other person. By virtue of section 10(*33*)‡ or 10(*34*), dividend income (in respect of which tax is charged under section 115-O) will be exempt in the hands of recipient.

■ Where in terms of an agreement, the assessee advances an interest-free loan to a borrower at his request on the conditions that the loan amount should be utilized for purchasing LML shares, and that dividend income as and when received by borrower should be paid to the assessee to extent of 50 per cent, dividend income is not exempt in hands of the assessee under section 115-O but it is assessable as business income—***Rasoi Trading & Agencies (P.) Ltd.*** v. ***ITO*** [2006] 8 SOT 426/101 ITD 399 (Mum.).

337.8 ***Dividend tax is not deductible*** - The company (or the shareholders) cannot claim any deduction from taxable income in respect of dividend tax levied under section 115-O. Moreover, no deduction is available from the tax on dividend under any provision.

337.9 ***Interest for non-payment of tax [Sec. 115P]*** - If the company or the principal officer fails to pay the whole or any part of dividend tax within the specified time limit, then it or he shall be liable to interest in addition to dividend tax as follows—

Rate of interest	1 per cent per month or part thereof
Amount on which interest chargeable	Amount of tax as reduced by the amount paid within the time-limit
Period for which interest is payable	Interest is chargeable for the period commencing from the next date after the last date of payment and ending on the date of actual payment.

337.9 ***When company is deemed to be in default [Sec. 115Q]*** - In case a domestic company or principal officer of a domestic company does not pay tax on distributed profits within the specified time-limit, then he or it shall be deemed to be an assessee in default in respect of the amount of tax payable by him or it. Consequently, all provisions regarding collection and recovery of tax contained in the Act would apply.

337.10 ***Penalty under section 271C*** - Section 271C has been amended with effect from June 1, 1997 to provide that if any person fails to comply with the provisions of section 115-O, he shall be liable to pay as penalty a sum equal to the amount of tax which he has failed to pay. The penalty is, however, not applicable, if the assessee proves that there was reasonable cause for failure.

337.11 ***Prosecution*** - If a person fails to pay to the credit of the Central Government the tax payable by him, as required by or under the provisions of section 115-O, he shall be punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine.

However, no person will be punishable if he proves that there was a reasonable cause for the default/failure.

337.12 ***Judicial rulings*** - The following judicial rulings shall be kept in view—

1. Section 115-O(1) is a specific provision overriding, in case of conflict, general provisions. This provision is applicable whether shares are held as investment or stock-in-trade—***CIT*** v. ***S.G. Investments & Industries Ltd.*** [2004] 89 ITD 44 (Kol.) :

2. Dividend tax paid by company under section 115-O cannot be regarded as tax paid by shareholders—***Harish Krishnakant Bhatt*** v. ***ITO*** [2004] 91 ITD 311 (Ahd.).

Tax on income distributed to unitholders [Secs. 115R, 115S and 115T]

337A. The provisions of sections 115R, 115S and 115T are given below :

1. The income distributed to a unit holder of the Unit Trust of India or a Mutual Fund shall be charged to tax under section 115R at the rate given below :

‡Exemption under section 10(*33*) is available if dividend is declared, distributed or paid during June 1, 1997 and March 31, 2002.

	Up to March 31, 2007	*From April 1, 2007*
■ Income distribution in respect of equity oriented mutual fund or US64	*Nil*	*Nil*
■ Income distribution in respect of money market mutual fund or liquid fund	No separate rate, *see* rate given below	25%
■ Income distribution in respect of any other mutual fund—		
- When the unit holder is an individual or a Hindu undivided family	12.5%	12.5%
- When the unit holder is any other person	20%	20%

Note - The above rates will be increased by surcharge, education cess and (on or after April 1, 2007) secondary and higher education cess.

It is payable by the Unit Trust of India or the Mutual Fund, as the case may be.

2. The tax under section 115R shall not be chargeable in respect of any income distributed to the unit holders of the Unit Scheme, 1964 of the Unit Trust of India or any other open-ended (and from June 1, 2006, even close ended) equity oriented fund in respect of income distributed under such schemes. For this purpose, "equity oriented fund" is such fund where the investible funds are invested by way of equity shares in domestic companies to the extent of more than 65 per cent (up to May 31, 2006, 50 per cent) of the total proceeds of such fund.

The percentage of equity shareholding of the fund shall be computed with reference to the annual average of the monthly averages of the opening and closing figures.

3. The recipient of income will not be chargeable to tax whether the income comes under (*1*) or (*2*) *supra.*

4. The person responsible for making the payment of income distributed by the UTI or a Mutual Fund and the UTI or the Mutual Fund itself, as the case may be, shall be liable to pay the tax to the credit of the Central Government within 14 days from the date of distribution or payment of such income, whichever is earlier.

5. No deduction under any other provision of the Act shall be allowed to the Unit Trust of India or to a Mutual Fund in respect of the income which has been charged to the aforesaid tax.

6. If the person or UTI or Mutual Fund liable to make the payment fails to so pay the tax to the credit of the Central Government, he or it shall be liable to pay simple interest at the rate of 1 per cent every month or part thereof on such amount of tax which has not been paid or was not paid in time.

7. If the person or UTI or Mutual Fund liable to make the payment fails to so pay the tax to the credit of the Central Government, he or it shall be deemed to be an assessee in default in respect of the amount of tax payable and all the provisions of the Act for the collection and recovery of income-tax shall apply.

8. The person responsible for making payment of the income distributed by the Unit Trust of India or the Mutual Fund and the Unit Trust of India or the Mutual Fund, as the case may be, shall be liable to file a statement of distributed income in Form No. 63 (for UTI) or Form No. 63A (for mutual fund), giving details of income distributed to unit holders, tax paid thereon and other relevant details. The statement should be submitted on or before September 15 giving details of amount distributed during the immediately preceding previous year.

Tax on income received from venture capital companies and venture capital funds [Sec. 115U]

337B. The provisions of section 115U are given below —

1. Any income received by a person out of investments made in a venture capital company or venture capital fund shall be chargeable to income-tax in the same manner as if it were the income received by such person had he made investments directly in the venture capital undertaking.

2. The person responsible for making payment of the income on behalf of a venture capital company or a venture capital fund and the venture capital company or venture capital fund shall furnish a

statement of distribution of income in Form No. 64. The statement of distributed income shall be furnished by the 30th November (of the financial year, following the previous year during which such income is distributed). It shall be submitted to the Chief Commissioner or Commissioner of Income-tax, within whose jurisdiction, the principal office of the Venture Capital Company or the Venture Capital Fund, as the case may be is situated.

3. The income paid by the venture capital company and the venture capital fund shall be deemed to be of the same nature and in the same proportion in the hands of the person receiving such income as it had been received by, or had accrued to, the venture capital company or the venture capital fund, as the case may be, during the previous year.

4. The provisions of Chapter XII-D or Chapter XII-E or Chapter XVII-B shall not apply to the income paid by a venture capital company or venture capital fund.

Problems on computation of taxable income of a corporate-assessee

338-P1 *The profit and loss account of XYZ Ltd., Indian public company engaged in the manufacture of cement and refractories (not listed in the Eleventh Schedule), for the year ending March 31, 2009, showed profit of Rs. 81,50,000. The company has an authorised capital of Rs. 5 crore, of which capital worth Rs. 2 crore has been issued and subscribed for and paid-up. In addition, the company has borrowed Rs. 1 crore from IFCI payable on the expiry of 3 years after the company goes into production. The company was registered in April 1988 and its factory is set up in the District of Gulbarga in the Karnataka State, which is a "backward area". The machinery was newly acquired and installed between April 1989 and January 1998 and after some test runs the company commenced regular commercial production on March 30, 1998.*

The shares of the company are quoted on the Bombay and Madras Stock Exchanges.

A scrutiny of the profit and loss account and balance sheet and other statements elicited the following further information :

1. The normal depreciation (without considering multiple shift working) is Rs. 13,72,500.

This is made up as under :

	[illegible] Rs.	[illegible] (Percentage)	[illegible] Rs.
Building (newly constructed)			
Factory - 2nd class	*25,00,000*	*10*	*2,50,000*
Office - 2nd class	*10,00,000*	*10*	*1,00,000*
Staff quarters - 2nd class	*4,50,000*	*5*	*22,500*
Machinery in factory	*50,00,000*	*15*	*7,50,000*
Furniture & equipment in office	*5,00,000*	*10*	*50,000*
Air-conditioners, typewriters, accounting machines & other office machines	*5,00,000*	*15*	*75,000*
Motor cars and jeeps	*3,33,333*	*15*	*50,000*
Motor trucks	*5,00,000*	*15*	*75,000*
Total			*13,72,500*

The factory worked double shift on 180 days during the year.

2. Expenditure incurred prior to March 30, 1998 amounting to Rs. 10,50,000, appears as an asset in the balance sheet. This amount is made up as under :

	Rs.
Preparation of project report	*5,00,000*
Conducting market survey	*2,50,000*
Legal charges for drafting the memorandum and articles of association, printing the same, fees for registering the company under the Companies Act and underwriting commission and brokerage for public issue of shares	*3,00,000*
Total	*10,50,000*

3. The company acquired the patent rights over the process used by it for manufacture of refractories from another company (which had obtained the patent in March 1992 and used it for four years) by paying Rs. 3,50,000 in April 1998. This amount is shown as an asset in the balance sheet.

4. *The managing director of the company was paid a remuneration of Rs. 96,000. In addition, the company had spent Rs. 15,000 in providing rent-free residential accommodation (unfurnished) to him and Rs. 6,000 in providing a motor car exclusively for his personal use.*

5. *The company had given a donation of Rs. 20,000 to the Gulbarga Municipality to be used for any charitable purpose and this amount is debited in the P & L account.*

You are required to advise the company as to its tax liability and prepare its return of income for the assessment year 2009-10, indicating briefly the reasons for the additions, exclusions and deductions to be made in computation of the gross total income and total income. You are also required to indicate whether any amount will be carried forward to future assessment years for being allowed in computing the total income of those years and specify the amount or amounts and the number of years for which these will be so carried forward.

SOLUTION :

	Rs.	Rs.
Profits as per P & L account		81,50,000
Add : Inadmissible expenses		
Depreciation (taken separately)	13,72,500	
Donation to the Gulbarga Municipal Corporation	20,000	13,92,500
		95,42,500
Less : Deductible expenses		
Depreciation [see Note 1]	13,72,500	
Patents under section 35A [see Note 2]	*Nil*	
Preliminary expenses under section 35D [see Note 3]	*Nil*	13,72,500
Gross total income		81,70,000
Less : Deductions under sections 80C to 80U		
Under section 80G in respect of donation (*i.e.*, 50% of Rs. 20,000)	10,000	
Under section 80-IB in respect of tax holiday (not available after 10 years)	*Nil*	10,000
Net income (rounded off)		81,60,000

Notes :

1: Amount of depreciation is computed as under :

	Block of assets			
	Building	*Building*	*Plant and machinery*	*Furniture*
Rate of depreciation	10%	5%	15%	10%
	Rs.	Rs.	Rs.	Rs.
Depreciated value	35,00,000	4,50,000	63,33,333	5,00,000
Depreciation	3,50,000	22,500	9,50,000	50,000
Total depreciation				13,72,500

2. As the patent becomes effective 4 years prior to the commencement of production by the company, expenditure of Rs. 3,50,000 will be written off in 10 years (14—4 years) under section 35A [see para 115]. However, the 10-year period expires with the assessment year 2008-09. No deduction is, therefore, available for the current assessment year.

3. Provisions regarding amortisation of preliminary expenses are laid down by section 35D [see para 121]. The maximum amount of expenditure which can be amortised is 2.5 per cent of cost of project or capital employed, whichever is higher. Since the information on cost of project is not available, one has to make calculation on the basis of capital employed which is Rs. 3 crore. Maximum qualifying amount, therefore, works out to Rs. 7,50,000 (being 2.5% of Rs. 3 crore). The amount to be written off is Rs. 75,000 (*i.e.*, Rs. 7,50,000 ÷ 10). However, the 10-year period expires with the assessment year 2007-08. No deduction is, therefore, available for the current year.

4. The company will have to pay fringe benefits in respect of car expenses.

338-P2 *XYZ Ltd. proposes to construct a hospital for its workers. The alternatives open to it are :*

1. To purchase building worth Rs. 40 lakh, the purchase price being payable in two annual equal instalments.

2. To purchase the aforesaid building but instead of paying the price in instalments, an agreement would be entered into with the vendor of the building to pay him 10 per cent of the net profits of the company for an indefinite period of time.

3. To contribute Rs. 30 lakh to the UP Government, which will construct a building on land owned by it and allow the company to use it as a hospital for its workers though the ownership of the building will vest with the Government.

Consider each proposal in detail and advise the company to enable it to make the right choice.

SOLUTION : Under situation (1), the company can claim normal depreciation on Rs. 40 lakh. Under situation (2), the company has to pay 10% of profits to the vendor of the building. The amount on this account is allowable deduction as per ruling given by the Supreme Court in *CIT* v. *Travancore Sugar & Chemicals Ltd.* [1973] 88 ITR 1. If the ownership of the building is transferred to the assessee, it can also claim normal depreciation. Under situation (3), the assessee has to pay Rs. 30 lakh to the UP Government for construction of building. The ownership of the building will, however, remain with the Government. Even if the title of the building will remain with the Government, the assessee can claim deduction of Rs. 30 lakh. It cannot, however, claim depreciation.

338-P3 *On April 1, 2008, X and Mrs. X purchased all the shares of a private limited company. The company had the unabsorbed allowances/losses :*

	Rs.
❑ *Accumulated loss*	*3,00,000*
❑ *Unabsorbed depreciation*	*8,00,000*

State the effect of change of shareholders on the right of the company to carry forward the above items.

SOLUTION : Section 79 provides that where a change in the shareholdings of a closely-held company has taken place during the previous year, no loss can be carried forward under sections 70 to 80 unless on the last day of the previous year the shares of the company carrying not less than 51 per cent voting rights are being beneficially held by persons who similarly held shares carrying 51 per cent voting rights on the last day of the previous year(s) in which the loss was incurred.

In the given problem, since the entire shareholding is changed, the aforesaid condition is not satisfied. The loss of Rs. 3,00,000 cannot be carried forward. Unabsorbed depreciation can, however, be carried forward under section 32(2) and hence the abovesaid restriction contained in section 79 has no application—*CIT* v. *Concord Industries* [1979] 119 ITR 458, *CIT* v. *Kalpaka Enterprises (P.) Ltd.* [1986] 157 ITR 659 (Ker.).

338-P4 *A public sector company is proposing to enter into an agreement for transfer of technology with a Japanese company. The consideration is a lump sum royalty of Rs. 25,00,000 (net of the Indian taxes). The company will get the necessary Government approval. It wants to know the tax implications and in particular whether the Indian tax payable by it would be grossed up. Advise the company.*

SOLUTION :

It is chargeable to tax @ 10.3%	Rs.
Grossed amount [Rs. 25 lakh ÷ 0.897]	27,87,068
Less : Tax to Government @ 10.3% of Rs. 27,87,068	2,87,068
Payment to Japanese company	25,00,000

338-P5 *X Ltd. maintaining the financial year as its previous year, went into liquidation in April 2008 consequent upon the compulsory acquisition of its business by the Government on March 31, 2008. On March 31, 2008, its summarised balance sheet was as under :*

Capital	Rs.	Assets	Rs.
Paid-up share capital	*1,00,00,000*	*Fixed assets*	*3,00,00,000*
Reserves and surplus	*3,00,00,000*	*Current assets*	*1,50,00,000*
Sundry creditors	*50,00,000*		
	4,50,00,000		*4,50,00,000*

The share capital consisted of 10,00,000 equity shares of Rs. 10 each out of which 5,00,000 equity shares had been issued in 1990 as fully paid-up bonus shares by capitalising an equal amount of reserves created out of profits. The

reserves and surplus account includes a capital reserve of Rs. 95,00,000 created by revaluation of the assets in the year 1996. The profit and loss account shows a balance of Rs. 5,00,000 and reserves created out of profits for the last ten years at Rs. 10,00,000 every year. The liquidator got a compensation of Rs. 5,00,00,000 which was dealt with as follows :

	Rs.
1. *First distribution to shareholders on September 30, 2008*	*19,50,000*
2. *Expenses in forming a new company in November 2008*	*4,50,000*
3. *Money taken over by the new company which issued four shares (fully paid-up equity shares of face value of Rs. 10 each) to the shareholders of X Ltd. for each share held by them in the last named company*	*4,00,00,000*
4. *Liquidator's expenses*	*50,000*

Consider the effect of the transactions in the assessments of the shareholders.

SOLUTION : Money received by shareholders at the time of liquidation of a company is either dividend or capital gain. According to section 2(22)(c), any distribution made by a company to its shareholders is dividend to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not. The expression "accumulated profits" for this purpose will not include any profits of the company prior to three successive previous years immediately preceding the previous year in which acquisition took place. The company is taken over by the Government in the previous year 2007-08. Therefore, "accumulated profits" will not include any profits of the company prior to the year 2004-05. In other words, it will include profit of the year in which acquisition took place and profits of three successive preceding previous years, *i.e.*, 2006-07, 2005-06 and 2004-05, which work out to Rs. 45,00,000 (*i.e.*, Rs. 5,00,000 being the balance shown by the profit and loss account and Rs. 10,00,000, being profit of each of the years 2007-08, 2006-07, 2005-06 and 2004-05. The distribution out of Rs. 45,00,000 will amount to dividend but it will not be taxable in the hands of shareholders as income from other sources. The company will pay dividend tax. Distribution of any amount in excess of Rs. 45,00,000 will amount to return of capital to the shareholders.

There is total distribution of Rs. 41.95 per share by the liquidator [i.e., (Rs. 19,50,000 in cash and Rs. 4,00,00,000 in the form of shares) ÷ 10,00,000], out of which Rs. 4.50 per share (*i.e.*, Rs. 45,00,000 ÷ 10,00,000) will be treated as dividend and the balance Rs. 37.45 per share will be deemed as return of capital in the hands of shareholders and capital gains tax will be levied on it.

338-P6 *X (P.) Ltd. is engaged in the manufacture of engineering goods. The profit and loss account of the company for the year ending March 31, 2009 shows a net profit of Rs. 30 lakh (before tax). The company gives you the following information :*

1. *Surplus on sale of building Rs. 2 lakh has been credited to profit and loss account. This building was purchased on July 1, 2006 for Rs. 4 lakh and was sold on September 30, 2008 for Rs. 6 lakh. No depreciation was provided in the books of the company although the same was claimed and allowed in earlier years in the income-tax assessments of the company @ 5 per cent. The building was let out to employees of the company for their residence.*

2. *The managing director has spent Rs. 36,000 during his visit to UK and USA. This visit was for studying the market for engineering goods in foreign countries but no orders could be booked during his visit.*

3. *The company has given donation of Rs. 2 lakh to scientific research association approved under section 35(1)(ii) and Rs. 1,00,000 to an approved charitable trust.*

4. *The company has a guest house at its factory at Nasik. Expenditure on maintenance of guest house : Rs. 5,000 and on messing of customers visiting the factory : Rs. 5,000 have been included in miscellaneous expenses.*

5. *Miscellaneous income includes dividend of Rs. 29,750 from a foreign company. The shares in the foreign company were allotted in consideration of supply of technical know-how under a collaboration agreement approved by the Central Government. Dividend distributed for the financial year 2008-09 is Rs. 40,000.*

6. *The profit and loss account has been debited with Rs. 2,00,000 for depreciation which has been worked out on straight line basis. The figures of written down value of assets as per income-tax records and rates of depreciation are given below :*

Assets	WDV on April 1, 2008 (Rs. in lakh)	Rate of depreciation (in percentage)
Building (excluding the building let out to employees and sold during the year)	8	5
Machinery	10	25
Motor cars	1	25
Furniture	1	10

The factory worked for 300 days in first shift and for 200 days in second shift.

7. The company has set up a new industrial undertaking at Nasik for production of engineering goods. This unit started production on July 1, 2005 and worked on single shift basis. For this purpose, fresh capital of Rs. 10 lakh was called from members and their relatives. The company has spent Rs. 10,000 for the purpose of setting up this new unit (the expenditure was incurred before April 1, 2005). This expenditure has not been debited to profit and loss account but appears in the balance sheet under the head "Preliminary expenses". Other particulars about this unit are as under :

Cost of new building constructed during 2000 : Rs. 2 lakh.

Cost of new machinery installed during 2000 : Rs. 10 lakh.

Capital employed in the unit after adjustment of liabilities : Rs. 12 lakh.

Profit of the unit during 2008-09 : Rs. 2,00,000. This is included in the figure of net profit as per profit and loss account.

No separate books are maintained for this unit. Deduction under section 80-IB is available.

8. The company earns a short-term capital gain of Rs. 4,40,000.

9. The company has suffered losses in earlier years. The figures of losses and unabsorbed depreciation of earlier years as per income-tax assessment are as under :

	Assessment years			
	2005-06 (Rs. lakh)	2006-07 (Rs. lakh)	2007-08 (Rs. lakh)	2008-09 (Rs. lakh)
Long-term capital loss on sale of land	0.81	—	1.665	—
Short-term capital loss	—	3.00	—	—
Business loss	2.00	1.00	3.00	4.00
Unabsorbed depreciation (for tax purposes)	3.50	7.50	—	—
Unabsorbed depreciation (for accounting purposes)	0.70	0.30	0.05	0.10

You are required to :

a. compute the total income of the company,

b. state whether any part of the above dividend will be exempt in the hands of the shareholders and, if so, what part,

c. give your reasons, in brief, for any adjustments that you may make in your computations.

SOLUTION :

	Rs.	Rs.
Profit as per profit and loss account		30,00,000
Add : Inadmissible expenses		
Donation to charitable trust	1,00,000	
Contribution to scientific research association [taken separately]	2,00,000	
Depreciation (taken separately)	2,00,000	5,00,000
		35,00,000
Less : Expenses not already deducted		
Depreciation [see Note 1]	2,03,050	
Contribution to an approved scientific research association [1.25 of Rs. 2 lakh]	2,50,000	
Amortisation of preliminary expenses (*i.e.*, 1/5 of Rs. 10,000)	2,000	4,55,050
		30,44,950

		Rs.	Rs.
Less : Incomes taxable separately			
Surplus on sale of building		2,00,000	
Dividend from foreign company		29,750	2,29,750
			28,15,200
Less : Brought forward losses			
Business loss of the assessment years 2005-06 to 2008-09		10,00,000	
Unabsorbed depreciation of the assessment years of earlier years		11,00,000	21,00,000
Business income			7,15,200
Short-term capital gains		4,40,000	
Less : Brought forward short-term capital loss		3,00,000	
		1,40,000	
Less : Brought forward long-term capital loss (cannot be set off against short-term capital gains)		—	1,40,000
Income from other sources			
Dividend from foreign company			29,750
Gross total income			8,84,950
Less : Deductions under sections 80C to 80U			
Under section 80-IB [see para 254] [*i.e.*, 30% of Rs. 2 lakh]		60,000	
Under section 80G [see para 242] in respect of donation			
Amount of donation	Rs. 1,00,000		
Qualifying donation [*i.e.*, 10% of (Rs. 8,84,950—Rs. 60,000)]	Rs. 82,495		
Amount deductible (*i.e.*, 50% of Rs. 82,495)		41,248	1,01,248
Net income (rounded off)			7,83,700

Notes :

1. Amount of depreciation is computed as under :

Actual cost of building on July 1, 2006	4,00,000
Less : Depreciation of the previous year 2006-07 (*i.e.*, 5% of Rs. 4 lakh)	20,000
WDV on April 1, 2007	3,80,000
Less : Depreciation of the previous year 2007-08 (*i.e.*, 5% of Rs. 3.80 lakh)	19,000
WDV as on April 1, 2008	3,61,000

Computation of depreciation

Block of assets	*Building*	*Plant and machinery*	*Furniture*
Rate of depreciation	*5%* Rs.	*15%* Rs.	*10%* Rs.
Depreciated value on April 1, 2008	11,61,000 (Rs. 8,00,000 + Rs. 3,61,000)	11,00,000	1,00,000
Add : Cost of assets acquired during the previous year	*Nil*	*Nil*	*Nil*
	11,61,000	11,00,000	1,00,000
Less : Sale proceeds of assets sold during the year	6,00,000	*Nil*	*Nil*
Written down value	5,61,000	11,00,000	1,00,000
Less : Depreciation of 2008-09	28,050	1,65,000	10,000
Depreciated value on April 1, 2009	5,32,950	9,35,000	90,000

338-P7 *Profit and loss account of X Ltd., a public limited company, discloses a net profit of Rs. 6 lakh for the year ending March 31, 2009. From scrutiny of records the following position emerged :*

1. *Workmen and staff welfare expenditure debited in profit and loss account includes a sum of Rs. 50,000 being the cost of construction of a primary school exclusively for the benefit of children of employees.*

2. *A sum of Rs. 20,000 was debited in profit and loss account, being penalty by way of 1 per cent reduction in selling price imposed by the purchaser for non-fulfilment of delivery conditions of contract of sale due to factors beyond the control of the company.*

3. *General Manager was paid a monthly salary of Rs. 8,500 and was provided with perquisite of the total value of Rs. 20,000 during the previous year.*

4. *Foreign technician (appointment approved by the Central Government) covered under section 10(6)(viia) who has come for the first time for production of sophisticated products of the company, was paid salary of Rs. 1.50 lakh and perquisites Rs. 26,000 per annum.*

5. *Guest house expenses of Rs. 40,000 was debited to profit and loss account.*

6. *Interest account includes payment of Rs. 25,000 in respect of funds borrowed separately for acquisition of machinery.*

7. *Company received remuneration of Rs. 1 lakh for supply of know-how in the installation of machinery in pursuance of an agreement approved by the Board from a foreign enterprise.*

8. *Managing Director incurred expenses on his foreign tour for promotion of sales outside India Rs. 60,000 debited to profit and loss account.*

9. *During the year one machinery (rate of depreciation : 15 per cent) was sold for Rs. 22,000. Its original cost and written down value on income-tax basis as on April 1, 2008 were Rs. 30,000 and Rs. 2,000 respectively and the surplus was credited to capital reserve account.*

Compute the taxable income of the company for the assessment year 2009-10 after taking the following into account :

1. *Depreciation on all assets including all additions made during the year on straight line basis charged to profit and loss account amounted to Rs. 2 lakh.*

2. *Depreciated value of assets on April 1, 2008 is as follows : Plant and machinery : Rs. 20,00,000 (rate of depreciation : 15 per cent), building : Rs. 6,05,000 (rate of depreciation : 10 per cent).*

3. *Plant and machinery (new) additions during the year amounted to Rs. 80,000 (assume normal depreciation at 15 per cent on 3 shifts working, date of installation : April 10, 2008).*

4. *Plant and machinery (solar power generating system) additions during the year amounted to Rs. 1.20 lakh (assume normal depreciation at 100 per cent and 3 shifts working, date of installation : April 10, 2008).*

Indicate the reasons for the particular treatment given by you to the different items.

SOLUTION :

	Rs.
Profit as per Profit & Loss account	6,00,000
Add :	
Cost of school building being capital expenditure hence disallowed	50,000
Guest house expenses [now it is deductible under section 37(1)]	*Nil*
Depreciation written off (separately considered)	2,00,000
	8,50,000
Less : Depreciation on all assets [see Note 2] [*i.e.*, Rs. 65,500 + Rs. 3,08,700 + Rs. 16,000 + Rs. 1,20,000]	5,10,200
Business income	3,39,800
Any other income	*Nil*
Gross total income	3,39,800
Less : Deduction	*Nil*
Net income	3,39,800

Notes :

1. Penalty of Rs. 20,000 is an expenditure incidental to business.
2. Depreciation is calculated as under :

Block of assets	Building	Plant and machinery	Plant and machinery
Rate of depreciation	10%	15%	100%
	Rs.	Rs.	Rs.
Depreciated value on April 1, 2008	6,05,000	20,00,000	—
Add : Cost of assets acquired during the year	50,000	80,000	1,20,000
	6,55,000	20,80,000	1,20,000
Less : Sale proceeds of assets sold during the year	—	22,000	—
Written down value	6,55,000	20,58,000	1,20,000
Amount of depreciation	65,500	3,08,700	1,20,000
Additional depreciation	—	16,000	—

338-P8 *XYZ Ltd. furnishes the following particulars. Compute the total taxable income of the company for the assessment year 2009-10 (accounting year ended on March 31, 2009).*

	Rs. (in lakh)
1. *Net income which includes penal interest of Rs. 31,000 paid for delayed payment of sales tax and interest of Rs. 2 lakh paid on fixed deposits from public subject to the following adjustments :*	*31.34*
❑ *depreciation which included Rs. 0.50 lakh for guest house building*	*1.65*
❑ *unabsorbed depreciation of the assessment year 2003-04*	*7.35*
❑ *unabsorbed business loss brought forward*	*24.48*
2. *Short-term capital gain on sale of shares (trade investment)*	*0.99*
3. *Long-term capital gain on sale of equity shares on May 10, 2008 (computed under section 48)*	*2.52*
4. *Brought forward short-term capital loss*	*0.45*
5. *Brought forward long-term capital loss of the assessment year 2004-05 on sale of shares*	*0.50*
6. *Gross interest from Government securities*	*1.27*
7. *Bank commission, etc., for realising interest*	*0.07*

SOLUTION :

	Rs.	*Rs.*
Income from business		
Business income	31,34,000	
Less : Depreciation	1,65,000	
	29,69,000	
Less : Brought forward business loss	24,48,000	
	5,21,000	
Less : Unabsorbed depreciation	5,21,000	
Income from business		*Nil*
Capital gains :		
Short-term capital gains	99,000	
Long-term capital gains	2,52,000	
	3,51,000	

	Rs.	Rs.
Less : Brought forward short-term capital loss	45,000	
	3,06,000	
Less : Brought forward long-term capital loss	50,000	2,56,000
Income from other sources		
Interest on Government securities	1,27,000	
Less : Bank commission	7,000	1,20,000
Gross income before unabsorbed depreciation		3,76,000
Less : Unabsorbed depreciation		2,14,000
Gross total income		1,62,000
Less : Deductions under Chapter VI-A		*Nil*
Net income		1,62,000

Notes :

1. It is assumed that net income of Rs. 31.34 lakh has been arrived at after debiting interest of Rs. 31,000 paid for delayed payment of sales tax and interest of Rs. 2 lakh paid on fixed deposits from public.

2. Penal interest for delayed payment of sales tax is admissible as business expenditure, not being in the nature of penalty—*Mahalakshmi Sugar Mills* Co. v. *CIT* [1980] 123 ITR 429 (SC).

3. If equity shares are transferred in the above case in a recognised stock exchange, the long-term capital gain will be exempt from tax.

338-P9 *Engineering Services Ltd., an Indian company, having acted as the agents of a corporation established in USA earned commission of Rs. 8,50,000 for effecting sales in India, of the goods manufactured by the American concern. The amount was credited to the Indian company's account in America with the permission of the Reserve Bank of India. The prevailing rate of exchange being $ 1 = Rs. 41.50 the sum credited in dollars amounted to $ 1,00,000. The Indian company retained the money in America for the time being as it was planning to acquire certain new plant and machinery from another American company for use in its own manufacturing activities. The total cost was estimated to be $ 5,00,000 and with the permission of the Reserve Bank of India a further sum of Rs. 1,67,20,000 equivalent to $ 4,00,000 at the then prevailing exchange rate of $ 1 = Rs. 41.80 was remitted by Engineering Services Ltd. to America. The deal, however, did not ultimately materialise and the entire sum was brought back to India by the Indian company. At the time of remittance the prevailing rate of exchange was $ 1 = Rs. 43.00 and thus, as much as Rs. 2,15,00,000 was received on remittance. The company wants to know how the surplus realised by it should be treated for purposes of the Income-tax Act. Discuss fully all the aspects as to whether there can be a charge as a revenue profit and/or capital gains.*

SOLUTION : The Indian company has retained foreign currency in USA for the purpose of acquiring plant and machinery. In view of the ruling given by the Supreme Court in *CIT* v. *Tata Locomotive & Engg. Co. Ltd.* [1966] 60 ITR 405, the surplus arising as a result of fluctuation in foreign exchange rate is capital receipt if foreign currency is kept for the purpose of acquiring capital asset. Therefore, surplus of Rs. 6,30,000 [*i.e.*, (Rs.43—Rs. 41.50) × $ 1,00,000 *plus* (Rs. 43—Rs. 41.80) × $ 4,00,000] is not chargeable to tax.

338-P10 *An Indian company proposes to supply to a foreign concern the know-how for construction of spans of bridges. The foreign concern situated in the Middle East is to construct the spans of bridges by utilising such know-how, but thereafter the task of actual building of the bridges in the Middle East country is to be undertaken by the Indian company. For the supply of know-how the Indian company is to receive Rs. 50 lakh in foreign exchange and for the construction of the bridges another sum of Rs. 2 crore in foreign exchange. The company wants to know the benefits in Indian income-tax, if any, it may be entitled to in its assessments and also what formalities it must observe in order to obtain those. Discuss.*

SOLUTION : No tax incentive is available in the above case now-a-days. Earlier, for supply of know-how for construction of bridge spans to a foreign concern, an assessee was entitled to deduction under section 80-O. Similarly, profit resulting from construction of bridge outside India was qualified for tax benefit provided by section 80HHB.

338-P11 *On receipt of assessment order for the assessment year 2009-10 of X Ltd., the chief accountant of that company finds that the following deductions claimed by it in the return of total income have not been allowed* :

1. *Expenditure of Rs. 15,000 incurred on accommodation maintained, at the place where the factory is located, for the directors and other employees of the company, who visit the factory for the purposes of the company's business.*

2. *A sum of Rs. 17,500 incurred for lunch at a five-star hotel where seven representatives of a prominent raw material supplier were taken for lunch and the purchase manager of the assessee had accompanied them.*

3. *Export markets development allowance on a sum of Rs. 18,000 spent by it in connection with a party given to the overseas buyers of its products.*

4. *Claim for deduction of a sum of Rs. 4,50,000 being the amount of liability for gratuity for the calendar year 1991 calculated on actuarial basis for which no provision was made in the books of account. The company does not maintain any gratuity fund. It maintains its accounts on mercantile basis. So far as gratuity liability is concerned, it has made provision for the same in the books of account for the previous year ended December 31, 1976. Thereafter, it stopped making provision for gratuity liability in the books of account. However, actual payments are debited to the Profit and Loss Account.*

5. *Expenditure of Rs. 10,000 incurred for drilling a tube-well in the factory. The drilling operations were given up as the water was hard and not suitable for use. The expenditure thus became infructuous.*

6. *Annual preference dividend liability of Rs. 1,00,000 on the company's 10 per cent cumulative redeemable preference shares which are not entitled to any further rights to participate in profits or surplus assets. These shares are redeemable on December 1, 2008 according to the terms of issue.*

The Assessing Officer has also added a sum of Rs. 8,000 pertaining to unclaimed wages for the year 1991 which was transferred to the Profit and Loss Account of the year 2008-09 since the claim has become time barred. The assessee had claimed that the same was not liable to be included in the total income. The company seeks your advice on the correctness or otherwise of the disallowances.

SOLUTION :

1. Disallowance of expenses of Rs. 15,000 is not justified in view of the amendment made by the Finance Act, 1997. Now guest house maintenance expenses are deductible under section 37(1). It was subject to fringe benefit tax up to the assessment year 2008-09.

2. Expenditure of Rs. 17,500 on lunch for representatives of raw material supplier is deductible under section 37(1). It is, however, subject to fringe benefit tax.

3. The stand taken by the Assessing Officer is tenable in law. Deduction is, however, available under section 37(1). Fringe benefit tax is applicable.

4. In view of the provision of section 40A(7), the opinion of the Assessing Officer is justified — *People's Engg. & Motor Works Ltd.* v. *CIT* [1981] 6 Taxman 53 (Cal.).

5. Since the expenditure of Rs. 10,000 for drilling a tube-well in the factory is incurred wholly and exclusively for the purpose of the business of the assessee, the same is allowable under section 37(1).

6. Provision for dividend is not an expenditure.

7. The amount of unclaimed wages, transferred to the Profit and Loss Account is taxable under section 41(1).

338-P12 *Consider the admissibility or otherwise of the following payments in the income-tax assessment of X Ltd.—*

1. *Interest of Rs. 1,20,000 paid on money borrowed from A, one of its major shareholders, for the purchase of plant for the new tea garden at Assam. X Ltd.was already engaged in the business of cultivation, manufacture and sale of tea in its tea garden at Darjeeling. During the relevant previous year, the new plant so purchased was under installation. The company claims normal depreciation as also the said interest of Rs. 1,20,000 as deduction in computing the business income.*

2. *Loss of Rs. 45,000 arising from non-recovery of the amount lost in theft that took place in its Darjeeling garden cash office. An aggregate cash of Rs. 1,00,000 was initially lost. But, subsequently, the police were able to recover Rs. 55,000. The balance sum of Rs. 45,000 has been claimed by the company as a bad debt.*

3. *Legal charges of Rs. 98,000 which include, inter alia, (i) Rs. 36,000, retainer's fee paid to an advocate for advising on matters relating to company law, foreign exchange and excise at the rate of Rs. 3,000 per month ; (ii) Rs. 18,000 fee paid to a firm of cost accountants during the relevant previous year for appearing before the tax authorities including the Income-tax Appellate Tribunal in connection with their assessment proceedings for the assessment year 1998-99 ; and (iii) Rs. 20,000 towards cost of execution of mortgage in respect of the company's tea garden at Darjeeling as a security against a long-term loan of Rs. 20,00,000 taken from the Assam State Financial Corporation. The loan was utilised in purchasing the new tea garden at Assam.*

SOLUTION :

1. Interest on capital borrowed for acquiring a capital asset is allowable as deduction. Section 36(1)(*iii*) does not make any distinction between interest paid on capital utilised in acquiring a capital asset or a revenue asset—*India Cements Ltd.* v. *CIT* [1966] 60 ITR 52 (SC). However, interest incurred before the asset is put to use should be capitalised and added to the cost of fixed asset created as a result of such expenditure—*Challapalli Sugars Ltd.* v. *CIT* [1975] 98 ITR 167 (SC). Therefore, in such a case, interest will not be allowable as deduction under section 36(1)(*iii*). Since, in the given case, the plant is under installation, interest payable on capital borrowed to finance the extension of existing business before the plant is put to use, is not allowable as deduction. It can be added to the cost of plant. Depreciation on this plant is not available till the plant is put to use.

2. In view of the Supreme Court's ruling in *Badridas Daga* v. *CIT* [1958] 34 ITR 10, loss of Rs. 45,000 is allowable as deduction as revenue loss under section 28(*i*) rather than as bad debt [see para 102.14].

3. Retainer fees of Rs. 36,000 is allowable as deduction under section 37(1). Fees paid to the cost accountant is deductible under section 37(1). Rs. 20,000 being the expenditure incurred for securing a long-term loan is allowable as deduction—*India Cements Ltd.* v. *CIT* [1966] 60 ITR 52 (SC).

338-P13 *XYZ (P.) Ltd., carrying on business in manufacture and sale of sugar, had its factory in UP. During the accounting period ending March 31, 2009 the company paid two amounts, namely, (i) a contribution of Rs. 22,332 at the request of the collector towards the construction of the Deoni Dam and the Deoni Dam Majhala Road which has been completed several years before ; and (ii) a contribution of Rs. 50,000 to the State Government towards meeting the cost of construction of roads in the area around its factory under a sugarcane development scheme under which one-third of the cost of construction of roads was to be met by the Central Government, one-third by the State Government and one-third by sugar factories and sugarcane growers. Are these two amounts deductible in computing the assessee's profits under section 37(1) of the Income-tax Act ?*

SOLUTION : Since there is nothing to show that the contribution of Rs. 22,332 has anything to do with the company's business or that the construction of the dam and the road are in any way advantageous to its business, the contribution is not admissible as revenue expenditure. In the case of contribution of Rs. 50,000, the roads constructed around the factory will facilitate the transport of sugarcane into the factory and the flow of sugar out of the factory. This expenditure is, therefore, laid out wholly and exclusively for the purpose of the assessee's business. Moreover, as the expenditure does not result in acquisition of any assets by the assessee, its advantage, though of long duration, is not in the capital field. The expenditure of Rs. 50,000 is, therefore, admissible as revenue expenditure—*L.H. Sugar Factory & Oil Mills (P.) Ltd.* v. *CIT* [1980] 4 Taxman 5 (SC).

338-P14 *A foreign technician is sent by a foreign company to India in terms of a collaboration agreement dated January 1, 2007 with an Indian company to assist the Indian company in setting up a plant. The fees charged by the foreign company are Rs. 5,000 per day for every day of stay in India of the technician for such work. The technician draws total emoluments of Rs. 2,000 per day, out of which a sum of Rs. 1,200 per day is paid by the Indian company. The technician stays in India for 75 days. What are the tax effects in India of the transactions mentioned in the preceding paragraph ?*

SOLUTION : *Assessment of foreign technician* : The foreign technician, it is assumed, comes to India as an employee of the foreign company and not of the Indian concern. As he stays in India for less than 90 days and his salary is not deductible in computing business income of his employer. Salary income is taxable in the hands of the technician.

Assessment of foreign company : The entire receipt of Rs. 5,000 per day for 75 days, *i.e.*, Rs. 3,75,000 becomes chargeable to tax in its hands as fees for technical services under section 9(1)(*vi*) @ 10% *plus* surcharge *plus* education cess as per section 115A.

Assessment of Indian company : Since the foreign technician comes to India to assist the Indian company in setting up the plant, the expenses incurred on this account by the company are in the nature of expenses incurred for erection of machinery and putting the items of plant in working condition and can, therefore, be capitalised and treated as part of the "actual cost" of plant and machinery.

338-P15 *The shareholding of XYZ Ltd., a public limited company is as follows : (i) Government of India : 16 per cent ; (ii) Reserve Bank of India : 15 per cent ; (iii) a corporation wholly owned by the Reserve Bank of India : 5 per cent ; (iv) public : 64 per cent (none holds more than half per cent). Advise whether the company is one in which the public are substantially interested within the meaning of the Income-tax Act for the previous year ending March 31, 2009, if (a) its shares are listed on a recognised stock exchange throughout the previous year, or (b) its shares are listed on the Delhi Stock Exchange with effect from December 23, 2009, or (c) its shares are not listed on any recognised stock exchange in India throughout the previous year 2008-09.*

SOLUTION : In the case of public limited company, if equity shares are listed in a recognised stock exchange in India on the last day of the previous year, the company is treated as a company in which the public are substantially interested. Therefore, in situations (a) and (b) XYZ Ltd. will be a company in which the public are substantially interested. In situation (c), however, the shares of the company are not listed in a recognised stock exchange throughout the previous year. One has, therefore, to test conditions mentioned in section *2(18)(b)(B)* to decide whether (or not) it is a company in which the public are substantially interested [see para 333.6(7)]. Since in situation (c) 50% equity shares of XYZ Ltd. are not held by the Government, widely-held companies and statutory corporations, the company is one in which the public are not substantially interested.

338-P16 *A (P.) Ltd. rendered the following services as promoters prior to the incorporation of X Ltd., a public limited company :*

It applied to the Government for setting up a new industrial undertaking and pursued the matter until it obtained a letter of intent. It negotiated with the proposed foreign collaborators and finalised agreement with it. It made efforts to obtain licence for import of capital goods and approval of foreign collaboration agreement and as a result the Government sanctioned the necessary approvals. After completion of various formalities, it made an application for issue of industrial licence in the name of X Ltd. which was eventually sanctioned. It complied with various formalities with regard to the registration of X Ltd. and public company was eventually registered in February 1990. These services were rendered over a period of almost seven years.

X Ltd. intends to pay A (P.) Ltd. a sum of Rs. 2 lakh by cheque or by allotment of shares of equivalent amount. You are requested to examine the position regarding the payment of Rs. 2 lakh both in the hands of A (P.) Ltd. and X Ltd., with respect to income-tax exemption benefits available in their respective hands.

SOLUTION : It is clear that X Ltd. is an industrial company. Presumably, it is an Indian company as well. A (P.) Ltd. seems to be engaged in a business of promoting companies, without having to do anything with the setting up of the plant and machinery of the promoted company. Presumably, this too is an Indian company. The questions which arise for consideration are :

1. Whether and to what extent will X Ltd. be entitled to claim Rs. 2 lakh as deduction in arriving at its taxable income ?
2. Will X Ltd. be entitled to any other benefit ?
3. What benefits could A (P.) Ltd. expect in its income-tax assessment ?
4. Will it make any difference to the benefits of the two companies if Rs. 2 lakh be paid by allotment of shares, instead of in cash ?

Tax benefits of X Ltd. : The payment to the promoter company being relatable to services rendered by it prior to the formation of the company and the commencement of business by X Ltd., would have been totally disallowable as capital expenditure under the Income-tax Act, as it stood till March 31, 1971 ; but section 35D permits the amortisation of certain preliminary expenses specified therein. To the extent that the services rendered by A (P.) Ltd. are covered by the provisions of section 35D, the remuneration relatable to such services would be amortised. Out of the balance of the expenditure, though not eligible for deduction as revenue expenditure, that part of expenditure as can be attributed to acquisition of capital assets (plant and machinery) may be added to their cost to claim deduction under section 32 on such assets—*Challapalli Sugars Ltd.* v. *CIT* [1975] 98 ITR 167 (SC). No other benefit to X Ltd. is envisaged.

Tax benefits to A (P.) Ltd. : This company would be assessable on the net profits after allowing against the receipt of Rs. 2 lakh expenses incurred by it in rendering the services of X Ltd. The exemption/benefits would be the same as outlined above, irrespective of whether the promoter company is paid in cash or by allotment of shares.

338-P17 *Compute the business income as well as the total income of X Ltd. for the assessment year 2009-10 (previous year ended March 31, 2009) on the basis of the following particulars :*

1. The company is a "closely-held" public limited company incorporated in India in a notified backward area to carry on the business of manufacture and sale of typewriters. The company commenced commercial production on October 1, 1986.

2. The company exported goods worth Rs. 10 lakh to Malaysia during the previous year 2008-09 (the entire turnover is received in convertible foreign exchange) and incurred expenses as under :

- *Cost of advertisement outside India, Rs. 2 lakh in respect of goods exported but payment was made to an advertising agency in India.*
- *Cost of free samples incurred in India, Rs. 50,000 and incurred outside India Rs. 40,000.*
- *Expenditure on branch office outside India Rs. 1.5 lakh.*
- *Cost of tenders incurred outside India Rs. 10,000.*
- *Insurance of Rs. 1 lakh paid to the foreign insurer on goods exported.*

3. *The company contributed a sum of Rs. 50,000 to Rural Development Fund, notified by Central Government (amount debited to P & L Account).*

4. *The company incurred brokerage and legal charges (debited to P & L Account) as under :*

- *Rs. 50,000 on machineries purchased and installed before October 1, 2008 on instalment payment system.*
- *Rs. 5,000 on money borrowed for making investment in Government Bonds as security for electricity deposit.*

5. *Capital expenditure was incurred during the year on plant and machinery of the value of Rs. 5 lakh in the research development newly set up.*

6. *Salary to managing director was paid at Rs. 16,000 per month plus perquisites valued at Rs. 1,200 per month.*

7. *Rs. 2,00,000 was incurred on advertisement and publicity excluding advertisement referred to in item 2. (This sum of Rs. 2,00,000 includes Rs. 58,000 on guest house expenditure and Rs. 10,000 on advertisement in souvenir published by a political party). The turnover of the company is Rs. 160 lakh.*

8. *Donation to an institution recognised under section 80G of the Income-tax Act was Rs. 75,000 (debited to P & L Account).*

9. *The net profit of the company as per P & L Account is Rs. 25 lakh.*

10. *Gross dividend of Rs. 25,000 was received from a foreign company on April 10, 2008 and credited to profit and loss account. Amount of dividend distributed by the assessee-company to its shareholders for 2008-09 is Rs. 10,000 (date of distribution is April 1, 2009).*

11. *Depreciation is to be charged at 10 per cent on buildings (WDV : Rs. 40,00,000) and at 15 per cent on plant and machinery (WDV : Rs. 40,50,000, exclusive of brokerage/legal charges). Depreciation debited in the accounts is Rs. 6 lakh.*

SOLUTION :

	Rs.	Rs.
Profit as per P & L account		25,00,000
Add : Expenditures not deductible or considered separately		
Donation	75,000	
Advertisement in souvenir of political parties	10,000	
Brokerage and legal charges (being capital expenditure)	50,000	1,35,000
		26,35,000
Less : Expenses permissible/incomes taken separately		
Dividends	25,000	
Depreciation [i.e., 10% of Rs. 40,00,000 + 15% of Rs. 41,00,000 (i.e., Rs. 40,50,000 + Rs. 50,000, Brokerage and legal charges) — Rs. 6,00,000 provided in books of account]	4,15,000	
Capital expenditure on scientific research (on the assumption that the amount was not debited to P & L account)	5,00,000	9,40,000
Income from business		16,95,000
Income from other sources (i.e., dividends)		25,000
Gross total income		17,20,000
Less : Deductions under section 80G [see para 242] 50% of Rs. 75,000		37,500
Net income (rounded off)		16,82,500

338-P18 *X Ltd. transferred shares held by it in various companies, as stock-in-trade, to its subsidiary C Ltd. at the book value of Rs. 6,00,000. The market value of the shares at the relevant time was Rs. 18,00,000. The Assessing Officer, while making the assessment of X Ltd., assessed it on the surplus of Rs. 12,00,000 which in his opinion the assessee must be deemed to have made on the transfer of such shares to its subsidiary. X Ltd. holds 60 per cent of the share capital of C Ltd. X Ltd. seeks your advice as to the correctness of the assessment. In case you feel that the said assessment cannot be justified in law, suggest two alternative proposals for appropriate action in the matter.*

SOLUTION : Where a trader transfers his goods to another trader at a price less than the market price and the transaction is *bona fide* one, the taxing authority cannot take into account the market price of those goods, ignoring the real price fetched, to ascertain the profits from the transaction—*CIT* v. *Calcutta Discount Co. Ltd.* [1973] 91 ITR 8 (SC). Therefore, the Assessing Officer is not justified while assessing X Ltd. on deemed profits of Rs. 12,00,000. The company should, therefore, file an appeal before the Commissioner (Appeals) or revision petition under section 264 before the Commissioner of Income-tax.

338-P19 *X Ltd. (a company incorporated in the U.K.) and A Ltd. (an Indian company) have entered into an agreement on June 30, 2005 under which the English company agreed to give to the Indian company the know-how for the manufacture in India of cameras, projectors and allied equipments, on the following terms :*

1. The English company will hand over to the Indian company in London, the detailed data, documentation, drawings and specifications relating to the manufacture for which it will be paid £ 50,000 in London in foreign exchange.

2. The English company will depute two technicians to India to assist the Indian company in setting up of plant and also in the operation of the plant for a period of 12 months, during which time they will train an adequate number of Indians in the manufacturing operations. In return for these services, the Indian company will pay to the English company £ 10,000 in four equal quarterly instalments, which will be over and above the salary and allowances of the two technicians which will be paid to them in India by the Indian company.

3. The Indian company will pay to the English company a royalty at the rate of £ 2 per camera and £ 5 per projector manufactured by it, for a period of 15 years from the commencement of production.

The agreement has been approved by the Central Government. Discuss the following :

1. What is the scope of tax liability in India of the English company in respect of the amounts payable to it under the agreement?

2. What deductions, if any, are available to it in the computation of its income for tax purposes?

3. At what rate is tax chargeable on the various items? Also indicate the time at which the tax is to be paid or recovered.

SOLUTION : The cumulative impact of sections 5(2), 9 and 115A on the point raised in the problem would be as under :

1. Tax incidence on X Ltd. - X Ltd., the English company, will be liable to tax in India on the following receipts, namely, lump sum receipt of royalty : £ 50,000 ; fees for technical services : £ 40,000 ; and recurring royalty of £ 2 per camera and £ 5 per projector manufactured in India.

2. Deduction - By virtue of section 44D, X Ltd. cannot claim deduction of any expenditure.

3. Tax rates - Under section 115A, £ 50,000, being lump sum royalty will be charged to tax at the rate of 20%.† Technical fees and recurring royalty on cameras and projectors will be taxable at the rate of 10%.† X Ltd., the company making payments to the English company, should deduct tax at source under section 195.

338-P20 *X Ltd., carrying on business in manufacture of colour, dyes and chemicals, has submitted the following particulars of its income. On the basis of the further particulars obtained on inquiry, compute, giving reasons, its total income for assessment year 2009-10. The company follows mercantile system of accounting and the previous year is financial year ending March 31, 2009.*

1. Profit as per profit & loss account : Rs. 13,50,000.

2. The company has claimed the following deductions in its return of income :

- *In respect of expenditure on purchase of laboratory equipments and machinery incurred during the previous year for the purpose of setting up a scientific research unit for conducting research in dyes and chemicals : Rs. 2,00,000. The research unit is not, however, approved by the prescribed authority.*
- *In respect of furniture, fixtures and intercom equipment purchased in financial year 1988-89 for Rs. 30,000 transferred to newly set up scientific research unit at written down value of Rs. 20,000. It is ascertained that both these amounts appear on the asset side of the balance sheet.*
- *Depreciation debited to profit & loss account in respect of assets used for scientific research acquired in the previous year relevant to the assessment year 2008-09. In respect of such assets full deduction was allowed for the said assessment year : Rs. 10,000.*

3. Compensation account debited to profit and loss account : Rs. 5,00,000. It is ascertained that 50 per cent of shares of the assessee-company were held by R group. Under an agreement reached with R group the company decided to purchase the shares of the said group. It was also decided to terminate services of the managing director and other employees belonging to R group. As a result the company was required to pay retrenchment compensation as also compensation for termination of employment to the above persons. The company claims that there was substantial reduction in the wage bill and it has been able to conduct its business more efficiently.

4. A sum of Rs. 3 lakh was written off as bad debt. It is ascertained that P one of the directors of the company had obtained a loan of Rs. 3 lakh, for the purpose of constructing his own residential house, from a local bank on the strength of a guarantee furnished by the assessee-company. The director was unable to pay the loan. As a result the

†*Plus* SC+EC+SHEC.

company was required to pay to the bank a sum of Rs. 3,50,000, being the amount of loan along with interest. The interest of Rs. 50,000 paid was debited to interest account.

5. *Legal charges debited to P & L account include remuneration to auditors for conducting proceedings before income-tax authorities : Rs. 7,500.*

SOLUTION :

	Rs.
Net profit as per Profit and Loss account	13,50,000
Adjustments	
Capital expenditure for scientific research is fully deductible under section 35(1)(*iv*)	(–)2,00,000
Written down value of furniture, fixtures and intercom equipment, transferred to scientific research unit is not deductible, since the expenditure was not incurred during the previous year	—
Depreciation on scientific research asset is not allowable	(+)10,000
Compensation (Rs. 5,00,000) is allowable as deduction, since the assessee has been benefited by reduction in its wage bill and has been able to carry on its business more efficiently—*Sassoon J. David & Co. (P.) Ltd. v. CIT* [1979] 118 ITR 261 (SC)	—
Bad debt (Rs. 3,00,000) and interest (Rs. 50,000) are not allowable as deduction, as the guarantee was not given on ground of commercial consideration but on personal grounds	(+)3,50,000
Legal charges for conducting proceedings before tax authorities are deductible under section 37(1)	—
Gross total income	15,10,000
Less : Deductions under sections 80C to 80U	—
Net income	15,10,000

338-P21 *XYZ Ltd. is a public company engaged in the business of printing and publication of books. Its profit and loss account for the year ended March 31, 2009 disclosed a net profit of Rs. 8,00,000. Particulars noted from the company's accounts and on inquiry from the company are given below :*

1. *The head office of the company is situated in a building taken on lease. During the year, the company incurred an expenditure of Rs. 1,00,000 on extension of and improvements to this building. The sum of Rs. 1,00,000 was debited by the company to its Profit and Loss account.*

2. *In the past, the company used to value its closing stock at cost. This year, the closing stock was valued at 10 per cent below cost at Rs. 90,000. The company has resolved that it will henceforth adopt this method of valuation.*

3. *A motor car purchased by the company in the past for Rs. 25,000 was sold to an employee of the company for Rs. 16,000 which was also the written down value of the car at the beginning of the year. The market value of the car on the date of sale was Rs. 24,000.*

4. *Income-tax refund of Rs. 12,500 received during the year was credited to the Profit & Loss account.*

5. *A refund of Rs. 30,000 obtained from customs authorities in partial reduction of penalty of Rs. 1,00,000 levied and paid in the past for infringing customs regulations (and allowed by the Assessing Officer as deduction in the computation of total income) was credited to general reserve.*

6. *A manager of the company was paid salary Rs. 60,000, dearness allowance Rs. 12,000, commission Rs. 10,000, bonus Rs. 7,500 and leave salary Rs. 2,500. He was also allowed rent-free furnished house for which the company paid rent of Rs. 12,000 besides rent of furniture and air-conditioner Rs. 3,000. The company also paid salary of Rs. 6,000 to the watchman and sweeper provided free of charge to the manager.*

7. *Credits to Profit and Loss account included dividend of Rs. 60,000 received on September 6, 2008 from a foreign company.*

8. *Debits to the Profit and Loss account included the following :*

a. *Rs. 10,000 regarding expenditure incurred for printing invitation cards and hiring and transport charges of furniture and shamiana in connection with the inauguration of a new branch opened for expanding the business.*

b. *Rs. 2,500 regarding expenditure incurred on printing additional articles of association of the company.*

c. *Rs. 2,000 regarding legal expenses in connection with the alteration of the company's articles of association.*

d. *Rs. 20,000 paid as penalty to Government for the company's failure to perform the job of printing and supply of text books to the Education Department within the stipulated time. There was delay of 4 months and according to the agreement entered with the Government, the company had to pay a penalty of Rs. 5,000 per month.*

e. *Rs. 24,000 regarding payment by way of contribution towards approved gratuity fund.*

f. *Rs. 8,000 regarding deposit made under the own your telephone scheme.*

g. *Rs. 7,500 regarding penalty imposed by the Assessing Officer for concealment of income made by the company for an earlier assessment year for which assessment was completed during this year.*

h. *Rs. 5,000 regarding interest paid to bank for money borrowed to pay advance tax (Rs. 4,000) and wealth-tax (Rs. 1,000).*

i. *Rs. 6,000 paid as pension @ Rs. 500 per month to the widow of founder director.*

j. *Rs. 5,000 regarding loss of cash in burglary committed at night in the company's business premises.*

k. *Rs. 12,000 regarding expenses of shifting business premises from the original site to the present site which is more advantageously situated.*

l. *Rs. 1,00,000 paid by the company to an approved scientific research association which undertakes scientific research not related to the business of the company .*

m. *Rs. 10,000 paid as interest on borrowings made for purchase of shares of a company which has still not paid any dividend.*

Compute the total income of the company for the assessment year 2009-10. Give reasons for additions made or deductions allowed in respect of the various items. Assume that the company has not distributed any dividend for the financial year 2008-09.

SOLUTION :

	Rs.
Net profit as per profit and loss account	8,00,000
Adjustments	
Add : Expenditure on extension of building (being capital expenditure)	(+) 1,00,000
Less : Depreciation on extension of building (10% of Rs. 1,00,000)	(–) 10,000
Add : Undervaluation of closing stock (*i.e.*, 1/9 of Rs. 90,000)	(+) 10,000
Less : Income-tax refund	(–) 12,500
Add : Refund of customs duty [sec. 41(1)]	(+) 30,000
Less : Dividend	(–) 60,000
Add : Penalty for concealment of income	(+) 7,500
Add : Interest on money borrowed to pay income-tax and wealth-tax	(+) 5,000
Add : Expenses of shifting business premises	(+) 12,000
Less: Weighted deduction in respect of contribution to an approved scientific research association [1.25 of Rs. 1,00,000 *minus* Rs. 1,00,000 already debited to P & L A/c]	(–) 25,000
Add : Interest on money borrowed to purchase shares	(+) 10,000
Income under the head "Profits and gains of business or profession"	8,67,000
Dividend income (Rs. 60,000 – Rs. 10,000)	50,000
Gross total income	9,17,000
Less : Deductions under sections 80C to 80U	*Nil*
Net income (rounded off)	9,17,000

Notes :

1. Expenditure incurred in connection with the inauguration of new branch is allowable as deduction under section 37(1)—*Atlas Cycle Industries Ltd.* v. *CIT* [1981] 6 Taxman 145 (Punj. & Har.).

2. Expenditure incurred on printing additional Articles of Association and legal expenditure incurred for making alteration in Articles of Association are deductible expenditure—*CIT* v. *Merck Sharp & Dohme of India Ltd.* [1983] 140 ITR 334 (Bom.), *CIT* v. *Utkal Machineries Ltd.* [1981] 6 Taxman 288 (Ori.).

3. Penalty for failure to perform job in time is an allowable expenditure—*CIT* v. *Reliable Water Supply Services of India (P.) Ltd.* [1980] 124 ITR 199 (All.).

4. Interest on capital borrowed to purchase shares is deductible under the head 'Income from other sources' as dividend income is taxable under this head.

338-P22 *XYZ Ltd. is having business in manufacture, sale and export of goods. Its Profit and Loss Account for the year ending March 31, 2009 disclosed a net profit of Rs. 7.5 lakh. Compute the assessable income for the assessment year 2009-10 from the following data :*

1. *Tax paid on behalf of foreign collaborator, the company having failed to deduct tax on the remittances, such tax paid being Rs. 30,000 debited to the Profit and Loss Account.*

2. *Commission paid to foreign buyer in violation of Foreign Exchange Regulation Act in the course of invoicing exports, debited to Profit and Loss Account : Rs. 40,000.*

3. *Commission paid to local agents of foreign principals for securing export orders, debited to Profit and Loss Account : Rs. 20,000.*

4. *Remuneration to managing director comprised of salary at Rs. 45,500 per month, bonus for the year Rs. 10,000 and commission Rs. 20,000 all debited to Profit and Loss Account. The entire remuneration has been approved by the Company Law Board.*

5. *Interest paid on borrowings made in excess of the limits laid down under section 58A of the Companies Act read with rule 3 of the Companies (Acceptance of Public Deposits) Rules : Rs. 50,000 debited to Profit and Loss Account.*

6. *Contribution to a political party for securing help in getting loan from a Government financial institution, charged to Profit and Loss Account : Rs. 1 lakh.*

7. *Surtax paid : Rs. 25,000.*

8. *Interest paid for belated payment of income-tax : Rs. 8,000 debited to Profit and Loss Account.*

9. *Insurance compensation received Rs. 2 lakh for damage to a machinery, the expenditure incurred for repairing the same being Rs. 1,50,000, the balance Rs. 50,000 credited to Replacement Reserve Account in the balance sheet.*

10. *Amount realised on sale of import entitlements Rs. 80,000 taken to Reserve Account in the balance sheet. Give reasons for the additions or deletions suggested.*

SOLUTION :

	Rs.
Net profit as per P & L account	7,50,000
Add : Tax paid on behalf of foreign collaborator	(+) 30,000
Add : Commission in violation of foreign exchange regulation (not deductible since it is illegal expenditure of an otherwise legitimate business)	(+) 40,000
Add : Contribution to political parties	(+) 1,00,000
Add : Surtax	(+) 25,000
Add : Interest for belated payment of tax	(+) 8,000
Add : Money realised on sale of import entitlements—see *CIT* v. *Ashoka Lungi* Co. [1979] 120 ITR 413 (Mad.).	(+) 80,000
Gross total income	10,33,000
Less : Deduction under section 80GGB in respect of donation to political party	1,00,000
Net income	9,33,000

Note : Insurance compensation, being a capital receipt, is not taxable. It can be taxed under section 45(1A) read with section 50. For the purpose of section 48, Rs. 2 lakh shall be taken as sale consideration. On the assumption that the depreciated value of the block is more than Rs. 2 lakh on April 1, 2008, nothing is taxable under section 50 [read with sections 45(1A) and 48]. Moreover, it cannot be deducted from the value of block of assets since machinery is only damaged and after repairing the same is recommissioned—*CIT* v. *Sirpur Paper Mills Ltd.* [1978] 112 ITR 776 (SC) and section 45(1A) which states that insurance compensation is taken as full value of consideration received on transfer has no application while computing written down value of a block of assets under section 43(6).

338-P23 *The following information is available in respect of X Ltd. for the year ending March 31, 2009:*

During the year the company has —

1. *purchased wheat for its canteen from an agriculturist for Rs. 50,000 in cash ;*

2. *purchased a new plant costing Rs. 3,00,000 on deferred payment [interest payable for the period subsequent to the installation amounting to Rs. 1,00,000 has been capitalised] ;*

3. *purchased certain equipments to be used in its laboratory for research at a total cost of Rs. 1,50,000 ;*

4. *incurred Rs. 20,000 for digging a borewell which, however, did not yield any water ;*

5. *supplied spare parts to its customers (free of charge) under the warranty clause [the selling price of the spare parts so supplied is Rs. 1,80,000 and the cost is Rs. 1,20,000, no accounting entries in the financial books have been passed] ;*

6. *spent Rs. 70,000 towards training an employee in West Germany, the details are : air fare : Rs. 10,000 and daily allowance (@ $ 80 per day for 60 days) : Rs. 60,000 [in earlier years such expenditure has been disallowed on the ground that it is capital expenditure as well as in excess of the limits] ;*

7. *purchased a building to be exclusively used as a family planning centre for its employees at a cost of Rs. 5,00,000 ;*

8. *donated Rs. 10,00,000 to Prime Minister's National Relief Fund ; and*

9. *paid Rs. 30,000 as interest on loans borrowed for the purpose of paying instalments of advance tax. You are required to state how the above facts will be dealt with while computing the total income of the company.*

SOLUTION : The various items given in the problem will be dealt with in the following manner :

1. Where an assessee incurs any expenditure resulting in a payment exceeding Rs. 20,000, 100% of such expenditure is not allowed as a deduction while computing income from business if the payment has been made in cash or by bearer cheque or by a crossed cheque/draft [sec. 40A(3)]. But if any such payment has been made to purchase agricultural produce from an agriculturist, the above restriction does not apply even if the expenditure thereof exceeds Rs. 20,000 [rule 6DD(f)]. Therefore, the impugned expenditure cannot be disallowed under section 40A(3).

2. The amount of Rs. 1,00,000 being the interest relating to the period after installation of the machine cannot form part of actual cost in view of *Explanation 8* to section 43(1). However, the interest attributable to the period commencing from the date on which the asset is first put to use will be allowed as a deduction under section 36(1)(*iii*).

3. The expenditure of Rs. 1,50,000 on equipments to be used in the assessee's laboratory for research will be allowed as a deduction under section 35(1). No deduction is, however, admissible under section 32.

4. The expenditure has been incurred on capital account. There can be little doubt that had the well been successfully bored, it would have resulted in an addition to capital assets. The fact that the expenditure did not result in such addition would not alter the nature of the expenditure. This is a capital loss. As there is no transfer of a capital asset, such loss cannot be considered as a loss under the head "Capital gains"—*Fancy Corporation Ltd.* v. *CIT* [1986] 24 Taxman 155 (Bom.).

5. Supply of free spares during the warranty period is a normal incidence of business and, therefore, the cost of manufacturing of such spares is allowable as a deduction. The cost of manufacture of such spare parts has to be debited to profit and loss account. Since the company has not incurred any income profit of Rs. 60,000 is not chargeable to tax.

6. The amount of Rs. 70,000 is allowable as a revenue expenditure. Merely because in earlier assessment years such expenditure has been disallowed on the ground that it is capital expenditure, it does not mean that the Assessing Officer is bound to adopt the same view in the assessment year 2009-10. Air fare and daily allowance will be subject to fringe benefit tax.

7. One-fifth of capital expenditure incurred by a company-assessee for the purpose of promoting family planning amongst its employees is allowed as a deduction. Therefore, the company can claim Rs. 1,00,000 as deduction for the assessment year 2009-10. The balance of Rs. 4,00,000 is allowed in equal instalments in the assessment years 2010-11 to 2013-14.

8. Rs. 10,00,000 is deductible in full under section 80G.

9. Interest on money borrowed for paying income-tax is not deductible. The assessee cannot claim this expense under section 36 since the money is not borrowed for the purpose of business. Since payment of taxes is always considered as personal expenses, deduction is also not admissible under section 37.

338-P24 *The profit and loss account of X Ltd., a manufacturer of electronic goods, disclosed a profit of Rs. 80,00,000 for the year ending March 31, 2009 before making any appropriations for taxes, reserves or dividends. You are required to state, with reasons, how you will treat the following while computing its total income (computation of total income is not required) :*

1. *Interest debited to Profit and Loss account includes :*

- *Rs. 2,00,000 on a loan borrowed for redeeming preference shares.*
- *Rs. 8,00,000 on deposits accepted from the public.*

2. *The company acquired a sick business on January 1, 2006 in respect of the said business :*

- *A trade debtor went bankrupt. The company received Rs. 2,00,000 as against the book balance of Rs. 5,00,000.*

- *A trade creditor to whom a sum of Rs. 1,40,000 is payable as on January 1, 1998 is not traceable.*
- *A development loan of Rs. 10,00,000 granted by the State Government has been waived to the extent of 20 per cent.*

The company has considered the above as revenue and accordingly adjusted its accounts by debiting or crediting the profit and loss account as the case may be.

3. The company has paid a lump sum amount of Rs. 30,00,000 to acquire technical know-how from a laboratory owned by the Government in September 2008. This is being treated as a deferred revenue expenditure and a sum of Rs. 5,00,000 has been charged off to Profit and Loss account.

4. Details of sales :

Domestic sales : Rs. 8,00,000

Export to U.S.A. : Rs. 2,00,000

It is ascertained that the export price is less by 20 per cent when compared to the normal domestic price.

5. The company has paid an annual remuneration of Rs. 3,00,000 to its production manager who retired in 2004-05 for supervising the erection of a new plant. This amount has been debited to capital work-in-progress.

6. The company has collected charity at 0.1 per cent of its domestic sales. It has spent Rs. 30,000 on charity during the year and the balance is being shown as a liability.

7. The audit fees debited to Profit and Loss account include Rs. 10,000 for appearing before the Assessing Officer, and Rs. 20,000 for conducting the tax audit.

SOLUTION : The tax treatment of the different items given in the problem for the assessment year 2009-10 is given below :

1. Interest paid on amount borrowed for purposes of redeeming preference share capital is to be considered as interest paid on capital borrowed for the purpose of the business of X Ltd. Therefore, the company is entitled to the deduction under section 36(1)(*iii*). No adjustment is necessary as the company has already debited the interest to the profit and loss account.

Interest on public deposits is fully deductible.

2. The Supreme Court has held in *CIT* v. *T. Veerabhadra Rao, K. Koteswara Rao & Co.* [1985] 155 ITR 152 that a successor to a business will be entitled to claim an allowance for bad debts under section 36(1)(*vii*) read with section 36(2), even though the debt did not relate to the business of the assessee, but to the business it has succeeded. The Court held that even if the debt had been taken into account in computing the income of the predecessor only and had subsequently been written off as irrecoverable in the accounts of the successor, the latter would be entitled to avail a deduction of the amount written off as a bad debt. It is not imperative that the assessee referred to in section 36(2)(*i*) must necessarily mean the identical assessee referred to in section 36(1)(*vii*). Assuming that the company has written off in its accounts Rs. 3,00,000, it has rightly claimed the same as bad debts. No adjustment is, therefore, necessary.

The writing back of a trade credit on the ground that the creditor is not traceable is chargeable to tax under section 41(1).

The waiver of a development loan by the State Government is not to be considered as income chargeable to tax. Moreover, the development loan does not represent an expenditure allowed as deduction to the assessee.

Therefore, Rs. 2,00,000 is not chargeable to tax and, consequently, it has to be deducted from the profit.

3. Section 35AB provides deduction in respect of lumpsum expenditure on technical know-how. It is applicable up to the assessment year 1998-99. From the assessment year 1999-2000, one may claim depreciation on technical know-how under section 32 @ 25%.

Therefore, X Ltd. is entitled to Rs. 7,50,000 [*i.e.*, Rs. 30,00,000 @ 25%] as depreciation. Since Rs. 5,00,000 has already been claimed as deduction, Rs. 2,50,000 should further be charged to Profit and Loss Account.

4. No deduction under section 80HHC is now available.

5. The remuneration paid to a former employee is not claimed by the assessee as an expenditure and has been debited to capital work-in-progress and, therefore, no disallowance can be made. In other words, no adjustment is necessary.

6. Charity collected by an assessee on a percentage of its sales price is not a trading receipt—*CIT* v. *Bijli Cotton Mills (P.) Ltd.* [1979] 116 ITR 60 (SC). The assessee is, however, under an obligation to utilise it exclusively for charitable purposes and it is implied that a trust has come into existence. The assessee has rightly treated the receipt as a capital receipt and hence no adjustment is necessary.

7. It is deductible.

338-P25 *X Ltd., a manufacturing company, retains you to assist in preparing the tax return for assessment year 2009-10. The company earns a net profit of Rs. 6,00,000, in the financial year 2008-09. You are required to compute its total income after taking note of the following :*

1. *2008-09 sales of Rs. 5 crore include exports of Rs. 50 lakh (goods imported Rs. 55 lakh).*
2. *Other income credited to profit and loss account, inter alia, include :*
   - *Rs. 35,000 received on termination of a contract entered into in the ordinary course of business.*
   - *Rs. 25,000 realised as penalty from a supplier of raw material whose supply fell short of the agreed quantity contracted to be supplied by him.*
   - *Rs. 50,000 being dividends received from a foreign company on shares allotted in pursuance of a collaboration agreement.*
3. *Interest debited to profit and loss account is inclusive of :*
   - *Payment of interest for late filing of return of income for the assessment year 2008-09 : Rs. 5,000.*
   - *Payment of interest on money borrowed from bank for purchase of land for constructing a building for own administrative office : Rs. 55,000.*
   - *Payment of interest on overdraft with bank utilised for payment of dividends : Rs. 40,000.*
4. *Repairs and maintenance include :*
   - *Expenditure incurred on replacement of worn out asbestos sheets of the factory shed with new sheets : Rs. 30,000.*
   - *Repairs to compound wall collapsed due to heavy rains : Rs. 25,000.*
5. *Salaries and staff welfare include :*
   - *Expenditure of capital nature incurred for the purpose of promoting family planning amongst its employees : Rs. 75,000.*
   - *Contribution to Government for construction of health centre adjacent to the company's factory where its employees are allowed to have treatment along with the members of public : Rs. 35,000.*
   - *Salary of foreign technicians retained on contract basis to study and suggest improved method of production : Rs. 80,000.*
6. *Legal expenses debited include :*
   - *The managing director, the manager and the company were jointly and severally prosecuted by the Government for breach of regulations and for lack of conformity to manufacturing regulations laid down by the Government. The company defended itself and its employees. The prosecution resulted in the company being found guilty while the others were acquitted. Legal expenses incurred in this regard : Rs. 7,000.*
   - *Expenses incurred in defending a suit filed by some shareholders against change in the Articles of Association : Rs. 8,000.*
7. *Trade expenses include :*
   - *Expenditure incurred on payment of secret commission to persons whose names and addresses are not available on records : Rs. 80,000.*
   - *Demurrage to the Indian railways for not clearing the goods in time : Rs. 8,000.*
8. *General expenses include :*
   - *Entertainment expenses : Rs. 10,000.*
   - *Cost of a statue of the founder-chairman erected within the factory premises : Rs. 15,000.*
9. *The company decided to close one of its divisions and accordingly retrenched employees working in that division by paying the retrenchment compensation and notice pay of Rs. 90,000 (separately debited to profit and loss account).*

The answer should clearly indicate the reasons for the treatment accorded by you to the various items given above.

SOLUTION :

	Rs.
Profit as per Profit and loss account	6,00,000
Adjustment	
Amount received on termination of contract is a trading receipt, no adjustment is necessary	—
Penalty realised for shortfall in supply of raw material is a trading receipt—*CIT* v. *Saraswati Industrial Syndicate Ltd.* [1982] 136 ITR 366 (Punj. & Har.)	—

	Rs.
Dividend income is taxable separately	(-)50,000
Interest payment for late filing of return is not deductible	(+)5,000
Interest paid on money borrowed for acquiring a business asset is a business expenditure—*CIT* v. *J.K. Industries (P.) Ltd.* [1980] 125 ITR 218 (Cal.)	—
Interest on overdraft utilised for payment of dividend is an allowable expenditure under section 36(1)(*iii*)—*CIT* v. *Sri Changdeo Sugar Mills Ltd.* [1983] 143 ITR 469 (Bom.)	—
Expenditure on replacement of worn out sheet is deductible expenditure	—
Expenditure on repairs to compound wall is deductible expenditure	—
Capital expenditure on family planning (1/5 of such expenditure is deductible in 5 years)	(+)60,000
Contribution to Government for construction of health centre is deductible—*CIT* v. *Rupsa Rice Mills* [1976] 104 ITR 249 (Ori.)	—
Payment made to suggest improved method of production is deductible—*CIT* v. *Aluminium Corpn. of India Ltd.* [1973] 92 ITR 563 (Cal.)	—
Legal expenses incurred for defending alleged offence of infringement of manufacturing regulations are allowable	—
Expenses incurred in defending suit against changes made in articles is allowable—*CIT* v. *Muir Mills Co. Ltd.* [1980] 123 ITR 534 (All.)	—
Secret commission payment is not allowable as deduction in absence of appropriate evidence to prove the actual incurring of expenditure—*CIT* v. *Moolchand Jai Kishandas & Co.* [1977] 108 ITR 500 (Guj.), *Chemaux (P.) Ltd.* v. *CIT* [1977] 109 ITR 705 (Bom.), *Goodlas Nerolac Paints Ltd.* v. *CIT* [1982] 137 ITR 58 (Bom.)	(+)80,000
Demurrage is an allowable expenditure	—
Entertainment expenditure [deductible under section 37(1)]. However, fringe benefits tax is applicable.	—
Cost of erecting the statue of the founder-chairman is not allowable—*Saru Smelting & Refining Corpn.* v. *CIT* [1979] 116 ITR 766 (All.)	(+)15,000
Retrenchment compensation and notice pay at the time of closure of one of the units of the business is allowable ; such expenses are not deductible if the entire business is closed— *Sassoon J. David & Co. (P.) Ltd.* v. *CIT* [1979] 118 ITR 261 (SC)	—
Business income	7,10,000
Dividends from foreign company	50,000
Gross total income	7,60,000
Less : Deductions under sections 80C to 80U	*Nil*
Net income	7,60,000

338-P26 *ABC Ltd. is an Indian company engaged in the business of manufacture and sale of engineering goods. Its net profit for 2008-09 is Rs. 20,000. The following are the other particulars :*

1. *Debits to profit and loss account include :*

a. *penalty paid for default in payment of sales tax : Rs. 10,000 ;*

b. *cost of machinery purchased and installed during the year : Rs. 5,000 ;*

c. *cost of imported motor car : Rs. 2,40,000 and depreciation thereon : Rs. 48,000 ;*

d. *rent for premises hired at Delhi for the stay of the company's employees when on tour for purposes of business : Rs. 10,000 ;*

e. *foreign tour expenses of executive director and his wife : Rs. 50,000 (the expenses of the wife are estimated at Rs. 24,000, the tour was undertaken for promotion of exports and the director being a diabetic patient, it became necessary, under medical advice, for his wife to accompany him for the purpose of attending on him) ;*

f. *annual premium paid for personal accident insurance policy taken by the company for its staff : Rs. 10,000 ;*

g. *interest on deposits received by the company from public : Rs. 30,000 ;*

h *security deposit paid for telex connection : Rs. 10,000 ;*

i. *interest paid on money borrowed from bank for purchase of shares in P. Inc., a company incorporated in New York : Rs. 10,000 ;*

j. *salary, etc., paid to B, the executive director ;*
   i. *salary : Rs. 72,000*
   ii. *commission on sales : Rs. 30,000*
   iii. *house rent allowance : Rs. 25,000*
   iv. *travel concession for self and wife in connection with his proceeding on leave to his home district : Rs. 5,000*
   v. *rent for office premises of the company owned by the director : Rs. 12,000 ;*

k. *salary, etc., paid to Y, an accounts officer : salary : Rs. 75,000, bonus : Rs. 18,000, house rent allowance : Rs. 2,400, special allowance : Rs. 5,000.*

l. *depreciation of plant purchased during 2008-09 : Rs. 4,00,000 (i.e., normal depreciation @ 33.33 per cent of cost of Rs. 12,00,000).*

2. *Credits to profit and loss account includes dividend received from P. Inc., a foreign company : Rs. 50,000.*

3. *Following items were credited to "capital reserve account" during the year :*

- *The assessee-company has purchased a plant on June 3, 1988 for Rs. 2,50,000 for its research laboratory and claimed a deduction of Rs. 2,50,000 under section 35(2)(ia). The research activity for which the machine is purchased ceases in 2006-07 and the machine is brought into business proper on November 1, 2007 (market value : Rs. 1,30,000). The machine is sold for Rs. 1,50,000 on April 4, 2008 Rs. 1,50,000 is credited to capital reserve account.*
- *The assessee-company has purchased a machine on December 1, 1988 for Rs. 3,00,000 and claimed a deduction of Rs. 3,75,000 (being 1.25 of Rs. 3,00,000) under section 35(2B), as the machine was meant for an approved in-house research activity. The particular research activity for which the machine was purchased ceases on November 1, 2008 and the machine is sold, without being used for any other purpose on December 19, 2008 for Rs. 2,00,000. This amount is credited to capital reserve account on the same day.*

The profit of Rs. 20,000 is calculated before deducting income-tax liability.

You are required to compute the total income of the company for the assessment year 2009-10. Give reasons for the adjustments that you make in the net profits.

SOLUTION :

		Rs.
Profit as per profit and loss account		20,000
Add : Inadmissible debits	*Rs.*	
Penalty paid for default in payment of sales tax is not admissible deduction	10,000	
Cost of machinery purchased and installed during the year is eligible for depreciation	5,000	
Cost of car is inadmissible being an expenditure of capital nature ; depreciation on car manufactured outside India is, however, deductible	2,40,000	
Rent of premises hired at Delhi treated as guest house is admissible	—	
Foreign tour expenses of the wife of director not admissible as sickness is personal to director having nothing to do with the company's business	24,000	
Premium paid for personal accident insurance policy taken by the company for its staff members is an admissible deduction	—	
Security deposit for telex connection allowed as deduction *vide* Circular No. 420, dated June 4, 1985	—	
Interest on money borrowed for purchase of shares to be considered separately	10,000	
Depreciation (*i.e.*, Rs. 4,00,000, being amount debited to P and L Account, *minus* Rs. 1,58,250, being the amount deductible under section 32—see Note *infra*)	2,41,750	5,30,750
		5,50,750
Deduct : Dividend considered separately		50,000
		5,00,750
Add : Receipts includible in total income		
Surplus arising on sale of machine of Rs. 1,50,000 is not includible under section 41(3) as this section covers that asset which is sold without having been used for any other purpose	—	

	Rs.	Rs.
Surplus arising on sale of machine on December 19, 2008 is taxable under section 41(3), as it is sold without being used for any other purpose. Amount taxable is Rs. 2,75,000 [*i.e.*, excess of sale price and deduction allowed under section 35(2B) over capital expenditure]	2,75,000	2,75,000
Income from business		7,75,750
Income from other sources		
Dividend from a foreign company	50,000	
Less : Interest on borrowings for purchase of shares	10,000	40,000
Gross total income		8,15,750
Less : Deductions under sections 80C to 80U		*Nil*
Net income (rounded off)		8,15,750
Note : Depreciation is calculated as under :		
Depreciated value of plant on April 1, 2007		*Nil*
Add : Actual cost of plant transferred from research laboratory on November 1, 2007 [sec. 43(1), *Expln. 1*]		*Nil*
Written down value of plant on March 31, 2008		*Nil*
Depreciation for 2007-08		*Nil*
Depreciated value of plant on April 1, 2008		*Nil*
Add : Actual cost of plant acquired during 2008-09 (*i.e.*, Rs. 12,00,000 + Rs. 5,000)		(+)12,05,000
Less : Sale price of plant (transferred from research laboratory) sold on April 4, 2008		(-)1,50,000
Written down value on March 31, 2009		10,55,000
Depreciation for 2008-09 (*i.e.*, 15% of Rs. 10,55,000)		1,58,250

338-P27 *X Ltd., an Indian company, discloses a profit of Rs. 40,00,000 for the year 2008-09 and the following further particulars are also made available :*

1. *The closing stock of the finished goods has uniformly been valued at 10 per cent under cost every year. The opening and closing stocks for the year were shown in the books at Rs. 56,00,000 and Rs. 83,00,000, respectively.*

2. *The book depreciation amounts to Rs. 15,00,000. For tax purposes depreciated value of block of assets on April 1, 2008 is Rs. 75,00,000 (rate of depreciation : 15 per cent).*

3. *The undernoted debits appear in the Profit and Loss Account :*

- *Loss on sale of fixed assets : Rs. 1,25,000.*
- *Transfer to investment allowance reserve account : Rs. 3,00,000, new machine was acquired during the year (i.e.,* during April) *at a cost of Rs. 16,00,000 and brought into use within a week (rate of depreciation : 15 per cent).*

4. *The salaries include gratuity of Rs. 80,000 paid to a retired employee in accordance with the rules and payment of Rs. 1,35,000 to the managing director by way of salary and commission as permitted by the Company Law Board. The managing director was provided with a house owned by the company for which depreciation of Rs. 25,000 and repairs expenses of Rs. 20,000 were claimed. The repairs expenses are included in the Profit and Loss Account under the head "Repairs to buildings". The managing director was also reimbursed the salary of Rs. 2,400 paid for a gardener and of Rs. 3,600 paid for a domestic servant. The expenses are charged to "Miscellaneous expenses".*

5. *During the year plant and machinery of book written down value of Rs. 2,00,000 was sold for Rs. 75,000. The written down value for income-tax was Rs. 1,20,000.*

6. *There is a credit of Rs. 5,00,000 to the Profit and Loss Account as being sale proceeds of import entitlements which the company claims as a capital receipt not chargeable to income-tax.*

7. *"Interest account" includes a sum of Rs. 35,000 charged by the Provident Fund Commissioner for delay in depositing the members as well as the company's contribution.*

Compute the total income of the company on the basis of the abovenoted information giving your reasons wherever necessary.

SOLUTION :

	Rs.
Profit as per P and L A/c	40,00,000
Add : Expenses not deductible and other items of adjustments	
One-ninth of difference between opening and closing stock (to bring them at cost)	3,00,000
Depreciation considered separately	15,00,000
Loss on sale of fixed asset (considered separately)	1,25,000
Transfer to "Investment allowance reserve account"	3,00,000
Gratuity paid to retired employee (fully deductible)	—
Total	62,25,000
Less : Depreciation [see Note 1]	16,73,750
Total income	45,51,250

Notes :

1. Computation of depreciation allowance

Depreciated value of block of assets on April 1, 2008	75,00,000
Add : Cost of machine acquired during the year	16,00,000
	91,00,000
Less : Sale proceeds of machine sold during the year	75,000
Written down value	90,25,000
Depreciation @ 15% of Rs. 90,25,000	13,53,750
Additional depreciation (20% of Rs. 16 lakh)	3,20,000

2. Sale proceeds of import entitlements arise from the business simultaneously with the export of goods. The sale of the rights gives rise to profits or gains taxable under section 28(*iiia*). As the amount has already been credited to Profit and Loss Account, no further adjustment is necessary.

3. Interest charged by Provident Fund Commissioner for delay in depositing contribution cannot be equated with penalty payable for infraction of law. It is a kind of damage for default in performance of an obligation. Hence it is deductible as business expenditure.

338-P28 *A State Industrial Development Corporation recommends a project in a backward State to your client. The estimated outlay is about Rs. 10 lakh of which your client will have to borrow Rs. 5 lakh which will be lent by State financial institutions at 14 per cent interest. Sales tax and energy concessions are available. The project will qualify for relief under section 80-IB. If the annual income expected to be generated is Rs. 1.5 lakh per annum prior to deduction of interest on borrowed capital and allowances under section 80-IB, advise your client as to the advisability of accepting the project with reasons. Make suitable assumptions.*

SOLUTION : While evaluating the proposed project, the following assumptions are made :

- The client is a company, in which the public are not substantially interested.
- The cost of plant and machinery constitutes 60 per cent of the total outlay.
- The annual income of Rs. 1.5 lakh is calculated after making provisions for depreciation and after considering sales tax and energy concessions.
- Provisions of section 80-IB will continue for the next 10 years.
- The first assessment year is 2009-10.
- Tax rates on companies applicable for the assessment year 2009-10 and provision of section 115JB will continue.

On the basis of the above assumption, after-tax income of next 11 years would be as follows :

Assessment years 2009-10 to 2013-14

	Rs.
Expected return	1,50,000
Less : Interest	70,000
Gross total income	80,000
Less : Deduction under section 80-IB (100% of Rs. 80,000)	80,000
Net income	*Nil*

	Rs.
Assessment years 2014-15 to 2016-17	
Expected return	1,50,000
Less : Interest	70,000
Gross total income	80,000
Less : Deduction under section 80-IB [30% of Rs. 80,000]	24,000
Net income	56,000
Assessment year 2019-20	
Gross total income	80,000
Less : Deduction under section 80-IB (*not available since 10-year time-limit is expired)	—*
Net income	80,000

The following chart highlights disposable income and maximum rate of dividends :

Assessment years	Taxable income Rs.	Tax† [illegible] 30% Rs.	Income after tax i.e., Rs. 80,000 minus tax Rs.	[illegible]
2009-10 to 2013-14	*Nil*	8,240	71,760	14.35%
2014-15 to 2018-19	56,000	17,304	62,696	12.54%
2019-20	80,000	24,720	55,280	11.06%

The rate of return on shareholder's funds is on declining trend—it is below 15% in first 5 years and below 13% in the next 5 years and 11% after the expiry of 10 years. Thus, rate of return is not satisfactory. Moreover, the company will need funds for replacement of plant and machinery and repayment of loan of Rs. 5,00,000 taken from State financial institutions. From this it is clear that the company will find it difficult to honour these commitments. In view of the lower rate of return, it does not appear to be worthy of acceptance.

†Tax is 30 per cent income-tax of taxable income or 10 per cent of book profit [under section 115JB] whichever is more. Minimum tax liability is 10 per cent of book profit of Rs. 80,000. Surcharge, education cess and secondary and higher education cess is considered.

CHAPTER SEVENTEEN

Assessment of co-operative societies

Meaning of co-operative society [Sec. 2(19)]

339. Co-operative society means a society registered under the Co-operative Societies Act, 1912, or under any other law for the time being in force in any State for the registration of co-operative societies.

A regional rural bank (to which provisions of the Regional Rural Banks Act, 1976, apply) is deemed as co-operative society—Circular No. 319, dated January 11, 1982.

Taxable income and tax liability - How computed

340. It is determined as follows—

1. First ascertain income under different heads of income.

2. Income of other persons may be included in the income of the co-operative societies under sections 60 and 61 [*see* paras 206 and 207].

3. Current and brought forward losses should be adjusted according to the provisions of sections 70 to 80 [*see* paras 226 to 233].

4. The total of income so computed under different heads is gross total income.

5. From the gross total income so computed, the following deductions are permissible under sections 80C to 80U—

Section	*Nature of deduction*
80G	Donations to charitable institutions and funds [*see* para 242]
80GGA	Donations for scientific research or rural development [*see* para 244]
80GGC	Contributions to political parties [*see* para 246]
80-IA	Profits and gains from industrial undertakings engaged in infrastructure, etc. [*see* para 253]
80-IAB	Profits and gains by an undertaking or enterprise engaged in development of Special Economic Zone [*see* para 253A]
80-IB	Profits and gains from certain industrial undertakings other than infrastructure development undertakings [*see* para 254]
80-IC	Profits and gains of certain undertakings in certain States [*see* para 255]
80-ID	Profits of hotels and convention centres [para 255A]
80-IE	Profits of undertakings in North-Eastern States [*see* para 255B]
80JJA	Profits from the business of collecting and processing of bio-degradable waste [*see* para 256]
80P	Income of co-operative society [*see* para 341]

The resulting sum is net income.

340.1 ***Tax liability - How calculated*** - Tax is computed as follows :—

1. Find out income-tax on net income [tax rates are given in Annex 1].

2. Add: Education cess @ 2% of (*1*).

3. Add: Secondary and higher education cess @ 1% of (*1*)

4. Find out (*1*) + (*2*) + (*3*).

5. Less : Rebate under sections 86, 90, etc.

Deduction in respect of co-operative societies [Sec. 80P]

341. The following are deductible by virtue of section 80P—

341.1 ***Income of banking business [Sec. 80P(2)(a)(i)]*** - In the case of a co-operative society providing credit facilities to its members, the whole of the amount of profits and gains from such business are deductible. From the assessment year 2007-08, deduction under section 80P will not be available to any co-operative bank. A primary agricultural credit society or a primary co-operative agricultural and rural development bank will continue to claim the benefit of deduction under section 80P.

341.1-1 *PROVIDING CREDIT FACILITIES TO MEMBERS* - The expression 'facilities' used in the provision is an inclusive term of wide import embracing anything which aids or makes easier the performance of a duty—*Andhra Pradesh Co-op. Central Land Mortgage Bank Ltd.* v. *CIT* [1975] 100 ITR 472 (AP). The expression 'providing credit facilities' would comprehend not only the business of lending money on interest but also the business of lending services for guaranteeing payments—*CIT* v. *U.P. Co-op. Cane Union Federation Ltd.* [1980] 122 ITR 913 (All.).

When section 80P(1)(*a*)(*i*) refers to a co-operative society engaged in providing credit facilities to its members, it really refers to a credit society whose primary object is to provide loans or other credit facilities to its members; it does not include any society whose primary object is something other than the provision of loans or other credit facilities, such as a consumer co-operative society—*Rodier Mill Employees' Co-op. Stores Ltd.* v. *CIT* (*supra*).

■ *Members - Meaning of* - In section 80P(2)(*a*)(*i*) when Parliament has used the expression "members", it has used it in the normal sense of a member of a co-operative society. The intention was to extend the exemption to co-operative societies directly extending credit facilities to its members. There is nothing in the said provisions to show that the intention was to grant exemption to co-operative societies which were extending credit facilities to the person, who, though not the members of the said society, were members of another co-operative society which was a member of the co-operative society seeking exemption. The meaning of the expression "members" cannot, therefore, be extended to include the members of a primary co-operative society which is a member of the federated co-operative society seeking exemption—*U.P. Co-operative Cane Union Federation Ltd.* v. *CIT* [1999] 237 ITR 574/103 Taxman 376 (SC).

A few instances of income held/not held as deductible under section 80P(2)(*a*)(*i*) are given below—

■ *Selling goods on credit* - The facility of selling goods on credit to members is an activity of business of selling of goods, of which the credit facility is only an incidence; it will not amount to providing credit facilities in the nature of the business of banking so as to amount to carrying on the business of banking or providing credit facility to its members—*CIT* v. *Co-operative Supply & Commission Shop Ltd.* [1993] 204 ITR 713 (Raj.), *CIT* v. *Kerala State Co-operative Marketing Federation Ltd.* [1998] 234 ITR 301 (Ker.).

■ *Chit fund* - Conducting chit fund amounts to providing credit facilities—*CIT* v. *Kottayam Co-operative Bank Ltd.* [1974] 96 ITR 181 (Ker.).

■ *Hire-purchase* - Selling goods on hire-purchase basis does not amount to providing credit facilities—*CIT* v. *Madras Autorickshaw Drivers' Co-operative Society Ltd.* [1983] 143 ITR 981 (Mad.).

■ *Service charges for loan arrangement* - Where the assessee-society had been carrying on business of providing facilities to its members for obtaining fertilizers, etc., as also arranging loans from bank by giving certificates about cultivated land, etc., for which certain amount was charged as service charges, such service charges received by the assessee would not be eligible for deduction under section 80P(2)(*a*)(*i*)—*CIT* v. *Anakapalli Co-op. Marketing Society Ltd.* [2000] 111 Taxman 702/245 ITR 616 (AP).

341.2 ***Cottage industry [Sec. 80P(2)(a)(ii)]*** - In the case of a co-operative society engaged in cottage industry, the whole of the amount of profits attributable to such activity are deductible under section 80P(2)(*a*)(*ii*).

341.2-1 *WHAT IS A COTTAGE INDUSTRY* - What constitutes a "cottage industry" has been the subject-matter of discussion in a number of cases decided by various courts. Based on the ratio of these decisions, a co-operative society engaged in cottage industry is required to satisfy the following criteria for availing of the benefits under section 80P(2)(*a*)(*ii*)—

a. a cottage industry is one which is carried on in a small scale with a small amount of capital and a small number of workers and has a turnover which is correspondingly limited;

b. it should not be required to be registered under the Factories Act;

c. it should be owned and managed by the co-operative society;

d. the activities should be carried on by the members of the society and their families [for this purpose, a family would include self, spouse, parents, children, spouses of the children and any other relative who customarily lives with such a member. Outsiders (*i.e.*, persons other than members and their families) should not work for the society. In other words, the co-operative society should not engage outside hired labour. [However, it has certain exceptions];

e. a member of co-operative society means a shareholder of the society;

f. the place of work could be an artisan shareholder's residence or it could be a common place provided by the co-operative society;

g. the cottage industry must carry on activity of manufacture, production or processing; it should not be engaged merely in trade, *i.e.*, purchase and sale of the same commodity.

In the case of a weaver's society, so long as weaving is done by the members of the society at their residences or at a common place provided by the society, without any outside labour, such a society will be eligible for deduction under section 80P(2)(*a*)(*ii*) even if certain payments have been made to outside agency for dyeing, bleaching, transport arrangements, etc., provided it satisfies all other conditions necessary for availing deduction under section 80P(2)(*a*)(*ii*)—Circular No. 722, dated September 19, 1995.

■ *There should be no hired labour* - A cottage industry is one which is carried on by the artisan himself using his own equipment with the help of the members of the family. It is the family unit which provides the labour force. The idea of cottage industry is alien to the deal of industry where hired labour is engaged and the relationship of employer and employee exists—*Distt. Co-op. Development Federation Ltd.* v. *CIT* [1973] 88 ITR 330 (All.). It has been held by the Kerala High Court that where members of the assessee, a co-operative society, were artisans weaving handloom cloth and workers were carrying out work in thatched shed belonging to the assessee, where looms were kept, the assessee was engaged in a cottage industry and was entitled to relief under section 80P(2)(*a*)(*ii*).

■ *Members forming a family are eligible* - A co-operative society can be regarded as a family consisting of its members and the premises belonging to the society can be regarded as its home or cottage—*CIT* v. *Chichli Brass Metal Workers Co-op. Society Ltd.* [1978] 114 ITR 720 (MP).

■ *There must be industrial activity* - Before it can be said that a co-operative society is engaged in an industry, it is necessary that there must be an activity relating to an industry. An industry obviously implies manufacture of certain articles and it cannot embrace a business of mere purchase and sale of goods—*CIT* v. *Indian Co-operative Union Ltd.* [1982] 134 ITR 108 (Delhi).

■ *Coir marketing* - An apex society for coir marketing cannot be said to be engaged in regard to any affairs of cottage industry so as to be entitled to deduction under section 80P(2)(*a*)(*ii*)—*CIT* v. *Quilon Central Coir Marketing Co-operative Society Ltd.* [1998] 229 ITR 348 (Ker.).

■ *Manufacture through primary societies* - The assessee-society had the power to direct, supervise and control over the manufacturing of cloth through the primary societies which were the members of the assessee-society. Members of the primary societies ran cottage industries in their houses. In

these circumstances, it could not be said that the assessee-society was not engaged in the manufacturing activities carried out by the weavers. The weavers got the raw material, *i.e.*, yarn through their primary societies, but thereafter weaving charges were paid by the assessee and it purchased the cloths through primary societies—*CIT* v. *Rajasthan Rajya Bunker Sahakari Sangh Ltd.* [2002] 124 Taxman 135 (Raj.).

341.2-2 *PROFITS ATTRIBUTABLE TO COTTAGE INDUSTRY ARE DEDUCTIBLE IN ENTIRETY* - Expression 'whole of the amount of profits and gains of business attributable to any one or more of such activities' indicates that deduction under section 80P(2)(*a*) is to be given to the extent of whole of profit attributable to cottage industry without deducting therefrom any loss arising in any other activity—*CIT* v. *Agency Marketing Co-operative Society Ltd.* [1993] 201 ITR 881 (Ori.).

341.3 ***Marketing agricultural produce [Sec. 80P(2)(a)(iii)]*** - The whole of the amount of profits attributable to the marketing of agricultural produce grown by the members of society is deductible under section 80P(2)(*a*)(*iii*).

341.3-1 *'MARKETING' - MEANING OF* - 'Marketing' is an expression of wide import, and it generally means 'the performance of all business activities involved in the flow of goods and services from the point of initial agricultural production until they are in the hands of the ultimate consumer'. The marketing functions involve exchange functions such as buying and selling physical functions such as storage, transportation, processing and other commercial functions such as standardization, financing, market intelligence, etc.—*CIT* v. *Ryots Agricultural Produce Co-op. Marketing Society Ltd.* [1978] 115 ITR 709 (Kar.), *Meenachil Rubber Marketing & Processing Co-operative Society Ltd.* v. *CIT* [1992] 193 ITR 108 (Ker.), *CIT* v. *Karjan Co-op. Cotton Sale Ginning & Pressing Society Ltd.* [1981] 129 ITR 821 (Guj.).

341.3-2 *OTHER POINTS* - The question regarding entitlement of apex marketing society to exemption of income from marketing of agricultural produce under section 80P(2)(*a*)(*iii*), is a question of law—*CIT* v. *Haryana State Co-operative Supply & Marketing Federation Ltd.* [1995] 80 Taxman 330 (Punj. & Har.).

■ *Manufacture of sugar* - Where the assessee, a co-operative society, incorporated for manufacture of sugar, purchased sugarcane from its members as well as non-members as well as a co-operative society and manufactured sugar to sell the same in open market to earn profit, since profit so derived was not on account of marketing of sugarcane of its members but was on account of manufacturing of sugar out of sugarcane purchased on its own account, deduction claimed under section 80P(2)(*a*)(*iii*) would not be available thereon to the assessee society—*Kamal Co-op. Sugar Mills Ltd.* v. *Dy. CIT* [1998] 66 ITD 521 (Delhi).

■ *Eggs are agricultural produce* - Poultry farming being an extended form of agriculture, eggs qualify to be treated as 'agricultural produce'—*CIT* v. *Mulkanoor Co-op. Rural Bank Ltd.* [1988] 173 ITR 629 (AP).

■ *Subsidy* - Amount of subsidy received by the assessee from National Co-operative Development Corpn. towards loss incurred on account of price fluctuation qualifies for deduction—*CIT* v. *Punjab State Co-operative Supply & Marketing Federation Ltd.* [1989] 46 Taxman 156/[1990] 182 ITR 58 (Punj. & Har.).

341.4 ***Purchase of agricultural implements [Sec. 80P(2)(a)(iv)]*** - Whole of income from the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for the purposes of supplying them to its members is deductible under section 80P(2)(*a*)(*iv*).

■ *Assessee must prove factum of purchase* - It is necessary that the assessee must prove that it has purchased certain articles, which means that it has acquired property in certain articles, and those articles have been sold to the members—*Vidarbha Co-op. Marketing Society Ltd.* v. *CIT* [1985] 156 ITR 422 (Bom.).

■ *Supply need not necessarily be to members* - Section 80P(2)(*a*)(*iv*) does not require that the supplies shall be made by the co-operative society only to members and to no one else—*CIT* v. *Guntur Distt.*

Co-op. Marketing Society Ltd. [1985] 154 ITR 799 (AP). However, deduction is not available under section 80P(2)(*a*)(*iv*) in respect of profit on sale of commodities to non-members—*CIT* v. *Vidarbha Co-operative Marketing Society Ltd.* [1995] 212 ITR 327 (Bom.).

■ *Apex society can also be a member* - The expression 'members' in section 80P(2)(*a*)(*iv*) cannot be restricted to either a member of a primary society or to an agriculturist alone—*CIT* v. *Tamil Nadu Co-op. Marketing Federation Ltd.* [1983] 144 ITR 744 (Mad.). Apex Society can also claim deduction.

■ *Coal* - Coal is not an article which can be described as an "article intended for agriculture"—*U.P. Co-operative Federation Ltd.* v. *CIT* [1972] 84 ITR 317 (All.).

■ *Cattle-feed* - It cannot be said that cattle-feed meant for livestock has no connection with agricultural operations and as such is outside the exemption contemplated under section 80P(2)(*a*)(*iv*)—*CIT* v. *Thudialur Co-operative Agricultural Services Ltd.* [1997] 143 CTR (Mad.) 362.

■ *Sale of fertilizers to members* - Where the assessee was a co-operative marketing federation registered under the Co-operative Societies Act, and it mainly dealt, *inter alia*, in general fertilizers, products from mixing units, etc., it would be entitled to deduction in respect of profit from sale of fertilizers to its members—*CIT* v. *Tamil Nadu Co-operative Marketing Federation Ltd.* [1999] 151 CTR (Mad.) 232.

■ *Irrigation* - Where the assessee undertook schemes to lift water from rivers known as Lift Irrigation Scheme and the water lifted by the assessee was supplied by it to its members for the purpose of cultivation, water being purchased by the assessee, the assessee would be entitled to deduction in respect of income from Lift Irrigation Scheme—*CIT* v. *Shetkari Sahakari Sakhar Karkhana Ltd.* [1999] 107 Taxman 532/238 ITR 983 (Bom.).

■ *Mixing pesticides* - By purchasing different kinds of manures and pesticides and mixing them up for the purpose of selling the same to the small farmers in retail, it cannot be said that the assessee is indulging in any manufacturing activity or processing of goods, so as to disentitle it to exemption under section 80P(2)(*a*)(*iv*)—*CIT* v. *Thudialur Co-operative Agricultural Services Ltd.* [1997] 143 CTR (Mad.) 362.

341.5 ***Processing of agricultural produce [Sec. 80P(2)(a)(v)]*** - Income from the processing (without the aid of power) of the agricultural produce of its members is deductible under section 80P(2)(*a*)(*v*).

341.6 ***Collective disposal of labour [Sec. 80P(2)(a)(vi)]*** - Income from the activity of collective disposal of the labour of its members is deductible under section 80P(2)(*a*)(*vi*).

This deduction is available only when the earning of the society is through the utilisation of the actual labour of its members. Thus, a society of engineers engaged in collective disposal of labour of members where actual supervision of work in field is done by paid employees, will not be entitled to exemption, since there is no direct connection between the work executed and the speciality of members of the society as engineers—*Nilagiri Engg. Co-op. Society Ltd.* v. *CIT* [1994] 208 ITR 326 (Ori.). Likewise, where not only members but also a large number of non-members were contributing collective disposal of labour and condition laid down in proviso to section 80P(2)(*a*)(*vi*) was not fulfilled, the assessee-society would not be entitled to exemption of its income—*Assessing Officer* v. *Ganesh Co-op. (L&C) Society Ltd.* [1998] 67 ITD 436 (Asr.).

341.6-1 ***RESTRICTION ON VOTING RIGHT*** - The aforesaid deduction is available subject to the conditions that the rules and bye-laws of the society restrict the voting rights to the following classes of its members—

a. individuals, who contribute their labour;

b. the co-operative credit societies which provide financial assistance to the society; and

c. the State Government.

■ *Persons not falling in specified categories can be members but they should have no right to vote* - If the co-operative society as specified in sub-clause (*vi*) wants to claim full deduction of the profits

made by it, persons other than those falling under the three specified categories can be members of the society, but they should not be given the right to vote and that fact should be clearly borne out from the rules and bye-laws restricting the right to vote only to members specified in the proviso—*Gora Vibhag Jungle Kamdar Mandali* v. *CIT* [1986] 161 ITR 658 (Guj.).

341.7 ***Fishing and allied activities [Sec. 80P(2)(a)(vii)]*** - The whole of the profits of a co-operative society engaged in fishing and allied activities are deductible under section 80P(2)(*vii*). Fishing and allied activities include the catching, curing, processing, preserving, storing or marketing of fish or the purchase of materials and equipment in connection therewith for the purpose of supplying them to its members.

341.7-1 *RESTRICTION ON VOTING RIGHT* - The deduction is available subject to the conditions that the rules and bye-laws of the society restrict the voting rights to the following classes of its members, *viz.*, the individuals who carry on the fishing or allied activities, the co-operative credit societies which provide financial assistance to the society and the State Government.

341.8 ***Primary society engaged in supply of milk, oil seeds, fruits, etc. [Sec. 80P(2)(b)]*** - If the following conditions are satisfied, then the whole of the amounts of profits and gains of a co-operative society are deductible under section 80P(2)(*b*).

1. The co-operative society is a primary society engaged in supplying milk, oil seeds, fruits or vegetables.

2. Milk, oil seeds, fruits or vegetables are grown or raised by its members.

3. Milk, oil seeds, fruits or vegetables are supplied to the following :

To whom milk, oil seeds, etc., are supplied	*Object of the society/company to whom milk, oil seeds, etc., are supplied*
■ A federal co-operative society	It must be engaged in the business of supplying milk, oil seeds, fruits or vegetables as the case may be.
■ The Government or a local authority	—
■ A Government company or a statutory corporation	The company/corporation must be engaged in the business of supplying milk, oil seeds, fruits, or vegetables as the case may be.

341.9 ***Income from other activities [Sec. 80P(2)(c)]*** - If a co-operative society is engaged in any other activity (either independently or in addition to those specified in paras 341.1 to 341.8), then the following amount is deductible under section 80P(2)(*c*) :

a. in the case of a consumer co-operative society (*i.e.*, a society for the benefits of consumers): Rs. 1,00,000; and

b. in any other case: Rs. 50,000.

341.9-1 *OTHER POINTS* - The following points should also be kept in view—

■ *Income derived from the activity of letting out* - Though income derived by the assessee co-operative housing society from letting out of shops to persons other than its members is not its primary activity, but being an activity in addition to its primary activity, it would fall within ambit of section 80P(2)(*c*), and, therefore, the assessee would be entitled to deduction in respect of profits and gains attributable to the activity of letting out of shops to non-members—*CIT* v. *Ratanabad Co-operative Housing Society Ltd.* [1995] 81 Taxman 257/215 ITR 549 (Bom.). This rule is applicable in the case of a co-operative society engaged in the business of letting out of building (maybe shops) even if such income is computed under the head "Income from house property"—***Film Nagar Co-operative Housing Society Ltd.*** v. ***ITO*** [2004] 91 ITD 27 (Hyd.) (SC). However, the same rule is not applicable if the society is not engaged in the letting out of buildings. For instance, where surplus land is given on rent, such income is not subject to deduction under section 80P(2)(*c*)—*Kottayam District Co-operative Bank Ltd.* v. *CIT* [1988] 172 ITR 443 (Ker.).

■ *Reserve fund* - A co-operative bank is legally obliged to invest part of deposit received from its members as reserve fund in Government securities. Generally, such reserve fund cannot be utilised as working capital and the same can be withdrawn only to meet losses or when the bank is wound up. Interest on such Government securities cannot be treated as essential part of banking activity as the same is not part of stock-in-trade or working/circulating capital. Such interest income is not fully deductible under section 80P(2)(*a*)(*i*), but deduction is available under section 80P(2)(*c*)—*Madhya Pradesh Co-operative Bank Ltd.* v. *CIT* [1996] 84 Taxman 640 (SC).

■ *Sugar mill* - Where the assessee a co-operative society running a sugar mill had not commenced any business of production of sugar and its activities undertaken were pre-operative activities, it was not entitled to deduction under section 80P(2)(*c*)—*National Co-operative Sugar Mills Ltd.* v. *CIT* [1998] 96 Taxman 352 (Punj. & Har.). *Karnal Co-operative Sugar Mills Ltd.* v. *CIT* [1998] 233 ITR 531 (Punj. & Har.).

■ *Consumer society* - A society supplying coal and diesel to its members, who are manufacturers of bricks and tiles, is not a "consumer" co-operative society. A "consumer society" means a registered society which has as its principal object the supply of the requirements of its members for the consumption of such members. Consumption does not include consumption of raw material for manufacturing purposes — ***Tamil Nadu Brick & Tile Mfrs. Industrial Service Co-operative Society Ltd.*** v. ***CIT*** [2003] 129 Taxman 343 (Mad.).

341.10 ***Interest/dividend [Sec. 80P(2)(d)]*** - The whole of interest and dividend income derived by a co-operative society from its investments in any other co-operative society is deductible under section 80P(2)(*d*).

■ Interest derived by the assessee co-operative sugar mill from its investment in co-operative bank would qualify for deduction in its entirety under section 80P(2)(*d*), without adjustment of interest paid by the assessee to the co-operative bank—*CIT* v. *Doaba Co-operative Sugar Mills Ltd.* [1998] 96 Taxman 509/230 ITR 774 (Punj. & Har.).

341.11 ***Letting of godowns [Sec. 80P(2)(e)]*** - The whole of the income derived by a co-operative society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities is deductible under section 80P(2)(*e*)—***CIT*** v. ***District Co-operative Federation*** [2004] 271 ITR 22 (All.). However, if the godown or warehouse is let for a purpose other than storage, processing or facilitating the marketing of commodities, the income derived therefrom by a co-operative society would not be deductible under section 80P—*CIT* v. *Ahmedabad Maskati Cloth Dealers Co-operative Warehouses Society Ltd.* [1986] 162 ITR 142 (Guj.).

341.11-1 OTHER POINTS - One should also keep in view the following—

■ *Commission for stocking goods* - Commission received by the assessee-society from State Government for stocking its goods in godown, would qualify for deduction under section 80P(2)(*e*)—*CIT* v. *Coimbatore District Central Co-op. Supply & Marketing Society Ltd.* 1995 Tax LR 1308 (Mad.). The commission received by the assessee, a co-operative society, from Food & Civil Supplies Corporation for procurement of paddy and rice and reimbursement of transport charges in relevant assessment year, was not eligible for deduction under section 80P(2)(*e*)—*Udupi Taluk Agricultural Produce Co-operative Marketing Society Ltd.* v. *CIT* [1987] 166 ITR 365 (Kar.).

■ *Shops* - Shops in which wholesale or retail business in cloth is carried on, cannot come within the meaning of 'godowns' or 'warehouses'—*CIT* v. *Ahmedabad Maskati Cloth Dealers Co-operative Warehouses Society Ltd.* [1986] 162 ITR 142 (Guj.).

■ *Incidental services* - Amount received for letting of godowns, where incidental services of taking delivery of stock at rail-head and transporting it to godowns are also rendered is wholly exempt—*CIT* v. *South Arcot District Co-operative Marketing Society Ltd.* [1989] 176 ITR 117/43 Taxman 328 (SC).

■ *Sole agent* - Where the assessee-co-operative society is appointed the sole agent and entrusted with the handling, distribution and sale of fertilizers and it received commission-*cum*-incidental charges, it is entitled to exemption only on that part of its income which is attributable to storage of fertilizers

in its godowns—*CIT* v. *J & K Co-operative Supply & Marketing Federation Ltd.* [1993] 204 ITR 289 (J & K).

341.12 ***Interest on securities/property income [Sec. 80P(2)(f)]*** - The whole of the interest income from securities and property income in the case of a co-operative society (other than housing society or an urban consumers' society or a society carrying on transport business or a society engaged in manufacturing operations with the aid of power) is deductible under section 80P(2)(*f*) provided the gross total income of such co-operative society does not exceed Rs. 20,000.

341.13 ***Consequences in the case of multiple deduction*** - Deduction under section 80P in respect of business income of a co-operative shall be available with reference to income after claiming deduction under sections 80HHB, 80HHC, 80HHD and 80-IA.

341.14 ***Other points*** - One should also keep in view the following—

❑ *Deduction is on net computed income and not on gross profits* - Co-operative society is entitled to deduction of exemption from income-tax payable by it only on its net profits and gains—*Sabarkantha Zilla Kharid Vechan Sangh Ltd.* v. *CIT* [1993] 203 ITR 1027 (SC).

❑ *Unabsorbed losses/depreciation should first be set off* - Deduction under section 80P should be allowed after set off of unabsorbed loss and unabsorbed depreciation of earlier years—*CIT* v. *Kotagiri Industrial Co-operative Tea Factory Ltd.* [1997] 91 Taxman 214/224 ITR 604 (SC).

❑ *Where income is partly exempt and partly taxable, proportionate share of expenses should only be allowed against taxable part* - Where a co-operative society was earning income which was partly taxable and partly entitled to special deduction, proportionate share of expenses attributable to earning income which was entitled to deduction should be deducted in computing such income—*Kota Co-operative Marketing Society Ltd.* v. *CIT* [1994] 207 ITR 608 (Raj.), *CIT* v. *Rajasthan Rajya Sahkari Upbhokta Sangh* [1995] 215 ITR 448 (Raj.).

❑ *Other activities* - A society is not disentitled from claiming exemption only because it also carries on the activities, income from which is not exempt—*CIT* v. *Nagpur Zilla Krishi Audyogik Sahakari Sangh Ltd.* [1994] 75 Taxman 399/209 ITR 481 (Bom.).

Problems on computation of income of a co-operative society

342-P1 *Bombay Suburban Co-operative Society, which is engaged in processing agricultural produce of its members, without the aid of power, and its marketing, furnishes the following particulars, determine its net income for the assessment year 2009-10 : income from processing of agricultural produce : Rs. 17,000; income from marketing agricultural produce : Rs. 3,000 ; dividends from another co-operative society : Rs. 55,000 ; income from letting of godowns : Rs. 10,000 ; and income from agency business : Rs. 85,000.*

SOLUTION :

	Rs.	*Rs.*
Income from letting of godowns		10,000
Business income :		
❑ from processing	17,000	
❑ from marketing	3,000	
❑ from agency	85,000	1,05,000
Dividend income		55,000
Gross total income		1,70,000
Less : Deductions in respect of income from		
a. processing of agricultural produce [sec. 80P(2)(*a*)]	17,000	
b. marketing of agricultural produce [sec. 80P(2)(*a*)(*iii*)]	3,000	
c. agency business [sec. 80P(2)(*c*)]	50,000	
d. dividend [sec. 80P(2)(*d*)]	55,000	
e. letting of godowns [sec. 80P(2)(e)]	10,000	1,35,000
Net income		35,000

342-P2 *For the assessment year 2009-10, the Calcutta Co-operative Society derives total income from the following sources : income from processing with the aid of power : Rs. 10,000 ; income from collective disposal of labour of its members : Rs. 15,000 ; interest from another co-operative society : Rs. 30,000 ; income from house property : Rs. 80,000 ; and income from other business : Rs. 61,000. Determine its taxable income.*

SOLUTION :

	Rs.	*Rs.*
Income from house property		80,000
Business income		
❑ processing with the aid of power	10,000	
❑ collective disposal of labour	15,000	
❑ other business	61,000	86,000
Interest received from a co-operative society		30,000
Gross total income		1,96,000
Less : Deductions in respect of income from		
❑ interest [sec. 80P(2)(*d*)]	30,000	
❑ collective disposal of labour [sec. 80P(2)(*a*)(*vi*)]	15,000	
❑ other business [sec. 80P(2)(c)]	50,000	95,000
Net income		1,01,000

342-P3 *The assessee is a co-operative society registered under the Madras Co-operative Societies Act. The assessee enters into an agreement with the State Government during the previous year ending March 31, 2009, relevant to the assessment year 2009-10, whereby the assessee agrees to hold a stock of ammonium sulphate belonging to, and on behalf of, the State Government, and to store it in godowns belonging to the assessee. Under the agreement, the assessee is required further to take all necessary steps to enable such stocking and storage of the fertiliser, including taking delivery of the stock at the rail-head and transporting it to the godowns. During the previous year relevant to the assessment year 2009-10, the assessee received a sum of Rs. 31,316 on this account, the amount being described as commission. In the assessment proceedings the assessee claims exemption from tax under section 80P, in respect of the said sum of Rs. 31,316. Discuss whether deduction is available under section 80P.*

SOLUTION : Having regard to the object with which the provision has been enacted, it is apparent that a liberal construction should be given to the language of the provision and that, therefore, in the circumstances of the present case, it must be regarded that the assessee lets out its godowns for the purpose of storing the ammonium sulphate handed over to it by the State Government. The remaining services performed by the assessee are merely incidental to the essential responsibility of using the godowns for the purpose of storing the ammonium sulphate handed over to it by the State Government. The remaining services performed by the assessee are merely incidental to the essential responsibility of using the godowns for the storage of that stock. It is true that a certain sum is paid to the assessee and described as commission for the services performed by it, but having regard to the totality of the circumstances and to the true substance of the agreement, it seems plain that the amount is paid merely by way of remuneration for the use of the godowns. Therefore the amount received as commission is wholly deductible under section 80P—*CIT* v. *South Arcot District Co-operative Marketing Society Ltd.* [1989] 176 ITR 117 (SC).

CHAPTER EIGHTEEN

Assessment of charitable and other trusts

Meaning of trust

343. A "trust" is an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner.

- *Author of trust* - The person who reposes or declares the confidence is called the "author of the trust".
- *Trustee* - The person who accepts the confidence is called the "trustee".
- *Beneficiaries* - The person for whose benefits the confidence is accepted is called the "beneficiary".
- *Trust property* - The subject-matter of the trust is called "trust property" or "trust money".
- *Instrument of trust* - The instrument, if any, by which the trust is declared is called the "instrument of trust".

Tax exemption

344. Income of a charitable trust is exempt according to the provisions of sections 11, 12 and 13. The trust should be one established in accordance with law and its objects should fall within the definition of the term "charitable purposes".

Charitable purpose [Sec. 2(*15*)]

345. It is defined to include relief of the poor, education, medical relief, and the advancement of any other object of general public utility.

345.1 ***Promotion of sports and games*** - Promotion of sports and games is considered to be a charitable purpose within the meaning of section 2(*15*). Therefore, an association or institution engaged in the promotion of sports and games can claim exemption under section 11, even if it is not approved under section 10(*23*)—Circular No. 395, dated September 24, 1984.

345.2 ***Business activities of a trust/institution - Can it be taken as "charitable purpose" [Sec. 11(4A)]*** - Where trust property comprises a business undertaking, the income shown in the books of account should not be less than the income determined by the Assessing Officer according to the provisions of the Act. Moreover, the trust or institution can carry out business activities if the following conditions given by section 11(4A) are satisfied—

a. the business is incidental to the attainment of the objectives of the trust or, as the case may be, institution; and

b. separate books of account are maintained by such trust or institution in respect of such business.

In order to ensure that the business income of a trust or institution is exempt, the business should be incidental to the attainment of the objectives of the trust or institution. A business whose income is utilized by the trust or the institution for the purpose of achieving the objectives of the trust or the institution is, surely, a business which is incidental to the attainment of the objectives of the trust. In any event, if there be any ambiguity in the language employed, the provision must be construed in a manner that benefits the assessee - *CIT* v. *Thanthi Trust* [2001] 115 Taxman 126 (SC).

Irrespective of whether any business is carried on by such a trust or institution or the business undertaking itself is held in trust, in either case, the trust or institution is charged to tax on such

profits and gains at the rates of tax applicable in the case of individuals, association of persons, body of individuals, etc., if the above conditions are not satisfied.

345.2-1 *COMMERCIAL ACTIVITIES VIS-A-VIS ADVANCEMENT OF AN OBJECT OF GENERAL PUBLIC UTILITY* - "Charitable purpose" is defined to include relief of the poor, education, medical relief and advancement of any other object of general public utility.

In a number of judicial pronouncements, the words "any other object of general public utility" have been interpreted - *see CIT* v. *Gujarat Maritime Board* [2003] 295 ITR 561 (SC), *Director of Income-tax* v. *Bharat Diamond Bourse* [2003] 259 ITR 280 (SC), *CIT* v. *Agricultural Produce and Market Committee* [2007] 291 ITR 419 (Bom.), *CIT* v. *Federation of Indian Chambers of Commerce & Industry* [1981] 130 ITR 186 (SC). So long as the dominant object is of general public utility and there is no profit motive, it cannot be said that the trust/institution is not established for charitable purposes, even if there is some profit in the activity carried on by the trust/institution.

From these decisions it emerge that the expression "any other object of general public utility" is of the widest connotation. Consequently, a number of entities operating on commercial lines are claiming exemption on their income either under section 10(*23C*) or section 11 on the ground that they are charitable institutions. This is based on the argument that they are engaged in the "advancement of an object of general public utility" as is included in the fourth limb of the definition of "charitable purpose".

345.2-2 *THE AMENDMENT MADE BY THE FINANCE ACT, 2008 - MODIFIED VERSION OF "CHARITABLE PURPOSE" UNDER SECTION 2(15)* - The definition of "charitable purpose" under section 2(*15*) has been modified with effect from the assessment year 2009-10 so as to provide that "the advancement of any other object of general public utility" shall not be a charitable purpose if it involves the carrying on of—

a. any activity in the nature of trade, commerce or business; or

b. any activity of rendering of any service in relation to any trade, commerce or business,

for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity, or the retention of such income, by the concerned entity.

345.2-3 *SECTION 11(4A) VIS-A-VIS NEW DEFINITION OF "CHARITABLE PURPOSE" UNDER SECTION 2(15)* - Though the definition of "charitable purpose" under section 2(*15*) has been modified, section 11(4A) has not been omitted. Section 11(4A) will not have any practical role to play after the aforesaid amendment in respect of "advancement of an object of general public utility". However, the amendment will not affect the application of section 11(4A) in respect of the property held in a trust for other charitable purposes (being relief of the poor, education and medical relief).

Essential conditions for exemption [Sec. 11]

346. The compliance of the following main conditions is essential for claiming exemption under section 11 :

- The property from which income is derived should be held under a trust or other legal obligation.
- The property should be held for charitable or religious purposes. In the case of a charitable trust created on or after April 1, 1962, the further conditions are :

a. the trust should not be created for the benefit of any particular religious community or caste ;

b. no part of the income should enure, directly or indirectly, for the benefit of the settlor or other specified persons ; and

c. the property should be held wholly for charitable purposes.

The conditions mentioned at (*b*) and (*c*) also apply to religious trusts created on or after April 1, 1962.

- The exemption is confined to only such portion of the trust's income which is applied to charitable or religious purposes or is accumulated for applying to such purposes within the limits of accumulation permitted under section 11(1) and (2) [*see* paras 344 and 345].
- The exemption is restricted to such portion of the income as is applied to charitable or religious purposes in India except in the cases covered by section 11(1)(*c*).

- The trust shall apply for registration with the Commissioner [*see* para 346.1].
- The accounts of the trust should be audited* for such accounting year in which its income (without giving effect to the provisions of sections 11 and 12) exceeds the exemption limit.
- The funds of the trust should be invested or deposited in any one or more of modes or forms mentioned in section 11(5) [*see* para 349.4-2].

346.1 ***Registration with the Commissioner*** - The trust should apply for registration (Form No. 10A). If an assessee is an institution whose object is charitable as defined under section 2(*15*), it would be entitled to registration under section 12A, even though, as per definition of 'person' under section 2(*31*), it is falling in other category like company or AOP or local authority—***Gujarat Maritime Board*** v. ***CIT*** [2005] 147 Taxman 31 (Ahd.) (Mag.). Registration under section 12A is a condition precedent for availing benefit under sections 11 and 12. Unless and until an institution is registered under section 12A, it cannot claim the benefit of section 11(1)(*a*)—***U.P. Forest Corporation*** v. ***CIT*** [2007] 165 Taxman 533 (SC).

346.1-1 *CONDITIONS FOR REGISTRATION* - The two conditions which are provided under section 12A for registration of a trust are, firstly, that the person concerned should have made an application for registration in Form No. 10A to the prescribed authorities within the time limit given below. The second condition provides for the keeping of the accounts in a particular manner and further that such accounts should be audited*. The language of the section does not show that in order to be able to get registration under section 12A, there is necessity of first establishing as to how the concerned institution or, as the case may be, the society would be able to claim the exemptions under section 11 or 12. At the stage of grant of certificate under section 12A, the only enquiry which could possibly be made would be whether the society has actually made an application in time and whether the accounts of the society are maintained in the manner as suggested by the said section. Beyond that the scope of enquiry would not go—*New Life in Christ Evangelistic Association (NLC)* v. *CIT* [2000] 111 Taxman 16 (Mad.). At the stage of consideration of the issue of registration under section 12AA, it is not a *sine qua non* to examine the aspect of the application of income. When the Commissioner has not doubted the aims and objects of the society, he cannot throw away the application of registration on this pretext—***Modern Defence Shikshan Sansthan*** v. ***CIT*** [2007] 108 TTJ (Jodh.) 732. While considering an application for registration under section 12AA sufficiency or otherwise of initial contribution made by founder of trust and dedicated to objects of trust, is not a relevant factor - ***Acharya Sewa Niyas Uttaranchal*** v. ***CIT*** [2007] 13 SOT 54 (Delhi) (URO).

346.1-2 *TIME LIMIT UPTO MARCH 31, 2007* - The application should be submitted with the Commissioner of Income-tax within one year from the date on which the trust is created. The Commissioner may, in his discretion, admit an application for the registration of any trust or institution after expiry of the aforesaid period. Where an application for registration is made after the aforesaid period, the provisions of sections 11 and 12 will apply from the date of the creation of the trust, if the Commissioner is satisfied that the person in receipt of income was prevented from making the application within the aforesaid period for sufficient reason. If, however, the Commissioner is not so satisfied, provisions of sections 11 and 12 will be applicable from the previous year in which application is made.

In the case of ***All India Primary Teachers Federation*** v. ***Director of Income-tax*** [2004] 140 Taxman 50, the assessee trust applied for registration under section 12A after more than 25 years with a request to condon delay. The reason for delay had been the continuous change of office bearer after a few years. On being satisfied that the funds received by the trust were utilized for the charitable

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*An omission to file audit report along with the return of income may be rectified by filing the report at a later stage before assessment is completed—*CIT* v. *Hardeodas Agarwalla Trust* [1992] 198 ITR 511 (Cal.), *CIT* v. *Devradhan Madhavlal Genda Trust* [1998] 230 ITR 714 (MP). If the audit report is not furnished with the return, the Assessing Officer must bring this defect to notice of the assessee so that the assessee can rectify this defect within the time allowed by the Assessing Officer; however notwithstanding continued existence of such defect, the Commissioner (Appeals) would not be justified in granting registration to the assessee-trust—*Director of Income-tax (Exemptions)* v. *SPIC Educational Foundation* [2002] 257 ITR 46 (Mad.).

objects, the Delhi Bench of the Tribunal following the Supreme Court's decision in *Motilal Padampat Sugar Mills Co. Ltd.* v. *State of Uttar Pradesh* [1979] 118 ITR 326 held that everyone is not supposed to know the law.

346.1-3 ***TIME-LIMIT FROM JUNE 1, 2007*** - The aforesaid provisions of making application within one year and condonation of delay by the Commissioner shall be applicable only in respect of any application made up to May 31, 2007. In respect of application made on or after June 1, 2007, the time-limit of one year will not be applicable. However, the exemption under sections 11 and 12 will be available only if the trust is registered under section 12AA and the benefit of exemption will be available only from the financial year in which the application is made.

346.1-4 ***REGISTRATION PROCEDURE*** - Section 12AA provides for a procedure to be followed for grant of registration to a trust or institution. The Commissioner shall call for documents and information and hold enquiries regarding the genuineness of the trust or institution. After he is satisfied about the charitable or religious nature of the objects and genuineness of the activities of the trust or institution, he will pass an order granting registration. Conversly, if he is not so satisfied, he will pass an order refusing registration, subject to the condition that an opportunity of being heard shall be provided to the applicant before an order of refusal to grant registration is passed by the Commissioner and the reasons for refusal of registration shall be mentioned in such order.

346.1-5 ***TIME LIMIT FOR PASSING ORDER*** - The order granting or refusing registration has to be passed within six months from the end of the month in which the application for registration is received by the Commissioner and a copy of such order shall be sent to the applicant. On failure on part of the Commissioner to pass an order on the assessee's application for registration within a period of 6 months, a presumption should be raised that registration has been granted—***Karnataka Golf Association*** v. ***DIT*** [2004] 91 ITD 1 (Bang.), ***Sardari Lal Oberai Memorial Charitable Trust*** v. ***ITO*** [2005] 3 SOT 229 (Delhi).

346.1-6 ***REGISTRATION NOT THE ONLY CONDITION FOR EXEMPTION*** - The grant of registration shall be one of the conditions for grant of income-tax exemption. Registration under section 12A would not *ipso facto* entitle the assessee to claim exemption under section 11—*Surat Tennis Club* v. *CIT* [2000] 75 ITD 362 (Ahd.). In other words, just because section 12A registration is granted to the assessee, it cannot be presumed that the assessee-trust is a charitable trust—*CIT* v. *Peare Lal Sharma Memorial Trust Society* [2001] 77 ITD 50/118 Taxman 143 (Delhi).

346.1-7 ***CANCELLATION OF REGISTRATION*** - If the Commissioner is satisfied that the activities of any trust or institution are not genuine or are not carried out in accordance with the objects of the trust or institution, he shall pass an order in writing (after providing an opportunity of being heard to the concerned trust or institution), cancelling the registration granted under section 12AA.

How to find out exemption under section 11

347. One has to proceed as follows—

Steps	*Income and exemption therefrom*	*Remarks*
Step 1 - Income	Find out taxable income of the trust/institution	One has to find out taxable income of the trust/institution applying different provisions of the Income-tax Act but before giving any exemption under section 11*
Step 2 - Exemption	◆ *General exemption* - Fifteen per cent of "income from property held for charitable or religious purposes" is exempt for tax under section 11. It can be accumulated for future	Meaning of "income from property held for charitable or religious purposes" is given in para 347.1

*It is incorrect to state that income of a trust/institution shall be calculated on commercial basis ignoring the different provisions of the Income-tax Act. Section 11 does not provide mode of computation of income of a trust/institution. Section 11 provides the quantum of exemption in respect of income from property held for charitable or religious purposes.

Steps	*Income and exemption therefrom*	*Remarks*
	without any specific time-frame. It is 15 per cent of income derived from property held under charitable purpose (and it is not 15 per cent of amount remained after expending money on charitable purposes)—*CIT* v. *Programme for Community Organisation* [2001] 116 Taxman 608 (SC).	
	• *Exemption based upon application of income* - Remaining 85 per cent of the "income from property held for charitable or religious purposes" is exempt if it is applied for charitable or religious purposes in India	For the meaning of "application of income", *see* para 347.2. There are specific provisions in the Act for those cases where application of income falls short of 85 per cent because of non-receipt of income during the year or because of the fact that the trust/institution wants to apply the income in the next previous year
	• *Exemption based upon accumulation* - Where 85 per cent of the "income from property held for charitable or religious purposes" is not applied for charitable purposes, etc., during the previous year, it can be accumulated or set apart for application in future	For availing exemption in respect of amount accumulated or set apart for future, there are specific provisions under section 11(2) [*see* para 348]

347.1 ***How to compute income from property held for charitable purposes*** - For this purpose income means real income which has been received by the assessee. It shall be computed not in accordance with the provisions of the Income-tax Act but in accordance with the normal rule of accountancy. The "accumulation" or "application" in section 11(1)(*a*) must be of a real income. This view has been also adopted by the Central Board of Direct Taxes in Board's Circular dated May 19, 1968 which makes it clear that the word "income" in section 11(1)(*a*) must be understood in commercial sense. The following points one should note in this regard :

■ *Tax deduction at source* - The amount deducted as tax at source cannot be considered as "income" for this purpose — *CIT* v. *Jayshree Charity Trust* 1985 Tax LR 247 (Cal.). In other words, income to be applied under section 11(1) has to be ascertained after deducting income-tax liability — *CIT* v. *Baroda Industrial Development Corpn. Ltd.* [1986] 24 Taxman 36 (Guj.).

■ *Depreciation* - Depreciation should be allowed while computing such income for this purpose — *CIT* v. *Seth Manilal Ranchhoddas Vishram Bhavan Trust* [1992] 105 CTR (Guj.) 303. A trust can claim depreciation on assets even if the cost of assets has been fully allowed as application of income under section 11 in past years. Likewise, one can claim depreciation on assets which is received on account of transfer from another trust and cost of acquiring of which is not incurred by the assessee — ***CIT*** v. ***Institute of Banking Personnel Selection (IBPS)*** [2003] 131 Taxman 386 (Bom.).

■ *Voluntary contributions* - Voluntary contributions or donations with a direction to form part of corpus of trust is not chargeable to tax. Any other contribution/donation are deemed to be part of income derived from property held under trust. Tax is to be levied after deducting the expenditure— ***Society for Integrated Development in Urban and Rural Areas*** v. ***CIT*** [2004] 90 ITD 493 (Hyd.). The onus is entirely on the assessee to show that donations received were given with a direction that these shall form part of corpus of the trust. The mere fact that in the audited accounts these were shown as part of the corpus does not mean that the assessee had furnished requisite evidence during the course of assessment proceedings—***Sardarni Uttam Kaur Educational Society*** v. ***ITO*** [2007] 108 TTJ (Asr.) 197.

■ *Income-tax refund* - Refund of income-tax can by no stretch of imagination be held as income derived from property held under the trust—*CIT* v. *Hamdard Dawakhana (Wakf)* [2002] 120 Taxman 186 (Delhi).

■ *Tax-free income* - Section 10(*1*) of the Act excludes agricultural income. Agricultural income will not form part of total income for the purpose of computing the accumulation of income in excess of 15 per cent of the total income as laid down under section 11—*CIT* v. *Nabhinandan Digamber Jain* [2002] 257 ITR 91 (MP).

347.2 *Application of income - How to determine* - The term "application of income" for this purpose means disposal of income for charitable or religious purposes.

The following points one should note in this regard :

■ *Repayment of loans* - Repayment of loans taken to fulfil one of the objects of trust is treated as an application of income for charitable purposes.

■ *Educational purposes* - Interest bearing loans, advanced by an educational trust to students for higher studies amount to application of income for charitable purposes in the year of grant of such loans, if the object of trust is advancement of education and granting of scholarship. As and when such loan is returned to the trust, it will be treated as the income of that year. If, however, the only object of the trust is to give interest-bearing loans for higher studies, it amounts to carrying on of money-lending business *vide* Circular No. 100, dated January 24, 1973.

■ *Revenue or capital purposes* - Application of the amount can be for revenue or capital purpose. So long as the expenditure is incurred out of the income earned by the trust, even if such expenditure is for capital purposes, on the objects of the trust, the income would be exempt—*CIT* v. *Kannika Parameshwari Devasthanam & Charities* [1982] 133 ITR 779 (Mad.).

■ *Applied* v. *Expenditure* - The word "applied" is wider in import than the word "expenditure". The sum spent on the construction of additions to the buildings owned by a religious institution, which were let out, and the income wherefrom was used for religious purposes, can be said to be an application of the income for religious or charitable purposes—*CIT* v. *St. George Forane Church* 1987 Tax LR 1304 (Ker.).

It is not correct to equate the word "applied" as used in section 11 with the word "spent". For instance, if the charitable trust debits its accounts as soon as it passes resolutions sanctioning donations to various donees and such amounts, as are outstanding, are shown as liabilities in the balance sheet (this will happen when in certain cases the amounts, though sanctioned and debited as expenditure in one accounting year, are actually disbursed in the next year) the amounts which are sanctioned but not actually spent in the relevant accounting year will constitute application of the funds for charitable purposes within the meaning of section 11(1)(*a*)—*CIT* v. *Trustees of H.E.H. the Nizam's Charitable Trust* [1981] 131 ITR 497 (AP).

■ *Payment of taxes* - The expenditure incurred by way of payment of tax out of the current year's income has to be considered as application for charitable purposes. This is because payment is made to preserve the corpus, the existence of which is absolutely necessary for the trust. Thus, where the entire income during the assessment year had been applied for payment of tax, it should be treated as having been applied for charitable purposes—*CIT* v. *Janaki Ammal Ayya Nadar Trust* [1985] 23 Taxman 416 (Mad.). Tax liability shall be excluded in the year of payment whether it relates to the current or preceding year — *CIT* v. *Trustees of H.E.H. the Nizam's Supplemental Religious Endowment Trust* [1981] 127 ITR 378 (AP). If entire income of assessee-trust during relevant year is utilised to pay estate duty due on death of settlor and no income is available with it for application under section 11(1)(*a*), entire income of trust will be exempt and it cannot be taxed on the ground that the trust has failed to apply its income to charitable or religious purposes— *CIT* v. *Apostolos Raptakos Trust* [1995] 83 Taxman 422 (Bom.).

■ *Donation to other trusts* - When a donor trust which is itself a charitable and religious trust donates its income to another trust, the provisions of section 11(1)(*a*) can be said to have been met by such donor trust and the donor trust can be said to have applied its income for religious and charitable purposes. Utilisation by the donee trust in any year would not be relevant for the purpose of deciding whether the donor trust can get exemption under section 11 or not — *CIT* v. *Sarladevi Sarabhai Trust (No. 2)* [1988] 172 ITR 698 (Guj.), *CIT* v. *Thanthi Trust* [1999] 239 ITR 502 (SC), *CIT* v. *Nirmala Bakubhai Foundation* [1997] 226 ITR 394 (Guj.).

■ *Contrary to trust deed* - Under section 11(1)(*a*) what is relevant is application of income for charitable purpose and exemption under section 11 is available even if trustees have acted by spending money in India contrary to the terms of the trust deed which does not empower them to apply trust's income in India—*Trustees of H.E.H. the Nizam's Pilgrimage Money Trust* v. *CIT* [1987] 65 CTR (AP) 290.

■ *Expenditure of earlier years* - There is nothing in language of section 11(1)(*a*) to indicate that expenditure incurred in earlier year cannot be met out of income of subsequent year; utilization of such income for meeting expenditure of earlier year, would, thus, amount to such income being applied for charitable or religious purposes—*CIT* v. *Shri Plot Sweatamber Murti Pujak Jain* [1994] 119 CTR (Guj.) 144, *Gonvindu Naicker Estate* v. *Asstt. Director of IT* [1999] 105 Taxman 719 (Mad.).

■ *Defending criminal charges* - Where an assessee is a charitable institution, legal expenses incurred by the assessee-association for defending president of association against criminal charges are allowable as a permissible deduction while computing income of the assessee association—*Ananda Marga Pracharaka Sangha* v. *CIT* [1994] 76 Taxman 88 (Cal.).

■ *Business income* - For the purposes of section 11 "property held under trust" includes a business undertaking so held. Where a claim is made that the income of any such undertaking shall not be included in the total income of the persons in receipt thereof, the Assessing Officer shall have power to determine the income of such undertaking in accordance with the provisions of the Act relating to assessment and where any income so determined is in excess of the income as shown in the accounts of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious purposes by virtue of section 11(4).

Section 11(4) applies only if assessed income is more than returned income and where on deletion by the Tribunal of additions of certain items to the assessee-trust's income there is no excessive assessed income over and above income returned by assessee, then provisions of section 11(4) cannot be applied— *Director of Income-tax* v. *Thanthi Trust* [1995] 215 ITR 879 (Mad.).

■ *Repayment of loan taken for construction of building* - Repayment of debt incurred by the assessee for the construction of the commercial building taken by the assessee for the purpose of augmenting its funds, should be treated as 'application' of the income of the assessee-trust for charitable purposes—*CIT* v. *Janmabhoomi Press Trust* [2000] 242 ITR 703 (Kar.).

■ *Excess application of last year* - Amount of excess application of the last year can be set off against the deficiency of the subsequent assessment year—*CIT* v. *Matriseva Trust* [2000] 242 ITR 20 (Mad.).

Though trust would be entitled to claim carry-forward of excess expenditure, yet it would not be allowed to accumulate 15 per cent of total income first and then claim excess expenditure for its carry forward to subsequent years—***Dawat Institute of Dawoodi Bohra Community*** v. ***ITO*** [2008] 22 SOT 359 (Mum.). For instance if income of a trust is Rs. 1,00,000 and Rs. 86,000 is applied for charitable purposes during the current year, Rs. 1,000 cannot be carried forward to the subsequent year. On the other hand, if income is Rs. 1,00,000 and Rs. 1,01,000 is applied for charitable purposes during the current year, the excess application of income (*i.e.*, Rs. 1,000) can be set off against any deficiency of the next year.

347.2-1 *CAPITAL GAIN DERIVED BY CHARITABLE/RELIGIOUS TRUST [SEC. 11(1A)]* - Where a capital asset being property held under trust for charitable or religious purposes is transferred and the whole or any part of the net consideration for the transfer (*i.e.*, full value of the consideration as reduced by the expenditure incurred wholly and exclusively in connection with the transfer) is utilised for acquiring another capital asset to be held as part of the corpus of the trust, the capital gain arising from the transfer is regarded as having been applied to charitable or religious purposes.

■ Where the whole of such net consideration is utilised in acquiring the new capital asset, the entire amount of the capital gain is regarded as having been applied to charitable or religious purposes.

■ Where only a part of the net consideration is utilised for acquiring the new capital asset, an amount, if any, by which the cost of acquisition of the new asset exceeds the aggregate of the cost of acquisition of the capital asset transferred and the cost of any improvements made to such asset, is regarded as having been applied to such purposes.

■ In a case where the asset which is transferred formed part of property held under trust in part only for charitable or religious purposes, a proportionate amount of the capital gain is regarded as having been applied to charitable or religious purposes.

347.2-1a OTHER POINTS - One should also keep in view the following points :

1. Investment in a fixed deposit with a public sector company or scheduled bank amounts to acquisition of new asset—*CIT* v. *East India Charitable Trust* [1994] 206 ITR 152/73 Taxman 380 (Cal.), *Director of Income-tax (Exemption)* v. *DLF Qutab Enclave Complex Medical Charitable Trust* [2001] 115 Taxman 520 (Delhi).

2. For purposes of section 11(1A) so long as investments are actually made in units of UTI during accounting period, issue of units after expiry of accounting year is immaterial—*CIT* v. *East India Charitable Trust* [1994] 206 ITR 152/73 Taxman 380 (Cal.).

3. It is not correct to say that section 11(1A) is meant for calculation of capital gains tax. In fact this section is to operate after capital gains are worked in accordance with sections 45 to 55—*Akhara Ghamanda Dass* v. *Asstt. CIT* [2000] 68 TTJ (Asr.) 244.

347.2-1b PROVISIONS ILLUSTRATED - To have better understanding of the above provisions, the following examples are given —

1. A trust holds a capital asset (date of acquisition : April 1, 1979, cost of acquisition : Rs. 1,00,000, fair market value on April 1, 1981 : Rs. 1,17,641), income of which is fully utilised for charitable purposes. The capital asset is transferred on March 1, 2009 and the capital gain is calculated as under —

	Rs.
Sales proceeds	9,80,000
Less :	
Indexed cost of acquisition [Rs. 1,17,641 × 582 ÷ 100]	6,84,671
Expenses on transfer	20,000
Long-term capital gain as per section 45 without giving any exemption	2,75,329

In this case, net sale consideration is Rs. 9,60,000 (*i.e.*, Rs. 9,80,000—Rs. 20,000). The amount of exemption shall be determined as follows —

	Amount of investment in the new capital asset	*Cost of the old asset which is transferred*	*Amount exempt [(1) - (2)]*
	(1)	*(2)*	*(3)*
	Rs.	*Rs.*	*Rs.*
Case 1	9,60,000	6,84,671	2,75,329
Case 2	8,00,000	6,84,671	1,15,329
Case 3	7,00,000	6,84,671	15,329
Case 4	6,50,000	6,84,671	*Nil*
Case 5	1,00,000	6,84,671	*Nil*

2. Suppose in the above case, the property is held under trust in part only for charitable purposes [suppose 70% of the income of the trust is utilised for charitable purposes], then amount of exemption shall be determined as follows —

	70% of the amount invested in the new asset Rs.	*70% of the cost of old asset Rs.*	*Amount exempt [i.e., excess of (1) over 2] Rs.*
	(1)	*(2)*	*(3)*
Case 1	6,72,000	4,79,270	1,92,730
Case 2	5,60,000	4,79,270	80,730
Case 3	4,90,000	4,79,270	10,730
Case 4	4,55,000	4,79,270	*Nil*
Case 5	70,000	4,79,270	*Nil*

347.3 *When application of income falls short of 85 per cent† of income* - If the income applied to charitable or religious purposes, during the previous year, falls short of 85 per cent† of the income derived during the year, either because of (*a*) or (*b*) [column 1, of the table], the charitable trust or institution has been given the option to spend such income[1] for charitable or religious purposes in the manner given in column 2 of the table—

Application of income falls short of 85 per cent† of income because of the reasons given below	*When the income can be spent*
a. income has not been received during the relevant previous year	Either during the previous year in which income is so received or during the previous year immediately following such year [*see* problem 347-P2]
b. because of any other reason	During the previous year immediately following the previous year in which the income was derived [*see* problem 347-P1]

347.3-1 *HOW TO AVAIL THE BENEFIT OF EXTENDED TIME* - For availing the benefit of extended time beyond the relevant previous year, the charitable trust or institution, in either case, has to exercise the option in writing under *Explanation* (*2*) to section 11(1) within the time allowed, under section 139(1)[2] for furnishing the return of income. Income applied to such purposes during the extended time will be deemed to have been applied to such purposes during the previous year in which it was derived.

347.3-2 *WHEN INCOME IS NOT FULLY APPLIED FOR CHARITABLE PURPOSE DURING THE EXTENDED PERIOD* - Where any income in respect of which an option is exercised under *Explanation* (*2*) to section 11(1) is not applied for charitable or religious purposes in India during the extended time, such income shall be taxed in India as follows —

1. If the income is not received in the previous year and the option is exercised to apply the income in the year of receipt, then so much receipt which is not spent during the year of receipt and the immediately following year, shall be taxable as the income of the immediately following year.

For instance, Rs. 26,000, being income of the previous year 2008-09, is received on April 6, 2010 (in respect of which the option has already been exercised) and out of Rs. 26,000, Rs. 15,000 is spent during 2010-11 and Rs. 3,000 is spent during the next year, *i.e.*, 2011-12, the unutilised amount of Rs. 8,000 is taxable as income of the previous year 2011-12 [the same point is illustrated in problem 347-P2].

2. If the income is not spent in the year in which it is derived and the option is exercised to apply the income in the next year, then the amount not spent in the next year shall be taxable as income of the next year.

For instance, in respect of an income of Rs. 28,000 of the previous year 2008-09, the trust has exercised the option of spending it in the next year (*i.e.*, 2009-10), the amount not spent during 2009-10 will be taxable as income of the previous year 2009-10 [the same point is illustrated in problem 347-P1].

347-P1 *During the previous year 2008-09, a charitable trust derived income of Rs. 6,70,600 from the property held under trust for charitable purposes. The trust actually spent only Rs. 3,70,600 during the previous year 2008-09. Determine the taxable income of the trust on the assumption that (a) the trust has not applied for the option under clause (2) of the* Explanation *to section 11(1), and (b) the trust has applied for the option and has obtained extension of time for applying the unutilised portion of income for charitable purposes during the next previous year,* i.e., *2009-10 and has actually spent Rs. 67,800 during that previous year.*

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†75 per cent up to the assessment year 2002-03.

1. Including capital gains—*CIT* v. *East India Charitable Trust* [1994] 206 ITR 152 (Cal.).

2. If a return is filed within the time specified in section 139(4) and the option contemplated by the *Explanation* to section 11(1) is exercised in writing in a statement along with such return, the requirements of the *Explanation* to section 11(1) will stand satisfied—*Trustees of Tulsidas Gopalji Charitable & Chaleshwar Temple Trust* v. *CIT* [1994] 73 Taxman 612/ 207 ITR 368 (Bom.), ***CIT*** v. ***G.R. Govindarajulu & Sons Charities*** [2005] 144 Taxman 300 (Mad.).

SOLUTION :

	Rs.
Income from property held for charitable purposes	6,70,600
Less : 15% set apart for the future	1,00,590
	5,70,010
Less : Amount actually spent during the previous year	3,70,600
Unutilised balance	1,99,410

On the first assumption, Rs. 1,99,410 is taxable for the assessment year 2009-10 relevant to the previous year 2008-09. On the second assumption Rs. 1,31,610 (*i.e.*, Rs. 1,99,410—Rs. 67,800) will be treated as taxable income of the assessment year 2010-11 relevant to the previous year 2009-10.

347-P2 *During the accounting period ending March 31, 2009 a charitable trust derived (a) income from property held for charitable purposes : Rs. 4,40,000 (Rs. 2,15,000 received in cash and the remaining balance of Rs. 2,25,000 is to be received in the year 2010-11) ; (b) voluntary contribution : Rs. 7,05,000 (out of which Rs. 4,00,000 is with specific direction that it shall form part of corpus of the trust). During the previous year 2008-09, the trust spent only Rs. 70,000 for charitable purposes. Determine its taxable income on the assumption that the trust has obtained extension of time for applying the unrealised income of Rs. 2,25,000 in the year of receipt, i.e., 2010-11, whereas it actually spends Rs. 18,000 in the year 2010-11 and Rs. 32,000 in the year 2011-12.*

SOLUTION :

FOR THE ASSESSMENT YEAR 2009-10 (PREVIOUS YEAR 2008-09)	Rs.
Income from property held under trust for charitable purposes	4,40,000
Voluntary contributions (Rs. 7,05,000 — Rs. 4,00,000)	3,05,000
Total income	7,45,000
Less : 15% set apart for future	1,11,750
Balance	6,33,250
Less : Amount spent during the previous year	70,000
Shortfall	5,63,250
Less : Amount not realised during the previous year	2,25,000
Taxable income	3,38,250

FOR THE ASSESSMENT YEAR 2012-13 (PREVIOUS YEAR 2011-12), *i.e.*, the year next following the previous year in which the unrealised income of the previous year 2008-09 is received :

	Rs.	Rs.
Income received during the previous year 2010-11		2,25,000
Less : Amount spent :		
❑ during the previous year 2010-11	18,000	
❑ during the previous year 2011-12	32,000	50,000
Amount deemed as income of the assessment year 2012-13		1,75,000

Accumulation of income [Sec. 11(2)]

348. Where 85 per cent of income is not applied to charitable or religious purposes in the aforesaid manner, the charitable trust or institution may accumulate or set apart either the whole or part of its income for future application for such purposes in India.

Such income so accumulated or set apart will not be included in the total income of the trust or institution in the year of receipt of income. For this purpose, such trust or institution will have to specify, by means of a notice to the Assessing Officer in Form No. 10 [which shall be delivered before

the expiry of time allowed* under section 139(1)], the purposes and period [which in no case can exceed 5 years** (10 years** in respect of any income accumulated or set apart before April 1, 2001)] for which the income is accumulated or set apart. Further, the money so set apart or accumulated should be invested/deposited in any one or more of modes or forms specified in section 11(5) [*see* para 349.4-2].

348.1 ***Consequences of default*** - If in any year the income which is accumulated for the specified purpose or purposes of the trust is applied to the purposes other than charitable or religious purposes or ceases to be accumulated or set apart for application to such purposes, it will become chargeable to tax as the income of that year.

■ If in any year, the accumulations cease to remain invested in securities specified in section 11(5) then also the income so accumulated will become chargeable to tax as the income of that year.

■ If the accumulations are not utilised for the specified purposes during the period of accumulation or in the year immediately following the expiry of that period, then the accumulations, to the extent they are not so utilised, will become chargeable to tax as income of the previous year immediately following the expiry of that period.

348.1-1 *OTHER POINTS* - One should also keep in view the following points—

■ Handing over of the accumulated income to a trust having similar objects would not amount to utilization of the accumulated income for the purpose for which it was accumulated— *CIT* v. *M. CT. Muthiah Chettiar Family Trust* [2000] 245 ITR 400 (Mad.).

■ Payment to other trusts and institutions out of income from property held under trust in the year of receipt of such income is treated as application of income. However, any payment out of accumulated income to other trust/institutions (not being payment in the year in which a trust claiming exemption is dissolved) out of the accumulated income shall not be treated as application of income and will be taxed in the year in which such payment/credit is made out of accumulated income.

■ Sometimes failure to apply the income so accumulated or set apart in the specified manner may arise due to circumstances beyond the control of trustees. In such case the Assessing Officer may, on the receipt of an application from the person in receipt of the income, allow such income to be applied for such other charitable/religious purposes in India as are in conformity with the objects of the trust/institution.

■ The claim for accumulation of unapplied income cannot be denied even if the objects for which accumulation are sought are not particularized inasmuch as they cover entire range of objects of trust—***Bharat Krishak Samaj*** v. ***DIT*** [2008] 166 Taxman 147 (Delhi).

348-P1 *During the previous year 2008-09, a charitable trust derived the following income :* Rs.

- *Voluntary contribution (out of Rs. 20,90,000 is for specific direction that it shall form part of the corpus of the trust)* *41,10,000*
- *Income from property held in trust* *2,00,000*

During the previous year 2008-09, the trust spends Rs. 2,19,610 (it includes a sum of Rs. 10,000 donated to a charitable trust) and sets apart Rs. 7,46,000 for the purpose of construction of a charitable hospital up to March 31, 2013.

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*The time-limit has been prescribed under rule 17. It is reasonable to presume that the intimation required under section 11 has to be furnished before the assessing authority completes the concerned assessment because such a requirement is mandatory and without those particulars, the assessing authority cannot entertain the claim of the assessee under section 11. Further, any claim for giving the benefit of section 11 on the basis of information supplied subsequent to the completion of assessment would mean that the assessment order will have to be reopened. The Act does not contemplate such reopening of the assessment—*CIT* v. *Nagpur Hotel Owners Association* [2001] 114 Taxman 255 (SC).

**In computing the period of 10 or 5 years, the period during which the income could not be applied for the purposes for which it is accumulated or set apart, due to an order or injunction of any court, shall be excluded.

Determine the taxable income of the trust on the assumption that the trust utilises Rs. 4,65,000 up to March 31, 2014 for the purpose of construction of charitable hospital. Further, out of the accumulated amount a donation of Rs. 50,000 is given to another trust is made.

SOLUTION :

ASSESSMENT YEAR 2009-10 (*i.e.*, previous year 2008-09)	*Rs.*
Income from property held under trust	2,00,000
Add : Voluntary contribution (Rs. 41,10,000 — Rs. 20,90,000)	20,20,000
Total income	22,20,000
Less : 15% of Rs. 22,20,000	3,33,000
Balance	18,87,000
Less : Amount spent during 2008-09 (donation to another charitable trust is deductible)	2,19,610
Shortfall	16,67,390
Less : Amount set apart for charitable hospital	7,46,000
Net income	9,21,390

ASSESSMENT YEAR 2014-15 (PREVIOUS YEAR 2013-14) (*i.e.*, the previous year next following the previous year ending March 31, 2013) :

	Rs.
Amount set apart	7,46,000
Less : Amount actually spent	4,65,000
Amount deemed as income of the assessment year 2014-15 (donation to another trust out of the amount set apart is not taken into consideration)	2,81,000

Forfeiture of exemption [Sec. 13]

349. The following incomes of charitable/religious trusts/institutions do not qualify for exemption under section 13 :

349.1 ***Income for private religious purposes*** - Any part of income from property held under a trust for private religious purposes which does not enure for the benefit of the public is not eligible for exemption under section 11 or 12.

349.2 ***Income for the benefit of particular religious community*** - Entire income of a charitable trust/institution (established on or after April 1, 1962) created for the benefit of any particular religious community or caste is not eligible for exemption under section 11 or 12.

■ *Exception* - A trust or institution created or established for the benefit of Scheduled Castes, Backward Classes, Scheduled Tribes or women and children shall not be deemed to be a trust or institution created or established for the benefit of a religious community or caste for this purpose.

Where benefit under trust is available to Muslims from all over the world, none of whom, except those in Kerala, are of backward classes, the assessee-trust cannot be said to be established for backward classes so as to be covered by the above exception. Therefore, the trust is not entitled to exemption under section 11—*CIT* v. *Palghat Shadi Mahal Trust* [2002] 120 Taxman 889/254 ITR 212 (SC).

349.3 ***Income for the benefit of interested persons*** - If a religious/charitable trust/institution is created or established after March 31, 1962 and any part of its income enures directly or indirectly under the rules governing the trust, for the benefit of any person specified in section 13(3) [*see* para 349.3-1], then entire income of such trust is not eligible for exemption under section 11 or 12.

Entire income of a trust/institution created/established after March 31, 1962 is also not eligible for exemption under section 11 or 12 if income/property is used/applied, during the relevant year, for the direct/indirect benefit of the author of the trust and other persons mentioned in section 13(3) [*see* para 349.3-1]. This provision is also applicable in the case of trust/institution created/established prior to April 1, 1962 but in such case exemption is not forfeited if such use of the trust

income/property is in compliance with a mandatory provision in the terms of the trust or mandatory rule governing the institution.

349.3-1 *MEANING OF INTERESTED PERSON* - For the purposes of section 13 the following are interested persons :

a. the author of the trust or the founder of the institution ;

b. any person who has made a total contribution (up to the end of the relevant previous year) of an amount exceeding Rs. 50,000 (substantial contributor)* ;

c. any member of the HUF (or any relative of such member) where such author or founder or substantial contributor is an HUF ;

d. any trustee of the trust or manager (by whatever name called) of the institution ;

e. any relative of such author, founder, substantial contributor, member, trustee or manager ; and

f. any concern in which any of the persons referred to above has a substantial interest.

349.3-1a WHO IS FOUNDER - The expression 'founder of the institution' used in section 13(1)(*a*) means that the person concerned should be the originator of the institution, or, at least, one of the persons responsible for the coming into existence of the institution. The contribution of money is not an inexorable test of a person being a 'founder', though it might happen often that person who originates an institution might often have also found it—***Director of Income-tax*** v. ***Bharat Diamond Bourse*** [2003] 126 Taxman 365 (SC).

349.3-1b TRUST AND INSTITUTION - The trust and institution referred to in section 13 are not one and the same thing and they are different entities. Point (*d*) (*supra*) refers to the manager of the institution and not to the manager of the trust—*CIT* v. *Rai Bahadur Biseswarlal Motilal Halwasiya Trust* [2001] 118 Taxman 556 (Cal.).

349.3-1c FOUNDER DURING THE YEAR - When money is paid to founder of the institution, without adequate security or interest, it falls under mischief of section 13(2)(*a*). It is not necessary for this purpose that founder should be founder during the year in which transactions were entered into.

349.3-1d RELATIVE - MEANING OF - A "relative" in relation to an individual means :

a. spouse of the individual ;

b. brother or sister of the individual ;

c. brother or sister of the spouse of the individual ;

d. any lineal ascendant or descendant of the individual ;

e. any lineal ascendant or descendant of the spouse of the individual ;

f. spouse of a person referred to in (*b*), (*c*), (*d*) or (*e*) above ; and

g. any lineal ascendant or descendant of a brother or sister of either the individual or of the spouse of the individual.

349.3-1e SUBSTANTIAL INTEREST - MEANING OF - For the aforesaid provisions, a person will be deemed to have substantial interest in a company if he (or along with "interested persons" mentioned above) beneficially holds at least 20 per cent equity share capital of the company at any time during the previous year. In the case of a concern other than a company, a person will be deemed to have substantial interest, if he (or along with "interested persons" mentioned above) is entitled to at least 20 per cent of the profits of such concern at any time during the previous year.

349.3-2 *CONFERMENT OF BENEFIT, AMENITY OR PERQUISITE ON AN INTERESTED PERSON* - The income or the property of the trust (or institution) shall be deemed to have been used (or applied) in a manner which results (directly or indirectly) in conferring any benefit, amenity or perquisite (whether convertible into money or not) on any interested person, in the following cases :

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*Substantial contributor may be trust—*Champa Charitable Trust* v. *CIT* [1995] 214 ITR 764 (Bom.).

■ Where any part of the income or property of the trust (or institution) is (or continues to be) lent* to any interested person for any period during the previous year without either adequate security or adequate interest or both [Sec. 13(2)(*a*)].

The following judicial ruling should be noted—

1. Where secretary and executive secretary pledged FDRs of trust to raise loans for personal use without any security or compensation to trust, exemption granted under section 11 is not available—***Society for Integrated Development in Urban and Rural Areas*** v. ***CIT*** [2004] 90 ITD 493 (Hyd.).

2. Personal surety given by the directors of a company to which assessee-trust had advanced loan can be considered to be adequate security for allowance of exemption under section 11—***CIT*** v. ***Ram Smarak Nidhi*** [2004] 141 Taxman 297 (Delhi).

■ Where any land, building or other property of the trust (or institution) is (or continues to be) made available for the use of any interested person for any period during the previous year without charging adequate rent or other compensation [Sec. 13(2)(*b*)].

■ Where any amount is paid by way of salary, allowance or otherwise during the previous year to any interested person out of the resources of the trust (or institution) for services rendered by that person to such trust (or institution) and the amount so paid is more than what may be reasonably paid for such services [Sec. 13(2)(*c*)].

■ Where the services of the trust or institution are made available to any interested person during the previous year without adequate remuneration or compensation [Sec. 13(2)(*d*)].

■ Where any share, security or other property is purchased by or on behalf of the trust (or institution) from any interested person during the previous year for more than adequate consideration [Sec. 13(2)(*e*)].

■ Where any share, security or other property is sold by or on behalf of the trust (or institution) to any interested person during the previous year for less than adequate consideration [Sec. 13(2)(*f*)].

■ Where any income or property of the trust (or institution) is diverted during the previous year in favour of any interested person [Sec. 13(2)(*g*)]. Where, however, the aggregate of income or the value of the property so diverted does not exceed Rs. 1,000, this provision is not applicable.

■ Where any funds of the trust (or institution) are (or continue to remain) invested for any period during the previous year in any concern in which any interested person has a substantial interest [Sec. 13(2)(*h*)]. Where, however, the aggregate of the funds of the trust (or institution) invested in a concern in which any interested person has a substantial interest does not exceed 5 per cent of the capital of that concern, exemption under section 11 will not be denied in relation to the application of any income other than the income arising to the trust or institution from such investment [Sec. 13(4)]. The following points may be noted :

1. It cannot be said that concern contemplated by section 13(2)(*h*) is a stranger concern and not a concern in which trust itself is a partner—*CIT* v. *Sree Haryana Chandrika Trust* [1994] 77 Taxman 137 (Ker.).

2. Contribution of share capital to a firm is an 'investment' made by partner for purposes of section 13(2)(*h*)—*CIT* v. *Sree Haryana Chandrika Trust* [1994] 77 Taxman 137 (Ker.).

3. For determining 5 per cent of capital in the case of a company, it would not include its reserves—*CIT* v. *Lallubhai Gordhandas Mehta Charitable Trust* [1993] 115 CTR (Guj.) 315.

349.4 ***Funds not invested in section 11(5) securities/deposits*** - Income of a trust/institution is not eligible for exemption under section 11 or 12 if its funds are invested/deposited otherwise than in the forms specified in section 11(5).

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*Receipt by way of donation of fixed deposit receipts from donors of deposits made by them in a company does not amount to assessee lending its income or funds to a person of a kind specified in section 13(3) and as such prohibition under section 13(2)(*a*) and 13(2)(*b*) is not attracted—*CIT* v. *Pittie Charitable Trust* [1994] 207 ITR 1053/76 Taxman 491 (Bom.).

In this regard the following points should be noted :

1. The exemption under section 11(1)(*a*) is available only if at least 85 per cent† of the income is applied for charitable/religious purposes in India during the year and the remaining amount is invested in the forms/modes specified under section 11(5). Thus, both the requirements will have to be fulfilled before the trust can claim and avail of the exemption under section 11(1)(*a*). For instance, a trust derives income from property held for charitable purposes to the extent of Rs. 40,000 in a year. Under section 11(1)(*a*) it has to spend at least 85 per cent, *i.e.*, Rs. 34,000 on the charitable purposes. The balance of 15 per cent, *i.e.*, Rs. 6,000 will have to be invested in the forms/modes prescribed under section 11(5). It is only then that the entire income of the trust will get exemption — Circular No. 335, dated April 13, 1982.*

2. Any charitable or religious trust or institution will forfeit exemption from tax if any funds of the trust or institution are invested or deposited, after February 28, 1983, otherwise than in any one or more of the modes specified in section 11(5). Such trusts and institutions will also forfeit exemption from tax if any part of their funds invested before March 1, 1983 otherwise than in any one or more of the forms or modes specified in section 11(5), continue to remain so invested or deposited after November 30, 1983. Trusts or institutions which continue to hold any shares in a company [other than in a public sector company or shares which are prescribed as mode of investment under section 11(5)(*xii*)] after the said date will also forfeit exemption from income-tax.

349.4-1 ***EXCEPTIONS*** - In the cases given below exemption is not forfeited even if funds are invested otherwise than in the modes specified in section 11(5) :

1. The exemption is not denied in relation to assets held by the trust or institution where such assets form part of the corpus of the trust or institution as on June 1, 1973.

2. Similarly, exemption is not denied in relation to any accretion to the assets, being shares of a company forming part of the corpus of the trust or institution as on June 1, 1973, where such accretion arises by way of allotment of bonus shares.

3. Exemption is not forfeited in relation to debentures acquired by the trust or institution before March 1, 1983. Where the debentures of an Indian company are acquired by the trust or institution after February 28, 1983 but before July 25, 1991, the exemption from tax under section 11 will be denied only in respect of interest on such debentures. If, however, such debentures are not disinvested by March 31, 1992, the trust or institution will lose exemption under section 11.

4. Exemption is not forfeited in relation to any funds representing the profits and gains of a business, if the trust/institution maintains separate books of account in respect of such business.

5. Acceptance of donations in kind or acquiring any asset not conforming to the provision of section 11(5) will not make the fund or trust or institution lose tax exemption. The trust or institution shall be required to dispose of or convert the asset not conforming to the requirement of section 11(5) into permissible investment within one year from the end of the financial year in which such assets are acquired on March 31, 1993, whichever is later.

349.4-2 ***FORMS OR MODES OF INVESTMENT [SEC. 11(5)]*** - A uniform pattern of investment is laid down, with effect from April 1, 1983, for all categories of funds belonging to charitable and religious trusts or institutions. The same pattern of investment will apply in relation to accumulation of income in

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†75 per cent up to the assessment year 2002-03.

**See*, however, the rulings given in *CIT* v. *A. L. N. Rao Charitable Trust* [1995] 216 ITR 697 (SC) and *S.R.M.M.C.T.M. Tiruppani Trust* v. *CIT* [1998] 230 ITR 636 (SC), wherein the Court held that accumulated income which is exempt under section 11(1)(*a*) need not be invested in the Government securities; it is only in respect of any additional accumulated income beyond 15 per cent that, if the assessee wants exemption of its additional accumulated income also, the assessee is required to invest the additional accumulated income in the manner laid down in section 11(5).

excess of 15 per cent. The uniform forms or modes for investing funds of charitable and religious trusts and institutions are given below :

a. investment in Government savings certificates*;

b. deposit in any Post Office Savings Bank Account ;

c. deposit in any account with any scheduled bank or a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank) ;

d. investment in any Central Government or State Government securities ;

e. investment in units of the Unit Trust of India ;

f. investment in debentures of any corporate body, the principal whereof and the interest whereon are guaranteed by the Central or a State Government ;

g. investment or deposit in any public sector company (a proviso has been inserted in clause (*vii*) of section 11(5) with effect from the assessment year 2001-02. It provides that where an investment is made in the shares of any public sector company and such public sector company ceases to be a public sector company, the investment so made shall be deemed to be an investment made for a period of 3 years from the date such company ceases to be a public sector company and in the case of any other investment or deposit, it shall be deemed to be an investment made for the period up to the date on which such investment or deposit becomes repayable by such company) ;

h. immovable property ;

i. deposits with or investment in any bonds issued by any financial corporation engaged in providing long-term funds for industrial development in India, if the corporation is eligible for deduction under section 36(1)(*viii*) ;

j. deposits with or investment in any bonds issued by any public company carrying on the business of providing long-term finance for construction or purchase of house in India for residential purposes, if the company is eligible for deduction under section 36(1)(*viii*) ;

k. deposits with Industrial Development Bank of India ;

l. any other prescribed form or mode of investment**; and

m. from the assessment year 2001-02, deposit with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India (for this purpose "long-term finance" means any loan or advance where the terms under which money is loaned or advanced provide for repayment along with interest thereof during a period of not less than 5 years. "Urban infrastructure" means a project for providing potable water supply, sanitation and sewerage, drainage, solid waste management, roads, bridges and flyovers or urban transport).

349.5 ***Educational and medical facilities to specified persons [Secs. 12(2) and 13(6)]*** - Sections 12(2) and 13(6) provide as follows —

1. Income of a charitable or religious trust will not be exempt if any part of such income or any property of the trust is used or applied directly or indirectly for the benefit of any person such as the author of the trust, trustee or any relative of such persons or any concerns in which such persons have a substantial interest [referred to as interested person, *see* para 349.3-1]. Sub-section (6) has

*It has been clarified that the investment in "Indira Vikas Patra" and "Kisan Vikas Patra" is in accordance with the norms and modes specified in section 11(5)—Circular No. 566, dated July 17, 1990.

**Investment in (*a*) units issued under any scheme of mutual fund referred to in section 10(*23D*), (*b*) any transfer of deposit to the Public Account of India, (*c*) deposits made with an authority constituted in India by or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both, (*d*) investment by way of acquiring equity shares of a depository as defined in section 2(*1*)(*e*) of the Depositories Act, 1996, (*e*) investment in certain securities by a recognized stock exchange, (*f*) investment by way of acquiring equity shares of an incubatee by an incubator, and (*g*) investment by way of acquiring shares of National Skill Development Corporation.

been inserted in section 13 with effect from the assessment year 2001-02. It provides that a charitable or religious trust running an educational institution or a medical institution or a hospital shall not be denied the benefit of exemption under section 11 or section 12, in relation to any income by reason only that such trust has provided educational or medical facilities to interested persons.

2. Sub-section (2) has been inserted in section 12 with effect from the assessment year 2001-02. It provides that the value of any medical or educational services made available by any charitable or religious trust running a hospital or medical institution or an educational institution to any interested person shall be deemed to be the income of such trust or institution derived from property held under trust wholly for charitable or religious purposes during the previous year in which such services are so provided and shall be chargeable to income-tax notwithstanding the provisions of section 11(1).

349.6 ***Donation for providing relief to the victims of earthquake in Gujarat [Sec. 12(3)]*** - Any amount of donation received by a trust or institution under section 80G(5C) which has been utilised for purposes other than providing relief to the victims of earthquake in Gujarat or which remains unutilised on March 31, 2004 and not transferred to the Prime Minister's National Relief Fund on or before the said date shall be deemed to be the income of the previous year and shall be charged to tax accordingly.

349.7 ***Anonymous donation [Sec. 13(7)]*** - Section 13 has been amended from the assessment year 2007-08 to the effect that any anonymous donation will not be eligible for deduction under sections 11 and 12.

349.7-1 *WHAT IS ANONYMOUS DONATION [SEC. 115BBC(3)]* - The expression "anonymous donation" has been defined as follows—

1. It is a voluntary contribution referred to in section 2(*24*)(*iia*).

2. The person receiving such contribution does not maintain a record of—

a. the identity indicating the name and address of the person making such contribution ; and

b. such other records as may be prescribed.

349.7-2 *SPECIAL RATE OF TAX [SEC. 115BBC(1)]* - "Anonymous donation" would be taxable for at the rate of 33.99 per cent.

349.7-3 *INSTITUTIONS AFFECTED BY THE ABOVE PROVISIONS [SEC. 115BBC(1)]* - The above provisions are applicable in the case of following—

a. any trust or institution referred to in section 11;

b. any university or other educational institution referred to in section 10(*23C*)(*iiiad*) and (*vi*);

c. any hospital or other institution referred to in section 10(*23C*)(*iiiae*) and (*via*);

d. any fund or institution referred to in section 10(*23C*)(*iv*); and

e. any trust or institution referred to in section 10(*23C*)(*v*).

349.7-4 *DONATIONS NOT AFFECTED BY THE ABOVE PROVISIONS [SEC. 115BBC(2)]* - The following anonymous donations shall not be covered by the provisions of section 115BBC—

i. donations received by any trust or institution created or established wholly for religious purposes; and

ii. donations received by any trust or institution created or established for both religious as well as charitable purposes.

However, donation mentioned in (*ii*) (*supra*) does not include any anonymous donation made with a specific direction that such donation is for any university or other educational institution or any hospital or other medical institution run by such trust or institution.

349.7-5 CONCLUSIONS - The following conclusions can be drawn from the aforesaid discussion—

Who will be chargeable to tax at the rate of 30 per cent (+SC+EC+SHEC) in respect of anonymous donation	*Who will not be chargeable to tax at the rate of 30 per cent (+SC+EC+SHEC) in respect of anonymous donation*
■ Institutions mentioned in para 349.7-3.	■ A trust/institution established wholly for charitable purposes
■ Anonymous donation received by a trust established for both religious as well as charitable purposes with a specific direction that such donation is for any university or other educational institution or any hospital or other medical institution run by such trust or institution.	■ A trust established for both religious as well as charitable purposes (however, it does not include an anonymous donation with a specific direction that such donation is for any university or other educational institution or any hospital or other medical institution run by such trust or institution).

Public charitable/religious trust - How chargeable to tax

350. Subject to rule mentioned in para 350.1, in the following cases income of a charitable/religious trust which is not exempt under section 11 or 12 is chargeable to tax as if it is the income of an association of persons :

a. income from property held under trust wholly for charitable or religious purposes ;

b. voluntary contributions without any direction that they shall form part of corpus of trust ; or

c. income of trust or institution being profits and gains of business which is incidental to the attainment of the objectives of trust and separate books of account are maintained.

350.1 ***Levy of tax at maximum marginal rate in case of public charitable and religious trusts which forfeit tax exemption*** - Charitable or religious trusts, which may otherwise be eligible for tax exemption, are liable to forfeit this exemption in the following circumstances, namely :

1. Where the trust is created after March 31, 1962, any part of the income of the trust enures, under the terms of the trust deed, directly or indirectly, for the benefit of specified categories of persons such as, the author of the trust, trustee or manager of the trust, substantial contributor to the trust and any relative of such author, trustee, etc. [*see* para 349.3].

2. Any part of the income or any property of the trust (whenever created) is used or applied during the relevant year, directly or indirectly, for the benefit of specified categories of persons [*see* para 349.3].

3. The trust funds (with certain exceptions) are invested in contravention of the investment pattern of such funds [*see* para 349.4].

Where a charitable or religious trust forfeits tax exemption in the circumstances mentioned at (*1*) to (*3*) above, the trust shall be charged to tax at the maximum marginal rate (*i.e.*, 33.99 per cent for the assessment year 2009-10).

A trust will attract the maximum marginal rate of tax only on that part of income which has forfeited exemption under the above circumstances and not on the entire income of the trust—*Director of Income-tax (Exemption)* v. *Sheth Mafatlal Gagalbhai Foundation Trust* [2001] 114 Taxman 19 (Bom.).

Private discretionary trust

351. Income derived from property under a private discretionary trust is chargeable to tax as under :

351.1 ***Where shares of the beneficiaries are determinate*** - In such a case the shares falling to each of the beneficiaries are liable to be assessed in the hands of trustee(s) as a "representative-assessee" under section 161. Such assessment is made at the rate applicable to the total income of each beneficiary. However, the Income-tax Department has the option to make an assessment either in

the hands of the trustee(s) as a representative-assessee under section 161 or directly in the hands of the beneficiary entitled to the income under section 166. Having exercised this option once, it is not open to the Assessing Officer to assess the same income for that assessment year in the hands of other persons, *i.e.*, the beneficiary or the trustee *vide* Circular No. 157, dated December 26, 1974.

The rule mentioned above is applicable only if the beneficiaries and their shares are expressly stated in the order of the court or the instrument of trust or wakf deed, as the case may be. Where, however, beneficiaries and their shares are not expressly stated in the order of the court or the instrument of trust or wakf deed, as the case may be, income is taxable according to the rules mentioned in para 351.2.

■ Where income of the trust consists of or includes profits and gains of business, income-tax shall be charged in the hands of trustee(s) on the whole of the income at the maximum marginal rate (*i.e.*, 33.99 per cent for the assessment year 2008-09). However, it has been specifically provided that this provision is not applicable in a case where the profits and gains of business are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance, and such trust is the only trust so declared by him.

■ Wrong distribution of income by trustees may affect rights of beneficiaries *inter se* for which various other consequences may ensue, but it cannot lead to a conclusion that their shares are indeterminate or unknown—***CIT*** v. ***Gurmail Kaur Trust*** [2004] 141 Taxman 224 (Punj. & Har.)

351.2 ***Where shares of the beneficiaries are indeterminate or unknown [Sec. 164(1)]*** - In the case of a private discretionary trust, declared by a duly executed instrument in writing [provision of this section is not applicable in the case of oral trust—*see* para 352A] where the shares of the beneficiaries are unknown, trustee(s) is liable to tax as a representative assessee at the following rates :

351.2-1 *WHERE THE INCOME CONSISTS OF, OR INCLUDES, PROFITS AND GAINS OF BUSINESS* - Where the income consists of, or includes, profits and gains of business, the entire income of the trust is charged at the maximum marginal rate of tax (*i.e.*, 33.99 per cent for the assessment year 2008-09) except in cases where the profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is the only trust so declared by him. In such cases, the income of the discretionary trust is charged to tax at normal rates applicable to individuals and not at the maximum marginal rate of tax.

351.2-2 *WHERE INCOME DOES NOT CONSIST OR INCLUDE PROFITS AND GAINS OF BUSINESS* - Income is taxable at the maximum marginal tax rate (*i.e.*, 33.99 per cent for the assessment year 2008-09). However, the maximum marginal rate of tax is not applicable in the following cases and in the following cases income will be chargeable to tax as if it were income of an association of persons :

a. where none of the beneficiaries has any other income chargeable to tax under the Income-tax Act (*i.e.*, exceeding the maximum amount not chargeable to tax in the case of an association of persons) and none of the beneficiaries is a beneficiary under any other trust ; or

b. where the relevant income or part of relevant income is receivable under a trust declared by any person by will and such trust is the only trust so declared by him ; or

c. where the trust is a non-testamentary trust created before March 1, 1970 for the exclusive benefit of relatives of the settlor mainly dependent on him for their support or maintenance or, where settlor is a Hindu undivided family, for the exclusive benefit of its members so dependent upon it ; or

d. where the trust is created on behalf of a provident fund, superannuation fund, gratuity fund, pension fund or any other fund created *bona fide* by a person carrying on a business or profession exclusively for the benefit of persons employed in such business or profession.

It is worth mentioning that while in the cases of (*a*), (*b*) and (*c*) *supra*, the relevant income is taxable in the hands of trustees as if it were the total income of an association of persons, income falling under (*d*) *supra* is exempt from tax under section 10(*25*).

351-P1 *Determine the tax liability of XY Trust (individual share of beneficiaries is not known) for the assessment year 2009-10, if its income during the previous year is (a) Rs. 1,60,000 and (b) Rs. 11,10,000.*

Make the following assumptions :

1. *If none of the beneficiaries is a beneficiary under any other trust and has income exceeding Rs. 1,50,000.*
2. *If one of the beneficiaries is also a beneficiary under another trust or has income exceeding Rs. 1,50,000.*

SOLUTION :

	If income of the trust is	
	Rs. 1,60,000 Rs.	Rs. 11,10,000 Rs.
IF NONE OF THE BENEFICIARIES IS A BENEFICIARY UNDER ANY OTHER TRUST AND HAS INCOME EXCEEDING Rs. 1,50,000		
Tax as per rate applicable to an association of persons [see Annex 1]	1,030**	2,69,650**
IF ONE OF THE BENEFICIARIES IS A BENEFICIARY IN ANOTHER TRUST OR HAS TAXABLE INCOME EXCEEDING Rs. 1,50,000		
Tax at the maximum marginal rate of tax (*i.e.*, 33.99%*)	54,380*	3,77,290*

Income from property held under trust partly for religious purposes and partly for other purposes [Sec. 164(3)]

352. If property is held under trust partly for religious purposes and partly for other purposes and the individual share of the beneficiaries in the income applicable to purposes, other than charitable purposes, is not known, the tax liability will be the aggregate of the following :

a. the tax which would be chargeable on the part of the relevant income which is applicable to charitable or religious purposes (as reduced by the income, if any, which is exempt under section 11) as if such part (or such part so reduced) were the total income of an association of persons; and

b. the tax on that part of income which is applicable to purposes other than charitable or religious and in respect of which shares of beneficiaries are indeterminate or unknown, at the maximum marginal rate (*i.e.*, 33.99 per cent for the assessment year 2009-10) [*see* also para 352.1].

Where any part of income is not exempt under section 11 or 12 by virtue of section 13(1)(*c*)/13(1)(*d*) tax is charged on the relevant income at the maximum marginal rate (*i.e.*, 33.99 per cent for the assessment year 2009-10).

352.1 ***Cases where maximum marginal rate is not applicable*** - In the following cases tax shall be charged on the relevant income as if the relevant income (as reduced by the income, if any, which is exempt under section 11) were the total income of an association of persons (and not at the maximum marginal rate of tax) :

■ *Where income includes, or consists of, profits and gains of business* - Maximum marginal rate is not applicable (and income is taxable at the rate applicable to an association of persons) if the income is receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is the only trust so declared by him.

**Tax will be charged at the maximum marginal rate of tax [@ 33.99%] if income consists of profits and gains from business.

■ *In any other case* - Income will be charged to tax as if it were income of an association of persons :

a. where none of the beneficiaries has any other income chargeable to tax, *i.e.*, income should not exceed the maximum amount not chargeable to income-tax—*ITO* v. *Maharaja Daljit Singhji Trust* [1979] 1 Taxman 82 and none of the beneficiaries is a beneficiary under any other trust ; or

b. where the trust is created by any person by will and such trust is the only trust so declared by him ; and

c. where the trust is a non-testamentary one created before March 1, 1970, for the exclusive benefit (to the extent it is not utilised for charitable or religious purposes) of relatives of the settlor mainly dependent on the settlor for their support or maintenance or where settlor is a Hindu undivided family, for the exclusive benefit of its members so dependent upon it.

352-P1 *XY trust derives a total income of Rs. 6,40,000. Out of Rs. 6,40,000, Rs. 1,40,800 is meant for public charitable purposes and the balance Rs. 4,99,200 is for the benefits of X (29 years) and Y (31 years) whose individual shares are not known. The trust has actually applied Rs. 40,000 towards public charitable purposes during the previous year. Determine the tax liability of the trust for the assessment year 2009-10 under the following situations :*

a. *X and Y are neither beneficiaries under any other trust nor their taxable income exceeds Rs. 1,50,000.*

b. *X is member of another trust (no income is derived for the trust), though taxable income of X and Y does not exceed Rs. 1,50,000.*

c. *Taxable income of X and/or Y is Rs. 1,50,010 though they are not beneficiaries under any other trust.*

SOLUTION :

	Under situation (a) Rs.	*Under situation (b) or (c) Rs.*
Tax on Rs. 5,78,880[1] if it were income of an association of persons [see Annex 1]	81,024	*NA*
Tax on Rs. 79,680[2] if it were income of an association of persons [see Annex 1]	*NA*	*Nil*
Tax on Rs. 4,99,200[3] @ 33.99%	*NA*	1,69,679
Total	81,024[4]	1,69,679
Total (rounded off)	81,020	1,69,680

Notes :

1. Rs. 6,40,000 — 15% of Rs. 1,40,800 — Rs. 40,000
2. Rs. 1,40,800 — 15% of Rs. 1,40,800 — Rs. 40,000
3. Rs. 5,78,880 — Rs. 79,680 or Rs. 6,40,000 — Rs. 1,40,800
4. Tax will be charged at the maximum marginal rate, if income consists of profits and gains from business.

Oral trust

352A. With a view to curbing tax avoidance through the medium of oral trusts, the Finance Act, 1981 made the following provisions in clause (*v*) of section 160(1) and section 164A :

■ A trustee appointed under an "oral trust" will be regarded as a representative-assessee in respect of income received by him on behalf, or for the benefit, of any person.

■ An oral trust will, however, be regarded as a trust declared by a duly executed instrument in writing if a statement in writing signed by the trustee, setting out the purposes of the trust, particulars as to the trustees, the beneficiaries and the trust property, is forwarded to the Income-tax Officer within the specified time limit. Where the trust has been declared before June 1, 1981, the specified time limit will be the period of 3 months from that date and in any other case, 3 months from the date of the declaration of the trust.

■ Any income received by a trustee on behalf, or for the benefit, of any person under an oral trust will be chargeable to tax at the maximum marginal rate.

The effect of the above provisions will be as follows :

■ An oral trust, terms whereof are not subsequently recorded in writing and intimated to the Assessing Officer in the specified manner, will be chargeable to income-tax at the maximum marginal rate in all cases.

■ An oral trust, terms whereof are subsequently recorded in writing and intimated to the Assessing Officer in the specified manner, will be chargeable to income-tax at the maximum marginal rate in cases where the shares of the beneficiaries are indeterminate or unknown.

Where, however, such shares are known, the tax will be levied and recovered from the trustees in the same manner and to the same extent as would be leviable or recoverable from the beneficiaries.

Return of income and assessment

Voluntary return of income [Sec. 139(1), (4A), (4B), (4C), (4D)]

353. The following persons are under statutory obligation to file return of income by virtue of section 139(1), (4A), (4B), (4C)—

Taxpayer	*Minimum income to attract the provisions of filing return of income*
Company or firm [sec. 139(1)]	Any income or loss
Other than a company or firm [sec. 139(1)]	If the income is in excess of the amount not chargeable to tax (*i.e.*, the amount of exempted slab†)‡
A person in receipt of income derived from property held under a trust for charitable or religious purposes [sec. 139(4A)]	If the income (without giving exemption under section 11 or 12) exceeds the maximum amount† not chargeable to tax
Chief executive officer of every political party [sec. 139(4B)]	If the income (without giving exemption under section 13A) exceeds the maximum amount† not chargeable to tax
Scientific research association, news agency, association/institution for control or supervision of a profession, institution for development of khadi and village industries, fund/institution referred to in section 10(*23C*)(*iv*), (*v*), educational/medical institution, trade union [sec. 139(4C)]	If the income (without giving exemption under section 10) exceeds the maximum amount† not chargeable to tax
University/educational institution existing solely for educational purposes and not for the purpose of profit if the aggregate annual receipt does not exceed Rs. 1 crore [sec. 139(4C)(*e*)]	If income without giving exemption under section 10 exceeds the exemption limit*
Hospital/other institution existing solely for medical purposes and not for the purpose of profit if the aggregate annual receipt does not exceed Rs. 1 crore [sec. 139(4C)(*e*)]	If income without giving exemption under section 10 exceeds the exemption limit*
Any university/college/other institution referred to in section 35(1)(*ii*)/(*iii*) [sec. 139(4D)]	Any income or loss (return has to be submitted whether there is income or loss. Such return has to be submitted even if it is not required by any other provision)

■ *Resident or non-resident* - Section 139(1) applies to all persons whether they are resident or non-resident—*Pannalal Nandlal Bhandari* v. *CIT* [1961] 41 ITR 76 (SC).

†For the assessment year 2009-10, the exemption limit is Rs. 1,80,000 (in the case of a resident woman below 65 years), Rs. 2,25,000 (in the case of a resident senior citizen 65 years or more) and Rs. 1,50,000 (in the case of any other individual or every HUF).

‡An individual/HUF/AOP/BOI/ artificial juridical person will have to submit the return of income, if his total income, without giving effect to the provisions of sections 10A, 10B, 10BA[ε] and sections 80C to 80U exceeds the maximum amount which is not chargeable to income-tax (*i.e.*, the exemption limit given above).

[ε] Sections 10, 10AA and 10C are not in this list.

*Rs. 1,50,000 for the assessment year 2009-10.

■ *Political parties* - Political parties are under a statutory obligation to file return of income in respect of each assessment year in accordance with the provisions of the Income-tax Act and the total income for this purpose has to be computed without giving effect to provisions of section 13A—*Common Cause A Registered Society* v. *Union of India* [1996] 85 Taxman 600/222 ITR 260 (SC).

■ *Liquidator* - Under the Companies Act, a liquidator is not exempt from making an income-tax return on business managed by him for the beneficial winding up of the company—*CIT* v. *Official Liquidator of the Agra Spg. & Wvg. Mills Co. Ltd.* [1934] 2 ITR 79 (All.).

■ *Charitable trust* - Submission of return by charitable trust is essential even if its income is exempt—*Lala Gopi Mal Kuthiala Trust* v. *ITO* [1962] 46 ITR 436 (Punj.). If the total income of a charitable trust (without claiming exemption under sections 11, 12 and 13A) exceeds the maximum amount not chargeable to tax, then submission of return by the trust is essential.

■ *No need to file return if non-agricultural income is less than the amount of exemption limit in the case of an individual/HUF* - If non-agricultural income of an individual/HUF is equal to or less than the exemption limit, then he may not submit his return of income. Likewise, an individual deriving income from growing and curing coffee [with or without mixing chicory or other flavouring ingredients] would not be obliged to file his return, if his income from growing and curing of coffee is Rs. 6 lakh or less for the assessment year 2009-10 as only 25 per cent of such income is taxable as business income. Where such an individual derives income from growing, curing, roasting and grounding (with or without mixing chicory or other flavouring ingredients) and his income from such activity for the assessment year 2009-10 is Rs. 3,75,000 or less, he would not be obliged to file his return of income as only 40 per cent of such income is taxable as business income—**Circular No. 10/2003**, dated December 24, 2003.

353.1 ***One by six scheme obligatory filing of return when income is lower than exemption limit [First proviso to section 139(1)]*** - Now one by six scheme is not applicable.

353.2 ***Return form*** - *New return Forms* - For the assessment years 2007-08 and 2008-09, the Central Board of Direct Taxes has notified the following new forms—

New ITR Forms	*Subject*
ITR-1	For individuals having income from salary and interest
ITR-2	For individuals and HUFs not having business/professional income
ITR-3	For individuals/HUFs being partners in firms and not carrying out business or profession under any proprietorship
ITR-4	For individuals and HUFs having income from a proprietary business or profession
*ITR-5**	For firms, AOPs and BOIs or any other person (no being individual or HUF or company or to whom ITR-7 is applicable)†
*ITR-6**	For companies other than companies claiming exemption under section 11†
*ITR-7**	For persons including companies required to furnish return under section 139(4A)/(4B)/(4C)/(4D)
ITR-8	Return for fringe benefits
ITR-V	Where the data of the return of income/fringe benefits in Forms ITR-1, ITR-2, ITR-3, ITR-4, ITR-5, ITR-6 & ITR-8 transmitted electronically without digital signature

*These forms include fringe benefit tax return

†In case of firms (if audit is required under section 44AB) and companies, return should be submitted in electronic format with or without digital signature. In other cases, return can be in paper format or electronic format. However ITR-7 can be submitted only in paper format.

353.2-1 *CLARIFICATIONS FROM BOARD* - Following clarifications are also issued in respect of certain issues arising from furnishing the returns in the above-mentioned forms:

1. The report of audit under section 44AB is not to be attached with the return. It should not be furnished separately also before or after the due date. However, an assessee should get the report of audit from an accountant under said section before the due date of the furnishing of the return and should fill out the relevant columns of these forms on the basis of such report. The assessee should retain the report with himself. It may be furnished in original during the assessment proceedings. No penalty under section 271B shall be initiated or levied for not furnishing the tax audit report on or before the due date. However, if the audit report has not been obtained before the due date, provisions of section 271B shall be attracted.

2. These returns are not to be accompanied with any other document including any statutory form or report of audit (other than the report under section 92E which is otherwise required to be furnished before the due date or along with the return for making any claim). The provisions of the law shall be deemed to have been complied with in respect of the requirement of the filing of the attachments or documents or reports along with the return. No penalty shall be initiated/levied for not furnishing such documents if such documents were otherwise obtained before the specified date, if any, provided in the statute. All these documents should be retained by the taxpayers and be furnished in original during the scrutiny proceedings.

3. The report as required under section 92E of the Income-tax Act shall continue to be furnished before the specified in rule 10E.

4. In case, a return is furnished under digital signature, the date of such furnishing shall be the date of furnishing the return. In case, the assessee chooses to transmit the data in the return electronically and thereafter submit the verification of the return in Form ITR-V, the date of transmitting the data electronically will be the date of furnishing the return if ITR-V has been furnished within 15 days from the date of transmitting the data electronically. In case, Form ITR-V, is furnished after the above-mentioned period, the date of furnishing Form ITR-V shall be deemed to be the date of furnishing the return. Further, in case, Form ITR-V is not furnished, it will be deemed that no return has been furnished.

5. The e-Return has to be furnished at http://income tax-indiaefiling.gov.in. The ITR-V shall be furnished at separate counter(s) to be set up exclusively for this purpose at each local income-tax office (whether on net-work or not).

6. The ITR-V Forms are bar-coded. Therefore, CCITs/CITs must ensure that these Forms are handled and stored with care and caution. While storing the returns, precaution should be taken not to fold them. These ITR-V should be sent to the RCCs immediately.

7. The returns filed electronically shall be processed on priority basis - **Circular No. 5/2007,** dated July 26, 2007.

353.3 ***Time for filing return of income [Sec. 139(1)]*** - The due dates for filing the returns of income are as given below :

Different situations	*Due date of submission of return [see also Note]*
1. Where the assessee is a company	September 30
2. Where the assessee is a person other than a company:	
2.1 Where accounts of the assessee are required to be audited under any law	September 30
2.2 Where the assessee is a "working partner" in a firm whose accounts are required to be audited under any law	September 30
2.3 In any other case	July 31

353.4 ***Salaried employees may furnish return through their employers [Sec. 139(1A)]*** - The provisions are given below —

1. The taxpayer is an "eligible employee". He is employed by an "eligible employer" and assessed to tax at Ahmedabad, Bangalore, Baroda, Bhopal, Chandigarh, Chennai, Delhi, Gandhinagar, Hyderabad, Jaipur, Jabalpur, Kolkata, Mumbai, Nagpur, Pune and Thane.

2. Eligible employer means (*a*) an employer who has a minimum of 50 employees (with income exceeding the amount of exemption limit) assessed to tax at any of the specified cities given above, and (*b*) who has been allotted tax deduction account number (TAN).

3. The "eligible employee", at his option, may furnish a return in Form No. 2D/3 together with documents to his employer (*i.e.*, "eligible employer").

4. Such employer shall furnish returns received by him on or before the due date on computer readable media using the authorized Bulk Return Preparation Software (BRPS). The BRPS can be collected from the Income-tax Department.

5. Such return shall be deemed to be a return furnished under section 139(1).

6. The following types of returns cannot be submitted under the above scheme —(*a*) return of a year other than current year; (*b*) return without PAN or with incorrect PAN; (*c*) return under block assessment; (*d*) return of an employee having more than one employer; (*e*) return of an employee who is not getting salary from an "eligible employer" on the last day of the previous year; and (*f*) revised return.

353.5 ***Filing of return of income on computer readable media [Sec. 139(1B)]*** - Any person may, at his option, on or before the due date, furnish a return of his income under section 139(1) in accordance with scheme specified by the Board. Under this scheme, a return has to be submitted in a computer readable media (including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media) and such return shall be deemed to be a return furnished under section 139(1) and the provisions of the Act would apply accordingly.

■ *Optional Scheme* - This is an optional scheme. It offers an additional mode of filing of returns, to salaried taxpayers. The scheme is currently introduced in Chennai, Kolkata, Mumbai, New Delhi, Ahmedabad, Bangalore and Hyderabad.

■ *Who are eligible* - A person satisfying the following conditions is eligible —

a. individuals not having income from business and profession,

b. who are assessed or assessable at specified cities, and

c. who have been allotted a valid PAN.

■ *Procedure* - The following procedure is adopted :—

1. Willing taxpayers can approach an authorised "e-returns intermediary" of his choice either with details of its income and its supporting documents or with a prepared return of income. The intermediary will prepare his return of income and obtain his signature on the same.

2. The intermediary will transcribe the data on the return of income, and transmit the same online to the server of the department in predefined format.

3. Department will send a provisional receipt online to the intermediary indicating date of receipt and the office of the Assessing Officer, where the paper return is to be furnished by the intermediary.

4. The intermediary will submit the paper return along with the provisional receipt at the Income-tax office and will get an acknowledgement, which he will handover to the taxpayer.

5. The department will process the electronically received returns on priority basis and issue refunds, if any.

Return of loss [Sec. 139(3)]

354. A return of loss can also be filed within the dates mentioned in para 353.3. The return of loss should be filed in the prescribed form* and within the time allowed under section 139(1)†.

As discussed in para 229.1-5, the following losses cannot‡ be carried forward if the return of loss is not submitted in time —

a. business loss (speculative or otherwise) ;

b. capital loss ; and

c. loss from the activity of owning and maintaining race horses.

Extension of time

355. Under the amended provisions applicable from April 1, 1989, the Assessing Officers do not have any power to extend the date of filing the returns and dates mentioned in para 353.3 are, therefore, mandatory.

Belated return [Sec. 139(4)]

356. If return is not furnished within the time allowed under section 139(1) or within the time allowed under notice issued under section 142(1), the person may, before the assessment is made, furnish the return of any previous year at any time before the end of one year from the end of relevant assessment year.

For instance, a company is supposed to file return for the assessment year 2009-10 by September 30, 2009. If it does not file return up to September 30, 2009, then such return, if submitted after the said date, will be belated return. Such belated return may be submitted within 1 year from the end of assessment year (*i.e.*, up to March 31, 2011). If, however, the assessment is completed before March 31, 2011, then such return should be submitted before the completion of assessment.

■ *Consequences of late submission* - If return is submitted after the due date of submission of return of income, the following consequences will be applicable. These rules are applicable even if a belated return is submitted within the time-limit given above—

1. The assessee will be liable for penal interest under section 234A.

2. A penalty of Rs. 5,000 may be imposed under section 271F if belated return is submitted after the end of assessment year.

3. If return of loss is submitted after the due date, a few losses cannot be carried forward [see para 354]

4. If return is submittedly belated, deduction under sections 10A, 10B, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID and 80-IE is not be available.

■ *Return after service of notice of demand* - If a return is filed after the completion of assessment but before service of demand notice, such return is not a valid return—*Dhaniram Dharam Pal* v. *CIT*[1936] 4 ITR 113 (Lahore). For instance, the best judgment assessment is made on February 11, 2008 for the assessee's failure to file return (for the assessment year 2006-07) despite notice under section 142. But before the assessment order is served on February 23, 2008, the assessee files a return on February 15, 2008. It is not a valid return—*see Bhaskaran* v. *ITO*[1963] 47 ITR 334 (Ker.). Return in this case can be filed before February 11, 2008. If, however, the best judgment assessment is made after March 31, 2008, then return of income can be filed up to March 31, 2008. Where the assessee filed the return for the first time after best judgment assessment had been made in the absence of the return and later on the best judgment assessment was set aside, the return filed would

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**See* para 353.2.

†*See* para 353.3.

‡The delay may be condoned if certain conditions are satisfied [*see* para 432.1] - *Circular No. 8/2001*, dated May 16, 2001.

be treated as a return filed under section 139(4)—*Ram Bilas Kedar Nath* v. *ITO* [1963] 47 ITR 586 (All.).

Revised return [Sec. 139(5)]

357. If certain conditions are satisfied a person may furnish a revised return of income under section 139(5).

357.1 *Conditions* - The following conditions one has to satisfy :

1. Only return filed under section 139(1) or in pursuance of a notice under section 142 can be revised - A return can be revised only if such return is furnished under section 139(1) or in pursuance of a notice under section 142(1). A belated return filed under section 139(4) cannot be revised — *Kumar Jagdish Chandra Sinha* v. *CIT* [1996] 86 Taxman 122 (SC).

2. Any omission/wrong statement can be corrected - The benefit of filing a revised return cannot be claimed by a person who has initially filed a return, knowing it to be false—*CIT* v. *Radhey Shyam* [1980] 123 ITR 125 (All.), *CIT* v. *Badridas Ramrai Shop* [1939] 7 ITR 613 (Nag.). In other words, section 139(5) is not applicable in cases of concealment or false statements—*CIT* v. *J.K.A. Subramania Chettiar* [1977] 110 ITR 602 (Mad.). Omission or wrong statement in the original return must be due to a *bona fide* inadvertence or mistake on the part of the assessee— *Sunanda Ram Deka* v. *CIT* [1994] 210 ITR 988 (Gauhati). Where omission or wrong statement in original return is discovered by the department as a result of enquiry and thereafter a revised return is furnished making amendment, that would not amount to a revised return as contemplated under section 139(5)—***CIT*** v. ***Grey Cast Foundry Works*** [2006] 99 ITD 515 (Ahd.).

3. Revised return should be filed within one year from the assessment year or before completion of assessment - Revised return under section 139(5) can be filed at any time before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment, whichever is earlier.

For instance, for the assessment year 2009-10, a revised return can be filed up to March 31, 2011. If, however, the assessment is completed before March 31, 2011 (say on April 15, 2010), then revised return can be filed before April 15, 2010.

357.2 *Other points* - The following broad propositions taken from different judicial pronouncements should be kept in view while understanding the implications of section 139(5) :

■ *Meaning of assessment* - "Assessment" refers to the assessment made under section 143(3) or 144. An intimation served to the assessee under section 143(1) will not constitute an "assessment". Consequently, if an assessee files a revised return after the service of an intimation under section 143(1) (but before the time given above) it will be duly considered by the Assessing Officer - ***S.R. Koshti*** v. ***CIT*** [2005] 146 Taxman 335 (Guj.), ***CIT*** v. ***Rajesh Jhaveri Stock Brokers (P.) Ltd.*** [2007] 161 Taxman 316 (SC).

■ *Auditor's report* - Where the assessee who is required to file the auditor's report with its return but does not file the same with the original return, he can file the same with the revised return—*CIT* v. *Sri Baldeoji Maharaj Trust* [1983] 142 ITR 584 (All.).

■ *Substitution of original return* - There is a distinction between a revised return and a correction of the return. If the assessee files some application for correcting a return already filed or making amendments therein, it would not mean that he has filed a revised return. It will still retain the character of an original return, but once a revised return is filed, the original return must be taken to have been withdrawn and to have been substituted by a fresh return for the purpose of assessment—*Dhampur Sugar Mills Ltd.* v. *CIT* [1973] 90 ITR 236 (All.). If the assessee files a revised return, assessment based on such revised return would be valid—*Zulekha Begum (Khatoon)* v. *CIT* [1981] 129 ITR 560 (Cal.).

■ *Application by the assessee* - Where, after filing his return and after receiving notice for production of accounts, the assessee sent an application to the Income-tax Officer stating that a further income was required to be added to the declared income, it was held that it would not amount to filing of a revised return—*Gopaldas Parshottamdas* v. *CIT* [1941] 9 ITR 130 (All.). An assessee cannot amend a return filed by him for making a claim for deduction other than by filing a revised return—***Goetze (India) Ltd.*** v. ***CIT*** [2006] 157 Taxman 1 (SC).

■ *More than one revised return* - An assessee can file revised return as many number of times so long as it is within the limitation period and the assessee discovers any omission or wrong statement therein—***CIT*** v. ***Samson Distilleries (P.) Ltd.*** [2006] 9 SOT 24 (Bang.).

■ *Period of limitation when an assessee files more than one revised return* - A second revised return can be filed under section 139(5) correcting omissions or wrong statements made in the first revised return, for, the first revised return filed under section 139(5) would, in law, be a return under section 139(1) also. The period of limitation for compilation of assessment prescribed under section 153(1) will run from the date of filing of second revised return, if the assessee has filed two revised returns—*Niranjan Lal Ram Chandra* v. *CIT* [1982] 134 ITR 352 (All.).

■ *Permission not required* - There is no provision in the Income-tax Act to seek permission to revise a return. It is a right of the assessee to submit such return. However, an application purporting to be under section 139(5), seeking permission to revise the return as originally filed, cannot be treated as a revised return—*Waman Padmanabh Dande* v. *CIT* [1952] 22 ITR 339 (Nag.).

Defective or incomplete return [Sec. 139(9)]

358. Section 139(9) is applicable as follows —

1. Defective return - The Assessing Officer considers that the return of income furnished by the assessee is defective [when a return becomes defective—*see* para 358.1].

2. Intimation of defect - The Assessing Officer may intimate the defect to the assessee.

3. Time-limit for rectification of defect - The Assessing Officer may give the assessee an opportunity to rectify the defect within a period of 15 days from the date of such intimation. This time-limit may be extended by the Assessing Officer on an application by the assessee.

4. If the defect is not rectified within the given time - If the defect is not rectified by the assessee within the period of 15 days or such further extended period, then the Assessing Officer shall treat the return as an invalid return and other provisions of the Income-tax Act would apply as if the assessee had failed to furnish the return.

5. If defect is rectified after the given time but before the completion of assessment - Where the assessee rectifies the defect after the expiry of the period of 15 days (or the further extended period), *but before assessment is made,* the Assessing Officer may condone the delay and treat the return as a valid return.

358.1 ***When a return is defective*** - A return of income is regarded as defective in the following cases—

358.1-1 *RETURN FORM HAS NOT BEEN DULY FILLED* - All items in income-tax return form (*i.e.*, ITR-1 to ITR-8) must be filled in the manner indicated in the return form. If any schedule of the relevant form is not applicable in the case of an assessee, it should be scored across as "——NA——". If any item is inapplicable, one should write "NA" against it. One should write "NIL" to denote *nil* figure. No column or row should be left blank. Otherwise the return may be liable to be held defective or even invalid.

358.1-2 ***ANNEXURES, STATEMENTS, ACCOUNTS, ETC.*** - Under section 139(9), a few statements, reports, proof of pre-paid taxes, accounts*, etc., should accompany the return of income, otherwise the return will become defective. However, it is not possible to attach any certificate or report or computation or final accounts with new income-tax return forms. Likewise, it is not possible to attach proof of pre-paid taxes (like tax deducted/collected at source, advance payment of tax, self-assessment tax). The assessee should, therefore, retain these certificates, report, computation, final accounts, proof of pre-paid taxes with him. These may be furnished whenever the Assessing Officer wants to examine them in assessment proceedings or otherwise. Return of income will not become defective because of non-fulfilment of this requirement.

358.2 ***Clarification from the Board*** - The following points (*vide* Circular No. 281, dated September 22, 1980) may be carefully noted in regard to the aforesaid provision in section 139(9) :

■ *Defects other than the specified defects* - The provisions in section 139(9) are not applicable in the case of returns which do not contain any defects specified above. However, the Calcutta High Court in *CIT* v. *Rai Bahadur Bissesswarlal Motilal Malwasie Trust* [1992] 195 ITR 825 has held that the defects specified in section 139(9) are only illustrative and not exhaustive. The Assessing Officer cannot ignore the specified defects and must get them rectified but to contend that only the defects specified can be got rectified and no other defects would be putting unnecessary restrictions on the power of the Assessing Officer, leading to inconvenient consequences and absurd results not intended by the Legislature. The Assessing Officer has the power to ask the assessee to remove all defects in the return other than the defects making the return invalid.

■ *Invalid return* - The provision makes a distinction between a defective return and an invalid return. A defective return is not always regarded as an invalid return. When a return contains any of the defects given by section 139(9), it is treated as defective return. If the assessee fails to rectify the same within the specified period the return will be treated as an invalid return. In this connection, a reference may be made to section 292B which, *inter alia*, provides that no return of income will be invalid merely by reason of mistake, defect or omission in such return of income. The provision in section 139(9), however, overrides other provisions of the Income-tax Act (including section 292B) in this regard and in a case where any of the specified defects are not removed within the time allowed, the return will be treated as invalid return and the provisions of the Income-tax Act will apply as if the assessee had failed to furnish the return.

358.3 ***Judicial pronouncements*** - The following judicial pronouncements, one should keep in view :

■ *Invalid return* - A return which is not verified by assessee is not valid in the eye of law—*CIT* v. *Dr. Krishan Lal Goyal* [1984] 148 ITR 283 (Punj. & Har.).

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*These are as follows—

a. a statement showing the computation of tax payable on the basis of the return ;

b. the report of audit obtained under section 44AB (or where the report has been submitted prior to furnishing of return, a copy of audit report together with proof of furnishing the report) ;

c. the proof of pre-paid taxes (*i.e.*, tax deducted/collected at source, advance tax, self-assessment tax);

d. where regular books of account are maintained by an assessee :

i. copies of manufacturing account, trading account, profit and loss account or income and expenditure account, or any other similar account and balance sheet ;

ii. in the case of a proprietary business or profession, the personal account of the proprietor; in the case of a firm, association of persons or body of individuals, personal accounts of the partners or members; and in the case of a partner or member of a firm, association of persons or body of individuals, his personal account in the firm, association of persons or body of individuals ;

e. where the accounts of the assessee have been audited, copies of the audited profit and loss account and balance sheet and a copy of the auditor's report and cost audit report under section 233B of the Companies Act ;

f. where regular books of account are not maintained by the assessee, a statement indicating the amount of turnover or gross receipts, gross profit, expenses and net profit of the business or profession and the basis on which such amount have been computed, as also of the amount of total sundry debtors, sundry creditors, stock-in-trade and cash balance as at the end of the previous year.

■ *Unsigned return* - An unsigned return is not a valid return at all—*Behari Lal Chatterji* v. *CIT* [1934] 2 ITR 377 (All.).

■ *Remand cases* - The statutory time of 15 days for removing defects in return of income is available not only to the proceedings before the first assessment is made but also to fresh assessment proceeding taken up on remand by appellate authorities—*Seeyan Plywood* v. *ITO* [2000] 109 Taxman 318 (Ker.).

■ *Improper jurisdiction* - Merely because a return is filed under improper jurisdiction, it cannot be treated as invalid—***CIT*** v. ***Hotel Diwakar Niwas*** [2004] 2 SOT 877 (Gau.).

■ *Failure to rectify defect* - As per section 139(9), defective return shall be held as invalid only when the defects are intimated to the assessee and the assessee fails to rectify them within the original or extended time—***SBM Engg. Products (P.) Ltd.*** v. ***CIT*** [2004] 91 ITD 116 (Mum.).

Scheme to facilitate submission of returns through Tax Return Preparers [Sec. 139B]

359. Section 139B has been inserted with effect from June 1, 2006. It provides as follows—

■ For the purpose of enabling any specified class or classes of persons to prepare and furnish returns of income, the Board may, by way of notification, frame a scheme providing that such persons may furnish their returns of income through a Tax Return Preparer authorised to act as such under the scheme.

■ The Scheme framed under the above provisions shall specify the manner in which the Tax Return Preparer shall assist the persons furnishing the return of income, and shall also affix his signature on such return.

■ A Tax Return Preparer may be an individual other than a person referred to in section 288(2)(*ii*)/(*iv*) or an employee of the specified class or classes of persons, who has been authorised to act as a Tax Return Preparer under the above scheme.

■ The above scheme shall also provide the manner in which a Tax Return Preparer shall be authorised, the educational and other qualifications to be possessed, and the training and other conditions required to be fulfilled, by a person to act as a Tax Return Preparer, the code of conduct for the Tax Return Preparer, the duties and obligations of the Tax Return Preparer, the manner in which the authorisation may be withdrawn, and any other matter which is required to be or may be specified.

Power of Board to dispense with furnishing of documents [Sec. 139C]

359A. Section 139C has been inserted with effect from June 1, 2006. It provides that the Board may make rules providing for a class or classes of persons who may not be required to furnish documents, statements, receipts, certificate, audited reports or any other documents, which are otherwise under any other provisions of this Act, except section 139D, required to be furnished, along with the return. However, such documents shall be produced on demand before the Assessing Officer.

Filing of return in electronic form [Sec. 139D]

359B. Section 139D has been inserted from June 1, 2006. It provides that the Board may make rules providing for the class or classes of persons who shall be required to furnish the return of income in electronic form; the form and the manner in which the return of income in electronic form may be furnished; the documents, statements, receipts, certificates or audited reports which may not be furnished along with the return of income in electronic form but shall be produced before the Assessing Officer on demand; the computer resource or the electronic record to which the return of income in electronic form may be transmitted.

Return by whom to be signed [Sec. 140]

360. The return of income or fringe benefits is required to be signed and verified :

Different assessees	*Who should sign the return*
Individual	By the individual himself or where the individual concerned is absent from India by the individual himself or by some person duly authorised by him on his behalf* and, where the individual is mentally incapacitated from attending to his affairs, by his guardian or a person competent to act on his behalf, and where for any other reason, it is not possible for the individual to sign the return, by any person duly authorised by him in this behalf.
Hindu undivided family	By the karta, or where the karta is absent from India or is mentally incapacitated from attending to his affairs, by any other adult member of the family.
Company	By the managing director thereof, or where, for any unavoidable reason, such managing director is not able to sign, or where there is no managing director, by any director of the company.
Firm	By the managing partner thereof or where, for any unavoidable reason, such managing partner is not able to sign or where there is no managing partner, by any partner thereof, not being a minor.
Local authority	By the principal officer thereof.
Political party	By the chief executive officer of such party.
Any other association	By any member of the association or the principal officer thereof.
Any other person	By that person or by some other person competent to act on his behalf.

*Such person shall be holding a valid power of attorney and such power of attorney shall be attached to the return.

In the case of a non-resident company, the return of income can be signed by a person holding a valid power of attorney which has to be attached with the return. Further, it has been provided that—

a. where the company is wound up, the liquidator of the company shall sign and verify the return, or

b. where the management of the company has been taken over by the Central or State Government, the principal officer shall sign and verify the return.

The following points, one should keep in view :

■ *Signature must be personal* - When signature by an agent is permissible, the writing of the name of the principal by the agent is regarded as the signature of the principal himself. But this result only follows when it is permissible for the agent to sign the name of the principal. Where in the return of income of an illiterate assessee, the physical act of putting the mark was found to have been made by his son who was not authorised in this behalf, the return must be treated as not properly signed and, consequently, invalid—*CAIT* v. *Sri Keshab Chandra Mandal* [1950] 18 ITR 569 (SC).

■ *Return of a HUF* - Since a junior member could act as karta with the consent of other members, a return of income of a HUF can be signed by such a junior member—*Narendra Kumar J. Modi* v. *CIT* [1976] 105 ITR 109 (SC).

■ *In case of deity/idols* - The concept of a Hindu deity is such that it must be taken that the signature of the shebait is the signature of the deity itself—*Sri Sri Sridhar Jiew* v. *ITO* [1967] 63 ITR 192 (Cal.).

■ *Return signed by secretary* - In ***Bharat Nidhi Ltd.*** v. ***CIT*** [2007] 165 Taxman 314 (Delhi), the Assessing Officer treated a return as invalid for it was signed by the secretary and not the managing director. The Delhi High Court held that such an error can be removed by submission of fresh return under the signature of the managing director.

In other words, if a return of income is filed by a company, which is signed and verified by a person other than the one authorized under the Act, it shall be treated to be defective which shall be

amenable to the provisions of sections 292B and 139(9). The assessing authority, in such circumstances, shall provide an opportunity to the assessee to rectify that defect under section 139(9) before treating the same to be invalid and *non est.* However, a different situation would arise where a return is not at all signed and verified. The question of rectifying of defect in such a situation does not arise as the defect goes to the very root and jurisdiction of the validity of the return—***Hind Samachar Ltd.*** v. ***Union of India*** [2008] 169 Taxman 304 (Punj. & Har.).

Permanent Account Number (PAN) [Sec. 139A]

361. Section 139A has been substituted with effect from July 1, 1995 to provide the following :

361.1 ***Allotment of permanent account number*** - The provisions regarding allotment of permanent account number are given below—

361.1-1 *WHO HAS TO APPLY FOR PERMANENT ACCOUNT NUMBER* - The following persons should apply for allotment of permanent account number in Form No. 49A—

1. If income exceeds exemption limit or turnover exceeds Rs. 5,00,000 - Every person, if his total income assessable during the previous year exceeds the maximum amount which is not chargeable to tax or any person carrying on business or profession whose total sales, turnover or gross receipts are or is likely to exceed Rs. 5,00,000 in any previous year and who has not been allotted any permanent account number, is obliged to obtain permanent account number.

Application should be submitted before May 31 of the assessment year for which the income exceeds the maximum amount not chargeable to tax or before the end of the accounting year for which gross receipt/turnover exceeds Rs. 5,00,000.

2. Charitable trust - A person who is required to furnish return of income under section 139(4A) (*i.e.,* charitable trust) is required to obtain permanent account number before the end of the accounting year.

3. Employer - Every employer, who is required to furnish a return of fringe benefits under section 115WD and who has not been allotted a permanent account number, shall apply to the Assessing Officer for allotment of a permanent account number. However, any person who has already been allotted a permanent account number shall not be required to obtain another permanent account number and the permanent account number already allotted to him shall be deemed to be the permanent account number in relation to fringe benefit tax.

4. Person specified by the Central Government - The Central Government has power to specify (by notification in the Official Gazette) any class (or classes) of persons by whom tax is payable under the Income-tax Act or any tax or duty is payable under any other law for the time being in force, including importers and exporters (whether any tax is payable by them or not) to apply to the Assessing Officer for the allotment of a permanent account number.

The Central Government has specified the following persons who shall apply to the Assessing Officer for allotment of permanent account number—

Persons	*Time limit for application*
1. Exporters and importers who are required to obtain an importer-exporter code under section 7 of Foreign Trade (Development and Regulations) Act, 1992	Before making any export or import
2. Assessees as defined in rule 2(3) of the Central Excise Rules	Before making any application for registration under the Central Excise Rules
3. Persons who issue invoice under rule 57E requiring registration under the Central Excise Rules	As given above
4. Assessees as defined in section 65(6) of the Finance Act, 1994 relating to service tax	Before making an application for registration under the Service Tax Rules, 1994

The Central Government has specified the following persons who shall apply to the Assessing Officer for allotment of permanent account number—

Persons	*Time limit for application*
Persons who are registered under the Central Sales Tax Act or general sales tax law of the appropriate State or Union territory on or before December 11, 2001	By January 10, 2002
Person who will register under the aforesaid Act(s) after December 11, 2001	Before making any application under the Central Sales Tax Act or general sales tax law of State/Union territory

■ From June 1, 2006, the Central Government has the power to notify (for collection of any information) any person (whether any tax is payable or not) to apply for PAN.

361.1-2 *WHEN CAN ASSESSING OFFICER ALLOT PERMANENT ACCOUNT NUMBER SUO MOTU* - Besides above cases, the Assessing Officer may also allot a permanent account number to any other person by whom tax is payable. Any other person may also apply for a permanent account number.

361.2 ***Intimation of permanent account number to be given to the person deducting or collecting tax at source [Sec. 139A(5A), (5C)]*** - The provisions are given below—

■ *Intimate permanent account number to the person deducting tax at source [Sec. 139A(5A)]* - Every person receiving any income from which tax has been deducted shall intimate his permanent account number to the person responsible for deducting tax.

Exception - A person whose total income is not chargeable to tax or who is not required to obtain permanent account number under the provisions of section 139A if such person furnishes a declaration in Form No. 15G or 15H to the payer under section 197A.

■ *Intimate permanent account to the person collecting tax at source [Sec. 139A(5C)]* - Every "buyer" or licensee or lessee† under section 206C shall intimate his permanent account number to the "seller".

361.3 ***Where the permanent account number should be quoted*** - The permanent account number should be quoted as follows—

361.3-1 *QUOTE OWN PERMANENT ACCOUNT NUMBER IN RETURNS, CERTIFICATES, CORRESPONDENCE* - Every person shall quote his Permanent Account Number in all documents pertaining to the transactions specified below, namely —

a. sale or purchase of any immovable property valued at Rs. 5 lakh or more ;

b. sale or purchase of a motor vehicle or vehicle, which requires registration by a registering authority*;

c. a time deposit‡, exceeding Rs. 50,000, with a banking company to which the Banking Regulation Act, 1949 applies ;

d. a deposit, exceeding Rs. 50,000 in any account with Post Office Saving Bank ;

e. a contract of a value exceeding Rs. 1 lakh for sale or purchase of securities as defined in section 2(*h*) of the Securities Contracts (Regulation) Act, 1956 ;

f. opening an account with a banking company‡ to which the Banking Regulation Act, 1949 applies (but other than time deposit account) ;

g. making an application for installation of a telephone connection (including a cellular telephone connection) ;

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†Licensee or lessee, from October 1, 2004.

*For this purpose, the sale/purchase of a motor vehicle or vehicle does not include two wheeled vehicles inclusive of any detachable side-car having an extra wheel, attached to the motor vehicle.

‡A minor can open a bank account or time deposit account by PAN of his father/mother.

h. payment to hotels and restaurants against their bills for an amount exceeding Rs. 25,000 at any one time;

i. payment in cash for purchase of bank drafts or pay orders or banker's cheques from a bank for an amount aggregating Rs. 50,000 or more during any one day;

j. deposit in cash aggregating Rs. 50,000 or more during any one day, with a bank;

k. payment in cash in connection with travel to any foreign country of an amount exceeding Rs. 25,000 at any one time;

l. making an application to any banking company or to any other company or institution, for issue of a credit card;

m. payment of an amount of Rs. 50,000 or more to a Mutual Fund for purchase of its units;

n. payment of an amount of Rs. 50,000 or more to a company for acquiring shares issued by it;

o. payment of an amount of Rs. 50,000 or more to a company or an institution for acquiring debentures or bonds issued by it; and

p. payment of an amount of Rs. 50,000 or more to the Reserve Bank of India, for acquiring bonds issued by it.

■ The following points should be noted—

1. For the purpose of (*k*) (*supra*) "payment in cash" includes payment for purchase of foreign currency.

2. For the purpose of (*k*) (*supra*), travel to foreign country does not include travel to Bangladesh, Bhutan, Maldives, Nepal, Pakistan or Sri Lanka or travel to Saudi Arabia for Haj or travel to China on pilgrimage to Kailash Mansarover.

3. Where a person, making an application for opening a bank account, is a minor and who does not have any income chargeable to income-tax, he shall quote the Permanent Account Number of his father or mother or guardian, as the case may be.

4. Any person, who has not been allotted a Permanent Account Number shall make a declaration in Form No. 60 giving therein the particulars of such transaction.

361.3-2 *QUOTE PERMANENT ACCOUNT OF RECIPIENT/PURCHASER IN TAX DEDUCTION/COLLECTION AT SOURCE* - The provisions are given below—

1. Tax deduction at source [Sec. 139A(5B)]- Where any sum or income has been paid after deducting tax, every person deducting tax shall quote the permanent account number of the recipient, in Form Nos. 16, 16A, 16AA, 24Q, 26Q and 27Q.

The above provisions shall not apply in case of a person whose total income is not chargeable to income-tax or who is not required to obtain permanent account number if such person furnishes to the person responsible for deducting tax a declaration referred to in section 197A to the effect that the tax on his estimated total income of the previous year to which such income relates will be *nil.*

2. Tax collection at source [Sec. 139A(5D)] - Every person collecting tax under section 206C shall quote the permanent account number of every buyer, in all certificates furnished in accordance with the provisions of section 206C(5) and in all returns (including quarterly return) to an income-tax authority.

361.4 ***Class or classes of persons to whom provisions of section 139A shall not apply*** - The provisions of section 139A shall not apply to following class or classes of persons, namely —

a. persons who have agricultural income and are not in receipt of any other income chargeable to income-tax [such persons shall make declaration in Form No. 61 in respect of transactions referred to in para 361.3-1] ;

b. non-residents ;

c. the Central Government, State Government and Consular Officers in transactions where they are the payers.

361.5 ***How the information collected shall be intimated to Director (Investigation)*** - Every person including,—

a. a registering officer appointed under the Registration Act, 1908 ;

b. a registering authority under Motor Vehicles Act ;

c. any manager or officer of a bank ;

d. post master ;

e. stock broker, sub-broker, share transfer agent, banker to an issue, trustee of a trust deed, registrar to issue, merchant banker, underwriter, portfolio manager, investment adviser and such other intermediaries registered under section 12 of the Securities and Exchange Board of India Act ;

f. any authority or company receiving application for installation of a telephone by it ;

g. any person raising bills of hotels/restaurants or any person raising bill in connection with foreign travel ;

h. any person who purchases or sells the immovable property or motor vehicle;

i. the principal officer of a company issuing credit card;

j. the principal officer of an institution issuing shares/debentures/bond;

k. any trustee or any other person duly authorised by the trustee of a Mutual Fund;

l. an officer of the Reserve Bank of India,

receiving any document relating to a transaction specified in para 361.3-1 shall ensure that Permanent Account Number has been duly and correctly quoted.

361.5-1 *TIME AND MANNER IN WHICH THESE PERSONS SHALL INTIMATE THE DETAILS OF TRANSACTION TO THE DIRECTOR OF INCOME-TAX (INVESTIGATION)* - The above-noted persons shall forward to the concerned Commissioner of Income-tax (Central Information Branch), the following documents, namely :—

a. copies of declaration in Form No. 60 ; and

b. copies of declaration in Form No. 61.

■ The following points should be noted—

1. Copies of declaration submitted while opening a bank account (not being a time deposit account) should not be submitted.

2. Form No. 60/61 shall be submitted as follows :

Forms received from April 1 to September 30	By October 31
Forms received from October 1 to March 31	By April 30

361.6 ***Other points*** - One should also keep in view the following points :

1. Every person, receiving any document relating to the prescribed transactions, shall ensure that the permanent account number has been duly quoted in the document.

2. Every person shall intimate the Assessing Officer any change in his address or in the name and nature of his business on the basis of which the permanent account number was allotted to him.

3. No person who has already been allotted a permanent account number under the new series shall apply to obtain or possess another permanent account number.

4. The "permanent account number under the new series" has been defined to mean a number which will have ten alphanumeric characters to be issued on a laminated card. The expression "Assessing Officer" has been defined to include an income-tax authority to whom the job of allotting permanent account numbers has been assigned.

5. In case of issuance of PAN number and card, the maximum period should be three months from the date of application—*Chandrakant Kandlal Sheth* v. *Union of India* [2002] 125 Taxman 975 (Cal.).

What is self-assessment [Sec. 140A]

362. The provisions of section 140A are given below —

■ An assessee is required to submit his return of income or fringe benefits under section 115WD or 115WH or 139 or 142 or 148 or 153A or 158BC.

■ Before submitting the aforesaid return, he is supposed to find it whether any tax and/or interest is payable. For this purpose tax and/or interest shall be calculated as follows:

Find out income-tax, surcharge and education cess as per return of income		xxxx
Add: Interest —		
Under section 234A or 115WK for late submissions of return of income*/fringe benefits	xxxx	
Under section 234B for non-payment or short payment of advance tax*/fringe benefits	xxxx	
Under section 234C for non-payment or short payment of different instalments of advance tax	xxxx	xxxx
Total tax and interest		xxxx
Less: Advance tax, tax deducted at source, tax collected at source, MAT credit and relief under section 90/90A/91		xxxx
Self assessment tax payable under section 140A		xxxx

*Interest under sections 234A and 234B shall be calculated on the basis of income declared in the return of income.

■ Self-assessment tax so determined shall be deposited by the assessee before submitting return of income. After March 31, 2008, all corporate assessees and other assessees (who are subject to compulsory audit under section 44AB) will have to make electronic payment of tax through internet banking facility offered by authorized banks. Alternatively, these taxpayers can make electronic payment of tax through internet by way of credit or debit cards. It is not necessary for the assessee to make payment of taxes from his own account in an authorized bank. An assessee can make electronic payment of taxes also from the account of any other person. However, the challan for making such payment must clearly indicate the Permanent Account Number (PAN) of the assessee on whose behalf the payment is made.—**Circular No. 5/2008,** dated July 17, 2008.

■ The proof of deposit should be submitted in the return of income (*i.e.*, BSR code/bank, serial No. of challan, amount of deposit and dates of deposit).

■ Where the amount paid by the assessee falls short of the aggregate of tax and interest, the amount so paid shall first be adjusted towards interest payable and the balance, if any, shall be adjusted towards tax payable.

Provisions illustrated - Tax liability of X Ltd. for the assessment year 2009-10 is Rs. 2,40,000. It is liable to pay interest under sections 234A, 234B and 234C of Rs. 4,340, Rs. 12,000 and Rs. 15,000 respectively. It is entitled for tax credit on account of pre-paid taxes (*i.e.*, advance tax paid during the financial year 2008-09 : Rs. 17,000 and tax deducted/collected at source : Rs. 6,000). At the time of filing of return of income for the assessment year 2009-10 on December 12, 2009, the tax payable under section 140A shall be determined as under :

	Rs.	*Rs.*
Income-tax		2,40,000
Add : Interest		
Under section 234A	4,340	
Under section 234B	12,000	
Under section 234C	15,000	31,340
Total		2,71,340

	Rs.	Rs.
Less : Prepaid taxes		
Advance tax	17,000	
Tax deducted or collected at source, MAT credit and double taxation relief under section 90/90A/91	6,000	23,000
Self-assessment tax under section 140A		2,48,340

If the amount of tax paid under section 140A is less than Rs. 2,48,340, then the amount paid under section 140A shall be first adjusted towards interest payable and the balance, if any, shall be adjusted towards tax payable. Suppose in the above case, X Ltd. pays (a) Rs. 1,69,000 or (b) Rs. 25,000 under section 140A, then tax so paid shall be adjusted as under :

	Situation (a) Rs.	Situation (b) Rs.
Tax paid under section 140A	1,69,000	25,000
Amount treated as payment of interest under sections 234A, 234B and 234C	31,340	25,000
Amount treated as payment of tax (Rs. 1,69,000—Rs. 31,340)	1,37,660	*Nil*

Other points - The following should also be kept in view :

- After a regular assessment of income or fringe benefits under section 115WE or 115WF or 143 or 144 or an assessment under section 153A or 158BC, has been made, any amount paid under section 140A shall be deemed to have been paid towards such regular assessment.
- If any assessee fails to pay whole or any part of such tax or interest or both in accordance with the provisions of section 140A, he shall (without prejudice to any other consequences which he may incur) be deemed to be an assessee in default in respect of the tax or interest or both remaining unpaid, and all the provisions of the Act shall apply accordingly.
- If an assessee is deemed to be an assessee in default, then under the different provisions of the Income-tax Act he is liable for the following —

1. The assessee is liable for payment of self-assessment tax (including interest) (as calculated above), which he has not paid so far.

2. Besides, he is liable for payment of simple interest under section 220(2) at the rate of 1 per cent per month (or part thereof) for the period of default. This interest is in addition to interest payable under sections 234A, 234B and 234C.

3. Moreover, he is liable for penalty under section 221(1). Under section 221(1) the Assessing Officer may impose a penalty of an amount not exceeding the amount of tax in arrears after giving the assessee a reasonable opportunity of being heard.

In ***Safari Mercantile (P.) Ltd.*** v. ***CIT*** [2008] 21 SOT 531 (Mum.) the assessee on the basis of the income computed had to pay Rs. 10.04 crore as tax including interest. The assessee paid only Rs. 90 lakh by way of self assessment under section 140A. The Assessing Officer initiated proceedings for levy of penalty by treating the assessee as assessee in default. The assessee challenged levy of penalty under section 221 on the ground that no notice of demand under section 156 was served by the Assessing Officer. The Tribunal held that the liability to pay self assessment tax arises on the basis of the return furnished by the assessee and the failure to pay tax or interest or both on the income admitted in the return, renders the assessee to be in default.

Inquiry before assessment [Sec. 142 or 142A]

363. Sections 142 and 142A deal with the following :

1. Giving notice to the assessee to submit return (if not submitted earlier), produce accounts, documents, etc.	Sec. 142(1)
2. Making inquiry and giving opportunity to the assessee	Sec. 142(2), (3)
3. Giving direction to get books of account audited	Sec. 142(2A) to (2D)
4. Valuation Officer	Sec. 142A

363.1 ***Giving notice to the assessee [Sec. 142(1)]*** - For the purpose of making assessment, the Assessing Officer may serve on any person a notice under section 142(1), for the following purposes :

363.1-1 *RETURN OF INCOME* - If the assessee has not submitted a return of income within the time allowed under section 139(1) or before the end of the relevant assessment year, the Assessing Officer may require him to submit the return of income in the prescribed form on or before a date specified in the notice. Such notice can be served during the assessment year or even after the end of the assessment year.

363.1-1a TIME-LIMIT - If a person has not submitted his return of income within the due date given under section 139(1), the Assessing Officer may serve a notice under section 142(1)(*i*) on such person requiring him to furnish the return of his income in the prescribed form and manner. Such notice can be issued at any time after the expiry of time-limit given under section 139(1).

363.1-2 *DOCUMENT AND ACCOUNTS* - The Assessing Officer may ask the assessee to produce (or cause to be produced), such documents/accounts as he may require. However, the Assessing Officer shall not require the production of any accounts pertaining to a period more than 3 years prior to the previous year. Where the Assessing Officer issues a notice calling for production of accounts relating to earlier years and one of those years falls beyond the prescribed three-year limit, the whole notice cannot be treated as bad, inasmuch as the illegal portion of the notice as regards one of the years is clearly severable from the rest of the terms of the notice which are legal—*Murlidhar Madanlal* v. *CIT* [1954] 20 ITR 231 (Pat.).

363.1-3 *FURNISHING INFORMATION* - The Assessing Officer may require the assessee to furnish in writing (and verified in the prescribed manner) information in such form and on such points or matters (including a statement of all assets and liabilities of the assessee, whether included in the accounts or not), as he may require. However, the previous approval of the Joint Commissioner shall be obtained before requiring the assessee to furnish a statement of all assets and liabilities not included in the accounts.

A combined notice calling upon the assessee to attend in person as well as to produce account books is legal—*Rm. Pl. S. Sivaswami Chettiar* v. *CIT* 4 ITC 207 (Mad.)/ *Chandra Sen Jaini* v. *CIT* 3 ITC 17 (All.)/ *Harmukhrai Dulichand* v. *CIT* 3 ITC 198 (Cal.).

363.2 ***Making inquiry [Sec. 142(2), (3)]*** - For the purpose of obtaining full information in respect of the income (or loss) of any person, the Assessing Officer may make such inquiry as he considers necessary. However, the assessee shall (except where the assessment is made under section 144) be given an opportunity of being heard in respect of any material gathered on the basis of any inquiry or any audit under section 142(2A) and proposed to be utilised for the purpose of the assessment.

363.3 ***Giving direction for audit [Sec. 142(2A) to (2D)]*** - If the following conditions are satisfied, the Assessing Officer may direct the assessee to get his accounts audited by an accountant nominated by the Chief Commissioner/Commissioner. Such direction can be issued under section 142(2A) even if accounts of the assessee have been audited under any other provision.

■ *Conditions* - These conditions are :

a. such direction can be issued at any stage of proceedings before the Assessing Officer (in other words, no such direction can be issued after the completion of proceedings before the Assessing Officer) ;

b. such direction can be issued only if having regard to the nature and complexity of the accounts of the assessee and interest of the revenue, the Assessing Officer is of opinion that it is necessary so to do ;

c. such direction can be issued only with the previous approval of the Chief Commissioner/ Commissioner ; and

d. (from June 1, 2007) such direction shall be issued only if the assessee has been given a reasonable opportunity of being heard.

363.3-1 *ACCOUNT INCLUDES BALANCE SHEETS AND OTHER RECORDS* - The expression 'accounts' used in section 142(2A) is not merely the 'books of account' of the assessee. It could include the books of

account, balance sheets and all other records which are available to the Assessing Officer during the course of assessment proceedings - ***Central Warehousing Corpn.*** v. ***Secretary, Department of Revenue*** [2005] 277 ITR 452 (Delhi).

363.3-2 *IT SHOULD NOT BE A MECHANICAL ORDER* - There must be application of mind on the part of the Assessing Officer for an eventuality which necessitates exercise of power under section 142(2A), namely; (*i*) the nature and complexity of the accounts; and (*ii*) the interest of the revenue—***Rajesh Kumar*** v. ***CIT*** [2006] 157 Taxman 169 (SC). If some vital information cannot be ascertained from the accounts, the Assessing Officer can ask for particulars from the assessee. There should be an honest attempt to understand the accounts of the assessee. A mechanical and perfunctory order directing special audit would be liable to be quashed— *U.P. State Handloom Corporation Ltd.* v. *CIT* [2000] 245 ITR 192 (All.). The Commissioner should not give any approval mechanically, if he finds that there is no examination of books of account by the Assessing Officer before sending proposal for special audit—***West Bengal State Co-operative Bank Ltd.*** v. ***CIT*** [2004] 138 Taxman 238 (Cal.).

363.3-3 *COMPLEXITY OF ACCOUNTS* - The power to appoint a special auditor cannot be lightly exercised. 'Complexity' of the accounts cannot be equated with doubts being entertained by the Assessing Officer either with regard to the correctness thereof or the need for obtaining certain vital information not ascertainable from the accounts.

Although the object behind enacting the above provision is to assist the Assessing Officer in framing the assessment when he finds the accounts of the assessee to be complex and is to protect the interests of revenue, but recourse to the said provision cannot be had by the Assessing Officer merely to shift his responsibility of scrutinising the accounts of an assessee to determine his true and correct income, on to an auditor — ***Gurunanak Enterprises*** v. ***CIT*** [2003] 130 Taxman 23 (Delhi).

Special auditor cannot be appointed to examine all related supporting vouchers in relation to the expenses under various heads. The mere assumption that accounts are complex will not satisfy the requirement of section 142(2A)—*Bata India Ltd.* v. *CIT* [2002] 125 Taxman 808 (Cal.).

363.3-4 *VOLUMINOUS IN NATURE* - Simply because accounts/documents are voluminous in nature, it would not make accounts complex so as to justify reference to special audit—***Bajrang Textiles*** v. ***CIT*** [2004] 3 SOT 115 (Jodh.)

363.3-5 *AUDIT REPORT SHOULD BE SUBMITTED WITHIN THE SPECIFIED TIME* - The audit report shall be furnished by the assessee within the period specified by the Assessing Officer.

■ *Extension of time on an application made by the assessee* - The Assessing Officer has power to extend the time for furnishing audit report on an application made by the assessee.

■ *Extension of time by the Assessing Officer* suo motu - The aforesaid power of extension of time-limit has been amended by the Finance Act, 2008 with effect from April 1, 2008 so as to also allow the Assessing Officer to extend this period of furnishing of audit report *suo motu*. Hence, while the Assessing Officer shall continue to have power to grant extension on an application made by the assessee (and when there are good and sufficient reasons for such extension), he can also grant such extension on his own. Although the law has been amended with effect from April 1, 2008, yet by virtue of a few judicial pronouncements the power of giving extension *suo motu* was available to the Assessing Officer even before April 1, 2008—*see Jagatjit Sugar Mills Co. Ltd.* v. *CIT* [1994] 210 ITR 468 (Punj. & Har.).

■ *Aggregate period not to exceed 180 days* - The aggregate period (fixed originally or extended) shall not exceed 180 days.

363.3-6 *PREPARATION OF BOOKS OF ACCOUNT* - The Assessing Officer cannot make reference to auditor to prepare books of account on the basis of seized records or to compute undisclosed income of different years—***Bajrang Textiles*** v. ***CIT*** [2004] 3 SOT 115 (Jodh.).

363.3-7 *AUDIT FEES* - Where any direction is issued (on or after June 1, 2007) under section 142(2A) by the Assessing Officer to an assessee to get the accounts audited, the expenses of, and incidental to, such audit (including the remuneration of the chartered accountant) shall be determined by the Chief Commissioner or Commissioner in accordance with prescribed guidelines. The expenses so determined shall be paid by the Central Government.

- Every Chief Commissioner shall maintain a panel of chartered accountants.
- Where the Assessing Officer directs for audit on or after June 1, 2007, the expenses of, and incidental to, audit (including the remuneration of the Accountant, qualified Assistants, semi-qualified and other Assistants who may be engaged by such Accountant) shall not be less than Rs. 3,750 and not more than Rs. 7,500 for every hour of the period as specified by the Assessing Officer.
- The period referred shall be specified in terms of the number of hours required for completing the report.
- The Chartered accountant shall maintain a time-sheet and shall submit it to the Chief Commissioner or Commissioner, along with the bill.
- The Chief Commissioner or the Commissioner shall ensure that the number of hours claimed for billing purposes is commensurate with the size and quality of the report submitted by the accountant.

363.3-8 *CONSEQUENCES OF FAILURE TO GET BOOKS AUDITED* - Failure to comply with the direction under section 142(2A) to get books of account audited entails a best judgment assessment under section 144. Besides, it attracts penalty under section 271 and prosecution under section 276D. These provisions are attracted only if there is a default by the assessee. If the accountant nominated by the Commissioner refuses to audit the accounts, the assessee cannot be held responsible—*Swadeshi Polytex Ltd.* v. *CIT* [1983] 144 ITR 171 (SC).

363.3-9 *NO OVERLAPPING BETWEEN SECTIONS 44AB AND 142(2A)* - There is no merit in the submission that section 44AB has replaced and rendered redundant section 142(2A) to the extent of the cases covered by the former provision—*Super Cassettes Industries Ltd.* v. *CIT* [1999] 102 Taxman 202 (Delhi).

363.3-10 *AUDIT REPORT IS NOT BINDING ON ASSESSING OFFICER* - Special audit report under section 142(2A) is not binding upon the Assessing Officer. Where the Assessing Officer neither rejects the report on its receipt nor directs the assessee to obtain a further report nor provides any opportunity to the assessee or to the auditor to meet out the defects, the Assessing Officer is not justified in discarding the report while passing the assessment order by observing that the same is incomplete and is demonstrative only. This is equally applicable even if he has mentioned that report has been utilized for the purpose of assessment wherever it is considered relevant and necessary—***CIT*** v. ***Sahara India Financial Corpn. Ltd.*** [2004] 135 Taxman 154 (Mag.).

363.3-11 *PAST HISTORY - NOT GUIDING FACTOR* - Merely because no special audit under section 142(2A) is directed in the past or even thereafter for the assessment years subsequent to the assessment year in question, it cannot be said that the assessing authority is denuded of its power to order such special audit if the facts and circumstances warrant a special audit under section 142(2A)—*Bata India Ltd.* v. *CIT* [2002] 257 ITR 622/125 Taxman 808 (Cal.).

363.3-12 *CONCLUSIONS* - From the above decisions, the following principles emerge which have to be kept in mind while exercising the powers under section 142(2A)—

1. The Assessing Officer should form an opinion that the nature of the accounts of the assessee is complex.

2. The interest of the revenue will be adversely affected if the special audit is not directed.

3. The opinion should be formed objectively on the basis of materials before him and should be based on relevant consideration.

4. The Chief Commissioner of Income-tax or the Commissioner of Income-tax should grant approval of such a proposal after applying his mind to all the materials placed before him.

5. The guidelines issued by the Central Board of Direct Taxes contained in Instruction No. 1076, dated July 12, 1977 is binding on the authorities and a special auditor can be appointed only if the case falls under any of clauses mentioned therein provided the conditions mentioned in section 142(2A) are fulfilled.

6. No show-cause notice or opportunity of hearing is required to be given to the assessee before appointing special auditor, as it does not involve civil consequences. The order appointing special auditor is an administrative order—***UP Financial Corpn.*** v. ***CIT*** [2005] 147 Taxman 21 (All.). However, from June 1, 2007, the Assessing Officer shall not direct the assessee to get the books of account audited unless the assessee has been given a reasonable opportunity of being heard.

363.4 ***Estimate by Valuation Officer in certain cases [Sec. 142A]*** - Section 142A provides as follows—

1. Where an estimate of the value of any investment referred to in section 69A or section 69B or the value of any bullion, jewellery or other valuable article referred to in section 69A or section 69B is required for the purposes of making any assessment or re-assessment, the Assessing Officer may require the Valuation Officer to make an estimate of the same and report to the Assessing Officer.

2. The Valuation Officer to whom such a reference is made shall, for the purpose of dealing with such reference, have all the powers that he has under section 38A of the Wealth-tax Act.

3. On receipt of the report from the Valuation Officer, the Assessing Officer may (after giving the assessee an opportunity of being heard) take into account such report for making assessment or reassessment.

Summary assessment without calling the assessee [Sec. 143(1)]

364. Under section 143(1), the Assessing Officer can complete the assessment without passing a regular assessment order. The assessment is completed on the basis of return submitted by the assessee. The provisions of section 143(1) are explained in the paras given below :

364.1 ***Intimation - Provisions applicable from April 1, 2008*** - Generally, tax administrations across countries adopt a two-stage procedure of assessment as part of risk management strategy. In the first stage, all tax returns are processed to correct arithmetical mistakes, internal inconsistencies, tax calculation and verification of tax payment. At this stage, no verification of the income is undertaken. In the second stage, certain percentage of the tax returns are selected for scrutiny/ audit on the basis of the probability of detecting tax evasion. At this stage, the tax administration is concerned with the verification of the income.

Under the provisions of section 143(1) as applicable before April 1, 2008, there was no provision for correcting arithmetical mistakes or internal inconsistencies. This leads to an avoidable revenue loss. With an objective to reduce such revenue loss, section 143(1) has been amended by the Finance Act, 2008 to provide with effect from April 1, 2008 that the total income of an assessee shall be computed under section 143(1) after making the following adjustments to the total income in the return—

a. any arithmetical error in the return; or

b. an incorrect claim, if such incorrect claim is apparent from any information in the return.

An intimation shall be prepared or generated and sent to the assessee specifying the sum determined to be payable by, or the amount of refund due to, the assessee after the aforesaid corrections. The amount of refund due to the assessee shall be granted to him. No intimation shall be sent after the expiry of one year from the end of the financial year in which the return is made. The acknowledgement of the return shall be deemed to be the intimation in a case where no sum is payable by, or refundable to, the assessee, and where no adjustment has been made.

■ *"Incorrect claim"* - The term "an incorrect claim apparent from any information in the return" has been defined. It means such claim on the basis of an entry, in the return—

a. of an item, which is inconsistent with another entry of the same or some other item in such return;

b. in respect of which, information required to be furnished to substantiate such entry, has not been furnished under the Act; or

c. in respect of a deduction, where such deduction exceeds specified statutory limit which may have been expressed as monetary amount or percentage or ratio or fraction.

■ *Adjustment only through computerized processing* - These adjustments will be made only in the course of computerized processing without any human interface. To put it differently, a software will be designed to detect arithmetical inaccuracies and internal inconsistencies and make appropriate adjustments in the computation of the total income. For this purpose the Department will establish a system of centralized processing of returns.

To facilitate this, the Board may formulate a scheme with a view to expeditiously determine the tax payable by, or refund due to, the assessee. For the purpose of giving effect to the scheme, the Central Government may, by notification (which may be issued at any time but before April 1, 2009), direct that any of the provisions of the Act relating to processing of returns shall not apply or shall apply with such exceptions, modifications and adaptations as may be specified in that notification.

364.2 ***Intimation - Provisions applicable during June 1, 1999 to March 31, 2008*** - During June 1, 1999 to March 31, 2008, there was no provision under section 143(1) for correcting arithmetical mistakes and internal inconsistencies in return submitted to the department. In other words, during this period summary assessment under section 143(1) may fall under any of the following three situations—

■ *Situation one - When tax/interest is payable by the assessee* - If any tax or interest is found due on the basis of return filed under section 139 [or in response to a notice under section 142(1)], after adjusting pre-paid taxes, then, an intimation shall be sent to the assessee specifying the sum so payable. Such intimation shall be deemed to be a notice of demand issued under section 156 and all the provisions of the Act shall apply accordingly.

■ *Situation two - When tax is refundable to the assessee* - If any refund is due on the basis of return, an intimation shall be sent the assessee specifying the sum refundable along with refund cheque/ advise.

■ *Situation three - When no tax/interest is due or refundable* - When either no sum is payable or no refund is due, the acknowledgement of the return shall be deemed to be the intimation under section 143(1). In other words, except for issuing intimations where any sum is payable by the assessee (*Situation one*) or refund is due to him (*Situation two*), the acknowledgement shall be deemed to be an intimation.

364.3 ***Time limit for intimation under section 143(1)*** - An intimation for tax or interest due under section 143(1) should not be sent after the expiry of one year from the end of the financial year in which return is made.

For instance, for the assessment year 2009-10, return is submitted on July 31, 2009. Intimation may be sent up to March 31, 2011 (even if it is received by the assessee after March 31, 2011).

Assessment in response to notice under section 143(2) [Sec. 143(3)]

365. Assessment under section 143(3) may be broadly grouped under the following two categories—

365.1 ***Scrutiny under section 143(3)(ii)*** - The scheme of comprehensive scrutiny is applicable as follows—

1. A return of income (or loss) has been made under section 139 or in response to notice under section 142(1).

2. The Assessing Officer considers it necessary or expedient to ensure that the assessee has not understated the income or has not computed excessive loss or has not under-paid the tax in any manner.

3. A notice shall be served on the assessee under section 143(2)(*ii*). The notice requires the assessee to produce any evidence which the assessee may rely in support of the return.

4. Such notice shall be served on the assessee within a period of 6 months from the end of the financial year in which return is furnished. This time-limit is applicable with effect from April 1, 2008

(up to March 31, 2008 such notice can be served before the expiry of 12 months from the end of the month in which return was furnished)*.

For instance, if return is submitted on November 2, 2009, notice under section 143(2) can be served on the assessee up to September 30, 2010. If such notice is issued on September 29, 2010, but is received by the assessee after September 30, 2010, it is not a valid notice.

If a notice under section 143(2) is sent to the assessee by registered post on last day of the period of limitation and it is served on the assessee a few days later, beyond period of limitation, it cannot be said to be validly served —***Adarsh Traders*** v. ***CIT*** [2003] SOT 12 (Delhi) (SMC II).

5. After hearing such evidence as the assessee may produce in response to the notice under section 143(2)(*ii*) and such other evidence as the Assessing Officer may require and after taking into account all relevant materials which the Assessing Officer has gathered, he shall pass an assessment order in writing determining (*a*) the total income or loss of the assessee; and (*b*) the sum payable by the assessee (or refund of any amount due to him) on the basis of such assessment order.

■ *Notice served after the prescribed time* - When an assessment is framed under section 143(3) by issuing statutory notice under section 143(2) beyond the prescribed time-limit, the said assessment is bad in law and has to be quashed, even though the assessee had not challenged the jurisdiction of the Assessing Officer during the course of assessment proceedings on the ground that notice under section 143(2) was served beyond the time-limit prescribed under the Act and the objection by the assessee was raised for the first time before the Commissioner (Appeals)—***CIT*** v. ***Mahi Valley Hotels & Resorts*** [2006] 287 ITR 360 (Guj.).

365.1-2 *TIME LIMIT FOR COMPLETION OF ASSESSMENT* - *See* para 370.

365.1-3 *JUDICIAL RULINGS* - The following propositions taken from judicial rulings are important while understanding the provisions of section 143 :

■ GENERAL

❑ *Quasi-judicial* - The taxing authorities have quasi-judicial powers and in doing so they must act in a fair and not a partisan manner— *CIT* v. *Simon Carves Ltd.* [1976] 105 ITR 212 (SC).

❑ *Piecemeal assessment* - Section 143 contemplates that the Assessing Officer should make a complete assessment on the basis of the total income of an assessee; it is not open to him to make assessments piecemeal—*Debi Prasad Malviya* v. *CIT* [1952] 22 ITR 539 (All.).

❑ *Review is not possible* - The Assessing Officer has got no power to review his order, nor can he do so under section 147—***CIT*** v. ***Feather Foam Enterprises (P.) Ltd.*** [2007] 164 Taxman 473 (Delhi)

■ LAW APPLICABLE

❑ *Assessment year in force* - The law to be applied is that in force in the assessment year unless otherwise provided expressly or by necessary implication—*Reliance Jute & Industries Ltd.* v. *CIT* [1979] 120 ITR 921 (SC).

■ ASSESSMENT - MEANING OF

❑ *Includes penalty* - 'Assessment' includes imposition of penalty— *CIT* v. *Kirkend Coal Co.* [1969] 74 ITR 67 (SC).

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*Section 282A (with effect from June 1, 2008) provides that where any notice or other document is required to be issued, served or given, it shall be deemed to have been authenticated if the name and office of a designated income-tax authority is printed, stamped or otherwise written thereon.

Section 292BB has been inserted by the Finance Act, 2008 with effect from April 1, 2008 to provide that where an assessee has appeared in any proceeding or cooperated in any inquiry related to an assessment or reassessment, it shall be deemed that any notice under any provision of the Act has been duly served upon him in time in accordance with the relevant provision of the Act. Further, such an assessee shall be precluded from taking any objection in any proceeding or inquiry under the Act that the notice was not served upon him or not served upon him in time or served upon him in an improper manner. However, the provisions of section 292BB shall not be applicable where the assessee has raised the aforesaid objections before the completion of such assessment or reassessment.

❑ *Final order* - Income-tax assessments have to be made for every year and cannot be held up until the final result of a legal proceeding, which may pass through several courts, is announced—*CIT* v. *H. Hirjee* [1953] 23 ITR 427 (SC).

❑ *Determination of tax* - Assessment is said to be complete when both assessment order is made and tax payable by the assessee is determined.

■ VALIDITY OF ASSESSMENT ORDER

❑ *Provisions subsequently held* ultra vires - Where an assessment has been made under the machinery provided by the Act and if a provision on which it was based was subsequently held to be *ultra vires*, the assessment still remains valid—*Raleigh Investment Co. Ltd.* v. *Governor-General in Council* [1947] 15 ITR 332 (PC).

❑ *Notice* - Where the assessee filed his original return and the Income-tax Officer made original assessment on "loss" only by a passing entry in order sheet, without signing relevant computation sheet and without notifying loss to the assessee, it was held that the assessment, as per impugned order sheet entry, could not be treated as a valid assessment order—*CIT* v. *Badri Prasad Bianwalla* [1982] 133 ITR 433 (Cal.).

❑ *Service of notice of demand* - The Income-tax Act does not provide for service of the assessment order on the assessee but the Act provides for service of notice of demand on the assessee. The existence of a demand notice and the acknowledgement slip showing service of notice of demand presuppose a valid assessment order passed under the Act—*CIT* v. *Kailasho Devi Burman* [1978] 115 ITR 732 (Cal.).

❑ *Similar error* - Mistake in one case is no reason to make mistake in another case—*Shyam Sunder Gupta* v. *CIT* [1963] 49 ITR 641 (All.).

❑ *Setting aside* - If an order made by an Assessing Officer is not open to objection on any legal ground it cannot be set aside merely on ground that in any subsequent year he himself or his successor did what he refused to do previously—*Tulsi Das Nagin Chand* v. *CIT* [1938] 6 ITR 385 (Lahore).

❑ *Liquidation of company* - The Assessing Officer is entitled to commence or continue assessment or reassessment proceedings in respect of a company ordered to be wound up by the Court, without obtaining leave of the Court under section 446(1) of the Companies Act, 1956. The assessment proceedings are not in any way affected by the proceedings for winding up—*S. V. Kondaskar, Official Liquidator & Liquidator of the Colaba Land & Mills Co. Ltd.* v. *V.M. Deshpande, ITO* [1972] 83 ITR 685 (SC).

■ ASSESSMENT ON DIFFERENT ENTITY

❑ *No bar* - There is no bar to income assessed in the hands of A, on fresh material, being assessed in the hands of B—*S. Gyani Ram & Co.* v. *ITO* [1963] 47 ITR 472 (All.).

❑ *Notice* - Where assessee filed its return in the status of HUF but the Assessing Officer completed the assessment in status of individual without giving any opportunity to the assessee, such assessment would be bad in law—*CIT* v. *Suresh Chandra Gupta* [1988] 173 ITR 487 (Raj.). But if opportunity of hearing is given to the assessee then assessment in changed status would not be said to be vitiated by non-issue of notice—*CIT* v. *Brijraj Singh* [1994] 209 ITR 56 (Raj.).

❑ *Void status* - Even though in previous year assessment was made on the assessee as a HUF, the Assessing Officer can hold later that these was in fact no HUF—*Manji Dana* v. *CIT* [1966] 60 ITR 582 (SC).

❑ *Amalgamation* - Completion of assessment in the name of amalgamating company, subsequent to amalgamation becoming effective and the fact of such amalgamation having been brought to the notice of the Assessing Officer, is bad in law and *void ab initio*—***Modi Corpn. Ltd.*** v. ***CIT*** [2007] 162 Taxman 214. To put it differently, amalgamating company is assessable in respect of income up to the date of amalgamation. When after amalgamation, amalgamating company is dissolved, it does not remain in existence, then income up to date of amalgamation should be assessed in hands of amalgamated company, *i.e.*, successor company in like manner and to same extent as it would have

been assessed in hands of amalgamating company. Assessment made in hands of a non-existent company is a nullity and invalid—***Pampasar Distillery Ltd.*** v. ***CIT*** [2007] 15 SOT 331 (Kol.).

■ PROTECTIVE ASSESSMENT

❑ In the Income-tax Act there is no provision to make a protective assessment or alternative assessment. The Act does not authorise the Assessing Officer to make an assessment on a person other than the assessee. However, it is open to the Assessing Officer to make a protective or alternative assessment where there is a doubt as to the hands in which the income is to be assessed. This principle is well-settled by the Supreme Court decision in *Lalji Haridas* v. *ITO* [1961] 43 ITR 387. Where owing to litigations it is not possible to establish finally as to who is the proper assessee, if the income-tax authorities are precluded from making an alternative assessment, then, by the time the disputes are over, the real assessment would be barred. Therefore, there is no reason why an alternative assessment, that is to say, protective assessment, should be declared to be illegal. In such cases, therefore, protective or alternate assessments are permissible in law, so that revenue may not be irretrievably lost if the final outcome of the dispute is different. But the law is equally well-settled that ultimately only one final assessment will stand while the other will get cancelled. Recovery of tax also is permitted only in one hand, normally and preferably in the main assessment, *i.e.*, substantive assessment. However, recovery is permissible in case of a protective assessment, if recovery could not be made in the assessment regularly/substantively made—*CIT* v. *Saraswati Devi* [1995] 212 ITR 445 (Raj.). Otherwise under the law a protective assessment is permissible but a protective recovery is not allowable at all—*CIT* v. *Cochin Co. (P.) Ltd.* [1976] 104 ITR 655 (Ker.), *Sunil Kumar* v. *CIT* [1983] 139 ITR 880 (Bom.), *Jagannath Hanumanbux* v. *ITO* [1957] 31 ITR 603 (Cal.).

Though it might be open to an Assessing Officer to make a protective assessment, it is not open to the Tribunal, which is the final court of fact, to make a protective order—*Hemlata Agarwal* v. *CIT* [1967] 64 ITR 428 (All.).

■ MATERIAL COLLECTED

❑ *Opportunity to assessee* - The Assessing Officer can collect evidence from any source but it is his duty to place it before the assessee prior to making it as the basis of assessment.—*Chiranji Lal Steel Rolling Mills* v. *CIT* [1972] 84 ITR 222 (Punj. & Har.). However, the Assessing Officer may not disclose the source of his information.

❑ *No biased approach* - Where the assessee has produced all his records, it is not open to the Assessing Officer to pick and choose those which are more favourable to the revenue, without considering the explanations of the assessee with regard to discrepancies in others—*Indore Malwa United Mills Ltd.* v. *State of Madhya Pradesh* [1966] 60 ITR 41 (SC).

❑ *Auditors reports* - Not only in respect of the relevancy but also in respect of proof, the material which can be taken into consideration by the Assessing Officer and other authorities under the Act is far wider than the evidence which is strictly relevant and admissible under the Evidence Act. It is quite competent for the income-tax authorities not only to accept the auditor's report where the assessee's account books have been destroyed in fire, but also to draw the proper inference from the same regarding supporting materials for the deductions claimed—*CIT* v. *Jay Engg. Works Ltd.* [1978] 113 ITR 389 (Delhi).

❑ *Circumstantial evidence* - The word "evidence" as used in section 143 is confined to direct evidence but is comprehensive enough to cover circumstantial evidence—*Paras Dass Munna Lal* v. *CIT* [1937] 5 ITR 523 (Lahore).

❑ *Books cannot be detained* - Under section 143, the Assessing Officer has only the power to call for certain books of account of the assessee, but not to detain them—*Pragdas Mathuradas* v. *ITO* [1950] 18 ITR 757 (Cal.).

❑ *Suspicion* - In making the assessment under section 143, the Assessing Officer is not entitled to make a pure guess and make an assessment without reference to any evidence or any material at all. There must be something more than bare suspicion to support the assessment under section 143(3)—*Dhakeswari Cotton Mills Ltd.* v. *CIT* [1954] 26 ITR 775 (SC). The statement recorded by the

Assessing Officer without administering oath to the persons attending is a good material—*Chowkchand Balabux* v. *CIT*[1961] 41 ITR 465 (Assam).

■ FRESH CLAIM

The Apex Court, in ***Goetze (India)*** v. ***CIT***[2006] 284 ITR 323/157 Taxman 1, has ruled that a fresh claim before the Assessing Officer can be made only by filing a revised return, not otherwise.

■ PRINCIPLE OF NATURAL JUSTICE

❑ *Cross-examination not necessary* - The department can rely upon any evidence even though it has not been subjected to cross-examination. There is no denial of natural justice if the Assessing Officer refuses to produce an informant for cross-examination though if a witness is examined in the presence of the assessee, the assessee must be allowed to cross-examine him—*T. Devasahaya Nadar* v. *CIT*[1964] 51 ITR 20 (Mad.).

❑ *Opportunity to assessee* - The principles of natural justice are applicable to assessment proceedings, and the assessee should have knowledge of the material that is proposed to be used against him, in order to enable him to rebut it. Thus, where the Assessing Officer made additions towards income from undisclosed sources, without furnishing to the assessee copies of the statements of the witnesses or even without giving the names of the witnesses, and without permitting the assessee to inspect the records, it was held that the assessment was vitiated, since it violated the principles of natural justice—*Gargi Din Jwala Prasad* v. *CIT*[1974] 96 ITR 97 (All.).

❑ *Past history* - An assessment cannot be based on a presumption relating to capital found to exist in some earlier year. "Past history" may be legitimate material, but that is not sufficient by itself without more, to justify assessment in a particular year. There must be some material relatable to the accounting, which taken with the "past history", may reasonably entitle the Assessing Officer to hold that there must in fact have been some concealed income during the accounting year which is liable to assessment—*Banshidhar Onkarmall* v. *CIT*[1953] 23 ITR 353 (Ori.).

■ PRINCIPLE OF 'RES JUDICATA' AND EXCEPTIONS TO IT

Though the principle of *res judicata* has no application to proceedings under the Income-tax Act and the findings reached for one particular assessment year cannot be held to be binding in the assessment proceedings for subsequent years, yet this general rule is subject to the qualification that a finding reached in the assessment proceedings for an earlier year, after due enquiry, would not be reopened in a subsequent year if it is not arbitrary or perverse, and if no fresh facts are found in the subsequent assessment year. This is on the principle that there should be a finality and certainty in all litigations including litigations arising out of the Income-tax Act.

Where the assessee was granted relief under section 80J in the earlier assessment year as there was substantial expansion by installation of new plant and machinery and construction of new building, and in later assessment year, the Income-tax Officer denied relief to the assessee on the ground that the expansion of the existing undertaking did not make it new industrial undertaking, it was held that as no fresh material was brought by Income-tax Officer to show that the finding reached for earlier year was erroneous, he could not deny relief to the assessee in relevant year—*CIT* v. *Bhilai Engineering Corporation (P.) Ltd.*[1982] 133 ITR 687 (MP). However, cannot be any estoppel against a statute. The fact that the departmental officers took a particular view of the statutory provisions at an earlier stage will not estop them from taking a correct view of the statutory provisions at a later point of time— *C.G. Krishnaswami Naidu* v. *CIT*[1975] 100 ITR 33 (Mad.).

■ BENAMI TRANSACTIONS

The word 'benami' is used to denote two classes of transactions. Firstly it signifies a transaction which is real. For instance, A sells goods to B but the sale deed stated X as purchaser. Here sale is genuine but real purchaser is B, X being his benamidar. Secondly, benami also occasionally refer to a sham transaction. For instance A sells his property to B without intending that his title should pass to B— *Shri Meenakshi Mills Ltd.* v. *CIT*[1957] 31 ITR 28 (SC). Onus of proof lies on the person who takes plea of benami investment— *Bank of India* v. *Union of India*[1987] 167 ITR 668 (Delhi).

365.2 ***Special procedure for assessment in the case of scientific research association, news agency, notified trust, etc.*** - A proviso has been inserted in section 143(3) with effect from the assessment year 2003-04. The proviso is applicable as follows—

1. The proviso is applicable in the case of following taxpayers who are required to submit return of income under section 139(4C)[1] or 139(4D)

a. scientific research association or fund or trust referred to in section 10(*21*);

b. news agency referred to in section 10(*22B*);

c. association or institution referred to in section 10(*23A*);

d. institution referred to in section 10(*23B*);

e. fund or institution or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in section 10(*23C*)(*iv*)/(*v*)/(*vi*)/(*via*);

f. university, collage, etc. mentioned in section 35(1)(*ii*)/(*iii*).

2. In the aforesaid cases, assessment order can be passed after giving exemption under section 10. If, however, the Assessing Officer wants to assess these taxpayers without giving effect to provisions of section 10, then he has to follow the following steps—

a. the Assessing Officer should intimate the Central Government or the prescribed authority the contravention of the provisions of clause (*21*) or clause (*22B*) or clause (*23A*) or clause (*23B*) or clause (*23C*)(*iv*)(*v*)(*vi*)(*via*) of section 10, as the case may be, by such scientific research association, news agency, association or institution or fund or trust or university or other educational institution or any hospital or other medical institution, where in his view such contravention has taken place; and

b. the approval granted to such scientific research association or other association or institution or university or other educational institution or hospital or other medical institution should be withdrawn or notification issued in respect of such news agency or fund or trust or institution should be rescinded.

3. Since there would be a time-lag in the process of sending the intimation to the Central Government and receipt of the order rescinding the notification or withdrawing the approval, section 153 has been amended so as to provide that the period commencing from the date on which the Assessing Officer intimates to the Central Government or the prescribed authority the contravention, of the provisions of section 10 [as mention in 2(*a*) *supra*] and ending with the date on which the copy of the order withdrawing the approval or rescinding the notification, as the case may be, under those clauses is received by the Assessing Officer [as mentioned in 2(*b*) *supra*], shall be excluded in computing the period of limitation under section 153.

Best judgment assessment [Sec. 144]

366. The Assessing Officer, after considering all relevant material which he has gathered, is under an obligation to make an assessment of the total income or loss to the best of his judgment in the following cases :

Case 1	If any person fails to make a return required under section 139(1) and has not made a return or a revised return under sub-section (4) or (5) of that section.
Case 2	If any person fails to comply with all the terms of a notice under section 142(1) or fails to comply with the direction requiring him to get his accounts audited in terms of section 142(2A).
Case 3	If any person, after having filed a return, fails to comply with the terms of a notice under section 143(2), requiring his presence or production of evidence and documents.
Case 4	If the Assessing Officer is not satisfied about the correctness or the completeness of the accounts of the assessee or if no method of accounting has been regularly employed by the assessee.

1. Though section 139(4C) is applicable in the case of a trade union referred to in section 10(*24*), proviso to section 143(3) does not include the same.

■ *Other points* - One should also keep in view the following points —

1. In the case of best judgment assessment, an assessee has a right to file an appeal under section 246A or to make an application for revision under section 264 to the Commissioner.

2. The best judgment assessment can only be made after giving the assessee an opportunity of being heard. Such opportunity shall be given by issue of notice to the assessee to show cause why the assessment should not be completed to the best of judgment and that opportunity for hearing will not be necessary where notice under section 142(1) has already been issued.

3. A refund cannot be granted under section 144.

366.1 ***Time limit for completion of assessment*** - *See* para 370.

366.2 ***Judicial rulings on scope of section 144*** - The following judicial rulings on the scope of section 144 should be kept in view :

■ WHEN BEST JUDGMENT ASSESSMENT CAN BE MADE

❑ Ex parte *proceedings* - An assessment made under section 144 can by no means be equated to *ex parte* proceedings in a civil court— *Dhanalakshmi Pictures* v. *CIT* [1983] 144 ITR 452 (Mad.).

❑ *Mandatory action for defaults* - Best judgment assessment is mandatory for any one of the defaults under section 144—*CIT* v. *Segu Buchiah Setty* [1970] 77 ITR 539 (SC).

❑ *Approximations* - Where the assessee had furnished only approximate figure in his return of income without any further details, it was held that the best judgment assessment made by ignoring such a return was invalid—*A.R.A.N. Chettiar Firm* v. *CIT* 2 ITC 477 (Rangoon).

❑ *Signing of returns* - A best judgment assessment can be made when the return is not signed and verified—*Behari Lal Chatterji* v. *CIT* [1934] 2 ITR 377 (All.).

❑ *Production of accounts* - Where, in response to a combined notice for personal appearance as well as production of account books, the assessee appeared in person but did not produce any account books, it was held that the Income-tax Officer would be justified in making a best judgment assessment—*Rm. Pl. S. Sivaswami Chettiar* v. *CIT* 4 ITC 207 (Mad.).

■ INVALID ASSESSMENT

❑ *Failure to produce books of account* - A best judgment assessment made pursuant to the assessee's failure to produce account books over which the assessee has neither possession nor control, is invalid—*CIT* v. *Bombay Trust Corporation* [1938] 6 ITR 445 (Bom.).

❑ *Reliance on books of account* - In order to commit the default under section 143(2), it is necessary that there must be a failure to produce books or documents or evidence on which the assessee relied in support of his return. Therefore, where the assessee had not relied on any such books, documents, or evidence, there could not be a consequent failure to produce them, so as to justify a best judgment assessment in his case—*ITO* v. *Luxmi Prasad Goenka* [1977] 110 ITR 674 (Cal.).

❑ *Refusal to audit* - If a chartered accountant refuses to audit company's account for frivolous reasons, section 144 is not attracted—*Swadeshi Polytex Ltd.* v. *ITO* [1983] 144 ITR 171 (SC).

■ ESTIMATION OF PROFITS

Estimate must be honest and fair—*Brij Bhushan Lal Parduman Kumar* v. *CIT* [1978] 115 ITR 524 (SC). Best judgment assessment must have reasonable nexus to the available material—*State of Kerala* v. *C. Velukutty* [1966] 60 ITR 239 (SC). However, in best judgment assessment guess-work is necessary and it is not required that the figures have to be proved of the exact amount determined by taxing authorities—*Lake Palace Hotels & Motels (P.) Ltd.* v. *CIT* [1995] 213 ITR 735 (Raj.), and basis of computation must be disclosed by Assessing Officer—*Ganga Prasad Sharma* v. *CIT* [1981] 132 ITR 87 (MP).

After rejecting book results, the Assessing Officer does not get unfettered powers to make assessment at any income; he is supposed to be guided either by previous results of the assessee or some comparable case—***Sriram Jhanwarlal*** v. ***ITO*** [2005] 98 TTJ (Jodh.) 639. However, if the assessee is able to explain that magical figure of past year cannot be applied in this year, it is more judicious to consider all these factors and in that eventuality even past history may not have much

relevance—***Madan Lal*** v. ***ITO*** [2006] 9 SOT 1 (URO) (Jodh.). The best judgment assessment must have some reasonable nexus to the available material and circumstances of each case. If the estimate made by the Assessing Officer is a *bona fide* estimate and is based on rational basis, it cannot be disturbed even when the court may think that it is not the most appropriate basis—***Sangrur Vanaspati Mills Ltd.*** v. ***CIT*** [2006] 283 ITR 267 (Punj. & Har.).

■ GENERAL

❑ *Determination of tax* - While making a best judgment assessment under section 144, the determination of tax in the assessment order is as much mandatory as the determination of income—*S. Mubarik Shah Naqshbandi* v. *CIT* [1977] 110 ITR 217 (J & K).

❑ *Assessment under section 144 on wrong finding* - Before the Assessing Officer can assume jurisdiction under section 144, he must record the finding in the first instance that there has been a non-compliance with any of the various notices mentioned in that section. If in a particular case, the Assessing Officer makes a best judgment assessment on a wrong finding as to a jurisdictional fact, *viz.*, non-compliance with any of the notices mentioned in section 144, the High Court, in exercise of its jurisdiction under article 226 of the Constitution, is competent to enquire into the correctness of such finding on a jurisdictional fact—*Mohini Debi Malpani* v. *ITO* [1977] 77 ITR 674 (Cal.).

Reassessment [Secs. 147 to 151]

367. The provisions of section 147 are given below —

1. If the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year.

2. He may assess/reassess such income.

3. Once an assessment has been reopened, any other income which has escaped assessment and which comes to the notice of the Assessing Officer subsequently in the course of the proceeding under section 147 can also be included in the assessment.

367.1 ***Two conditions*** - There are two conditions —

Condition one	The Assessing Officer must have reason to believe that income or profits or gains chargeable to income-tax had escaped assessment.
Condition two	The Assessing Officer must also have reason to believe that such escapement had occurred by reason of either omission or failure on the part of the assessee to disclose fully or truly all material facts necessary for his assessment of that year or failure on the part of the assessee to make a return of income under section 139 or in response to notice issued under section 142(1) or 148

367.1-1 *WHEN BOTH THESE CONDITION SHOULD BE SATISFIED TO TAKE ACTION UNDER SECTION 147* - Both these conditions should be satisfied if the original assessment was made under section 143(3)/147 and the Assessing Officer wants to take action after the expiry of 4 years from the end of the assessment year [proviso to section 147].

367.1-2 *WHEN ONLY CONDITION ONE SHOULD BE SATISFIED TO TAKE ACTION UNDER SECTION 147* - In the following cases only *Condition one* should be satisfied —

a. if the Assessing Officer wants to take action within 4 years (from the end of the assessment year) and the original assessment was completed under section 143(1), 143(3), 144 or 147; or

b. if the Assessing Officer wants to take action after the expiry of 4 years (but not beyond 6 years) from the end of assessment year and the original assessment was completed under section 143(1) or 144.

In case (*a*) and case (*b*), the Assessing Officer is free to initiate proceedings under section 147 and failure to take steps under section 143(3) will not render the Assessing Officer powerless to initiate reassessment proceedings even when intimation under section 143(1)(*a*) had been issued—***CIT*** v. ***Rajesh Jhaveri Stock Brokers (P.) Ltd.*** [2007] 161 Taxman 316 (SC).

367.2 ***Cases of income escaping assessment*** - *Explanation 2* to section 147 clarifies that the following shall also be deemed to be cases of income escaping assessment—

a. where no return of income has been furnished by an assessee, although total income is above the taxable limit ;

b. where a return of income has been furnished, but no assessment has been made, and the assessee is found to have understated his income or claimed excessive loss, deduction, etc., in the return ;

c. where an assessment has been made, but income chargeable to tax has been underassessed or has been assessed at too low a rate or any excessive loss or relief or depreciation allowance or any other allowance under the Act has been allowed.

■ As soon as assessment year is over and no return is filed by assessee nor any notice is issued to him under section 142(1)(*i*), income would escape assessment. By the mere fact that the assessee can file a return as per enabling provisions of section 139(4), it does not follow that no income can be said to have escaped assessment until period prescribed under section 139(4) is over. However, if an assessee voluntarily files a return within time allowed under section 139(4), then the Assessing Officer cannot proceed under section 147/148 against such assessee—***Motorola Inc.*** v. ***CIT*** [2005] 147 Taxman 39.

■ The Assessing Officer may assess or reassess such income, other than the income involving matters which are the subject matter of any appeal, reference or revision, which is chargeable to tax and has escaped assessment.

367.3 ***Other points [Sec. 152]*** - One should also keep in view the following provisions of section 152—

■ *Tax rate* - In an assessment/reassessment/recomputation made under section 147, the tax shall be chargeable at the rate or rates at which it would have been charged had the income not escaped assessment.

■ *Assessee can argue that ultimately tax liability will not be higher* - Where an assessment is reopened under section 147, the assessee may (if he has not preferred an appeal or applied for revision) claim that the proceedings under section 147 shall be dropped on his showing that he had been assessed on an amount or to a sum not lower than what he would be rightly liable for, even if the income alleged to have escaped assessment had been taken into account, or the assessment or computation had been properly made. However, in doing so, he shall not be entitled to reopen matters concluded by an order under section 154, 155, 260, 262 or 263.

367.4 ***Issue of notice [Secs. 148, 149, 150 and 151]*** - For provisions regarding issue of notice, time limit for issue of notice for assessment and other conditions, *see* para 368.

367.5 ***Time limit for completion of assessments and reassessments*** - *See* para 370.

367.6 ***Frequently asked questions*** - The following are some of the frequently asked questions—

367.6-1 *IS IT POSSIBLE TO RE-OPEN AN ASSESSMENT ONLY BECAUSE OF CHANGE OF OPINION* - An assessment cannot be reopened only because of change of opinion. The mere change of opinion or wrong legal reference will not empower the Assessing Officer to reopen assessment—*CIT* v. *Bhanji Lavji* [1971] 79 ITR 582 (SC). Similarly, reassessment cannot be made on fresh opinion on the same facts—*Sirpur Paper Mills Ltd.* v. *ITO* [1978] 114 ITR 404 (AP) or in view of changed legal position—*Maharaja Shri Umaid Mills Ltd.* v. *ITO* [1962] 44 ITR 303 (Punj.). In *Kamalchand* v. *ITO* [1981] 128 ITR 290/[1980] 4 Taxman 216 (MP), an assessment was sought to be reopened by the Assessing Officer on the ground that his predecessor-in-office had committed an error in allowing certain deductions. The Madhya Pradesh High Court held that since no fresh information had come into possession of the Assessing Officer, the assessment could not be reopened. The Court held that it amounts only to change of opinion without anything else. Similarly, where full facts and information regarding claim of depreciation at higher rate on commercial vehicles were furnished by the assessee and the Assessing Officer had consistently taken a view that higher depreciation was available, he could not re-open assessments subsequently under section 147 on mere change of

opinion that higher depreciation was not available—***Pressman Advertising & Marketing Ltd.*** v. ***CIT*** [2005] 142 Taxman 17 (Kol.). Section 147 does not empower the Assessing Officer to review already concluded issues—***CIT*** v. ***Ranjit Kaur*** [2003] 81 TTJ (Chd.) 269. Section 147 does not authorise the Assessing Officer to reopen assessment under garb of 'reason to believe', to review its own decision—***CIT*** v. ***Smithkline Beecham Consumer Brands Ltd.*** [2003] 126 Taxman 104 (Chd.) (Mag.).

If the assessee has disclosed fully and truly all material facts necessary for purpose of assessment, an action under section 147 cannot be taken after expiry of 4 years from relevant assessment year on basis of mere change of opinion of the Assessing Officer that a larger sum ought to have been disallowed under original assessment—***Oil & Natural Gas Corpn. Ltd.*** v. ***CIT*** [2003] 133 Taxman 27 (Uttaranchal).

Conclusions - The Allahabad High Court in ***J.P. Bajpai (HUF)*** v. ***CIT*** [2004] 140 Taxman 34 held that the responsibility of the assessee is limited to the disclosure of all primary facts and nothing beyond. Once the assessee has disclosed all the primary facts that is the end of his duty. It is then for the assessing authority to draw the proper conclusions from those facts. If the conclusions drawn by the Assessing Officer from the primary facts disclosed by the assessee are erroneous, the assessing authority cannot reopen the assessment merely on the basis of a change in opinion. A mere change in opinion would not confer jurisdiction upon the Assessing Officer to initiate a proceeding under section 147. If, however, 'reason to believe' of the Assessing Officer is founded on an information which might have been received by the Assessing Officer after completion of assessment, it may be a sound foundation for exercising power under section 147, read with section148—*CIT* v. *Kelvinator of India Ltd.* [2002] 123 Taxman 433/256 ITR 1 (Delhi) (FB). Moreover, there is nothing in section 147 to suggest that an Assessing Officer cannot reopen an assessment where he had failed to investigate and find out truth at initial stage—*Ram Prasad* v. *ITO* [1995] 82 Taxman 199 (All.). However, the action under section 147 can be taken only on the basis of rules mentioned in para 367.1.

367.6-2 *CAN ASSESSMENT BE REOPENED ON THE BASIS OF SUBSEQUENT DECISION OF HIGHER COURT* - It is true that the revenue authorities are empowered to reopen a completed assessment on the basis of a decision of the High Court or Supreme Court, but this power is not absolute. It should be within the time prescribed under the law, otherwise there will be no finality and the reopening can go on *ad infinitum*, which is against the canons of jurisprudence—***CIT*** v. ***Nedungadi Bank Ltd.*** [2003] 85 ITD 1 (Coch.).

In ***McDermott International Inc.*** v. ***CIT*** [2004] 134 Taxman 39 (Uttaranchal), the Assessing Officer reopened an assessment [completed under section 143(3)] after a period of four years on the basis of an adverse decision in another case. In this case, the non-resident offered one per cent of its gross receipts of work done outside India for assessment. The incomes were assessed at the returned sums. Later, on the basis of an adverse decision of the Tribunal read with section 44BB, the Assessing Officer pleaded escapement of income without pointing out any omission or suppression on the part of the assessee to disclose fully and truly all material facts necessary for his assessment.

The Uttaranchal High Court held that information relating to the position of law available through the verdict of the higher authority could not be such failure on the part of the assessee, which authorizes the assessing authority to reopen assessment after a gap of four years.

The revenue pleaded that appropriate sanction under section 151 has been obtained in this case from the Commissioner. The Court, however, commented that grant of such sanction does not dispense with the condition that after 4 years assessment [completed under section 143(3)] can be reopened only if escapement of income is on account of omission on the part of the assessee.

The proviso to section 147 casts exemplary burden for satisfaction that the assessment escaped only due to failure on the part of the assessee can be reopened after 4 years if the original assessment was completed under section 143(3) or 147. Information relating to the position of law available through the verdict of the higher authority cannot be such failure on the part of the assessee which

authorises the assessing authority to reopen the assessment—***Sesa Goa Ltd.*** v. ***CIT*** [2007] 294 ITR 101 (Bom.), ***Sesa Goa Ltd.*** v. ***CIT*** [2008] 168 Taxman 285 (Bom.)

367.6-3 *WHAT IS FAILURE TO DISCLOSE ALL MATERIAL FACTS* - An assessment completed under section 143(3) or 147 can be reopened after 4 years only if an income has escaped assessment because of an omission on the part of the assessee to disclose all material facts.

■ Where the assessee has disclosed all material necessary for assessment and thereafter claimed exemption thereon by treating itself to be an industrial undertaking on basis of interpretation of law, such a conduct of the assessee will not amount to failure to disclose all material facts under section 147—***Simplex Concrete Piles (India) Ltd.*** v. ***CIT*** [2004] 134 Taxman 74 (Cal.). In this case, the assessee was allowed deduction under section 32A/32AB/80HH initially. However, on a later date due to a decision of the Supreme Court, the Assessing Officer initiated action for reopening such assessment.

The Calcutta High Court held that any such action for reopening must begin with an allegation that the amounts now sought to be made taxable were not disclosed. In this case they were disclosed but claimed to be non-taxable. As a result, it cannot be said that there was any omission or failure to disclose fully and truly the materials necessary for assessment. The Assessing Officer must overcome the 4 years' embargo only by referring to the assessee's default or omission to furnish full facts and not otherwise on the basis of any subsequent decision of the higher court. Thus, before reopening, the Assessing Officer must satisfy the twin test of information or material in his possession and the extent of disclosure of primary facts by the assessee.

■ If an assessee after furnishing, all material facts, erroneously claims higher depreciation, it will not be a case of failure to disclose fully and truly all material facts. At what rate depreciation is to be claimed is a matter of legal inference which to be drawn from material facts and if legal inference drawn from material facts is erroneous, it cannot be said that there is failure on part of assessee to disclose material facts—***ICICI Bank Ltd.*** v. ***K.J. Rao, CIT*** [2004] 136 Taxman 669 (Bom.).

■ Once the assessee has disclosed all the primary facts that is the end of his duty. It is then for the assessing authority to draw the proper conclusions from those facts. If the conclusions drawn by the Assessing Officer from the primary facts disclosed by the assessee are erroneous, the assessing authority cannot reopen the assessment—***J.P. Bajpai (HUF)*** v. ***CIT*** [2004] 140 Taxman 34 (All.).

■ The Allahabad High Court in ***Girdhar Gopal Gulati*** v. ***Union of India*** [2004] 140 Taxman 312 held that once an assessment is proposed to be made under section 143(3), it is expected that the Assessing Officer will make all the relevant and detailed enquiries before passing the assessment order. He can make all enquiries to obtain the material he deems fit for finding out the correct income of the assessee. The Assessing Officer cannot issue notice under section 148 after the assessment has been made, unless there is deliberate concealment by the assessee or there is information that income has escaped assessment.

■ The production of books of account before the Assessing Officer or production of other evidence from which material evidence could with due diligence have been discovered by the Assessing Officer, will not necessarily amount to disclosure for the aforesaid purpose.

■ Non-disclosure by the assessee of true ratio of High Court's decision cannot be regarded as a non-disclosure of a primary fact—*Kuberdas Hargovandas Modi* v. *K.N. Lalchandani, ITO* [1972] 83 ITR 783 (Guj.).

■ Disclosure in an indirect and incidental manner in some other proceedings cannot absolve the assessee of his duty to fully disclose all material facts for income-tax assessment—*Shahdara (Delhi) Saharanpur Light Railway Co. Ltd.* v. *CIT* [1994] 208 ITR 882 (Cal.).

367.6-4 *WHAT IS "REASON TO BELIEVE" THAT INCOME HAS ESCAPED ASSESSMENT* - The words 'has reason to believe' are stronger than the words 'is satisfied'. In other words the Assessing Officer must form an objective and *prima facie* opinion himself on the basis of expressed statement or reasons or definite/relevant (and not vague) material in his possession. To put it differently, the words "reason to believe" suggest that the belief must be that of an honest and reasonable person based upon

reasonable grounds and that the Assessing Officer may act on direct or circumstantial evidence but not on mere suspicion, gossip or rumour. The Assessing Officer would be acting without jurisdiction if the reasons for his belief that the conditions are satisfied does not exist or is not material or relevant to the belief required by the section—*Sheo Nath Singh* v. *AAC*[1971]82 ITR 147 (SC). If the Assessing Officer has cause or justification to know or suppose that income has escaped assessment, it can be said to have 'reason to believe' that an income has escaped assessment. The said expression cannot be read to mean that the Assessing Officer should have finally ascertained the fact by legal evidence or conclusion. The function of the Assessing Officer is to administer the statute with solicitude for the public exchequer with an in-built idea of fairness to taxpayers—***CIT*** v. ***Rajesh Jhaveri Stock Brokers (P.) Ltd.*** [2007[161 Taxman 319 (SC).

■ *Can such "believe" be challenged* - The existence of the belief can be challenged by the assessee but whether these grounds are adequate or not is not a matter for the court to investigate—*S. Narayanappa* v. *CIT* [1967] 63 ITR 219 (SC), *Trivandrum Club* v. *Director of Income-tax (Exemption)*[2002]256 ITR 61 (Ker.), *Indra Prastha Chemicals (P.) Ltd.* v. *CIT*[2005]142 Taxman 205 (All.). While judging validity of notice Court has to confine itself to record as it was at time of issue of notice— *Tadikonda Ramulu* v. *ITO*[1990] 186 ITR 148 (AP). When a challenge is made to the action under section 147 what the court is required to examine is whether some material existed on record for the Assessing Officer to form the requisite belief. But the sufficiency of the grounds, which induced the Assessing Officer to act under the said section, is not a justiciable issue—*United Electrical Co. (P.) Ltd.* v. *CIT* [2002] 125 Taxman 775/258 ITR 317 (Delhi).

In determining whether commencement of reassessment proceedings is valid, the court has only to see whether there is *prima facie* some material on the basis of which the department opened the case. The sufficiency or correctness of the material is not a thing to be considered at this stage—*Raymond Woollen Mills Ltd.* v. *ITO*[1999] 236 ITR 34 (SC), ***Green Arts (P.) Ltd.*** v. ***ITO*** [2005] 257 ITR 639 (Delhi). The assessee cannot challenge sufficiency of belief—*ITO* v. *Lakhmani Mewal Das* [1976] 103 ITR 437 (SC). What is the ultimate result of enquiry is not material for deciding the jurisdiction of the Assessing Officer to reopen assessment, even if it is found ultimately that there has been no escapement of income—*Mahasukhram Madan Lal* v. *CIT* [1955] 28 ITR 299 (Pat.).

367.6-5 *CAN ASSESSEE CLAIM EXPENSES DISALLOWED IN ORIGINAL ASSESSMENT* - Claims which have been disallowed in original assessment proceedings cannot be permitted to be reagitated on assessment being reopened for bringing to tax certain income which had escaped assessment and a matter not agitated in concluded original assessment proceedings also cannot be permitted to be agitated in reassessment proceedings unless relatable to item sought to be taxed as 'escaped income'. Therefore, in reassessment proceedings under section 147, the assessee cannot seek a review of concluded item, unconnected with escapement of income for the purpose of computation of escaped income—*CIT* v. *Sun Engg. Works (P.) Ltd.* [1992] 198 ITR 297 (SC). However, during reassessment the assessee can put forward claims for deduction of any expenditure which is relatable to income which is sought to be assessed as escaped income—*CIT* v. *Caixa Economica De Goa* [1994] 210 ITR 719 (Bom.).

367.6-6 *IS THERE ANY LIMIT ON NUMBER OF REASSESSMENT OR IS IT POSSIBLE TO ISSUE SECOND NOTICE FOR REASSESSMENT WITHOUT COMPLETING REASSESSMENT ON THE BASIS OF FIRST NOTICE* - Section 147 does not place any limit on number of times an Assessing Officer may invoke his power in respect of an assessment order—*CIT* v. *S.S.R.G. Arthanariswamy* [1982] 136 ITR 147 (Mad.), *CIT* v. *Surendra Kumar Bhadani*[1987] 164 ITR 323 (Pat.).

Where, however, a return has been submitted in pursuance of notice under section 148 and the same has yet not been disposed of, second notice to reopen assessment is not justified—*A.S.S.P. & Co.* v. *CIT*[1988] 172 ITR 274 (Mad.).

367.6-7 *IS IT POSSIBLE TO INITIATE REASSESSMENT PROCEEDINGS WITHOUT COMPLETING ASSESSMENT* - The Assessing Officer cannot initiate reassessment proceedings without completing assessment proceedings already initiated—*CIT* v. *P. Krishnankutty Menon*[1990] 181 ITR 237 (Ker.). In other words, unless the return of income already filed is disposed of, notice for reassessment under section 148 cannot be issued, *i.e.*, no reassessment proceedings can be intimated so long as the assessment

proceedings pending on the basis of the return already filed are not terminated—*Trustees of H.E.H. the Nizam's Supplemental Family Trust* v. *CIT* [2000] 109 Taxman 193/242 ITR 381 (SC). However, merely because proceedings is pending in respect of the same income against another entity, reassessment proceedings cannot be challenged—*Sidh Gopal Gajanand* v. *ITO* [1969] 73 ITR 226 (All.).

367.6-8 *IS IT POSSIBLE TO TAX ANY OTHER INCOME IN THE CASE OF REASSESSMENT* - If assessment is reopened to disallow excess claim of depreciation by the assessee, the Assessing Officer can bring to tax any other item of income which may have escaped assessment and which comes to his notice during the course of the proceedings under section 147. However, for this purpose he cannot be allowed to make fishing inquiries to probe if any other income has escaped assessment or not. Such inquiries can only be permitted if in the first instance some material comes to his notice during the reassessment proceedings to suggest that some other item of income may have escaped assessment or had been under assessed. In that event he would be perfectly justified in requiring the taxpayer to furnish the requisite information on such other issue as well—*Vipan Khanna* v. *CIT* [2002] 122 Taxman 1 (Punj. & Har.).

367.6-9 *WHETHER VALUATION REPORT CAN FORM GROUND FOR RE-OPENING AN ASSESSMENT* - Valuation report is only an opinion of valuer and neither it amounts to 'information' nor can form a ground for reason to believe that the assessee had failed to disclose his income fully and truly—***CIT*** v. ***Saranga Aggarwal*** [2003] SOT 307 (Mum.), ***CIT*** v. ***Darshan Singh*** [2005] 272 ITR 650 (Punj. & Har.), ***Vidya Sagar*** v. ***CIT*** [2005] 277 ITR 120 (Punj. & Har.). A subsequent valuation report cannot be a ground for reopening assessment—*Amala Das* v. *CIT* [1984] 146 ITR 216 (Punj. & Har.). Report of the Department Valuation Officer as to cost of construction of property cannot be a basis of reopening assessment—***CIT*** v. ***V.T. Rajendran*** [2007] 288 ITR 312 (Mad.)

367.6-10 *WHETHER AUDIT PARTY'S REMARKS CAN FORM GROUND FOR REOPENING AN ASSESSMENT* - The Madras High Court in *CIT* v. *Mettur Chemical & Industrial Corpn.* [2000] 242 ITR 119 held that reassessment based solely on the audit party's remarks would be invalid under the law. The Delhi High Court too in *Duncan Services Ltd.* v. *ITO* [1992] 198 ITR 264/[1993] 66 Taxman 106 and ***Transworld International Inc.*** v. ***CIT*** [2005] 142 Taxman 35 held that audit party's view regarding interpretation of legal provision would not constitute a reason for issue of notice. It is the officer issuing the notice under section 148 who must himself be satisfied about the correctness of the audit report.

367.6-11 *WHETHER PROVISIONS OF SECTION 143(2) APPLICABLE IN THE CASE OF REASSESSMENT* - Section 147 is merely a machinery section. If notice is served under section 148, assessment/reassessment has to be completed either under section 143(1) or 143(3) or 144. Consequently, if the Assessing Officer wants to complete assessment/reassessment under scrutiny under section 143(3), he will have to issue a notice under section 143(2). Such notice can be issued within 12 months from the end of the month in the return is response to notice under section 148 was submitted. If however, such return was submitted during October 1, 1991 and September 20, 2005, scrutiny notice can be issued even after the expiry of 12 months but it cannot be issued after the expiry of time-limit for completion of reassessment under section 153(2).

367.6-12 ***Assessment completed under section 143(1) - Action under section 147 possible*** - If the assessment is not framed before the expiry of the period of limitation for a particular assessment year, it would have to be assumed that since proceedings has not been opened under section 143(2), the return has been accepted as correct under section 143(1). Thereafter recourse can be taken to section 147, provided fresh material has been received by the Assessing Officer after the expiry of limitation fixed for framing the original assessment. Such action can be taken by issue of notice under section 148 within 6 years from the end of the assessment year. If it is evident that, faced with severe paucity of time, the Assessing Officer has attempted to travel the path of section 147 in the vain attempt to enlarge the time available for framing the assessment, this is not permissible in law—***KLM Royal Dutch Airlines*** v. ***DIT*** [2007] 159 Taxman 205 (Delhi).

367.7 *Other points* - One should also keep in view the following—

- Section 147 is merely a machinery section and, therefore, assessment has to be completed either under section 143(3), 143(1) or under section 144—*CIT* v. *V.D. Saraf (HUF)* [1994] 207 ITR 217 (Bom.), *R. Dalmia* v. *CIT* [1992] 194 ITR 700 (Delhi).
- Rectification of an apparent mistake can be ordered by an Assessing Officer even if some income has escaped assessment and he could accomplish his objects by initiating reassessment proceedings instead—*Hira Lal Sutwala* v. *CIT* [1967] 56 ITR 339 (All.).
- The jurisdiction to reopen does not necessarily lead to the conclusion that there has been an escapement of income from assessment—*R.B. Seth Ram Rattan* v. *CIT* [1984] 18 Taxman 62 (Delhi).
- Even in proceedings under section 147, the burden is on assessee to prove that a receipt is not taxable—*Parimisetti Seetharamamma* v. *CIT* [1963] 50 ITR 450 (AP).
- Determination of loss in reassessment proceedings is not impermissible—*Himmatsingka Motor Works Ltd.* v. *CIT* [1993] 200 ITR 749 (Cal.).
- It is not correct to say that during reassessment Assessing Officer cannot reduce ordinarily assessed income from a business for a smaller figure—*B. Narsimha Reddy* v. *CIT* [1969] 74 ITR 276 (Mys.).
- Grant of excessive rebate from tax charged would result in assessment of income at too law a rate—*Sundaram & Co. (P.) Ltd.* v. *CIT* [1967] 66 ITR 604 (SC).
- Payment of excess interest on advance tax, is not a case of excessive relief and assessment cannot be reopened to withdraw it—*P.S. Subramanyam, ITO* v. *Simplex Mills Ltd.* [1963] 48 ITR 182 (SC).
- Pendency of reassessment proceedings cannot act as a bar to institution of criminal prosecution for offences punishable under section 276C or 277. Nor can prosecution under section 276C/277 be withheld on the ground that result of pending reassessment proceeding is awaited—*P. Jayappan* v. *S.K. Perumal, First ITO* [1984] 149 ITR 696 (SC).
- Where the Assessing Officer has exercised option to assess members of AOP, he cannot later initiate proceedings against the AOP for the same income even for a different assessment year—*Ch. Atchaiah* v. *ITO* [1979] 116 ITR 675 (AP).
- Reassessment or penalty proceeding against a company in liquidation can be initiated without leave of company court—*Official Liquidator, Swaraj Motors (P.) Ltd.* v. *ITO* [1972] 84 ITR 363 (Ker.).
- Every case of under assessment is not a case of escaped income—*CAIT* v. *Lucy Kochuvareed* [1976] 103 ITR 799 (SC).
- Merely because time is available to take the case in scrutiny by issuing notice under section 143(2), notice can be issued under section 147/148—***Mittal Court Premises Co-operative Society Ltd.*** v. ***ITO*** [2004] 140 Taxman 145 (Mum.). The failure to put into operation the provisions of section 143(3) will not make the Assessing Officer powerless or ineligible for invoking section 147 so long as the pre-requisites of section 147 are fulfilled.
- Reassessment proceedings cannot be initiated on the basis of the opinion held by the Commissioner and not on the basis of satisfaction recorded by the Assessing Officer—***Sutlej Industries Ltd.*** v. ***CIT*** [2005] 148 Taxman 28 (Delhi).
- In ***Inductotherm (India) (P.) Ltd.*** v. ***James Kurian, Asstt. CIT*** [2008] 169 Taxman 240/294 ITR 341, the Gujarat High Court held that there is no bar under the provisions of the Act for parallel proceedings in consequence of notices under section 148 and under section 263. After issuance of notice under section 148, the Assessing Officer himself can pass a fresh assessment order and under section 263 if the original assessment order of the Assessing Officer is erroneous and prejudicial to the interests of the revenue, the Commissioner of Income-tax can revise that order. Both the authorities are empowered under different provisions of the Act, though both have to ensure that the income escaped in the original assessment should be taxed.
- In the case of ***Travancore Cements Ltd.*** v. ***CIT*** 2006 (4) KLT 344, the High Court of Kerala has held that when notice period to make the general enquiry under section 143(2) has lapsed, the Assessing Officer cannot proceed in the guise of section 147 to reopen original assessment—***CIT*** v. ***Muthoot Leasing & Finance Ltd.*** [2008] 21 SOT 282 (Cochin). In absence of any new material, Assessing

Officer is not empowered to reopen an assessment whether original assessment was completed under section 143(1) or 143(3). In a case where assessment is made under section 143(1) and not under section 143(3), it is not possible to hold the view that income escaping assessment is always justified—***Aipita Marketing (P.) Ltd.*** v. ***ITO*** [2008] 21 SOT 302 (Mum.).

Issue of notice for reassessment [Sec. 148]

368. Before making the assessment, reassessment or recomputation under section 147, the Assessing Officer should serve on the assessee a notice requiring him to furnish a return of income within such period as may be specified in the notice. Before issuing a notice, the Assessing Officer is required to record reasons for doing so.

368.1 ***Time-limit and other conditions for issue of notice [Secs. 149 and 151]*** - Time-limit and other conditions for issue† of notice under section 148 are given below :

PROVISIONS AS APPLICABLE FROM JUNE 1, 2001[5]		
	Up to four years from the end of the relevant assessment year	*Beyond four years but up to six years from the end of the relevant assessment year*
■ In cases subject to scrutiny by way of assessment under section 143(3) or 147	Assessment can be reopened whatever is the amount of income escaped[1]	If the escaped income is Rs. 1,00,000 or more for that year[2]
■ In other cases	Assessment can be reopened whatever is the amount of income escaped[3]	If the escaped income is Rs. 1,00,000 or more for that year[4]

Notes :

1. Any Assessing Officer who is not below the rank of Assistant Commissioner or Deputy Commissioner can issue notice. An Assessing Officer who is below the rank of Assistant Commissioner or Deputy Commissioner can issue notice only if the Joint Commissioner (or Additional Commissioner) is satisfied on the reasons recorded by such Assessing Officer that it is a fit case for issue of such notice. However, if the Assessing Officer is the Additional Commissioner or the Joint Commissioner, then the prior approval of any higher officer is not required in case he has recorded the reasons for issuing notice.

2. Notice mentioned in point 1 *supra* can be issued only if the Chief Commissioner/Commissioner is satisfied on the reasons recorded by the Assessing Officer that it is a fit case for issue of notice.

3. Notice can be issued by the Assessing Officer.

4. No notice can be issued by an Assessing Officer who is below the rank of Joint Commissioner (or Additional Commissioner) unless the Joint Commissioner (or Additional Commissioner) is satisfied that on the reason recorded by Assessing Officer that it is a fit case for issue of such notice.

5. For determining income chargeable to tax which has escaped assessment, *see* para 367.1.

6. A notice issued without obtaining the prior sanction of the authority mentioned above would be invalid and the entire proceeding taken in pursuance thereof is liable to be quashed as the same would be without jurisdiction—***Dr. Shashi Kant Garg*** v. ***CIT*** [2006] 152 Taxman 312 (All.). The Joint Commissioner, the Commissioner or the Chief Commissioner, as the case may be, being satisfied on the reasons recorded by the Assessing Officer about fitness of a case for the issue of notice under section 148, need not issue the notice himself.

368.1-1 *EXCEPTIONS* - The following exceptions are applicable to time-limits given in para 368.1.

1. According to section 150(1), notice under section 148 may be issued at any time for the purpose of making an assessment, reassessment or recomputation in consequence of (or giving effect to) any finding or direction contained in an order passed by any authority in any proceeding by way of appeal, reference or revision or by a Court.

2. If the person on whom notice under section 148 is to be served is a person treated as an agent of non-resident (under section 163), then notice shall not be issued after the expiry of 2 years from the end of the relevant assessment year.

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†These time-limits are applicable for "issue of notice" and not for "service of notice". In other words, if the Assessing Officer issues notice within the time-limit, it is a valid notice even if "service of notice" takes place after the time-limit—*R.K. Upadhyaya* v. *Shanabhai P. Patel* [1987] 166 ITR 163 (SC).

3. If an assessment has been made for the relevant assessment year under section 143(3) or under section 147, action can be taken under section 147 after the expiry of four years from the end of the relevant assessment year only in the following cases—

a. income has escaped assessment due to the failure on the part of the assessee to file a return under section 139 or in response to a notice under section 142(1) or 148; or

b. income has escaped assessment due to failure of the assessee disclose fully and truly all material facts necessary for this assessment.

368.1-2 ***PROVISIONS ILLUSTRATED*** - To have better understanding of the aforesaid time limits for issue of notice for reassessment, the following problems are given :

368.1-2P1 *An Assessing Officer wants to issue notices under section 148 for different assessment years during the financial year 2008-09. Prepare a chart showing different years for which such notices can be issued pinpointing the minimum escaped income necessary for taking such action and other conditions.*

SOLUTION : During the financial year 2008-09, a notice can be issued under section 148 for the following assessment years if the income escaped from assessment is at least of the amount which is shown against these years :

Assessment year	*Minimum income which has been escaped from assessment*	
	If original assessment is completed under section 143(3) or 147	*If original assessment is completed under any other section*
(1)	*(2)*	*(3)*
	Rs.	*Rs.*
2002-03[5]	1,00,000[2]	1,00,000[4]
2003-04[5]	1,00,000[2]	1,00,000[4]
2004-05[5]	Any[1]	Any[3]
2005-06[5]	Any[1]	Any[3]
2006-07	Any[1]	Any[3]
2007-08	Any[1]	Any[3]

Notes :

1. Any Assessing Officer who is not below the rank of Assistant Commissioner or Deputy Commissioner can issue notice. An Assessing Officer who is below the rank of Assistant Commissioner or Deputy Commissioner can issue notice only if the Joint Commissioner (or Additional Commissioner) is satisfied on the reasons recorded by such Assessing Officer that it is a fit case for issue of such notice.

2. Notice mentioned in point 1 *supra* can be issued only if the Chief Commissioner/Commissioner is satisfied on the reasons recorded by the Assessing Officer that it is a fit case for issue of notice.

3. Notice can be issued by the Assessing Officer.

4. No notice can be issued by an Assessing Officer who is below the rank of Joint Commissioner (or Additional Commissioner) unless the Joint Commissioner (or Additional Commissioner) is satisfied that on the reason recorded by Assessing Officer that it is a fit case for issue of such notice.

5. If the person on whom notice under section 148 is to be served during the financial year 2008-09 is a person treated as an agent of a non-resident (under section 163), then notice shall not be issued for assessment years prior to the assessment year 2006-07.

6. During the financial year 2008-09, notice cannot be issued for any assessment year prior to the assessment year 2002-03 [see also exceptions 1 and 3, para 368.1-1].

368.1-2P2 *The Assessing Officer issues notices to X under section 148 for the following years on February 7, 2009 for taking action under section 147 :*

Assessment years	Income originally assessed Rs.	Assessment completed under section	Income which has escaped assessment Rs.
(1)	(2)	(3)	(4)
1996-97	50,000	143(3)	5,71,500
1997-98	55,000	147	71,000
1998-99	60,000	143(3)	1,05,000
1999-2000	65,000	143(3)	99,500
2000-01	67,000	143(3)	28,000
2001-02	70,000	144	28,000
2002-03	75,000	143(1)	24,600
2003-04	50,000	143(3)	99,000
2004-05	80,000	147	58,000
2005-06	(—) 25,000	143(1)	7,000
2006-07	(—) 15,000	143(3)	72,000

SOLUTION :

Assessment years	Validity of notice	Date up to which notice can be issued
1996-97	Not valid	March 31, 2003
1997-98	Not valid	March 31, 2002
1998-99	Not valid	March 31, 2005
1999-2000	Not valid	March 31, 2004
2000-01	Not valid	March 31, 2005
2001-02	Not valid	March 31, 2006
2002-03	Not valid	March 31, 2007
2003-04	Not valid	March 31, 2008
2004-05	Valid	March 31, 2009
2005-06	Valid	March 31, 2010
2006-07	Valid	March 31, 2011

368.1-2P3 *For the assessment year 2004-05, assessment of X Ltd. is completed under section 143(1) [income assessed : Rs. 4,47,000]. On March 28, 2009, the Assessing Officer issues a notice under section 148 to X Ltd. that an income of Rs. 45,760 has escaped assessment. The said notice is received by X Ltd. on April 3, 2009. Is the notice valid?*

SOLUTION : In this case notice can be issued up to March 31, 2009. A clear distinction has been made out between "issue of notice" and "service of notice" under the Act. Section 149 prescribes the period of limitation. It categorically prescribes that no notice under section 148 shall be issued after the prescribed limitation has lapsed. Section 148(1) provides for service of notice as a condition precedent to making the order of reassessment. Once a notice is issued within the period of limitation, jurisdiction becomes vested in the Assessing Officer to proceed to reassess. The mandate of section 148(1) is that reassessment shall not be made until there has been service. The requirement of issue of notice is satisfied when a notice is actually issued. In this case, admittedly, the notice is issued within the prescribed period of limitation as March 31, 2009 is the last day of that period. Service under the Act is not a condition precedent to conferment of jurisdiction on the Assessing Officer to deal with the matter but it is a condition precedent to the making of the order of assessment. The Assessing Officer has issued notice within limitation — *R.K. Upadhaya v. Shanabhai P. Patel* [1987] 166 ITR 163 (SC).

368.1-2P4 *X Ltd. is a non-resident sterling company. It is engaged in the purchase of tobacco from India through its duly appointed agents in India. For the assessment years 2003-04 and 2004-05 the returns were filed by the agents on behalf of X Ltd. and the assessments on the same were completed by the Assessing Officer after working out proportionate overhead expenses of the assessee for its tobacco business in India. Subsequently, in the course of assessment proceedings for another assessment year, the Assessing Officer noticed that the overhead expenses were attributable to the entire business of the assessee including the business as commission agents and not merely for the business of purchase and sale of tobacco. Thus, realising that the income had escaped assessment for the two assessment years 2003-04 and 2004-05, he issued notices to the agents of X Ltd. on June 10, 2009 but dropped*

the proceedings on finding that the said proceedings were barred by time in view of section 149(3) which states that if the person on whom notice under section 148 is to be served is a person treated as an agent of non-resident (under section 163), then notice shall not be issued after the expiry of 2 years from the end of the relevant assessment year. He, thereupon, issued notice under section 148 to X Ltd. Is it open to the Assessing Officer to proceed directly against X Ltd. as the assessments had been made originally on the agents?

SOLUTION : It is open to the Assessing Officer to assess either a non-resident assessee or to assess the agent of such non-resident assessee. The facts showed that the reassessment proceedings commenced on the agent were found to be barred by time by reason of section 149(3). The Assessing Officer dropped the proceedings when he was made aware of that prohibition. The assessment proceedings taken by him against the agent had to be ignored and cannot operate as a bar to assessment proceedings directly against X Ltd. Therefore, the Assessing Officer is right in proceeding against X Ltd. — *Claggett Brachi Co. Ltd.* v. *CIT* [1989] 177 ITR 409/44 Taxman 186 (SC).

368.1-2P5 *The Madras High Court gave a judgment in the case of X Ltd. for 1977-78 under the Central Sales Act on August 23, 2008 as a result of which an income of Rs. 76,800 becomes taxable for the assessment year 1978-79. The Assessing Officer issues notice on January 1, 2009 under section 148 to X Ltd. to tax income of Rs. 76,800 which has escaped assessment. Discuss whether the notice under section 148 can be issued.*

SOLUTION : By virtue of section 150, a notice under section 148 can be issued at any time for the purpose of making reassessment in consequence of (or to give effect to) any finding or direction contained in an order passed by any authority in any proceeding by way of appeal, reference or revision or by a Court.

368.2 *Frequently asked questions* - The following are the some of the frequently asked questions—

368.2-1 ***WHEN A NOTICE UNDER SECTION 148 IS TAKEN AS "VALID" OR "INVALID"*** - The following points should be kept in veiw—

- Notice must be in writing— *B.K. Gooyee* v. *CIT* [1966] 62 ITR 109 (Cal.).
- Before issue of notice it is not necessary to prove that a particular income has escaped assessment— *B.P. Halder & Sons, In re* [1942] 10 ITR 79 (All.).
- Specification of amount of escapement is not necessary — *East Coast Commercial Co. Ltd.* v. *ITO* [1981] 128 ITR 326 (Cal.).
- Wrong description in notice under section 148 of assessee which is corrected subsequently will not invalidate notice — *Mahabir Prosad Poddar* v. *ITO* [1971] 82 ITR 299 (Cal.).
- Where no prejudice is shown to have been caused due to misleading notice for reassessment, same cannot be quashed.
- Where there are two entities having same name and address and it is not clear from the notice as to which entity it was addressed, notice would not be a valid one — *ITO* v. *Chandi Prasad Modi* [1979] 119 ITR 340 (Cal.).
- Where one of four persons who were treated as AOP and on whom notice was served by registered post but was returned undelivered, filed return and assessment was framed on him, assessments on such person could not be treated as invalid on ground of non-service of notice — *CIT* v. *Har Prasad* [1989] 178 ITR 591 (Punj. & Har.).
- If registered notice comes back with endorsement of refusal, that is presumptive proof of service of notice — *CIT* v. *Har Prasad* [1989] 178 ITR 591 (Punj. & Har.).
- The proceedings which are initiated under section 154/155 cannot be made a ground of defence for invalidating the notice issued under section 147/148, as both the proceedings are independent of each other and cannot successfully be argued to point out that they overlap — *Dev Son (P.) Ltd.* v. *Union of India* [1991] 56 Taxman 122 (J&K).
- Notice must be issued within the limitation period, service within the limitation period is not a perquisite for conferment of jurisdiction on the Assessing Officer — *R.K. Upadhyaya* v. *Shanabhai P. Patel* [1987] 166 ITR 163 (SC). Therefore, the word 'issue' used in section 149, does not mean 'serve'— *CIT* v. *Sheo Kumari Debi* [1986] 157 ITR 13 (Pat.) (FB).
- If a notice is invalid entire proceedings are vitiated— *CIT* v. *Kurban Hussain Ibrahimji Mithiborwala* [1971] 82 ITR 821 (SC), even if the assessee has responded to such notice— *Sewlal Daga* v. *CIT* [1965] 55 ITR 406 (Cal.).

■ Where notice, though originally invalid, but is subsequently validated by statute, reassessment is valid— *Dayaldas Khushiram* v. *CIT* [1943] 11 ITR 67 (Bom.).

■ If validity of notice is not challenged before the Commissioner (Appeals)/Tribunal, it cannot be challenged in appeal before the High Court— *CIT* v. *Nemidas Vishaniji & Co.* [1984] 145 ITR 423 (AP).

■ Where return is filed within the time allowed in response to invalid notice for reassessment, second notice of reassessment by treating such return as invalid, will not be valid— *CIT* v. *S. Raman Chettiar* [1965] 55 ITR 630 (SC).

■ Where sanction has been obtained from the Commissioner, instead of the Joint Commissioner as required under section 151(2) before issuing notice under section 148, notice issued under section 148 shall be bad in law - ***R.P. Gupta & Sons (HUF)*** v. ***ITO*** [2006] 157 Taxman 158 (Delhi) (Mag.).

■ Section 282A (with effect from June 1, 2008) provides that where any notice or other document is required to be issued, served or given, it shall be deemed to have been authenticated if the name and office of a designated income-tax authority is printed, stamped or otherwise written thereon. For the purpose of this section, a designated income-tax authority shall mean any income-tax authority authorized by the Board for this purpose.

■ Section 292BB has been inserted by the Finance Act, 2008 with effect from April 1, 2008 to provide that where an assessee has appeared in any proceeding or cooperated in any inquiry related to an assessment or reassessment, it shall be deemed that any notice under any provision of the Act has been duly served upon him in time in accordance with the relevant provision of the Act. Further, such an assessee shall be precluded from taking any objection in any proceeding or inquiry under the Act that the notice was—

a. not served upon him; or

b. not served upon him in time; or

c. served upon him in an improper manner.

However, the provisions of section 292BB shall not be applicable where the assessee has raised the aforesaid objections before the completion of such assessment or reassessment.

368.2-2 *WHETHER RECORDING OF REASONS IS A MUST* - Before issue of notice under section 148, recording of reasons is mandatory— *CIT* v. *Thakurlal* [1981] 132 ITR 398, *East West Commercial Co. Ltd.* v. *ITO* [1981] 128 ITR 326 (Cal.).

On the basis of various judicial pronouncements, the following conclusions may be drawn—

1. There must be material for the belief.

2. Circumstances must exist and cannot be deemed to exist for arriving at an opinion.

3. Reason to believe must be honest and not based on suspicion, gossip, rumour or conjecture.

4. Reasons referred to must disclose the process of reasoning by which the Assessing Officer holds "reasons to believe" and change of opinion does not confer jurisdiction to reassess.

5. The reasons referred to must show application of mind by the Assessing Officer. No superior authority can substitute the reasons recorded by the Assessing Officer.

6. The reasons must be recorded in writing (such reason cannot be assumed) and should have link with the reopened assessment.

7. The reasons may not be supplied to the assessee and simply because these are not supplied to the assessee, reopening does not become bad.

8. If the reasons are asked for, the Assessing Officer is obliged to supply such reasons within a reasonable time.

9. When an assessee challenges a notice to reopen assessment under section 147 on ground that no reasons under section 148 have been recorded or disclosed, the court must call for and examine the reasons—*Comunidado of Chicalim* v. *ITO* [2000] 113 Taxman 331 (SC). Where the reasons said to have been recorded and said to be available before issue of notice under section 147, are not available even to the court or tribunal, reopening is bad in law.

10. On receipt of the reasons, the assessee can file his objections against the issuance of notice, and if so done, the Assessing Officer is bound to dispose of the same by passing a speaking order even before proceeding with the assessment.

The validity of initiation of reassessment proceedings has to be judged with regard to the material available with the officer at the point of time of issue of the notice under section 148 and cannot be sought to be substantiated by reference to material that may have come to light subsequently in the course of reassessment proceedings—***Sheth Bros.*** v. ***CIT*** [2003] 130 Taxman 367 (Guj.), ***Fisher-Xomox Sanmar Ltd.*** v. ***CIT*** [2003] 130 Taxman 247 (Mad.).

368.2-3 *WHAT COURSE OF ACTION THE ASSESSEE AND DEPARTMENT SHOULD FOLLOW AFTER ISSUE OF NOTICE UNDER SECTION 148* - The Apex Court in ***GKN Drive Shafts India Ltd.*** v. ***ITO*** [2003] 259 ITR 19 has framed the procedure to be followed by the Assessing Officer and the assessee after the issue of a notice under section 148. It must be followed by both. If any party makes a default in following the procedure, it is to his detriment. On receipt of the notice under section 148, the assessee may proceed as follows—

- *Action one* - The assessee can file a fresh return of income declaring his true income in compliance to the notice. The income may be more than what he had already declared in the original return filed under section 139(1) or it may be the same.
- *Action two* - Alternatively, he can write to the Assessing Officer that the return already filed under section 139(1) may be treated as a return filed in compliance to notice under section 148.
- *Action three* - After filing the return, the assessee should simultaneously request for the supply of reasons for the issue of notice under section 148.†
- *Action four* - He may file his objections to the issue of notice after taking legal advice and the Assessing Officer is bound to dispose of the same by a speaking order. If objections to the reopening of assessment, filed by an assessee, are not accepted by the Assessing Officer, he shall not proceed further in the matter within a period of four weeks from the date of service of rejection order on the assessee so that the assessee has sufficient time to take remedial action to challenge the order of rejection—***Housing Development Finance Corpn. Ltd.*** v. ***CIT*** [2007] 165 Taxman 8 (Bom.). If the Assessing Officer does not dispose of the objections by a speaking order and starts the assessment proceedings, then the assessee may file an application under section 144A before the Additional/ Joint Commissioner of Income-tax. If the application under section 144A is rejected, the assessee may file a writ in the High Court since the order under section 144A is not appealable. In writ petition, it is for the Assessing Officer to satisfy the Court about the existence of the conditions precedent by

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†The Supreme Court in the case of ***GKN Drive Shaft India Ltd.*** (***supra***) has introduced an intermediate stage for challenging the reassessment notices. It may, however, be noted that in spite of the Supreme Court judgment, different High Courts have entertained writ petitions directing against reassessment notices without following the procedure prescribed by the Apex Court in the above case. These High Courts' decisions are as follows—

- ***Dulichand Singhania*** v. ***CIT*** [2004] 136 Taxman 725 (Punj. & Har.).
- ***Hindustan Lever*** v. ***Wadkar R.B., Asstt. CIT*** [2004] 268 ITR 332 (Bom.).
- ***Caprihands India Ltd.*** v. ***Tarun Seem, CIT*** [2004] 266 ITR 566 (Bom.).
- ***Patidar Oil Cake Industries*** v. ***CIT*** [2004] 270 ITR 347/140 Taxman 575 (Guj.).

The Bombay High Court in ***Ajanta Pharma Ltd.*** v. ***CIT*** [2004] 267 ITR 200/135 Taxman 246, held that the Supreme Court nowhere pronounced a view that the assessee is totally debarred from approaching the High Court under article 226 of the Constitution of India when the exercise of power by the authority under section 148 *ex facie* appears to be without jurisdiction. The Court explained that the decision in *GKN Drive Shafts (India) Ltd.'s* case (*supra*) merely reminds the assessee that when a notice under section 148 is issued, the proper course of action is to file a reply with his objections including those in relation to the absence of jurisdiction. However, it does not lay down that when such an objection is in relation to the absence of jurisdiction and the same is revealed *ex facie* or apparent on the face of a notice or reasons in support thereof, the assessee has compulsorily to invite an order from the Assessing Officer in relation to the absence of jurisdiction.

The Gauhati High Court in its recent decision in ***Jaswant Kaur Sehgal*** v. ***CIT*** [2004] 271 ITR 475 also held that the decision of the Apex Court in *GKN Drive Shafts (India) Ltd.'s* case (*supra*) does not lay down a general principle of law that an assessee, aggrieved by a notice under section 148, cannot (before submitting a return as required) question the same in a writ proceeding.

filing affidavit and/or producing relevant records. In the absence of any material whatsoever placed by the Assessing Officer to disprove the challenge of the assessee to the existence of the conditions precedent, the writ petition cannot be dismissed—***Comunidade of Chicalim*** v. ***ITO*** [2003] 133 Taxman 274 (Bom.). In ***SICA Educational Trust*** v. ***Union of India*** [2008] 167 Taxman 19 (MP), while disposing of the writ petition, the court found that the objections raised by the assessee were not at all adverted to by the Assessing Officer. No speaking order had been passed rejecting the said objections as required under the law laid down by the Apex Court. Consequently, the reassessment order, as well as the demand raised as a consequence thereof against the assessee were quashed directing the Assessing Officer to consider the objections filed by the assessee and pass a separate speaking order on the said objections.

■ *Action five* - Alternatively he may assist in the assessment proceedings with a note of dissent and may go in appeal before the Commissioner (Appeals) against the order of assessment.

The Commissioner (Appeals) may be requested to decide the issue of validity of assessment first in view of ruling of *Makhan Singh Gurcharan Singh (HUF)* v. *CIT* [2002] 254 ITR 645/122 Taxman 818 (Delhi).

368.3 ***Other judicial rulings*** - One should also keep in view the following rulings—

■ Return filed in response to a notice under section 148 cannot be discarded by the Assessing Officer only for the reason that it is a revised return and the assessee has raised some new claim in it—***Amita Batra*** v. ***CIT*** [2004] 85 TTJ (Delhi) 92.

■ Defect of not sending notices to all legal representatives is not curable under Act, and reassessment made pursuant to such notice is null and void—***CIT*** v. ***Mangi Lal*** [2004] 83 TTJ (Jodh.) 590.

■ Challenge to jurisdiction to issue notice, 2 years after its issue and after complying with it, cannot be entertained—***West Bengal State Co-operative Bank Ltd.*** v. ***CIT*** [2004] 268 ITR 462 (Cal.).

■ Pursuant to notice under section 148, the Assessing Officer cannot call upon assessee to furnish information not connected with reasons on basis of which reassessment notice has been served on assessee—***Amrinder Singh Dhiman*** v. ***Assessing Officer*** [2004] 269 ITR 378 (Punj. & Har.).

■ Where the reassessment notice was served on four sons of the deceased assessee and one of whom filed return without raising any objection and pursued the matter till passing of the assessment order, non-issuance of the notice to some of legal heirs of the deceased assessee was merely an irregularity and the same did not affect the validity of the reassessment orders—***CIT*** v. ***Hukam Singh*** [2005] 276 ITR 347 (Punj. & Har.).

What are the provisions regarding rectification of mistake [Sec. 154]

369. The provisions of section 154 are given below—

369.1 ***Which order can be rectified [Sec. 154(1)]*** - To rectify any mistake apparent from record, an income-tax authority may amend the following orders—

a. an order passed under any provision of the Act;

b. an intimation or deemed intimation under section 143(1).

369.1-1 *IF THE ABOVE ORDER IS SUBJECT TO AN APPEAL [Sec. 154(1A)]* - If the above mentioned order has been subject-matter of an appeal/revision then it cannot be amended by the Assessing Officer under section 154. However, the Assessing Officer can amend the order in respect of any matter other than the matter considered and decided in appeal/revision. In other words, even if appeal has been preferred against an order, a mistake in that part of the order which was not subject-matter of appeal and which was left untouched by the appellate authority, can be rectified under section 154(1) [Sec. 154(1A)].

369.2 ***Meaning of "mistake"*** - A mistake which can be rectified under section 154 is one which is patent, which is obvious and whose discovery is not dependent on argument or elaboration.

369.2-1 *MISTAKE WHICH CAN BE RECTIFIED* - The following are some of the examples of mistakes which can be rectified under this section : an error of law or fact, a clerical or arithmetical mistake, error

in determining written down value, overlooking the obligatory provisions of the Legislature, and mistake arising as a result of subsequent retrospective amendment of law—*Southern Industrial Corpn. Ltd.* v. *CIT* [2002] 258 ITR 481 (Mad.).

Where the sums referred to section 43B had in fact been paid after the end of the previous year but on or before the due date of submission of return of income, but the evidence therefor had been omitted to be furnished along with the return, the Assessing Officers can entertain applications under section 154 for rectification of the intimation—Circular No. 669, dated October 25, 1993.

369.2-2 *MISTAKE WHICH CANNOT BE RECTIFIED* - Where the controversy can be resolved only by way of a complicated process of investigation, recourse cannot be taken to section 154. If on a question of construction on a point of law, two views are possible, no rectification can be done by invoking section 154. A question on which there is difference of opinion among the two judges of High Court, cannot be rectified by invoking provisions of section 154.

369.3 ***Who can point out the mistake to be rectified [Sec. 154(2)]*** - The provisions of section 154(2) are given below—

- An income-tax authority can rectify the mistake apparent from records on its own.
- An income-tax authority can rectify any mistake apparent from record if it has been brought to his notice by the assessee.
- If there is mistake apparent from record in an order passed by the Commissioner (Appeals), the Commissioner (Appeals) can rectify the mistake if it has been brought to his notice by the assessee or the Assessing Officer.

Successor Commissioner cannot refuse to entertain rectification application in respect of the order passed by his predecessor on the ground that, he being a succeeding Commissioner, cannot sit over the judgment of his predecessor and review his order under the guise of making rectification under section 154—*Trustees of Indore Cancer Foundation Charitable Trust* v. *Union of India* [2001] 116 Taxman 531/248 ITR 730 (MP).

369.4 ***Time-limit*** - An order to rectify mistake can be made within the time-limit given below—

- No amendment under section 154 can be made after the expiry of 4 years from the end of the financial year in which the order sought to be amended was passed. The point at which the period of limitation commences is 4 years from the date of order sought to be amended (and not the date of original order).

Where while allowing the appeal, the entire order of assessment dated February 20, 1980 was set aside and certain directions were given to the assessing authority to re-do the assessment and, thereafter, a fresh assessment came to be made on February 2, 1983, the period of limitation for rectification of the order is to be counted from February 2, 1983 and not from the date of assessment order which was set aside—*Southern Industrial Corpn. Ltd.* v. *CIT* [2002] 258 ITR 481/[2003] 126 Taxman 170 (Mad.).

The word "order" in expression "from the date of the order sought to be amended" in section 154(7) includes amended or rectified order and, therefore, where original assessment is subsequently rectified, a second application for rectification made within four years from date of first rectificatory order is valid—*Hind Wire Industries Ltd.* v. *CIT* [1955] 212 ITR 639 (SC).

- Where an application for amendment under section 154 is made by the assessee on or after June 1, 2001 to an income-tax authority, the authority shall pass an order within 6 months from the end of the month in which the application is received by it, either making the amendment or refusing to allow the claim.

369.4-1 *WHEN ORDER CAN BE PASSED AFTER THE TIME LIMIT* - The authorities making rectification are, however, authorised by the Board to dispose of an application even after the expiry of time-limit if a valid application had been filed by the assessee within the statutory time-limit but was not disposed of by the concerned authority within the aforesaid time-limit *vide* Circular No. 73, dated January 7, 1972.