conversion of self-acquired property into joint family property and subsequent partition [Sec. 64(2)]

214. The following transactions are covered by section 64(2) :

Case 1	Where an individual (being member of a Hindu undivided family) converts (after December 31, 1969) his self-acquired property into property belonging to the family. It is done by impressing such property with the character of joint family property or throwing such property into common stock of the family.
Case 2	When such an individual transfers his self-acquired property, directly or indirectly, to the family otherwise than for adequate consideration.

For the purpose of section 64(2), property includes any interest in property, movable or immovable, the proceeds of sale thereof and any money or investment for the time being representing the proceeds of sale thereof and where the property is converted into any other property by any method, such other property.

214.1 ***Clubbing of income before partition*** - Income from the converted property or property transferred for less than adequate consideration is chargeable to tax in the hands of the transferor (before partition of the family).

214.2 ***Clubbing of income after partition*** - If the property converted or transferred by an individual is subsequently transferred amongst the members of the family, the income derived from such converted property, as is received by the spouse of the transferor will be included in the income of the transferor. What is, essential for being demonstrated before this provision can be applied is that it must first be found that the income which is sought to be added to the income of the assessee is 'income derived from such converted property'. A thing is derived only when the source from which it is derived is the immediate cause for the coming into existence of that which is derived—***S. Balachander*** v. ***CIT*** [2003] 131 Taxman 184 (Mad.).

214-P1 *X transfers his self-acquired property being debentures of face value of Rs. 22,00,000 (yielding annual interest income at the rate of 15 per cent, interest accrues on March 31 every year) to his HUF without any consideration on April 1, 1976. On April 1, 1986, the HUF undergoes complete partition whereby the converted property is divided amongst the members of the family as follows :*

	Share in the converted property Rs.	Annual income from such property Rs.
X	50,000	7,500
Mrs. X	60,000	9,000
Y (major son of X)	5,00,000	75,000
Mrs. Y	8,00,000	1,20,000
A (minor son of Y, date of birth : August 17, 1977)	2,50,000	37,500
B (minor son of X, date of birth : June 10, 1970)	5,40,000	81,000

SOLUTION :

Income from the transferred property shall be taxable in the hands of the family members as follows :

Assessment years (Rs. in thousand)

	1977-78 to 1986-87	*1987-88 and 1988-89*	*1989-90 to 1992-93*	*1993-94 to 1995-96*	*1996-97 onwards*
X	3,30	7.5 + 9* + 81*	7.5 + 9*	7.5 + 9*	7.5 + 9*
Mrs. X	—	—	—	—	—
Y	—	75	75	75+36**	75
Mrs. Y	—	1,20	1,20	1,20	1,20
A	—	37.5	37.5	—	37.5
B	—	—	81	81	81
Total	3,30	3,30	3,30	3,28.5	3,30

Other profits

215. One should also keep in view the following points—

215.1 ***Income from the accretion to assets*** - In the aforesaid cases, income arising to the transferee from the property transferred is taxable in the hands of transferor. However, income arising to the transferee from the accretion of such property or from accumulated income of such property is not includible in the total income of the transferor.

Provisions illustrated - X transfers Rs. 1,00,000 to his wife without any consideration. Mrs. X deposits the money in a bank. Interest received from the bank on such deposit is taxable in the hands of X. If, however, Mrs. X purchases debentures of a company from the accumulated interest income, interest on debentures received by Mrs. X will be taxable in her hands and will not be clubbed with the income of X.

215.2 ***Clubbing of negative income*** - Under section 64, the income of the specified persons is liable to be included in the total income of the individual in the circumstances mentioned in paras 208 to 214. For the purposes of including income of the specified person in the income of the individual, the word "income" includes a loss.

In other words, if income is negative and clubbing provisions are applicable, then negative income would be clubbed.

Provisions illustrated - Consider the following cases—

1. X transfers Rs. 1,00,000 to Mrs. X. By investing Rs. 1,00,000, Mrs. X sets up a business (total investment only Rs. 1,00,000). For the previous year, income from business is (-) Rs. 40,000. The loss of Rs. 40,000 will be included in the income of X.

2. Minor son of Y has a business. For the previous year 2008-09, loss from business is Rs. 20,000. The loss of Rs. 20,000 will be included in the income of Y or Mrs. Y whoever has higher income.

215.3 ***Head of income under which the clubbed income will be included*** - Under the above provisions income of an individual includes income of other persons. In such a case a problem arises as how the income be computed and under which head such income will be chargeable to tax. In this respect the following procedure should be adopted.

- *Step one* - First compute the income in the hands of the actual recipient as if the actual recipient of income is taxable under the relevant head of income.

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*By virtue of section 64(2) before assessment year 1993-94, income of the minor child after partition of the family had to be clubbed with the income of the transferor. Section 64(1A) was inserted with effect from the assessment year 1993-94.

**By virtue of section 64(1A) on the assumption that income of Y is greater than that of Mrs. Y, amount included in the table is after claiming exemption of Rs. 1,500 under section 10(*32*). It may be noted that the exemption under section 10(*32*) is available from the assessment year 1993-94 onwards.

Provisions illustrated - Consider the following examples—

1. If X has substantial interest in a company and Mrs. X is employed by that company without any technical/professional qualification, then compute the salary income in hands of Mrs. X [e.g., house rent allowance received by Mrs. X which is exempt under section 10(13A) will be excluded; if gas is provided by the company, the perquisite value shall be included; professional tax deduction will be given to her, etc.]. Income under the head "Salaries" will be computed in the hands of Mrs. X as if it is taxable in her hands.

2. Y gifts Rs. 4 lakh to Mrs. Y and she starts a business. Business income of Mrs. Y will be computed in the hands of Mrs. Y as if she is chargeable to tax under the head, "Profits and gains of business or profession".

3. Z gifts a house property to his daughter-in-law Mrs. D. Income under the head "Income from house property" will be first computed in the hands of Mrs. D (e.g., if Mrs. D uses the property for own residence, the gross annual value will be zero, if Mrs. D lets out the property, municipal tax paid by her is deductible).

▪ *Step two* - After computing the income under the relevant head of income in the hands of actual recipient, it will be clubbed under the same head of income in the hands of other person.

For instance, in example 1, the salary income of Mrs. X (after computing it in the hands of Mrs. X) will become income of X chargeable under the head "Salaries". Similarly in example 2, after computing business income in the hands of Mrs. Y, it will become income of Y chargeable under the head, "Profits and gains of business or profession". In example 3, after calculating property income in the hands of Mrs. D, it will become income of Z chargeable under the head "Income from house property".

This rule is applicable regardless of the fact whether the clubbed income is positive or negative.

▪ *Step three* - Gross total income of person in whose hands the income is clubbed shall be calculated as if it is his own income. Provisions of set off and carry forward of losses would be applicable as if it is applicable in any other case.

For instance, in example 2 noted above, if business income of Mrs. Y is (-) Rs. 80,000 and income of Y is Rs. 65,000 (business income : Rs. 35,000 short term capital gain : Rs. 30,000), the income of Y will be determined as follows -

	Rs.	
Business income of Y	35,000	
Less : Clubbed income from business of Mrs. Y	35,000	*Nil*
Short term capital gain	30,000	
Less : Business income of Mrs. Y	30,000	*Nil*
Gross total income of Y		*Nil*

The unadjusted business loss of Rs. 15,000 will be carried forward for being set off in future by Y.

▪ *Step four* - Deductions under sections 80C to 80U will be given to the person in whose hands income is clubbed within the overall ceiling provided in these sections. No separate deductions is available to the actual recipient of income. Rebate under section 88E will be given as if this rebate is available in any other case.

Recovery of tax [Sec. 65]

216. Under sections 60 to 64, income belonging to other persons are included in the total income of the assessee. Likewise, under section 27(*i*) in some cases, a person is 'deemed' as owner of a house property. In such cases, by virtue of section 65, the actual recipient of income is liable, on service of notice of demand, to pay the tax assessed in respect of income included in the income of other person. To put it differently, the provisions of this section provide for the recovery of tax from the person to whom the income actually accrued if the Assessing Officer so desires.

For instance, for the assessment year 2009-10, X (66 years) files his return of income, declaring income of Rs. 10,55,000 from salary, Rs. 20,000 from assets transferred without consideration to his son's wife and Rs. 40,000 from assets transferred to Mrs. X without consideration. He is assessed at Rs. 11,15,000. Tax liability on Rs. 11,15,000 is Rs. 2,62,860. The concerned Assessing Officer, in this case, has the following options for the recovery of the tax :

a. he may recover entire amount of tax (*i.e.*, Rs. 2,62,860) from X ; or

b. he may recover amount of tax partly from X and partly from his son's wife as under :

X :	Rs. 2,58,145	(Rs. 10,95,000 ÷ Rs. 11,15,000 × Rs. 2,62,860),
Son's wife :	Rs. 4,715	(Rs. 20,000 ÷ Rs. 11,15,000 × Rs. 2,62,860) ; or

c. he may recover amount of tax partly from X and partly from Mrs. X as under :

X :	Rs. 2,53,430	(Rs. 10,75,000 ÷ Rs. 11,15,000 × Rs. 2,62,860),
Mrs. X :	Rs. 9,430	(Rs. 40,000 ÷ Rs. 11,15,000 × Rs. 2,62,860) ; or

d. he may recover amount of tax partly from X and partly from his son's wife and Mrs. X as under:

X :	Rs. 2,48,715	(Rs. 10,55,000 ÷ Rs. 11,15,000 × Rs. 2,62,860),
Son's wife :	Rs. 4,715	(Rs. 20,000 ÷ Rs. 11,15,000 × Rs. 2,62,860),
Mrs. X :	Rs. 9,430	(Rs. 40,000 ÷ Rs. 11,15,000 × Rs. 2,62,860).

Hints for tax planning

217. For the purpose of tax planning the following propositions should be borne in mind. However, these propositions would hold good in the context in which they have been made.

- Under section 64(1)(*ii*), salary earned by the spouse of an individual from a concern in which such individual has a substantial interest, either individually or jointly with his relatives, is taxable in the hands of the individual. To avoid this clubbing, as far as possible spouse should be employed in a concern in which the individual does not have any interest. In such a case this section will not be attracted, even if a close relative of the individual has substantial interest in the concern. Alternatively, the spouse may be employed in a concern which is inter-related with the concern in which the individual has substantial interest. For instance, if Mrs. X is employed by ABC Ltd. (in which X does not hold any share) which is subsidiary of XYZ Ltd., clubbing is not possible even if X holds 20 per cent or more equity shares in XYZ Ltd. It may be noted that the provisions of section 64(1)(*ii*) are mandatory in the nature and applicable even if it is beneficial to the assessee (if average tax rate of the spouse is more than the average tax rate of the individual) and disadvantageous to the revenue. It may be ensured that only taxable salary [*i.e.*, salary computed according to the provisions of sections 15, 16 and 17] of the spouse is clubbed after claiming all deductions under section 16 [*see* para 53].
- Income from property transferred to spouse is clubbed in the hands of transferor. However, it has been held that income from savings out of pin money (*i.e.*, an allowance given to wife by husband for her dress and usual household expenditure) is not included in the taxable income of husband—*R. B. N. J. Naidu* v. *CIT* [1956] 29 ITR 194 (Nag.). Likewise, a pre-nuptial transfer (*i.e.*, transfer of property before marriage) is outside the mischief of section 64(1)(*iv*) even if the property is transferred subject to subsequent condition of marriage or in consideration of a promise to marry. Consequently income from property transferred without adequate consideration before marriage is not clubbed in the income of transferor even after marriage—*Philip John Plasket Thomas* v. *CIT* [1963] 49 ITR 97 (SC). Income from property transferred to spouse in accordance with an agreement to live apart is not clubbed in the hands of transferor. It may be noted that the expression "to live apart" is of wider connotation and covers even voluntary agreement to live apart.
- Exchange of asset between one spouse and another is outside the clubbing provisions if such exchange of assets is for adequate consideration. The spouse within higher marginal tax rate can transfer income yielding asset to the other spouse in exchange of an equal value of asset which does not yield any income. For instance, X (whose marginal rate of tax is 33.99 per cent) can transfer fixed deposit in a company of Rs. 1,00,000 bearing 9 per cent interest, to Mrs. X (whose marginal rate of tax is *nil*) in exchange of gold of Rs. 1,00,000 ; he can reduce his tax bill by Rs. 3,059 (*i.e.*, 0.3399 × 0.09 × Rs. 1,00,000) without attracting provisions of section 64.
- Provisions of section 64(1)(*vi*) are not attracted if property is transferred by an individual to his son-in-law or daughter-in-law of his brother.

- If trust is created for the benefit of minor child and income during minority of the child is being accumulated and added to corpus and income from increased corpus is given to the child after his attaining majority, the provisions of section 64(1A) are not applicable—*Yogindraprasad N. Mafatlal* v. *CIT* [1977] 109 ITR 602 (Bom.), *CIT* v. *M. K. Doshi* [1980] 122 ITR 499 (Guj.), *CIT* v. *Sri Abhayananda Rath Family Benefit Trust* [2002] 123 Taxman 81 (Orissa).
- *Explanation 3* to section 64(1) lays down the method for computing income to be clubbed on the basis of value of assets transferred to the spouse as on the first day of the previous year. This proffers attractive approach for minimising income to be clubbed by transfers for temporary periods during the course of the previous year.
- If a trust is created by a male member to settle his separate property thereon for the benefits of his Hindu undivided family, with a stipulation that income shall accrue for a specified period and the corpus going to the trust afterwards, provisions of section 64(2) are not applicable.
- If gifts are made by a Hindu undivided family to the wife, minor child, or daughter-in-law of any of its male or female members (including karta), provisions of section 64 are not attracted.
- If an individual transfers property without adequate consideration to son's wife, income from the property is always clubbed in the hands of transferor. If, however, an individual transfers property without consideration to his Hindu undivided family and the transferred property is subsequently partitioned amongst the members of the family, income derived from the transferred property, as is received by son's wife, is not clubbed in the hands of the transferor. It may be noted that unequal partition of property amongst family members is not rare under the Hindu law and it does not amount to "transfer" as generally understood in law—*CGT* v. *N. S. Getti Chettiar* [1971] 82 ITR 599 (SC) and, consequently, if, at the time of partition, greater share is given out of the transferred property to son's wife or son's minor child, the transaction would be outside the scope of section 64(1)(*vi*) and 64(2)(*c*).
- In cases covered in section 64, income arising to the transferee, from property transferred without adequate consideration, is taxable in the hands of transferor. However, income arising from the accretion of such transferred assets or from accumulated income cannot be clubbed in the hands of the transferor—*Popatlal Bhikamchand* v. *CIT* [1959] 36 ITR 577 (Bom.).
- A loan is not a "transfer" for the purposes of section 64—*CIT* v. *M. Vinoda Rao* [1993] 200 ITR 50 (Kar.).
- Where the assessee withdraws funds lying in capital account of the firm in which he is a partner and advances the same to his HUF which deposits the said funds back into firm, the said loan by the assessee to his HUF cannot be treated as a transfer for the purposes of section 64 and income arising from such deposits is not assessable in the hands of the assessee—*CIT* v. *M. Vinoda Rao* (*supra*).

Problems explaining clubbing provisions

218-P1 *Discuss whether section 64 is applicable in the following cases :*

1. X creates a trust for the sole benefit of his friend's minor child Y and appoints Z as trustee. Z as trustee joins a partnership by investing trust funds and receives Rs. 20,000 as interest.

2. X, an individual, is engaged in the business of money-lending. On April 1, 2008, he advances Rs. 10,00,000 to his HUF at the market rate of interest of 12 per cent per annum. During the previous year 2008-09, HUF earns Rs. 4,00,000 as profit on the money advanced by X (before paying interest). Determine :

a. *Is the amount of net income of HUF (i.e., Rs. 4,00,000 minus 12 per cent of Rs. 10,00,000) includible in the income of X under section 64(2) ?*
b. *Does it make any difference if X is not engaged in the business of money-lending ?*
c. *Does it make any change in the applicability of section 64(2), if money is advanced at the rate of 4 per cent whereas the market rate of interest is 12 per cent ?*
d. *Will the transaction come within the scope of sections 60 to 64, if X foregoes his right to receive interest on the sum so advanced before the date of accrual ?*

SOLUTION :

1. By virtue of section 64(1A), Rs. 18,500 (*i.e.*, Rs. 20,000—Rs. 1,500) is taxable in the hands of father or mother of X during the minority of X. If, however, income during the minority is accumulated and added to corpus and income from increased corpus is given to the child after attaining majority, provisions of section 64(1A) are not applicable.

2. By advancing loan to the HUF, it cannot ordinarily be said that the lender has transferred any asset to HUF without adequate consideration, if the money is advanced at the market rate of interest. In the light of this observation, the specific points raised in the problem can be answered as follows :

a. Section 64(2) is not applicable, as it is not the case of transfer or conversion of separate property into HUF's property. As such, no part of HUF's income can be clubbed with X's income.

b. If the money is advanced at the market rate of interest, it does not make any difference whether X carries on money-lending business or not. In the given case, section 64(2) is, therefore, not attracted even if X does not carry on money-lending business.

c. If money is advanced at lower than market rate of interest, section 64(2) cannot be invoked, as the advance/loan does not amount to throwing of assets in common stock of the family or transfer of assets to the family. The Income-tax Department may, however, invoke section 60 which covers transfer of income without transfer of assets. Transfer, for the purpose of section 60, includes any agreement or arrangement. Therefore, giving advance at less than market interest rate will amount to transfer of income without transferring asset. Accordingly, excess of interest at market rate over 4 per cent per annum is chargeable to tax in the hands of X under section 60.

d. If X foregoes his right to receive interest, the case will be clearly covered by section 60. Income arising from the asset will be clubbed with the income of X.

218-P2 *A made a gift of Rs. 50,000 to the wife of his brother B for the purchase of a house by her and simultaneously B transferred certain debentures of the value of Rs. 50,000 owned by him to A's minor son. During the year ending March 31, 2009, the chargeable income from the house property was Rs. 5,000 while the amount of interest paid on the debentures was Rs. 3,000. State giving reasons how and in whose hands these two items of income will be taxed.*

SOLUTION : Though there is no direct transfer of asset by A to his minor son and by B to his wife, the transaction appears to be indirect transfer or cross transfer arranged to by-pass the provisions of section 64(1). In *CIT* v. *C. M. Kothari* [1963] 49 ITR 107, the Supreme Court observed that cross transfers which are so intimately connected as to form parts of single transaction, are covered by section 64(1). Though, the transaction may not be mutual, *i.e.*, in technical sense each transaction may not constitute consideration for the others. Therefore, income arising to Mrs. B will be taxed in the hands of B. Income arising to son of A will be taxable in the hands of A or Mrs. A after excluding exempted amount of Rs. 1,500.

218-P3 *X wanted to take his younger brother's son in adoption. His wife agreed to the adoption only after X acceded to her demands and transferred Rs. 50,000 to her name and executed a deed of transfer in respect of some assets. The Assessing Officer wants to include the income derived from these properties in the income of X but he resists the inclusion saying that section 64 is not applicable as he has made the settlement for adequate consideration, viz., obtained the consent of his wife for adoption. Is the view of X tenable in law?*

SOLUTION : Section 17 of the Hindu Adoptions and Maintenance Act prohibits the payment of consideration for obtaining consent for adoption. Moreover, the assessee's wife is a party to the adoption because she along with her husband must receive the boy at the time of adoption ceremony. Not only that, subsequent to the adoption, she would be the adoptive mother and adopted son would be her adopted son as well, getting all legal rights. Therefore, what has been given by X to his wife is not consideration for her consent for adoption but as a provision for her future security. Therefore, the view of X that section 64 is not applicable is not tenable in law—*Bansilal Vyas* v. *CIT* [1978] 113 ITR 537 (AP).

218-P4 *X, an individual, was originally a partner in two firms V and Q in his individual capacity. On August 20, 2007, out of his separate and self-acquired funds, he impressed a sum of Rs. 30,000 with the character of HUF property. He retired from the two partnership firms with effect from April 1, 2008 and on the same day he entered into these partnerships again in his capacity as karta of his HUF, contributing as share capital of the HUF a sum of Rs. 15,000 in each of these partnerships out of the aforesaid sum of Rs. 30,000. The Income-tax Department contends that interest on capital derived by the assessee from these two firms should be treated as his individual income under section 64(2)(b) but X is of the view that section 64(2)(b) is not attracted in the case and interest from these two firms is not includible in the computation of his income. Discuss.*