INCOME-TAX LAW & PRACTICE

INCOME-TAX
LAW & PRACTICE

(including the law relating to Wealth-Tax and Gift-Tax)

By

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THIRTYFOURTH EDITION

1975

MIRA PRAKASHAN
Educational Publishers
30/108, AZAD STREET
AGRA–3

Published by
MIRA PRAKASHAN
30/108, Azad Street, Agra (U. P.) India.

1st Edition 1941
34th Edition 1975

Acc. No. 9140
Date 3.7.15
Call No. 336.240 954/GUP

Price : Rs. 40·00

Printed in India
by Om Prakash Agarwal
at Om Printing Press, Agra–2 (U. P.)

Jangipur College Library
9140

PREFACE TO THIRTYFOURTH EDITION

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While every care has been taken to secure accuracy of the illustrations, the authors cannot claim that the book is absolutely free from errors.

Western Kutchery Road
Meerut
25th June 1975

R. R. G.
V. S. G.

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The following extract, which should be of particular interest to tax-payers, is taken from the address delivered by Justice O. Chinnappa Reddy, when inaugurating the refresher course for Income-Tax Officers, Class II, at Hyderabad on 11th May 1971 :

"It is common experience that a tax-payer who wishes to submit a return of income and who takes a look at the Income-Tax Act is immediately baffled and finds that he is facing a veritable *Padma Vyuha* and does not know how to get in and, if he gets in, he gets stuck like *Abhimanyu* and does not know how to get out. An Income-Tax Officer who assists the tax-payer by making helpful suggestions instead of merely finding fault will not only earn the respect of the tax-payer but will also minimise his own work when he proceeds to the work of assessment. The tax-payer that I have in mind is the ordinary tax-payer who does not retain the services of an income-tax consultant and who has not adopted any devices to avoid tax".

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In loving memory of my son

HAR SARAN

who died on 8th October 1942 while in his nineteenth year.

Rup Ram Gupta

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"In a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in; nothing is to be implied. One can only look fairly at the language used." —*Rowlatt J.*

"Every person is entitled so to arrange his affairs as to avoid taxation but the arrangement must be real and genuine and not a sham or a make-believe." —*Supreme Court.*

"Avoidance of tax is not tax evasion and it carries no ignominy with it, for it is sound law, and certainly not bad morality, for anybody to so arrange his affairs as to reduce the brunt of taxation to a minimum." —*55 ITR 642.*

CHAPTER 1

Introduction

Important Note :

This book contains the law of Income-tax which is in force for the assessment year 1975-76 beginning on 1st April 1975.

In India the law of income-tax is contained in the Income-Tax Act, 1961 and the Rules made thereunder. This Act came into force on 1st April 1962 and it applies to the whole of India.

The 1961 Act replaced the Indian Income-Tax Act, 1922 which had remained in force for forty years.

The Income-Tax Act, 1961, has been amended many times since it was passed, and has therefore become very complicated.

In this book (*i*) the sections referred to are the sections of the Income-Tax Act, 1961 as amended to date, unless stated otherwise, (*ii*) the "Act" means the Income-Tax Act, 1961, (*iii*) the "Board" means the Central Board of Direct Taxes, and (*iv*) the "Department" means the Department of Income-Tax.

DEFINITIONS

Sections 2 and 3 of the Income-Tax Act, 1961, and the Income-Tax Rules, 1962, define the terms and expressions used in the Act. Given below are some of such terms and expressions, other terms and expressions being explained in their appropriate places in the book.

Agricultural Income.

The definition of agricultural income is very important because agricultural income is exempt from tax as such, howsoever and by whomsoever it may be received. The exemption is conferred on a particular kind of income and does not depend on the character of the recipient. Agricultural income means the following :

(1) Any rent or revenue (revenue meaning income and not land revenue) derived from land which is situated in India and is used for agricultural purposes. It is not necessary that the land should be assessed to land revenue or be subject to a local rate in India. This is because lands in Terai areas or cantonments, forest land and small holdings in certain stages are not subject to any land revenue or a local rate.

(2) Any income derived from such land by agricultural operations including processing of the agricultural produce raised or received as rent-in-kind or the sale of such produce.

CORRECTION

On page 109, the paragraph number (6) is to be replaced by the following :

(6) **Provision for Gratuity.** In computing the taxable profits of an assessee, no deduction is allowed in respect of mere provisions made by employers in their accounts for the payment of gratuity to their employees without the setting up of an approved gratuity fund. This provision became effective from 1st April 1973.

As this provision has a retrospective effect, tax-payers are allowed to transfer the amount of provisions made by them to approved gratuity funds before 1-4-1977. For this purpose they will have to set up approved gratuity funds before 1-1-1976 and transfer to such funds at least 50% of the provisions made in the previous years relevant to the assessment years 1973-74 to 1975-76, and the balance before 1-4-1977.

Amounts transferred to approved gratuity funds within the specified time will be allowed as deduction in computing the taxable profits of the past years in which the provisions were made.

(3) Any income attributable to farm buildings if the following conditions are satisfied :

(*a*) The building is situated on or near the land used for agricultural purposes and is required by the cultivator or the recipient of agricultural income as a dwelling-house or a storehouse or an out-house.

(*b*) The land on or near which such building is situated is assessed to land revenue or is subject to a local rate, if it is in an urban area. If the land is outside an urban area, it may or may not be assessed to land revenue or be subject to a local rate.

Urban area means an area situated within the limits of a municipality or cantonment board having a population of not less than 10,000 or within such distance (up to 8 kilometres) from the limits of any such municipality or cantonment board as the Central Government may notify.

Agriculture means cultivation of the soil for raising food and other products. What is agriculture is explained in full later on. Unless there is some measure of cultivation of the land and some expenditure of labour and skill upon it, the land cannot be said to be used for agricultural purposes. Therefore income from forest trees of spontaneous growth is not agricultural income. For the same reason the following incomes are not agricultural incomes :

(*i*) Income from markets, ferries and fisheries.

(*ii*) Income from supply of water for irrigation purposes.

(*iii*) Income from stone quarries.

(*iv*) Income from mining royalties.

(*v*) Income from the sale of earth for brick-making.

(*vi*) Remuneration received as manager of an agricultural farm.

(*vii*) Profit from salt produced by flooding the land with sea-water.

Assessee.

An assessee means a person by whom any tax or other sum of money is payable under the Income-Tax Act, and includes :

(*a*) every person in respect of whom any proceeding under this Act has been taken for the assessment of his income or of the income of any other person in respect of which he is assessable, or of the loss sustained by him or by such other person, or of the amount of refund due to him or to such other person ;

(*b*) every person who is deemed to be an assessee under any provision of this Act ; and

(*c*) every person who is deemed to be an assessee in default under any provision of this Act.

Assessment Year.

This means the period of twelve months commencing on the 1st day of April every year. This is also known as the "tax year".

Average Rate of Income-Tax.

This means the rate arrived at by dividing the amount of income-tax calculated on the total income, by such total income.

Casual Income. This is income which is of a casual and non-recurring nature and which is accidental, foruitous, unexpected and unforeseen.

The term 'income' for income-tax purposes includes winnings from lotteries, crossword puzzles, races including horse races, card games, others games

of any sort or from gambling or betting. Therefore such incomes are not casual income. Such income (other than lottery winnings) is exempt from tax up to Rs. 1,000, the balance being chargeable to tax.

The following incomes, though of a non-recurring nature, are not treated as casual income :

(*a*) Capital gains.

(*b*) Income arising from a business, profession or occupation.

(*c*) Receipts by way of addition to the remuneration of an employee.

Casual income must be in the nature of an unforseen windfall like the finding of an article of value or the receipt of an unexpected gift or legacy.

Illustration

Are the following incomes casual income ?

(*a*) A layman purchases a large plot of land, divides it into smaller plots for building sites and sells them at a profit. This is not casual income, as it arises from an adventure in the nature of trade.

(*b*) *A* receives a gift of Rs. 5,000 from his maternal-grandfather (*nana*). This is casual income, as it is non-recurring, unexpected and unforeseen.

(*c*) A gratuity paid to the secretary of a company for additional services rendered in connection with the sale of the company's shares. This is not casual income as it is received for services rendered.

(*d*) A merchant dealing in hides agreed to act as an arbitrator to settle the dispute between the heirs of a nawab. He was not promised any remuneration nor did he expect any. But he was paid Rs. 7,000 by the Court. This is casual income.

(*e*) *A* was once a cloth merchant which business he had given up. He successfully negotiated the sale of certain cotton mills and received a commission. This is not casual income, as it must have been expected.

Charitable Purpose.

This includes relief of the poor, education, medical relief, and the advancement of any other object of general public utility, but the object of general public utility should not involve the carrying on of any activity for profit.

The purpose should not be wholly or mainly of a religious nature.

Person.

The word "person" includes :

(*i*) an individual,

(*ii*) a Hindu undivided family,

(*iii*) a company,

(*iv*) a firm,

(*v*) an association of persons or a body of individuals whether incorporated or not,

(*vi*) a local authority, and

(*vii*) every artificial juridical person not falling within any of the above.

Person who has a substantial interest in a company.

In relation to a company, such a person means a person who is the beneficial owner of shares, not being shares entitled to a fixed rate of dividend, carrying not less than 20% of the voting power.

Previous Year.

As the tax payable by an assessee for any assessment year is in respect of the income of the previous year, the definition of "previous year" is very important.

The "previous year" (otherwise known as accounting year or income year) is generally speaking either the financial year immediately preceding the assessment year or a period of 12 calendar months (according to the English calendar) ending at any date within that financial year for which the assessee has made up his accounts in the normal course.

Indian businessmen follow, for their own accounting purposes, the year according to one of the numerous calendars in force in different parts of India. The length of such years differs from that of the English calendar year and a few of them commence on some date in April. In order to meet the convenience of such assessees, the Commissioner is authorised to recognise as a "previous year" any period not less than eleven and not more than thirteen calendar months and ending not later than 30th April. Thus, such years as Dasehra year, Diwali year, Samvat year, etc., have been given recognition.

It is permissible for an assessee to adopt different previous years for different sources of income depending upon the accounting year actually adopted by him in respect of each source, but there are two limits to this rule, namely :

(*a*) If a particular item of income represents share of profits from a firm, the previous year for that item will be the same as the previous year of the firm. This will apply only when the firm itself has been assessed as a unit.

(*b*) The previous year once adopted cannot be changed without the permission of the Income-Tax Officer.

In the case of a new business or profession, the first "previous year" for purposes of assessment will be :

(*i*) If the assessee chooses to make up his accounts according to one of the specially recognised commercial years, the period ending on the last day of the commercial year during which the business was commenced.

(*ii*) If the assessee chooses to make up his accounts according to a year ending on any other date, the broken part of that year from the commencement of the business.

(*iii*) In any other case, the period ending on 31st March next after the commencement of the business.

To Illustrate : If an assessee starts a new business on 1st August 1973 and closes his accounts according to Diwali year, his first previous year will be from 1-8-1973 to Diwali 1973. If he adopts the calendar year, his first previous year will be from 1-8-1973 to 31-12-1973. In either case, the income of this period will be taxed in the assessment year 1974-75. If however he chooses to close his accounts on 30th June every year, his first previous year will be the eleven months ending 30th June 1973 and in that case there will be no assessment for 1974-75 and the first assessment will be in 1975-76.

It is to be particularly noted that the first previous year should not ordinarily exceed 12 months. As the transactions in the first few months of a new business may not be numerous, a businessman may find it convenient to make up his accounts for the first time after the lapse of (say) 15 or 18 months. For income-tax purposes, this period of 15 or 18 months will have to be broken up into two periods, the later period being one year, and the income of each period ascertained separately. Thus, if an assessee commencing

a new business on 1st August 1973 makes up his accounts up to 31-12-1974 the profits of the period from 1-8-1973 to 31-12-1973 have to be ascertained and are to be charged to tax in the assessment year 1974-75. The remaining profits (*i. e.*, profits for the calendar year 1974) will then be assessed in 1975-76.

Previous year for unexplained cash credits. In the case of unexplained cash credits, section 68 provides that the previous year would be the previous year for which the accounts of the assessee have been kept.

Previous year for undisclosed income or property. According to sections 69, 69A, and 69B, the previous year in the following cases is the financial year in which the income arose or the property was detected :

(*a*) Where any investment is found not to be recorded in the books of account.

(*b*) Where any money, bullion, jewellery or any other valuable article is found not to be recorded in the books of account.

(*c*) Where any money, bullion, jewellery or any other valuable article is found not to be *fully* recorded in the books of account.

Exceptions. The following are the exceptions to the general rule that the income of a previous year is charged to tax in the following assessment year :

(*i*) Income from shipping business of non-residents (section 172).

(*ii*) Income of persons leaving India (section 174).

(*iii*) Income of persons likely to transfer property to avoid tax (section 175).

(*iv*) Income of discontinued business or profession (section 176).

In these cases, the income of a previous year is assessed to tax in the same assessment year. The provisions of these sections are explained in subsequent chapters.

Change of Previous Year. Where the assessee has once adopted a particular accounting year as his previous year in respect of a certain source of income, he cannot change it except with the consent of the Income-Tax Officer and on such conditions as the latter may impose.

Where the Income-Tax Officer accords his consent to a change of the previous year, he has ample power to impose the condition that the full period from the end of the "previous year" for the preceding year's assessment to the end of the new accounting year should be taken as the previous year for the current assessment year.

For example, with the consent of the Income-Tax Officer an assessee changes his previous year. Instead of closing his accounts at the end of the calendar year 1973, he closes them on 30th June 1974. In this case the first previous year of the assessee after the change will consist of 18 months ending 30-6-1974. Therefore there will be no previous year for the assessment year 1974-75, but the income of the entire period of 18 months will be assessable to tax in the assessment year 1975-76.

Principal Officer.

When used with reference to a local authority or a company or any other public body or any association of persons or any body of individuals, the expression "principal officer" means :

(*a*) The secretary, treasurer, manager or agent of the local authority, company, association, or body ; or

(*b*) Any person connected with the management or administration of the local authority, company, association, or body, upon whom

the Income-Tax Officer has served a notice of his intention of treating him as the principal officer thereof.

Apart from the secretary, treasurer, manager or agent, it is only those persons who are *connected with the management or administration* of a local authority, company, association, or body, who can be treated as principal officers.

Relative.

In relation to an individual, the term, "relative" means the husband, wife, brother, or sister, or any lineal ascendant or descendant of that individual.

Tax.

The word "tax" in relation to the assessment year 1965-66 or any subsequent assessment year means income-tax chargeable under the provisions of the Act, and in relation to any other assessment year it means income-tax and super-tax chargeable prior to 1st April 1965.

CHAPTER 2

Capital And Revenue

The distinction between capital and revenue is of vital importance for income-tax purposes. In the first place, the method of charging tax on income and capital gains is different. Secondly, in computing the taxable profits of a business, profession or vocation, only the revenue expenditure (and not capital expenditure), is deducted from trading profits.

In some cases it is easy to make a distinction between capital and revenue, but in many others the line of distinction is not easily drawn and it becomes a puzzling question to decide the character of the receipt of expenditure. Courts have often observed that it is not possible to lay down satisfactory tests by which it can be conclusively judged whether a particular receipt is a capital receipt or a revenue receipt or whether a particular expenditure is a capital expenditure or a revenue expenditure. The decided cases therefore serve merely as illustrations and not as perfect guides.

RECEIPTS

The distinction between capital receipts and revenue receipts is much more difficult than the distinction between capital expenditure and revenue expenditure. It is a matter involving much refinement. It is true that no hard and fast rule can be laid down for determining whether a particular receipt is a capital receipt or a revenue receipt ; still the following tests may be applied for this purpose in particular cases :

1. A receipt on account of fixed capital is a capital receipt while a receipt on account of circulating capital is revenue receipt for income. Fixed capital is that which the owner keeps for earning profit, such as plant, machinery and buildings of a business. Circulating capital is that out of which the owner makes profit by parting with it and letting it change hands, such as stock-in-trade. The latter capital circulates because it is turned over and over, and in the process of being turned over it yields profit or loss. Fixed capital, on the other hand, is not involved directly in that process and remains unaffected by it. The term "capital assets" is also used for fixed capital. What is fixed capital will depend upon the nature of business. The very same thing may be fixed capital in the hands of one business, but circulating capital in the hands of another. The land on which the factory of a manufacturing concern stands is its fixed capital, but the land in the hands of a dealer in real estate is part of his circulating capital. Machinery in the hands of a manufacturer is part of his fixed capital, whereas the same machinery with a machinery merchant is part of his circulating capital. The books purchased by a practising chartered accountant for use in his profession are a fixed asset, but the same books would be circulating capital in the hands of a bookseller.

2. In case of an isolated transaction of purchase and sale of property, the motive of the owner will decide whether the receipt is a capital receipt or a revenue receipt. If the property is held as an investment, the receipt from its sale is a capital receipt. On the other hand, if the property is held for the purpose of selling it at a profit, its sale proceeds are a revenue receipt, because the transaction is in the nature of trade. Thus, the sale proceeds of shares and securities would be a capital receipt if the seller is an ordinary investor realising his holding, but it would be a revenue receipt if he is carrying on speculation in shares and securities.

3. Where a receipt is in substitution of a source of income, it is a capital receipt ; but where it is in substitution of the income alone, it is a revenue receipt. Compensation received by an employee from his employer for the termination of his services is a capital receipt (though taxable), because it is in replacement of the source of income itself, namely, the employment ; but a gratuity received by an employee from his employer in consideration of his past services is income as it is by way of additional remuneration.

4. Where a sum is received for the surrender of certain rights under an agreement, it is a capital receipt, because a capital asset (*i. e.*, the rights) is given up ; but where the sum received is in the nature of compensation for loss of future profits it is a revenue receipt. A lessor received a sum of Rs. 1,00,000 in payment of royalty on the abandoned coal when the lessee ceased to work the mine. The payment was expressly provided for in the lease. The sum being in lieu of future profits is income.

5. The nature of a receipt is determined entirely by its character in the hands of the recipient, and the source from which the payment is made does not affect the question at all. Where an amount is paid out of the payer's capital, but the payee receives it as income, the receipt is a revenue receipt. If the proprietor of a newly-started business pays the salaries of his employees out of his capital, the salary in the hands of his employees is a revenue receipt, because they receive it as income.

6. The fact that a particular receipt is a lump sum receipt does not mean that it is always capital receipt. There is no magic in the distinction between a lump sum and a periodic sum. A revenue receipt is not necessarily recurring, nor a capital receipt necessarily single.

A lump sum paid in lieu of a series of periodic income payment is itself income. A lump sum in lieu of future royalties or a single amount paid in advance in respect of ginning charges of cotton for ten years would be income. A lump sum taken in commutation of a right to future remuneration or in compromise or reduction of salary would also be revenue receipt.

An annual receipt recurring over a number of years may be a capital receipt, *e. g.*, sale proceeds of a capital asset received in instalments.

Illustrations

(1) A company carried on business as manufacturers of fireclay goods and was the lessee of a fireclay field, part of which ran along the lines of a railway company. The railway company in order to prevent the working of the beds of fireclay adjacent to the railway lines paid a lump sum to the manufacturing company. This is a capital receipt being a payment for the destruction of a capital asset.

(2) If a railway passenger meets with an accident and either dies or is permanently disabled, any compensation received from the railway company is capital receipt, being in replacement of source of income, *i. e.*, his life. On the oher hand, if he is disabled only for a temporary period during which he loses his earnings, compensation received in respect of such loss is a revenue receipt, because it is in replacement of the income alone.

(3) Damages received by an employee who is wrongly dismissed or a payment received by an employee in lieu of notice, are all capital receipts. In either case a source of income disappears and compensation for its loss is a capital receipt. But it is taxable.

(4) If an employer pays to an employee a sum of money not as compensation for the termination of his services but as an inducement to retain his service, the receipt in the hands of the employee is a revenue receipt, because it is in respect of his future services.

(5) A pension received by an ex-employee is a revenue receipt being compensation for past services ; but a lump sum received in commutation of a pension is a capital receipt, being in replacement of a capital asset, namely, the right to the pension, but it is taxable.

(6) A company owning a chalk quarry, contracted to supply a purchaser a certain quantity of chalk yearly for ten years. The purchaser after some time did not wish to take further delivery and the company agreed to release him from obligation in consideration of a lump sum payment. This is a revenue receipt in the hands of the company, as it is in replacement of income that would have been earned had the contract not been terminated.

(7) A "pugree" (*i. e.*, an illegal premium) received by the owner of house property from the tenant is a revenue receipt, as it is a payment of extra rent in advance.

(8) The owner of a large bungalow sells it in consideration of a payment to him by the purchaser of an annuity of Rs. 5,000 for the next ten years. This annuity is a revenue receipt. But if he sells the bungalow to the purchaser for Rs. 50,000 to be paid by ten equal instalments of Rs. 5,000 each, each instalment received is a capital receipt. The seller has the right to choose which of the two methods he should adopt and naturally he should adopt the second method for the purpose of avoiding income-tax on Rs. 5,000 a year.

(9) A, B and C are partners in a firm. A retires and his share is fixed at a sum equal to a certain fraction of the firm's profits for five years. The annual amount to be received by A from the firm would be capital receipt, being an instalment of a capital sum due to him.

(10) A company contracted to build two steamers but agreed to the cancellation of the contract in consideration of the payment of compensation. The compensation so received is a revenue receipt being in substitution of the profit the company might have made by the building of the steamers. Compensation received for the cancellation of a contract which is made in the ordinary course of business is revenue receipt.

(11) Know-how is a capital asset and the price received on the sale of know-how is a capital receipt.

EXPENDITURE

The term "capital expenditure" is distinct from "revenue expenditure". The former is an expenditure attributable to capital and is not therefore deductible from the trading receipts in order to compute the profits which are liable to tax, but the latter is deductible before arriving at such profits. It is not easy in any particular case to decide whether a particular expenditure is in the nature of capital expenditure or in the nature of revenue expenditure. Most cases raise very difficult and debatable questions and very many of them usually lie on the border line, but in order to decide on which side of the line a particular case falls, it is essential to consider the nature of the business, the exact form of the transaction and the object with which the expenditure is incurred, and then to apply the following tests :

1. When expenditure is incurred with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade it is capital expenditure. The words 'permanent' and 'enduring' do not mean everlasting. They

merely indicate that the asset or advantage acquired must be sufficiently durable to justify its being treated as a capital asset. The advantage may be either a positive one (*e. g.*, the acquisition of a right) or a negative one (*e. g.*, the elimination of competition). An enduring advantage having been gained in either case the cost of procuring it is capital expenditure. What is important is that the expenditure must be incurred with a view to securing an advantage which may not accrue. It is the object alone and not the result that counts. Thus, expenditure incurred in obtaining a licence which is not used or in securing an agency which is not obtained is capital expenditure.

2. A payment made by an assessee to free himself from a capital liability (*e. g.*, an onerous lease) is capital expenditure, while a payment made by an assessee to free himself from the liability to make an annual revenue payment is revenue expenditure (*e. g.*, a sum paid to free himself from a disadvantageous agency agreement or a sum paid to an employee in commutation of an annual pension).

3. The fact that a certain payment constitutes a revenue receipt or a capital receipt in the hands of the recipient is not material in determining the nature of the payment from the point of view of the payer. An amount paid may be a capital receipt in the hands of the recipient but a revenue payment from the point of view of the payer, and *vice versa.*

4. An item of expenditure is capital expenditure when it is referable to a capital asset, and it is revenue expenditure when it is referable to circulating capital or stock-in-trade. A lump sum payment made by an oil producing company to its agents for the cancellation of their selling agency is revenue expenditure, as the payment refers to the stock-in-trade of the company. On the other hand, if the payments were made for the cancellation of the oil concession it would be capital expenditure being referable to its capital asset.

However, the principle that expenditure referable to or connected with a capital asset is capital expenditure does not hold good in all cases. Where expenditure is incurred in merely preserving or maintaining capital assets it is revenue expenditure.

The expenditure incurred for the purpose of preserving a capital asset of a business could properly be regarded as a revenue expense only when there was a business going on and when the capital asset was supporting an actual business.

When a sum of money is laid out for the acquisition or improvement of a capital asset, it is capital expenditure ; but if no alteration is made in the capital asset by the payment, then it is revenue expenditure, being merely a maintenance of the capital asset.

5. Expenditure is deemed to be capital expenditure when it is made for the initiation of a business, for extension of a business or for a substantial replacement of equipment. Initial expenditure is regarded as capital expenditure, for it is incurred not in earning profits but in setting up the profit-earning machinery. Where a company purchases a capital asset in an imperfect condition and reconditions it before using it for the purposes of its trade, the expense of reconditioning is a capital expenditure.

Illustrations

(1) Expenditure incurred in the registration and re-registration (renewal) of a trade-mark is a revenue expenditure. A trade-mark endures for a period of seven years only, after which a fresh registration has to be made. Therefore, it does not possess the permanency which is required to make the expenditure a capital expenditure and to bring into existence a benefit of an enduring nature.

(2) When the services of a director, agent or other employee are terminated not on personal grounds, but on the ground that it is not in the interest of the empolyer

to keep them, a sum paid as compensation is a revenue expenditure. A sum paid by a company to a retiring director in consideration of his agreeing not to compete with the company was held to be a capital expenditure, because by buying off potential competition the company had improved the value of its goodwill and thus had brought into existence an advantage for the enduring benefit of its trade.

(3) Expenditure incurred in securing the supply of raw materials for a long period is revenue expenditure, as it relates to circulating capital.

(4) Compensation paid to directors, managing agents and other employees on termination of their services is a revenue expenditure, being in replacement of future revenue payments.

(5) A brewery company spent money on publishing anti-prohibition literature just before an election in which the issue was whether there should be prohibition or not the expenditure so incurred is a capital expenditure as the object is to secure an enduring benefit.

(6) A company made annual payments for trucks under a hire-purchase agreement extending over a period of years. Each annual payment should be disintegrated and that part of it which represented rent was a revenue expenditure, while the balance of the sum which represented the payment of price towards the eventual purchase was a capital expenditure.

(7) Litigation is often conducted by businessmen in order to maintain, preserve or defend an existing right or title to property, or to prevent the invasion of such right in future. Legal expenses incurred in such litigation do not create a new capital asset but are incurred in the ordinary course of preserving or maintaining the assets of the business. Such expenses are therefore a revenue expenditure.

(8) A company contracted for the construction and purchase of a new ship. As there was a heavy slump in the trade and there was no prospect of working the ship at a profit, the company sought and secured the cancellation of the contract on payment to the builders of a sum of Rs. 2,00,000. The amount of Rs. 2,00,000 so paid is capital expenditure because it has been paid by the company to free itself from capital liability.

(9) A company paid Rs. 40,000 to one of its directors under the terms of an agreement with him that on his retirement from the directorship he would not engage for 10 years in any business competing with that of the company. As the undertaking on the part of the director would result in an enduring benefit to the trade of the company, the payment of Rs. 40,000 is capital expenditure.

(10) A machine-tool manufacturing company began to manufacture tools in October 1974. It paid Rs. 9,000 to one of its directors who went to U.S.A. in April 1974, to study the set-up and working of a tool-manufacturing concern. Rs. 9,000 is part of preliminary expenses of the company because it was incurred before the starting of the company's business, and it is therefore capital expenditure.

(11) A machine-tool manufacturing company, which commenced production in December 1973, spent Rs. 8,000 on the technical training of an employee in the U.S.A. during 1974, on the condition that the employee would serve the company for five years on a monthly salary of Rs. 2,000 as against Rs. 3,000 paid to the foreign expert employed by the company. As this expenditure of Rs. 8,000 would result in a saving on salary charges, it is revenue expenditure.

(12) The expenditure on foreign travel incurred by a surgeon to keep himself abreast of the latest technique in surgery and treatment and to maintain his efficiency in the profession is not an expenditure of a capital nature but is a revenue expenditure.

(13) An individual carrying on the business of supplying lime and sand, took a lease for a term of 11 months whereby he obtained exclusive right to remove the sand lying loose on the river bed and paid Rs. 82,500 as lease money. It was held that the money so paid was revenue expenditure because he did not acquire any fixed asset of an enduring nature (*68 ITR 493*).

LOSSES

Section 28 enacts that an assessee is liable to pay tax in respect of the profits of any business carried on by him. Nowhere in the Act is the method of computation of the profits of the business laid down and all that sections 30 to 37 enact is that the profits should be computed after making the allowances enumerated in those sections.

The liability to pay income-tax in respect of a business is only on the profits of the business. It is well-settled that profits should be ascertained by ordinary commercial principles. The legislature, after specifying the permissible deductions in sections 30 to 37, has left the determination of the profit to be made in accordance with the principles well understood by business people. That is the reason why revenue or trade losses to be set off against the profits of the year are not specifically mentioned as an allowance.

It is not possible to give a precise definition of a capital loss and a revenue loss. A revenue loss is a loss of some revenue receipt or a loss of stock-in-trade or a loss incurred in the course of the business and as incidental to it. It should not merely be connected with the business, but it should really be incidental to the trade. Any loss which is not a revenue loss would be a capital loss.

The law governing a claim to deduction of a loss was clearly enunciated by the Supreme Court in *Badridas Daga v. C. I. T.* in the following terms :

"When a claim is made for a deduction for which there is no specific provision in the Income-Tax Act, whether it is admissible or not will depend on whether, having regard to accepted commercial practice and trading principles, it can be said to arise out of the carrying on of the business and to be incidental to it. If that is established, then the deduction must be allowed provided of course there is no prohibition against it, express or implied in the Act." (*34 ITR 10 and 15*).

What is it that makes the misappropriation or the interception of the funds of the assessee by a subordinate a trade loss ?

It is the employment of subordinates and the necessity to employ them and to entrust them with various duties including collection of moneys that makes the loss arising in the course of the business. The trade cannot be carried on without the employment of the servants and it is impossible to carry on the trade without reposing confidence in them. If, taking advantage of the situation in which they are placed and of the confidence reposed in them, they pocket a portion of the funds and intercept them without allowing such funds to reach the till, it follows that the loss incurred by such embezzlement is a loss in the course of the trade.

If, however—and this is the line of demarcation—the funds reach the till, and the moneys get home to the person entitled to their custody and control, and if thereafter the funds are lost either by theft or by embezzlement, such loss is altogether outside the trade and the course of the business. *This theory is, however, inapplicable to business such as banking or money-lending.*

Illustrations

(1) A loss of stock-in-trade by fire or ravages of white-ants or by theft is a revenue loss, but the loss arising from the destruction of a capital asset is a capital loss.

(2) The loss caused to a business by reason of defalcations by an employee is a trading loss and the assessee is entitled to claim the amount of the loss as a permissible deduction. This deduction is permissible as a trading loss and not as expenditure because it is not expenditure. If embezzled moneys which have been treated as a revenue loss in any year are subsequently recovered, they should be brought in as a revenue receipt in the year of recovery.

When loss by embezzlement by employees is claimed as a deduction, the material date is not the date when the embezzlement took place but the date when the loss is caused. So long as there is any possibility of the money being recovered from the employee who embezzled the money, there is no loss to the assessee. It is only when it is clear that the money cannot be recovered that the loss is caused (*27 ITR 700*).

(3) Once the revenue receipts have found their way into the till, they become part of the capital of the business. Therefore, when a trader is robbed of his cash by a stranger to the business, *e. g.*, where dacoits enter into his office and rob the cashier of his cash or when money is stolen from his employee who is carrying it to bank the loss is a capital loss.

(4) Shortage in cash in a money-lending business found on making up the accounts of the day is a revenue loss because cash in a money-lending business is stock-in-trade.

(5) A theft committed by an employee during usual business hours is revenue loss, being incidental to the trade ; but a theft committed by an employee who breaks into the shop after office hours stand on the same footing as a theft by a stranger and is therefore a capital loss.

(6) A loss arising from a payment made in advance to an employee is a revenue loss if the advance was made with reasonable business prudence. But where the managing director of a company was allowed to overdraw on account of the commission payable to him, any loss resulting from such overdrawing would be a capital loss, because the financial indulgence shown to him by the company could not be considered to be consistent with any trading interest of the company.

(7) A deposit made by a person with a manufacturing company to secure for himself an appointment as an agent of the company is capital expenditure. If this deposit is lost through the insolvency of the company, the loss would be a capital loss.

(8) An assessee carried on business as money-lender, dealer in shares and bullion and commission agent, through an agent who held a power of attorney which conferred on him large powers of management including authority to operate on bank accounts. The agent withdrew from the bank account sums aggregating to Rs. 2,30,636 and applied them in satisfaction of his personal debts incurred in speculative transactions. On being informed of the true state of affairs, the assessee cancelled the power of attorney and called upon the agent to pay the amounts withdrawn by him. The assessee later filed a suit against the agent for recovery of the amount but could recover only a sum of Rs. 28,000 and wrote off the balance as irrecoverable. The question was whether this amount was an admissible deduction in computing the profits of the assessee from business for the purpose of income-tax.

It was held by the Supreme Court (*34 ITR 10*) that :

(*i*) the theory that once moneys were put into the bank they had "got home" and their subsequent withdrawal from the bank would *de hors* the business was inapplicable to a business such as banking or money-lending ;

(*ii*) as the business of the assessee consisted in lending moneys, realising them and making fresh loans, a continuous operation on the bank account by the agent was incidental to the conduct of the business ;

(*iii*) once it was established that the agent was in charge of the business, that he had authority to operate on the bank account, and that he withdrew moneys in the purported exercise of the authority, his action was referable to his character as agent and any loss resulting from misappropriation of funds by him was a loss incidental to the carrying on of the business ; and

(*iv*) the loss sustained by the assessee as a result of the agent was one which was incidental to the carrying on of the business and should therefore be deducted in computing the profits from business.

(9) An assessee, who was a dealer in cloth and government securities, encashed government securities for Rs. 20,790 but lost the cash by theft at a railway station.

It was held that the loss of Rs. 20,790 was not incidental to the assessee's business and was not an allowable deduction. It was only when it could be pointed out that it was part of the assessee's business to take cash with him that it could be said that the loss was incidental to the business.

Every loss sustained by an assessee having some connection with his business would not amount to a loss incidental to his business. It must be directly connected with the business or it must arise out of the business. The mere fact that there is some remote connection between the loss and the business would not bring the loss within the expression "loss incidental to the business". It should spring directly from the carrying on of the business and be incidental to it. The loss should be inseparable from the business (*43 ITR 249*).

(10) An assessee carried on business in several commodities. In the course of the business, he submitted tenders to a railway and undertook to supply certain commodities. The amount which he had deposited as security for properly carrying out the contract in accordance with the terms of the tender was forfeited as he could not carry out the contract. The assessee claimed this amount as a trading loss.

It was held that as the assessee was already carrying on business and the tender was only a transaction in that business and it was in order to put through that transaction that he made the deposit and the deposit was made solely for the purpose of earning profits in the course of business, the amount paid as deposit, which was forfeited, was a trading loss (*35 ITR 461*).

(11) A company, which was carrying on business in timber, hired an elephant for hauling timber from the forests. Under the agreement the mahout attached to the elephant was also to be engaged by it. During the hauling of timber the mahout inflicted such injuries on the head of the elephant that the elephant died of injuries, and the company had to pay Rs. 9,000 as damages to the owner of the elephant.

As the business of the assessee involved the hauling of timber for which the services of elephants were necessary, and risk of negligence of the mahout in controlling the elephant in the hauling of timber was also incidental to the business of the company, the loss resulting from the payment of damages to the owner of the elephant was a trading loss (*47 ITR 814*).

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CHAPTER 3

Tax Liability

Income-tax, as its very name implies, should be a tax on income and not on capital receipts, but in India Income-tax is levied not only on income but also on certain capital receipts.

INCOME

Section 2(24) does not define income, but it widens the accepted meaning of the term so as to include in it the following receipts, all of which cannot be strictly called income :

1. Profits and gains.
2. Dividend as defined in a subsequent chapter dealing with taxation of dividend income.
3. The value of any perquisite or profit in lieu of salary taxable under the head "Salaries".
4. The value of any benefit or perquisite obtained from a company either by a director or by a person who has a substantial interest in the company, or by a relative of the director or such person, and any sum paid by any such company in respect of an obligation which would have been payable by the director or other person aforesaid.
5. Any sum chargeable to income-tax under clauses (ii) and (iii) of section 28 or section 41 or section 59. The provisions of these sections are explained in subsequent chapters.
6. The value of any benefit or perquisite taxable under clause (iv) of section 28 as explained later.
7. Any capital gains chargeable under section 45, as explained in a subsequent chapter dealing with capital gains.
8. The profits of any insurance business carried on by a mutual insurance company.
9. Any annuity due, or commuted value of any annuity paid, under the "Annuity Deposit Scheme" now discontinued.
10. Voluntary contributions received by a charitable or religious trust or institution. Contributions received with a specific direction that they shall form part of the corpus of the trust or institution will not however be treated as income.
11. Winnings from lotteries, crossword puzzles, races including horse-races, card games, other games of any sort or from gambling or betting.

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The definition of income as given in section 2(24) is inclusive and not exhaustive. Income includes not only those things which this sub-section lays down but also such things as the word signifies according to its natural meaning. The object of the Income-Tax Act is to tax income which is difficult to define in precise terms. It is a word of the broadest connotation. With regard to income that is liable to tax, guidance is to be sought from judicial pronouncements, which in their turn are largely based on commercial usage.

Income connotes a periodical monetary return coming in with some sort of regularity or expected regularity from definite sources. The source need not necessarily be one which is expected to be continuously productive, but it must be one whose object is the production of a definite return excluding anything in the nature of a mere windfall. Such sources are classified in the Act as employment, investments, house property, business or profession, capital gains and other sources. *If there is no source to which a particular receipt can be attributed, then such receipt is not income liable to tax.* For instance, the profit resulting from an isolated transaction of purchase and sale, which is not in the nature of a trade, is not income liable to tax, because it has no source. Income has, therefore, been liked to the fruit of a tree or the crop of a field.

Income is not necessarily a recurrent return from a definite source. In fact, it may never recur at all and the source may never yield a return. Business is not necessarily the continuous exercise of an activity. An isolated adventure may constitute business.

In section 2(24), income includes profits and gains. The term income, when contrasted with profits and gains, means a periodical monetary return coming in independently and not as the proceeds of a business. Profits, on the other hand, are the surplus by which receipts from a business exceed the expenditure necessary for earning those receipts. Profits and gains mean the same thing.

The following are the fundamental principles relating to income :

(1) Income may accrue to an assessee without the actual receipt of the same. If the assessee acquires a right to receive the income, the income can be said to have accrued to him, though it may be received later. The basic conception is that he must have acquired a right to receive the income. There must be a debt owed to him by somebody. Unless and until there is created in favour of the assessee a debt due by somebody it cannot be said that he has acquired a right to receive the income or that income has accrued to him.

(2) The taint of illegality associated with income is immaterial for the purpose of taxation. It is absurd to suppose that honest gains are charged to tax and dishonest gains escape. The income-tax law is not restricted in its application to lawful business only. A thief who carries on the business of committing thefts is as liable to tax as an honest businessman, and he may in addition be prosecuted for the offence.

(3) Income is taxable notwithstanding that there is a rival claim to the source of the income. The mere existence of a dispute as to title, even where a suit has been filed, cannot of itself hold up an assessment.

(4) There is no distinction for income-tax purposes between temporary and permanent income. Everything in the nature of income is taxable whether temporary or permanent, steady or fluctuating, precarious or secure.

(5) Income may be realised in the form of money or money's worth. The receipt of the equivalent of cash would be the receipt of income.

(6) The receipt of a lump sum may be income. Sums received under a consequential loss policy by the assessee, who has insured against loss of profits consequent on fire, is income liable to tax. Remuneration, which is income when paid over a number of years, would be income even though paid once and for all in a lump sum.

(7) Mere relief from expenditure is not income. A person is chargeable to tax on what goes into his pocket and not on what he saves. In a suit by the debenture-holders, the assets of a company were sold for a sum much below the amount due by the company under the debentures. The commission of the auctioneer at the court sale would have been 5 per cent, but the court relieved the debenture-holders of the payment of this commission by allowing one of them to act as the auctioneer. The relief from the auctioneer's commission cannot be the income of the person who acted as the auctioneer.

(8) The nature of a receipt for income-tax purposes is fixed once and for all when it is received, and a receipt, which at the time of its receipt was not income, cannot be made income by a subsequent operation. Thus, if a man receives an advance from a customer, the advance remains unclaimed for a number of years, and finally it is appropriated to the credit of the firm's capital account, then such credit in the capital account is not income, because when the money was originally received from the customer it was not received as income.

(9) It is important to observe the distinction between **"application of income"** and **"diversion of income"**. Where a person applies his income in a particular way it remains his income. In the case of diversion of income, the income diverted is not regarded as the income of the transferor.

Where the transfer of income arises out of a voluntary act on the part of the tax-payer, there is an application of income, and the fact that he created a binding obligation on himself to make the payment is immaterial. Where a man grants an allowance to his wife, child or aged parent, whom he is under a personal obligation to maintain, it is merely a case of application of income.

Where the transfer of income is in pursuance of a legally enforceable obligation of the tax-payer, there is a diversion of income. Income may have to be diverted by a decree of the court or under the provisions of a will or under any other legal obligation.

The true test (as laid down by the Supreme Court) is whether the amount sought to be deducted *in truth never reached the assessee*. Obligations, no doubt, there are in every case, but it is the nature of the obligation, which is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee. Where by the obligation income is diverted before it reaches the assessee, it is deductible ; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence in law does not follow. It is the first kind of payment which can truly be excused and not the second.

The distinction between an application of income and a diversion of income will be clear from the following important cases :

(*a*) *Raja Bejoy Singh Dudhuria v. C. I. T.* (*1 ITR 135*). This is the leading case on the subject. There, the stepmother of the Raja had brought a suit for maintenance and a compromise decree was passed, under which the stepmother was to be paid Rs. 1,100 per month, which amount was declared by the court a charge upon the properties in the hands of the Raja. It was held by the Privy Council that this amount of maintenance was a diversion of income and was not the income of the Raja at all. The decree of the court by charging the Raja's whole resources with a specific payment to his stepmother had to that extent diverted his income from him and had directed it to his stepmother ; to that extent what he received for her was not his income.

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(*b*) *C. I. T. v. Sitaldas Tirathdas* (*41 ITR 367*). In computing his total income for purposes of income-tax, the assessee sought to deduct amounts paid by him as maintenance to his wife and children under a decree of court by consent in a suit. No charge on any property of the assessee was created. It was held by the Supreme Court that this was a case in which the wife and children of the assessee received a portion of the assessee's income after he had received it as his own and was therefore one of application of a portion of the income to discharge an obligation and not one in which by an overriding charge the assessee became only a collector of another's income. The assessee was not therefore entitled to the deduction claimed by him. If an overriding charge had existed either upon the property or upon its income, the amount of maintenance would have been allowable as a deduction.

(10) The general principle of law, as is now well settled, is that when any payment is received in part, it should first go towards the payment of costs due, then interest and the balance, if any, towards the payment of principal. In the absence of any appropriation by either party there is no reason why this principle should not be applied. For example, assume that A owes B Rs. 10,000 for the principal amount lent, Rs. 1,000 for interest and Rs. 500 for costs, that A pays B Rs. 4,500 and that there are no circumstances indicating to which item of the dues the sum of Rs. 4,500 is to be appropriated. Therefore, the sum of Rs. 4,500 should be first applied to the payment of costs (Rs. 500), Rs. 1,000 towards interest and Rs. 3,000 towards the principal. Hence, Rs. 1,000 is income of B which is liable to tax.

(11) Income must come from outside. A surplus accruing to a mutual concern cannot be regarded as income liable to tax. A body of persons contributing to a common fund in pursuance of a scheme for their mutual benefit, having no dealing or relation with any outsiders, cannot be said to have made a profit when they find that they have overcharged themselves and that some portion of their contributions may be safely refunded. Where the contributors are to receive back a part of their own contributions, the complete identity between the contributors and recipients negatives the idea of any profit, for no man can make a profit out of himself. The fact that a mutual association is incorporated as a company would not affect its mutual character, for incorporation does not destory the complete identity between the contributors and the participators.

A mutual concern may carry on mutual activities, resulting in a non-taxable surplus and also non-mutual activities resulting in taxable profits. Thus in the case of a members' club, any surplus accuring from subscriptions and charges for various conveniences paid by members is not income or profit at all nor can a social club be deemed to trade as far as dealings with its own members are concerned. But a club is taxable on the profit derived from subscriptions and charges paid by non-members as well as on the income derived from its capital assets. Similarly, in the case of a mutual benefit society even if it is a limited company, the income earned by it by way of interest from its members on loans and overdue subscriptions is not profit liable to tax, but interest derived from investments with banks is assessable.

The general principle that the mutual activities of a mutual concern do not yield a taxable surplus is, however, subject to two exceptions, namely :

(*i*) Although the surplus accruing to a mutual insurance company is not income in the true sense of the term, yet it has been made liable to tax by section 2(24).

(*ii*) Section 28(iii) enacts that a trade, professional or similar association (*e. g.*, a chamber of commerce or a stock exchange) performing specific services for its members shall be deemed to carry on business in respect of those services, and the profit therefrom shall be liable to tax. The object of this provision is to charge as profit the surplus arising from specific services rendered to members by mutual trade, professional or similar association which would not otherwise be liable to tax.

TAX LIABILITY

Section 4 is the charging section. It lays down the incidence of the charge of income-tax, namely :

(*a*) Income-tax is to be charged at the rate fixed for the assessment year by the annual Finance Act.

(*b*) The charge is to be on every person, as defined in the first chapter.

(*c*) The tax is to be charged on the assessee's total income of the previous year computed in accordance with the provisions of the Act.

(*d*) Notwithstanding that tax is to be paid in respect of the income of a previous year, tax may be recovered on current income whenever so provided.

(*e*) Even where tax is deducted at source or paid in advance, liability to pay the tax arises by virtue of this section.

The Income-Tax Act is a permanent enactment, but there is no liability to tax until the annual Finance Act is passed. However, section 294 provides that, if on 1st April in any assessment year the new Finance Act has not been passed, the provisions in force in the preceding assessment year or the provisions proposed in the Finance Bill then before Parliament, whichever is more favourable to the assessee shall apply until the Finance Act becomes effective.

The subject of charge is the income of the previous year and not the income of the assessment year. *Though the subject of the charge is the income of the previous year, the law to be applied is that in force for the assessment year, and not that which was in force during the year the income of which is under assessment.*

Section 4 charges every person in respect of his total income, while section 5 defines the extent of total income.

RESIDENCE OF ASSESSEES

According to section 5, the scope of the total income of an assessee is determined by reference to his residence in India *in the previous year*, and with regard to residence the assessees are divided into three classes, namely :

(1) Persons resident in India.
(2) Persons not ordinarily resident in India.
(3) Persons not resident in India, *i. e.*, non-residents.

Each of these three classes is chargeable to tax on a different basis. It is with reference to the *previous year* that the various tests of residence have to be applied, residence during the assessment year being immaterial.

The question of residence must be determined with reference to each previous year, because the finding of residence in one previous year would not mean that an assessee had the same residential status in the next. An individual, who has been regularly assessed as a resident, would have to be treated as a non-resident in any particular year if he stayed outside India throughout the whole of that year.

Note : An assessee may have different previous years in respect of different sources of income. It is therefore provided that if a person is resident in India in a previous year in respect of any source of income, he shall be deemed to be resident in India in the previous year in respect of each of his other sources of income.

The residence of an assessee is determined according to the following rules :

Persons Resident in India

Individuals.

According to section 6(1), an individual is resident in India in any previous year, if :

(*a*) he is in India in that year for a period or periods totalling not less than 182 days ; or

(*b*) he maintains or causes to be maintained for him a dwelling-place in India for a period or periods totalling not less than 182 days in that year and has been in India for 30 days or more in that year ; or

(*c*) he has been in India (*i*) for at least 365 days in the four years preceding that year, and (*ii*) for 60 days or more in that year.

In order to decide whether an individual maintains or causes to be maintained a dwelling-place in India, the vital fact to determine is not ownership of the house property, but the right of the assessee to reside in a building which is ready and fit for his occupation and which is intended to be used by him as his home. The building or a portion of the building must be available to him and must be at his disposal, and he must be in a position to go and occupy it without the permission of anyone else.

The period of 182 or 365 days referred to above need not be continuous, nor it is essential that the stay should be at the same place. A resident may pass from place to place or from house to house or from hotel to hotel. The dwelling-place need not be one's own house. It may be a rented building or rooms in a hotel or a friend's place.

Further in order that an individual may be resident in any previous year, he must fulfil both the following conditions, namely :

(*a*) That he has been resident according to any of the above three rules in nine out of the ten previous years preceding that year ; and

(*b*) That he has, during the seven previous years preceding that year been in India for periods amounting in all to 730 days or more.

If either of these two conditions is not fulfilled, the individual would be a person not ordinarily resident in India.

Hindu Undivided Families.

According to section 6(2), a Hindu undivided family is resident in India in any previous year if any portion of the control and management of its affairs is situated there. It is only when the control and management of its affairs is situated *wholly* outside India that it is regarded as non-resident.

Further, in order that a Hindu undivided family may be a resident in any previous year, it must fulfil both the following conditions, namely :

(*a*) That its manager has been resident as an individual in nine out of the ten previous years preceding that year ; and

(*b*) That its manager has, during the seven previous years preceding that year, been in India for periods amounting in all to 730 days or more.

If either of these two conditions is not satisfied, the family would be not ordinarily resident in India.

Thus, whether or not a Hindu undivided family is resident in India is decided by the situation of the control and management of its affairs and also by the residence of its manager or karta.

What is a Hindu undivided family for income-tax purposes is explained in a subsequent chapter dealing with assessment of Hindu undivided families.

The expression "control and management" means the controlling and directive power, the "head and brain" as it is sometimes called, and "situated" implies the functioning of such power at a particular place with some degree of permanence, while "wholly" would seem to recognise the possibility of the seat of such power being divided between two separate places. If the seat of control and management is in more than one place, at least one of which is in India, then the control and management of its affairs would not be wholly outside India and the family would be treated as resident. But an isolated or a casual act of management and control done in India by a karta who lives abroad is not sufficient to make the family resident.

The control and management of affairs implies continuous looking after the affairs of the family with some degree of permanence and stability. It does not mean occasional looking after the affairs of the family.

If a Hindu undivided family contends that it is not resident in India, it must prove that the control and management of its affairs is wholly outside India. The onus of proof lies on the family.

Firms and Other Associations of Persons.

According to section 6(2), a firm or other association of persons is resident in India in any previous year if any portion of the control and management of its affairs is situated there. It is only when the control and management of its affairs is situated *wholly* outside India that it is regarded as non-resident.

The residence of partners or members is immaterial for the purpose of determining the residence of the firm or association, except in so far as such residence affects the control and management of the affairs of the firm or the association.

Companies.

According to section 6(3), a company is resident in India in any previous year if (*a*) it is an Indian company, or (*b*) the control and management of its affairs is situated *wholly* in India in that year.

Companies incorporated outside India will be resident in India only if the control and management of their affairs is wholly in India. At the same time, all companies incorporated in India are to be treated as resident companies even if in some cases the control and management is shifted outside India.

Other Persons.

According to section 6(4), every other person (*e. g.*, an artificial juridical person) is resident in India in any previous year, if any portion of the control and management of his affairs is situated there. It is only when the control and management of his affairs is situated *wholly* outside India that he is regarded as non-resident.

Persons Not Ordinarily Resident in India

According to section 6(4), a person not ordinarily resident in India is defined as follows :

Individuals.

An individual is not ordinarily resident in India in any previous year, if :

(*a*) he has not been resident in India in nine out of the ten previous years preceding that year ; or

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(*b*) he has not during the seven previous years preceding that year been in India for periods amounting in all to 730 days or more.

In order that an individual is "not ordinarily resident" in India, he should satisfy *one* of the two conditions mentioned above. In this connection what has got to be considered is the assessee's residence in India and not his residence outside India.

Hindu Undivided Families.

A Hindu undivided family is not ordinarily resident in India in any previous year, if :

(*a*) its manager has not been resident in India in nine out of the ten previous years preceding that year ; or

(*b*) its manager has not during the seven previous years preceding that year been in India for periods amounting in all to 730 days or more.

Whether a Hindu undivided family is resident in India depends upon the location of the control and management of its affairs ; but whether it is not ordinarily resident in India is determined by reference to the residence of its manager. This is rather illogical.

It should be noted that only individuals and Hindu undivided families can be "not ordinarily resident" in India.

Persons Not Resident in India

According to section 2(30), a non-resident means a person who is not resident in India according to the tests laid down above.

Illustrations

(1) A person, after about 25 years' stay in India, retired to England in April 1972 and returned to India on 15th February 1975 to take up a salaried appointment. What is his residential status for the previous year 1974-75 ?

In the previous year ended 31st March 1975 he has not been here for 182 days nor did he have a house here. During the four years preceding 1974-75 he was here for more than 365 days, but in 1974-75 was not here for at least 60 days. Therefore by every test he is non-resident for the previous year 1974-75.

(2) A person, after about 25 years' stay in India, retired to England in March 1972 and returned to India in September 1974 to take up a salaried appointment. What is his residential status for the previous year 1974-75 ?

In the previous year ended 31st March 1975 he was here for more than 182 days. Therefore, he is a resident. He was not resident in India in nine out of the ten previous years (1964-65 to 1973-74) preceding the previous year (1974-75) although he was in India for a period of more than 730 days during the seven previous years (1967-68 to 1973-74) preceding the previous year 1974-75. Therefore, he is a person not ordinarily resident in India for the previous year 1974-75.

(3) A Punjabi merchant trading in Iran has an ancestral home in Amritsar and he visits India for about two months each year. What is his residential status for the previous year 1974-75 ?

He maintains a dwelling-place in India for more than 182 days and has been in India for more than 30 days in the previous year 1974-75. Therefore, he is a resident for the previous year. He was not in India for a period of 730 days during the seven previous years (1967-68 to 1973-74) preceding the previous year 1974-75 although he was resident in India in nine out of the ten previous years (1964-65 to 1973-74) preceding the previous year 1974-75. Therefore, he is a person not ordinarily resident in India for the previous year 1974-75.

(4) X came to India for the first time from U. S. A. on 30th June 1968. He stayed here at a stretch for 3 years and left for Japan on 1st July 1971. He returned to India on 1st April 1972 and remained in India till 31st July 1972 when he went back to U. S. A. He again came to India taking up an employment with an American concern on 31st January 1975. What is his residential status for the previous year ended 31st March 1975 ?

In the four previous years (1970-71 to 1973-74) preceding the previous year 1974-75 he was in India for more than 365 days and during the previous year 1974-75 he was in India for just 60 days. Therefore, he is a resident for the previous year 1974-75. As he has not been resident in India in nine out of the ten previous years prior to the previous year 1974-75 he is a resident not ordinarily resident for the previous year 1974-75 ?

(5) Y, an individual residing at Agra, left India for England for higher studies on 1st March 1971. He however maintained a dwelling-place for himself at Agra throughout the period when he was abroad. During the winter vacation he came to India twice, once on 20th December 1972 and again on 20th December 1973 and stayed at the dwelling-place at Agra for two months in each year. During the year ended 31st March 1975 he did not come to India at all. What is his residential status for the previous year 1974-75 ?

He maintained a dwelling-place for himself in India for the whole previous year 1974-75 but he did not come to India for any period that year. Therefore, he is a non-resident for the previous year 1974-75.

(6) James, a British national, was appointed a senior scientific officer in India on 1st April 1964. On 31st January 1972 he went to Iran on deputation for a period of three years, but left his wife and children in India. On 1st May 1973 he came to India and took with him his family to Iran on 30th June 1973. He returned to India and joined his original job on 2nd February 1975.

What would be the status of James for income-tax purposes for the assessment years 1972-73 to 1975-76 ?

The status of an assessee for any particular assessment year is his status for the relevant previous year. Therefore, the residential status of James for the assessment years 1972-73 to 1975-76 will be as per his status for relevant previous years 1971-72 to 1974-75 respectively. The residential status of James for the four relevant previous years 1971-72 to 1974-75 will be as under :

1971-72. For this previous year he is resident but not ordinarily resident in India. He was in India for more than 182 days during this previous year, but he was not resident in India in nine out of the ten previous years prior to the previous year 1971-72.

1972-73. For this previous year he is a non-resident. When he left his wife and children in India, he maintained a dwelling-place for him throughout the year, but he did not come to India at all during that year. Therefore, he cannot be a resident.

1973-74. For this previous year he is resident but not ordinarily resident in India. He was in India for more than 365 days in the four previous years (1969-70 to 1972-73) prior to the previous year 1973-74 and was in India for 60 days (from 1st May 1973 to 30th June 1973) in the previous year 1973-74. But he was not resident in India in nine out of the ten previous years (1963-64 to 1972-73) prior to the previous year 1973-74.

1974-75. He is non-resident for this previous year. He was not in India for 182 days in this previous year nor did he maintain a house for himself for that period. Of course, he was in India for 365 days in the four previous years (1970-71 to

1973-74) prior to the previous year 1974-75 but he was not in India for 60 days in the previous year 1974-75 because he returned to India on 2nd February 1975.

(7) The previous year of an individual is the calendar year. It is found that he was physically present in India from 1st May 1974 to 15th July 1974 (both days inclusive). It was also ascertained that he was physically present in India in the preceding years as shown below :

Calendar year 1969	25 days
,, ,, 1970	100 days
,, ,, 1971	75 days
,, ,, 1972	125 days
,, ,, 1973	85 days

The individual has claimed that, since he has been physically present in India for less than 182 days in the previous year relevant to the assessment year 1975-76 he should be treated as non-resident for the assessment year 1975-76. Can his claim be accepted ? What will be his residential status for the assessment year 1975-76 ? Give reasons for your answer.

In order to determine the residential status of an individual, the conditions obtaining in 1974 and the four preceding years (1970, 1971,1972 and 1973) have to be examined.

In 1974 he was physically present in India for 76 days ; but he was also physically present in India for 385 days (more than 365 days) in the four preceding previous years and he has also been physically present in India during the year 1974 for more than 60 days. Therefore, he will be treated as resident in respect of the assessment year 1975-76 and his claim to be treated as non-resident will be rejected.

Further, assuming that he does not satisfy any *one* of the following two conditions, he will be a person "not ordinarily resident" in India :

(*a*) That he has been resident in nine out of the ten previous years preceding the year 1974 ; and

(*b*) That he has, during the seven previous years preceding the years 1974, been in India for 730 days or more.

STATUS OF AN ASSESSEE

The status of an assessee may be legal or residential. The Income-Tax Act classifies assessees as below according to their *legal* and *residential* status :

Classification according to Legal Status :

(*a*) Individual.
(*b*) Hindu undivided family.
(*c*) Company.
(*d*) Firm.
(*e*) Association of persons or body of individuals.
(*f*) Local authority.
(*g*) Artificial juridical person such as a statutory corporation, an idol or a deity (*e.g.*, Balaji etc.). The word "juridical" means 'legal'.

Classification according to Residential Status :

(*a*) Resident.
(*b*) Not ordinarily resident.
(*c*) Non-resident.

The incidence of taxation varies with the residential status of an assessee; while the classification according to the legal status of assessees is necessary for the following reasons :

(*a*) There are different rates of income-tax for assessees of different legal status.

(*b*) There is a different maximum exemption limit in the case of certain assessees, *e. g.*, individuals, Hindu undivided families, unregistered firms, etc ; while in the case of companies and co-operative societies there is no such exemption limit.

(*c*) The maximum deduction for life insurance premiums is higher in the case of Hindu undivided families than that available to individuals.

INCIDENCE OF TAX

As already stated, the scope of the total income of a person is determined by reference to his residential status in India in the previous year. Under section 5, the scope of the total income of residents and non-residents is as follows :

Residents.

Under section 5(1), the total income of any previous year of a person who is a resident includes all income from whatever source derived which :

(*a*) is received or is deemed to be received in India in such year by or on behalf of such person ;

(*b*) accrues or arises or is deemed to accrue or arise to him in India during such year ; and

(*c*) accrues or arises to him outside India during such year.

Persons, who are not ordinarily resident in India, are chargeable in exactly the same manner as persons who are resident, *with one special exemption.* Persons who are not ordinarily resident in India are exempt from tax in respect of their foreign income unless it is derived from a business controlled in or a profession set up in India. Only an individual or a Hindu undivided family can be not ordinarily resident in India.

Non-residents.

Under section 5(2), the total income of any previous year of a person who is non-resident includes all income from whatever source derived which :

(*a*) is received or is deemed to be received in India in such year by or on behalf of such person ; and

(*b*) accrues or arises or is deemed to accrue or arise to him in India during such year.

The foreign income of a non-resident, which is not received in India but which is remitted to India in the previous year, does not attract tax.

Some incomes are charged on accrual and some on receipt. When a particular income has once been taxed, it cannot be taxed again either in the same year or in a subsequent year. For instance, income, which is taxed on accrual cannot be taxed again or receipt.

Summary.

The tax liability of residents and non-residents in respect of income of several kinds may be summarised as follows :

(1) Income received in India (whether earned here or outside) is taxable in the case of all assessees.

(2) Income earned in India (whether received here or outside) is taxable in the case of all assessees.

(3) Income earned from any source outside India but not received in India is taxable in the case of residents.

(4) Income earned outside India from a business controlled in or a profession set up in India but not received in India is taxable in the case of persons not ordinarily resident in India.

(5) Income earned and received outside India in past previous years but remitted to India in the previous year is not taxable in the hands of any assessee.

VARIOUS TYPES OF INCOME

The various types of income brought under charge may be classified as follows :

Income Received.

Income received in India is chargeable in the hands of all assessees whether resident or not. Receipt of income in India attracts tax, irrespective of whether the income accrued or arose in India or outside. The receipt must be in the previous year. It may be by or on behalf of the assessee.

Income accruing or arising outside India shall not be deemed to be received in India by reason only of the fact that it is taken into account in a balance-sheet prepared in India.

Income may be received in the form of money or money's worth, in cash as well as in kind. A sum of money may be received by the transfer of coins or currency notes or a negotiable instrument. What among businessmen might be equivalent to receipt of cash would be receipt for taxation purposes. Adjustment of cross claims, a settlement in account, an exchange effected by a book entry or a set-off would be equivalent to an actual receipt of a sum of money although no money may pass. A company declared a dividend to a certain shareholder who owed a like amount to the company for goods supplied by the company to him. The company effected a settlement by cancelling the debt for the goods supplied and setting it against the dividend. The agreement was given effect to by both the parties making corresponding entries in their books. In such a case there is an actual receipt of the dividend by the shareholder and concurrently an actual receipt by the company from the shareholder of the amount due for goods supplied.

Constructive receipt of money is as good as actual receipt. Receipt by a bank or any other agent of the assessee would be constructive receipt. When an employer deducts income-tax from the salary of an employee and pays it to Government on behalf of the latter, the amount of the income-tax so deducted is constructive receipt by the employee.

According to a decision of the Supreme Court (*23 ITR 230*), the 'receipt' of income refers to the first occasion when the recipient gets the money under his own control. Once an amount is received as income, any remittance or transmission of the amount to another place does not result in 'receipt' at the other place, within the meaning of section 5(1)(*a*) or section 5(2)(*a*). *It is the first receipt that determines the year and the place of receipt for purposes of taxation.* A non-resident is taxed on his foreign income only if it is received in India, *i. e.*, received for the first time in India. If he has already received the income outside India, he would not be chargeable when he remits it to India.

The question as to the place of receipt of income becomes somewhat difficult when payment is received by cheque. If the understanding between the parties is that payment should be made by cheque, the place where the cheque is posted becomes the place of receipt, and if this place is in India, it amounts to a receipt of the income in India.

Income Deemed to be Received.

The expression "deemed to be received in India" includes those incomes which the law regards as received in India though they are not actually received there. Where income is deemed to be received in India, the result is that, though it is not in reality received there, the law requires it to be treated as if it were. The phrase "statutory receipt" might be conveniently employed to cover income which is deemed to be received in India.

According to section 7, the following incomes are deemed to be received in India :

(1) The annual accretion to the account of an employee participating in a recognised provident fund. The "annual accretion", in relation to the balance to the credit of the employee, means the increase to the balance in any year arising from contributions and interest.

(2) The transferred balance in a recognised provident fund to the extent specified in the next chapter.

Under section 8, any dividend declared by a company or distributed or paid by it is deemed, in the case of shareholders, to be income of the previous year in which it is so declared, distributed or paid, as the case may be. Similarly, an interim dividend paid by a company is deemed to be the income of the previous year in which the amount of such dividend is unconditionally made available by the company to the shareholder entitled to it.

An amount cannot be deemed to be received merely by the volition or sweet will of an individual.

Income Accruing or Arising.

The words "accrue" and "arise" are used to contradistinguish the word "receive". Income is said to be received when it reaches the assessee. When the right to receive the income becomes vested in the assessee, it is said to accrue or arise to him.

Income becomes taxable on the footing of accrual only after the right of the tax-payer to the income accrues or arises.

Section 5(1) requires that the income should not only accrue or arise in India but it should also accrue or arise in the previous year. A distinction may be drawn between the two words, accrue and arise. So far as the locale of income is concerned, they mean the same thing ; but they may not mean the same thing so far as the date is concerned. Income accruing in the previous year may not arise in the previous year. The distinction between the two words as regards the point of time is due to the provisions of section 145 which provides that the income from a business or profession and the income from other sources is to be computed in accordance with the method of accounting regularly employed by the assessee.

Income accrues when it first comes into existence or the right to receive it comes into existence, but is said to arise when the method of accounting shows it in the shape of income. Thus, when the accounts are kept on the cash basis, income may accrue in one previous year but it may arise in the next, when it is actually received and treated as income in the accounts. Where the accounts are kept on the mercantile accountancy basis, income arises when the appropriate entries are made or should be made in the books.

Date of Accrual of Business Income. According to a decision of the Supreme Court (*26 ITR 27*), business income accrues at the date when a debt becomes due, *e. g.*, if the accounts of a business are made up on 31st December, the year's income accrues on that date and not on any earlier date.

Person to Whom Income Accrues. Income accrues to a person in whose favour a debt is created at the time the income accrues, or who has acquired a right to receive payment.

Illustration

M, the manager of a Hindu undivided family, held on behalf of the family a share of 25% in the profit or loss of a firm. The partnership agreement provided for the accounts of the firm being made up every calendar year. On 1st October 1974 there was a partition in the family and M was allotted the share in the firm.

In the assessment of the family for the assessment year 1975-76 (previous year ended 31st December 1974) the Income-Tax Officer indicates his intention to include the share of profit from the firm in the income of the family proportionate to the period 1-1-1974 to 30-9-1974. M contends that the whole of the income is liable to inclusion in his assessment. Examine the rival claims. (*C. A. Final, Nov. 1973*).

The contention of M is correct. The share income from the firm accrued on 31-12-1974, and it was M who was entitled to receive it from the firm. Therefore the share income will be taxed in the hands of M and not according to the intention of the Income Tax-Officer.

Place of Accrual of Income. The importance of the place of accrual of income has been materially reduced. A resident has to pay tax on income accruing or arising in any part of the world. In the case of a person not ordinarily resident in India, the place of accrual is entirely immaterial in dealing with income derived from a business controlled in or a profession set up in India.

It is only in the case of non-residents that the place of accrual of income still remains important. But even for non-residents the actual place of accrual has been rendered irrelevant by the provisions of section 9(1)(i), under which certain foreign incomes are deemed to accrue or arise in India.

It is not possible to lay down any general test for determining the place of accrual of business profits. But in the light of judicial decisions the following rules may be applied in ascertaining the place of accrual of business profits :

(1) Where the business consists merely of buying and selling goods, profits arise, as a general rule, at the place where the sales are effected. Where goods purchased outside India are sold in India, the entire profits arising from the sale has been held to accrue or arise in India. Similarly, profits derived from the sale in a foreign country of goods purchased in India do not accrue or arise in India but in the foreign country where they are sold. But if there is a business connection in India a part of the profits attributable to the operation of buying is deemed to accrue or arise in India.

(2) It is a misconception to think that any profit arises out of the valuation of the closing stock or that the *situs* of its arising or accrual is where the valuation is made. Valuation of unsold stock at the close of an accounting period is a necessary part of the process of determining the trading results of that period, and can in no sense be regarded as the source of such profits. The source of the profits of a business is indubitably the business, and the place of their accrual is where the business is carried on.

(3) Profits accrue at the place where the business transactions are actually effected and not at the place from which the business is controlled or directed. In the leading case of *C. I. T. v. Chunnilal Mehta*, the assessee, carrying on business in India, directed and controlled transactions abroad in the course of such business. The profits of the transactions effected abroad were held by the Privy Council not to accrue or arise in India. In this case no contract was made in India under which any profits arose or could have arisen.

(4) In the case of business of which all the operations are not carried out in India, the income which accrues or arises in India shall be only such part of the income as is reasonably attributable to the operations carried out in India. Thus, where goods are manufactured in one place and sold in

another, the profit resulting from the sale must be apportioned between the manufacturing and the selling operations, and a part should be considered as accruing at the place where the goods are manufactured and a part at the place where they are sold. This is now established by the decisions of the Supreme Court in *C. I. T. v. Ahmadbhai Umarbhai & Co.* (*18 ITR 472*) and *Anglo-French Textile Co. Ltd. v. C. I. T.* (*25 ITR 27*).

(5) According to a decision of the Supreme Court (*37 ITR 145*), where the goods or the railway receipt in respect thereof is sent by V. P. P., the post-office is the agent of the seller for the recovery of the goods and as the goods pass at the place where the price is paid, the income arises and is received at the place of the buyer.

Similarly, where the goods ordered are sent to customers by rail and the railway receipt in favour of self is sent through a bank to be delivered to the customer against payment of the demand draft drawn on the buyer, the goods cannot be delivered to the buyer till the money is paid. In such a case, although the goods are delivered to a common carrier, the appropriation to the contract is only conditional and performance is completed only when money is paid and the railway receipt is delivered. Therefore, such a contract must be taken to have been performed at the place where the price is paid to the bank as agent of the seller and the railway receipt delivered to the buyer. The income from such sales thus arises and is received at the place of the buyer.

Illustrations

(1) An English jeweller, having no business connection in India, sells his wares to customers in India by means of the V. P. P. system. Where does the profit on such sales arise ?

When the goods are sent by V. P. P. the post-office is the agent of the seller for the recovery of the price of the goods. Therefore, the profit arises and is received in India where the price is paid and the goods delivered.

(2) An assessee, who was trading as a broker in Bombay, instructed S & Co., another firm of brokers who also carried on business in Bombay, to enter into transactions for the assessee for the buying and selling of cotton on the New York Exchange. The transactions resulted in profit which was paid by S & Co. to the assessee who allowed the money to remain in New York. It was found that there was no contract between the assessee and the brokers of New York and that S & Co. alone was responsible to the assessee. Where did this profit accrue ?

The profit in question accrued in India, because it was derived from and paid on the contract made with S & Co. in Bombay, the place where the money was payable being immaterial.

(3) An Indian company entered into contracts for sale of unascertained goods to European customers. The price and delivery of goods were F. O. B. Madras and insurance was to be effected by the buyers, but the Indian company reserved the right of disposal of the goods by shipping the goods under bill of lading in its own name and providing that the buyer would not be entitled to the bill of lading until the bill of exchange, drawn by the Indian company on the buyers' bank, where an irrevocable letter of credit was required to be opened, was honoured.

Where did the profit on these sales arise ?

It was held by the Supreme Court that the property in the goods passed in London where the bill of lading was handed over to the buyers' bank against the acceptance of the relative bill of exchange and thus the sales took place outside India. The profit from such sales therefore arose outside India (*27 ITR 128*).

Income Deemed to Accrue or Arise.

When income is deemed to accrue or arise in India, it means that the income does not really accrue or arise there, but it is regarded as such by law. According to section 9, the following incomes are deemed to accrue or arise in India :

(1) All incomes accruing or arising, whether directly or indirectly, from the following sources :

(*a*) any business connection in India ;
(*b*) any property in India ;
(*c*) any assets or source of income in India ;
(*d*) any money lent at interest and brought into India ; or
(*e*) the transfer of a capital asset in India.

Such incomes are fully discussed in a subsequent chapter dealing with the assessment of non-residents.

(2) Income which falls under the head "Salaries" if it is earned in India.

(3) Salary paid by the Government to a citizen of India for service outside India. When a government employee who is a citizen of India is non-resident for any previous year, the salary paid to him by Government for service outside India in that year is deemed to accrue or arise in India and is taxable in his hands ; but any allowances or perquisites paid or allowed to him outside India are not included in his total income.

(4) A dividend paid by an Indian company outside India.

Indian Income.

This means income which (*i*) accrues or arises in India, or (*ii*) is received in India, or (*iii*) is deemed to have accrued or arisen in India, or (*iv*) is deemed to have been received in India in the previous year.

Foreign Income.

This is income which (*i*) accrues or arises outside India but is not deemed to have accrued or arisen in India, and (*ii*) is also not received or deemed to have been received in India in the previous year.

CHAPTER 4

Heads of Income—Salaries

Section 4 charges the total income of an assessee (subject to certain statutory exemptions) ; section 5 defines the scope or extent of the total income according to the residence of an assessee ; and section 14 prescribes six heads under which the income of an assessee is to be classified for the purposes of charge of income-tax and computation of total income. These six heads are :

1. Salaries.
2. Income on securities.
3. Income from house property.
4. Profits and gains of business or profession (the word 'profession' including 'vocation').
5. Capital gains.
6. Income from other sources.

The method of computing income and the permissible deductions vary with the different heads of income. Therefore sections 15-59 deal separately with each head of income.

Income-tax is only one tax levied on the total of the chargeable income under the various heads. A loss sustained in any year under one head of income is to be set off against income under any other head in that year, as provided in section 71. Moreover, under section 70, a loss sustained in respect of a source of income under any one head should be set off against income from another source chargeable under the same head in order to arrive at the taxable income under that head. Thus, where an assessee carries on both a business and a profession, any loss in business should be deducted from professional income before arriving at the figure of taxable profits under the head "Profits of Business or Profession".

Income-tax is undoubtedly levied on the total taxable income of the tax-payer and the tax levied is a single tax on the aggregate taxable receipt from all the sources ; it is not a collection of taxes separately levied on distinct heads of income. But the distinct heads specified in section 14 of the Income-Tax Act indicating the sources are mutually exclusive and income derived from different sources falling under specific heads has to be computed for the purpose of taxation in the manner provided by the appropriated sections. If the income from a source falls within a specific head set out in section 14, the fact that it may indirectly be covered by another head will not make the income taxable under the latter head. This is the decision of the Supreme Court (*42 ITR 49*).

The method of computing the taxable income of an assessee under these six heads will be considered in detail in this chapter and those that follow.

SALARIES

Under section 15, the following income is chargeable to income-tax under the head "Salaries" :

(*a*) Any salary due from an employer or a former employer to an assessee in the previous year, whether paid or not.

(*b*) Any salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer though not due or before it becomes due to him.

(*c*) Any arrears of salary paid or allowed to him in a previous year by or on behalf of an employer or a former employer, if not charged to income-tax for any earlier previous year.

Where any salary paid in advance is included in the total income of any person for any previous year, it shall not be included again in the total income of the person when the salary becomes due.

This section deals separately with salary chargeable on the 'due' basis, salary chargeable on the 'receipt' basis and salary received in arrears.

Any portion of salary withheld under an order of a court is liable to tax. Advances taken by an employee from his employer on account of salary are deemed to be salary due on the date when the advance is received. Other advances taken by an employee from his employer (*e. g.*, an advance for purchasing a motor-car or for building a house) are not deemed to be salary because they are loans.

The voluntary foregoing by an employee of the salary due to him is merely application of income, and the salary foregone is therefore taxable. It would be taxable on the further ground that section 15 brings to charge salary which is due whether paid or not.

The word 'employer' would include every type of employer—Government, a local authority, a company, and other public body or association, a foreign government, any private employer, and so on. The risk of omission of any particular type of employer is thus eliminated.

No payment can be taxed under this section unless the relationship of employer and employee exists between the payer and the payee. Thus, salary received by a member of Parliament cannot be taxed under the head "Salaries" but will be taxed under the head "Income from Other Sources".

Place of Accrual of Salary Income.

The income from salary arises at the place where the service for which it is paid is rendered. Thus, if a person employed in India goes on leave to Japan and gets his leave salary there, the leave salary so paid is income arising in India, because it is paid on account of service rendered in India. Similarly, if a person employed in India retires and settles in England, the pension paid to him in England is Indian income because it is paid on account of service rendered in India. On the other hand, if a person employed by a company in India is transferred to its branch in England, the salary received by him in England is not Indian income, but it is income arising in England as the service is rendered in England. There are, however, two exceptions to this rule. These are :

(1) A pension payable outside India to a person permanently residing outside India is not deemed to arise in India, if the pension is payable to a person appointed by the Secretary of State or to a person who was appointed before 15th August 1947 as a judge of the Federal Court or of a High Court and who continued to serve on or after the commencement of the Constitution as a judge

in India. This is a special concession granted to certain officials of Government.

(2) In the case of a citizen of India, who is employed by the Government, salary paid outside India is deemed to accrue or arise in India even if the service is rendered outside India. This provision brings to charge salaries received by Government servants posted abroad, who technically become non-residents after some time and may thus escape Indian taxation. But in such cases, allowances and perquisites paid or allowed by the Government outside India are to be excluded from total income under section 10(7).

What is included in Salary ?

According to section 17(1), the salary chargeable under section 15 includes the following amounts received by an employee from his employer :

(*i*) Wages.

(*ii*) Any annuity or pension.

(*iii*) Any gratuity except in cases stated later.

(*iv*) Any fees, commission, perquisites or profits in lieu of or in addition to any salary or wages.

(*v*) Any advance of salary, but not any other advance (*e. g.*, an advance for purchasing a motor-car or a house).

(*vi*) Any accretion to the account of an employee in a recognised provident fund. This accretion includes employer's contribution in excess of 10% of the employee's salary and interest on his provident fund account in excess of 6% p. a., and one-third of the employee's salary.

(*vii*) The taxable amount of the balance transferred from an unrecognised provident fund to a recognised provident fund account of an employee.

Annuities, pensions and gratuities are chargeable under section 15 only when they are paid by the employer, whether voluntarily or under a contract. Any gratuity, bonus or other payment voluntarily given by an employer for services rendered is taxable. But if the payment is personal in the sense that it is given to the employee, not as the holder of an office, but merely as a gift on personal grounds, it is not included in salary and is not taxable.

Allowances. The following allowances paid to an employee by his employer are to be treated in the manner stated against each :

(*a*) *House-rent allowance.* Any excess of such allowance over the prescribed limit is to be included in salary. This is explained and illustrated later in this chapter under the heading "Profits in Lieu of Salary".

(*b*) *Special allowance.* This includes travelling allowance, conveyance allowance or motor-car allowance granted to meet expenses incurred by an employee in the performance of his duties. Any excess of such allowance over the amount actually spent for the purpose is to be included in the salary income.

(*c*) *Foreign allowance.* Any allowance paid outside India by Government to a citizen of India serving outside India is excluded from salary income.

(*d*) *Entertainment allowance.* The treatment of this allowance is explained later in this chapter under the heading "Deductions from Salaries".

(*e*) *Dearness allowance.* The full amount of this allowance is included in salary income.

Perquisites.

The word 'perquisite' in the ordinary sense means any casual emolument attached to an office. It may take various forms. Under the general law a benefit which is not convertible into money cannot be treated as a perquisite. Rent-free accommodation and free educational facilities for children provided by the employer are examples of benefits not convertible into money as they are not saleable. But according to section 17 the value of any benefit or amenity provided by the employer is treated as a perquisite and is taxable.

For income-tax purposes it is immaterial whether perquisites are voluntary or obligatory. According to section 17(2) perquisites include the following :

(1) The value of rent-free accommodation provided by the employer.

(2) The value of any concession in the matter of rent respecting any accommodation provided by the employer.

(3) The value of any benefit or amenity granted or provided free of cost or at concessional rate in any of the following cases :

(*a*) by a company to an employee who is a director thereof;

(*b*) by a company to an employee who has substantial interest in the company, that is to say, who is the beneficial owner of at least 20% of the ordinary shares ; and

(*c*) by any employer (including a company) to any other employee whose income under the head "Salaries" (exclusive of non-monetary benefits) exceeds Rs. 18,000.

If a director is an employee of the company, the value of any benefit or amenity granted by the company would be taxable as salary. If the director is not an employee and his remuneration in the shape of fees, etc., is assessable as income from other sources, the value of the benefit or amenity would also be assessed as income from other sources.

Note : In the case of an employee whose income under the head "Salaries" (exclusive of non-monetary benefits) does **not** *exceed Rs. 18,000, the value of any benefit or amenity granted free by the employer is not to be included in the employee's salary income.*

(4) Any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the employee, *e. g.*, the sum spent by the employer on the education of an employee's children or the reimbursement by the employer of the employee's club or hotel bills.

According to executive instructions, the provision of sweepers, gardeners and night watchmen by the employer for the upkeep of the house property in the occupation of the employee, whether belonging to the employer or employee or taken on lease by them, is to be regarded as a benefit or amenity to the employee and charged as a perquisite in his hands. The taxable amount of this perquisite will be as follows :

(*a*) Sweeper : 75% of actual wages or Rs. 60 per month whichever is less.

(*b*) Watchman : 50% of actual wages or Rs. 60 per month whichever is less.

The provision of a gardener by the employer for the upkeep of the garden is not regarded as a perquisite and no part of the gardener's salary is taxable.

Also the provision of free medical facilities to the employee or his family (*e.g.*, in the employer's own hospital) is not regarded as a perquisite.

(5) Any sum payable by the employer, otherwise than through a recognised provident fund or an approved superannuation fund, to effect an insurance on the life of the employee or in respect of a contract for an annuity on the life of the employee.

Valuation of Perquisites. According to rule 3 of the Income-Tax Rules, 1962, the value of the perquisites, which are not given by way of monetary payment, is to be determined in the following manner :

(1) *Rent-free accommodation.* The value of rent-free accommodation provided by the employer is *ordinarily* taken as 10% of the salary due to the employee in respect of the period of his occupation of the house or 12½% thereof, according as the accommodation is unfurnished or furnished. If the assessee claims that the fair rental value is less than 10% or 12½% of his salary and the Income-Tax Officer is satisfied that the claim is correct, the value of the perquisite will be limited to the fair rental value.

Where, however, the fair rental value of the accommodation provided is in excess of double the normal valuation, the excess over 20% or 25% will also be added to the normal valuation. In special cases, the Income-Tax Officer may take only a portion of this excess and not the whole of it.

According to executive instructions, in the cities of Bombay, Calcutta, Delhi and Madras, only the excess over 30% of salary in the case of unfurnished accommodation and 37½% of salary in the case of furnished accommodation is to be taxed in addition to the normal valuation of 10% and 12½%.

The fair rental value means (*i*) in the case of accommodation provided by Government, the rent fixed by Government ; and (*ii*) in other cases, where the accommodation is not furnished the rent which a similar accommodation would fetch in the same locality or the municipal valuation, whichever is higher ; and where the accommodation is furnished the fair rental value of the accommodation as if it were not furnished, *plus* 15% of the cost of furniture which would include television sets, radio sets, refrigerators, household appliances and air-conditioning plants.

Salary for this purpose includes the pay, allowances, bonus or commission payable monthly or otherwise, but does not include the following :

(*a*) Dearness allowance unless it enters into the computation of retirement benefits of the employee.

(*b*) Employer's contribution to the provident fund account of the employee.

(*c*) Allowances which are exempted from payment of tax.

Illustrations

(1) An employee in Agra getting a salary of Rs. 3,000 per month is in occupation of an unfurnished house for which his employer pays a rent of Rs. 900 per month. What is the value of this rent-free accommodation ?

	Rs.
10% of Rs. 3,000	300
Excess of Rs. 900 over Rs. 600 being 20% of salary	300
Monthly value of the house	600

(2) An employee in Delhi is provided with rent-free quarters by his employer. The annual municipal valuation of the quarters is Rs. 15,000 and the cost of furniture was Rs. 8,000. For the previous year ended 31-3-1975 the employee's salary (including bonus and commission) was Rs. 60,000. Work out the value of the rent-free accommodation.

	Rs.
Annual municipal valuation	15,000
Add 15% of the cost of furniture	1,200
Fair rental value	16,200
12½% of Rs. 60,000	7,500
Excess of Rs. 16,200 over Rs. 22,500 being 37½% of Rs. 60,000	Nil
Annual value of quarters	7,500

The value of residential accommodation provided at a concessional rent will be determined in the above manner after deducting the rent paid by the employee.

(2) *Motor-car etc.* (*i*) The value of a motor-car provided by the employer exclusively for the private use of an employee will be the actual amount expended by the employer in the running and maintenance of the car including the normal wear and tear.

(*ii*) The value of a motor-car provided for the use of an employee partly for his personal purposes and partly for business purposes will be that part of the expenses actually expended by the employer and normal wear and tear that can reasonably be attributed to the user by the employee for his private purposes.

However, where the determination of the value on this basis presents difficulty, the value may be determined as follows :

Where the motor-car is owned or hired by the employer and all the expenses of maintenance and running are met by the employer : Rs. 150 per month for a car of not more than 16 h. p. and Rs. 250 per month for a car of higher h. p.

Where the expenses of maintenance and running for the personal use of the employee are paid by him : Rs. 60 per month for a car of not more than 16 h. p. and Rs. 100 per month for a car of higher h. p.

Moreover, if a driver is provided by the employer to the employee for driving the car, Rs. 150 per month will also be added to the valuation of the car.

(*iii*) Where the motor-car is owned by the employee and used for both private and business purposes but the expenses of maintenance and running are met by the employer, the value of the perquisite to the employee will be the amount of such expenses which in the opinion of the Income-Tax Officer may reasonably be attributed to the user of the car by the employee for his private purposes.

Note : Where an employee, who is paid a salary, is provided by the employer with a motor-car for use (otherwise than wholly in the performance of his duties), the value of the motor-car is not to be treated as a perquisite but the maximum standard deduction is reduced from Rs. 3,500 to Rs. 1,000.

(*iv*) The value of the free use by the employee of any other type of conveyance provided by the employer will be the amount actually expended by the employer in the maintenance and running of the conveyance (including the normal wear and tear) which in the opinion of the Income-Tax Officer can reasonably be attributed to the user by the employee for his private purposes.

Illustration

During the previous year ended 31st March 1975 an employee was provided a 20 h. p. motor-car by his employer both for private and business purposes, the running and maintenance expenses incurred by the employer being Rs. 4,000. The car is owned by the employer and its written-down value on 1-4-1974 was Rs. 20,000. It is conceded by the Income-Tax Officer that 60% of the running of car is for official purposes. What would be the value of this perquisite ?

	Rs.
Motor-car expenses (40% for private use)	1,600
Depreciation for private use 40% of (20% of Rs. 20,000)	1,600
Value of perquisite of motor-car	3,200

In this case, the value of the perquisite of motor-car can be determined ; but if for want of information the value could not be determined, the value of the perquisite would be Rs. 250 per month, *i. e.*, Rs. 3,000 for the year.

(3) *Gas, electricity and water.* The value of the free supply of gas, electricity and water to an employee for his household consumption will be the amount paid on that account by the employer to the agency supplying them. If such supply is made from resources owned by the employer without purchasing them from an outside agency, their value will be taken as nil.

(4) *Education.* The value of free education facilities provided by the employer for any relative of an employee will be the amount of expenditure actually incurred by the employer in that behalf.

(5) *Free transport.* The value of free transport provided by the employer, who is engaged in the business of transport, to an employee and his family will be taken as nil.

(6) *Other benefits.* The value of any other benefits provided by the employer will be determined on such basis as the Income-Tax Officer considers fair and reasonable.

Profits in Lieu of Salary.

According to section 17(3), profits in lieu of salary include the following :

(1) The amount of any compensation due to or received by an assessee from his employer or former employer in connection with the termination of employment or modification of terms of employment.

Whatever may be the consideration on the basis of which the compensation is given, it is to be treated as profit in lieu of salary and included in the salary income. It does not matter whether the compensation is received by the employee as a matter of right or is given to him voluntarily by the employer. The employee is, however, entitled to relief under section 89(1) in respect of the compensation. The provisions of section 89(1) are explained later in this chapter.

(2) Any payment due to or received by an assessee from his employer or former employer. Such an amount is taxable as a profit of employment although it may be paid after the employment has come to an end.

According to a decision of the Supreme Court, where a sum is paid to an employee by his employer (past or present), not in token of appreciation of the services rendered but as a personal gift for the personal qualities of the employee and as a token of personal esteem, such an amount is not taxable in the hands of the employee (*41 ITR 481*).

(3) Any payment due to or received by an assessee from an unrecognised provident fund or other fund (not being an approveds uperannuation fund) less the contributions of the assessee and interest on such contributions. In other words, only the sum representing the employer's contributions and the interest on such contributions is brought to tax. It is immaterial whether the payment from the fund is made during or at the termination of the employment.

However, the interest on the employee's contributions to an unrecognised provident fund is not exempt from tax. It does not fall under the head

"Salaries" as it is not a profit in lieu of salary, but it is income falling under the head "Income from Other Sources". This is according to a decision of the Supreme Court (*80 ITR 177*).

Exceptions. The following amounts received by an employee are not however to be included in the salary income :

(1) According to section 10(10), the gratuity received by an employee is to be treated in the following manner :

(*a*) Death-cum-retirement gratuities received by all categories of government employees and employees of local authorities are exempt from tax in full.

(*b*) The entire gratuity received under the provisions of Payment of Gratuity Act, 1972, is exempt from tax.

(*c*) In the case of other employees, who are not covered by the provisions of Payment of Gratuity Act, the amount of gratuity exempt from tax will be equal to half a month's salary for each year of completed service calculated on the basis of the average salary for the three years immediately preceding the year in which the gratuity is paid, subject to a maximum of Rs. 30,000 or 20 months' salary whichever is less. Salary for this purpose includes dearness allowance if the terms of employment so provide, but excludes all other allowances and perquisites.

This exemption is available only when such gratuities are received on retirement, incapacitation or death of the employee or on termination of his employment.

Where gratuity is received by an employee from two or more employers in the same year, the maximum amount of gratuity exempt from tax will not exceed Rs. 30,000. In cases where an employee, who has received any gratuity in any earlier year from his former employer or employers, receives gratuity from his present employer in a later year, the ceiling of Rs. 30,000 will be reduced by the amount of gratuity which has been exempted in any earlier year or years.

(2) Any payment received in commutation of pension from Government, a local authority or a statutory corporation.

Any payment received in commutation of pension from any other employer without any limit if such payment was made before 19th August 1965, but subject to the following limits when the payment is made on or after that date :

(*a*) commuted value of one-third of the pension where the employee receives a gratuity also from his employer ; and

(*b*) commuted value of one-half of the pension where no gratuity is received.

(3) Any payment received from a provident fund to which the Provident Funds Act, 1925, applies, or from the Public Provident Fund, or from a recognised provident fund.

(4) Any special house-rent allowance granted to an employee by his employer to such extent (not exceeding Rs. 400 per month) as may be prescribed. The prescribed limit is the *lowest* of the following amounts :

(*a*) The amount of such allowance.

(*b*) The amount by which the rent paid exceeds 10% of the employee's salarly.

(*c*) 20% of salary in Ahmedabad, Bangalore, Bombay, Calcutta, Delhi, Hyderabad, Kanpur, Madras or Poona, or 10% of salary in any other place.

(*d*) Rs. 400 per month.

The term "salary" for this purpose includes dearness allowance if the terms of employment so provide but excludes all other allowances and perquisites.

Relief under Section 89(1).

When on account of the following reasons the salary income of an employee is assessed at a rate higher than that at which it would otherwise have been assessed, the Income-Tax Officer shall, on an application made to him in this behalf, grant such relief as may be prescribed :

(*a*) Where salary is paid in arrears or in advance.

(*b*) Where he has received in any one financial year salary for more than 12 months.

(*c*) Where he has received a payment which is a profit in lieu of salary.

Deductions from Salaries.

Under section 16, the income chargeable under the head "Salaries" is to be computed after making the following deductions, namely :

(1) Instead of separate deductions in respect of travelling, books, profession-tax and expenditure incurred in the performance of duties, a standard deduction is to be allowed. This standard deduction is equal to 20% of the salary as such up to Rs. 10,000 and 10% of the salary in excess thereof, subject to a maximum of Rs. 3,500.

In cases where the employee is in receipt of a conveyance allowance or where he is provided with any motor-car, motor-cycle, scooter or other moped by his employer (for use otherwise than wholly in the performance of his duties) or where he is allowed the use of any one or more motor-cars (otherwise than wholly in the performance of his duties) out of a pool of motor-cars owned or hired by the employer, the deduction will be limited to Rs. 1,000.

Important Correction.

According to section 17, the term 'salary' for the purpose of standard deduction is not 'salary as such' but it is the income taxable under the head "Salaries".

In some of the illustrations the standard deduction is based on salary as such, which is not correct. Readers are therefore requested to correct such illustrations by calculating the standard deduction on the basis of the taxable income from salary, before making any deductions.

from Taxation) Act, 1961, enables an employee to surrender for the credit of the Central Government a part of his salary and allowances. The part so surrendered is to be excluded from his salary income.

Illustrations

(1) An employee of a company drew a salary of Rs. 1,000 p.m. for the months of March 1974 to February 1975, payable on the first of the following month.

The term "salary" for this purpose includes dearness allowance if the terms of employment so provide but excludes all other allowances and perquisites.

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When on account of the following reasons the salary income of an employee is assessed at a rate higher than that at which it would otherwise have been assessed, the Income-Tax Officer shall, on an application made to him in this behalf, grant such relief as may be prescribed :

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(2) Any allowance in the nature of an entertainment allowance specifically granted to an employee by his employer is to be included in the salary income, but after including that allowance the following deduction is allowed therefrom :

(*a*) In the case of a Government employee, a sum equal to one-fifth of his salary (exclusive of any allowance, benefit or other perquisite) or Rs. 5,000 whichever is less. This deduction is granted even though the employee was not in receipt of an entertainment allowance before 1st April 1955.

(*b*) In the case of any other employee, *if he had regularly been receiving such entertainment allowance from his present employer before 1st April 1955*, the *least* of the following amounts is allowed as a deduction :

(*i*) Amount drawn as allowance before 1st April 1955 ;
(*ii*) One-fifth of salary (exclusive of allowance, benefit or other perquisite) ;
(*iii*) Rs. 7,500 ; or
(*iv*) Actual amount of entertainment allowance.

Surrender of Salaries. The Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961, enables an employee to surrender for the credit of the Central Government a part of his salary and allowances. The part so surrendered is to be excluded from his salary income.

Illustrations

(1) An employee of a company drew a salary of Rs. 1,000 p.m. for the months of March 1974 to February 1975, payable on the first of the following month.

From March 1975 the employer started paying salaries on the last day of the month. The employee received the salary for March 1975 on 31-3-1975.

What is his income from salary for the assessment year 1975-76 ?

	Rs.
Salary for 12 months on accrual basis	12,000
Salary for 1 month on receipt basis	1,000
	13,000
Less Standard deduction on Rs. 12,000 being the salary drawn	2,200
Salary income	10,800

(2) On 1st December 1974 an employee X, drawing a salary of Rs. 1,000 per month, went to Switzerland on six months' leave on full pay. His salary for the months December 1974 and January 1975 was remitted to him in Switzerland, but his salary for the remainder of his leave was received by him on his return to India in June 1975.

What is his salary income for the previous year ended 31st March 1975 ?

	Rs.
Salary for the year on accrual basis	12,000
Less Standard deduction	2,200
Salary income	9,800

(3) An employee with 17 years' good continuous service in a firm resigned on 1-2-1975. The employer accepted his resignation and agreed to pay, in view of his past services, four months' salary, *i. e.*, up to 31st May 1975 and also a gratuity of Rs. 25,000. The four months' salary and the gratuity were paid to him on 3-2-1975. The employee's salary was as follows :

		Rs.
Year ended	31-3-1972	1,700 per month
,, ,,	31-3-1973	1,800 ,, ,,
,, ,,	31-3-1974	1,900 ,, ,,
,, ,,	31-3-1975	2,000 ,, ,,

Compute the employee's salary income for the assessment year 1975-76.

	Rs.
Salary for 10 months at Rs. 2,000 p. m.	20,000
Advance salary received for 4 months	8,000
Gratuity as calculated below	9,700
	37,700
Less Standard deduction (maximum)	3,500
Salary income	34,200

The average salary for the three years immediately preceding the year in which the gratuity is paid is Rs. 1,800 per month.

	Rs.
Gratuity paid	25,000
Exempt amount being Rs. 900 per year for 17 years	15,300
Amount of gratuity to be taxed	9,700

(4) X is offered an employment by A Ltd. on a consolidated salary of Rs. 6,000 per month. The company gives X the option either to take a rent-free furnished accommodation at Bombay for which the company would bear directly the rent of Rs. 1,000 per month or to accept a cash house-rent allowance of Rs. 1,000 per month and find his own accommodation. X decides to accept the cash house-rent allowance and takes a furnished house at Bombay on a rent of Rs. 800 per month.

Examine from the income-tax point of view whether X has made a wise choice.

	Rs.
Salary income under the first option :	
Salary	72,000
Perquisite or free house (12½% of Rs. 72,000)	9,000
	81,000
Less Standard deduction (maximum)	3,500
Salary income	77,500
Salary income under the second option :	
Salary	72,000
Taxable amount of house-rent allowance being Rs. 12000 *less* the lowest of the following amounts being Rs. 2,400 :	
(*a*) Amount of allowance Rs. 12,000.	
(*b*) Amount by which the rent paid by X exceeds 10% of salary *i. e.*, Rs. 9,600 – Rs. 7,200=Rs. 2,400.	
(*c*) 20% of Salary in Bombay=Rs. 14,400	
(*d*) Rs. 400 per month=Rs. 4,800	9,600
	81,600
Less Standard deduction (maximum)	3,500
Salary income	78,100

Under the second option which X has accepted he has to pay tax on Rs. 600 more, and it appears that he has not made a wise choice. But that is not so, because he receives Rs. 12,000 house-rent allowance and pays Rs. 9,600 as rent, thereby making an annual saving of Rs. 2,400.

The amount of income-tax payable on Rs. 600 additional income is much less than Rs. 2,400. Therefore X has made a wise choice by accepting the house-rent allowance.

(5) X, an employee of a company since 1953, is drawing a salary of Rs. 3,750 and an entertainment allowance of Rs. 800 per month from 1-4-1974. Prior to 1-4-1955 his entertainment allowance was Rs. 700 per month. He owns a motor-car which he uses for the purpose of his employment. He paid Rs. 250 as profession-tax and received Rs. 1,500 as bonus for the year ended 31-3-1975. Compute his salary income for the assessment year 1975-76.

			Rs.
Salary as such			45,000
Bonus			1,500
Entertainment allowance			9,600
			56,100
Less Standard deduction (maximum)		3,500	
Entertainment allowance*		7,500	11,000
Salary income			45,100

*This is the lowest of the following amounts :

(*a*) Amount drawn before 1-4-1955 Rs. 8,400
(*b*) One-fifth of salary (exclusive of allowance, benefit or other perquisite *i. e.*, 1/5 of Rs. 45,000) Rs. 9,000
(*c*) Rs. 7,500
(*d*) Actual amount of allowance Rs. 9,600

(6) The manager of a bank has been paid a monthly salary of Rs. 5,000 and an annual entertainment allowance of Rs. 5,000 since 1st April 1954. During the year ended 31st March 1975 he purchased some books on banking at a cost of Rs. 800. On 5-12-1974 he purchased a motor-car which he uses for purposes of his employment.

(*a*) Work out his salary income for the assessment year 1975-76.

(*b*) Would it make any difference if the annual entertainment allowance received by him were Rs. 8,000 ?

			Rs
(*a*)	Salary for the year		60,000
	Entertainment allowance		5,000
			65,000
	Less Standard deduction (maximum)	3,500	
	Entertainment allowance	5,000	8,500
	Salary income		56,500
(*b*)	Salary for the year		60,000
	Entertainment allowance		8,000
			68,000
	Less Standard deduction	3,500	
	Entertainment allowance	7,500	11,000
	Salary income		57,000

(7) X, the principal of a college, draws a monthly salary of Rs. 1,000 and a dearness allowance of Rs. 100. On 20-7-1974 he purchased a motor-car which he uses for the purpose of his employment. On 1-12-1974 in order to meet the expenses of his daughter's marriage, he received an advance of two months' salary and also took a loan of Rs. 5,000 from his employer for the purpose. What is his salary income for the assessment year 1975-76 ?

		Rs.
Salary and D. A. for 12 months		13,200
Advance salary for 2 months		2,200
		15,400
Less Standard deduction :		
20% of Rs. 10,000	2,000	
10% of Rs. 5,400	540	2,540
Salary income		12,860

The loan of Rs. 5,000 taken from the employer for his daughter's marriage is not taxable as salary.

(8) As the manager of a company, X is getting a monthly salary of Rs. 3,000, a commission of 1% on the net profits and a motor-car allowance of Rs. 150 per month. He is also provided with a free unfurnished house. The profits of the company for the year were Rs. 2,00,000. As an ex-employee of Government he is also getting a pension of Rs. 300 per month. Compute his salary income for the assessment year 1975-76.

	Rs.
Salary	36,000
Pension	3,600
Commission	2,000

Value of free house being 10% of Rs. 36,000 + Rs. 2,000	3,800
	45,400
Less Standard deduction (maximum allowable as he is getting a motor-car allowance)	1,000
Salary income	44,400

(9) (*a*) A salaried director holding a majority of shares in a company is given the option to subscribe for shares in the company at a nominal price, though the market value is more. Is the monetary value of the option assessable ? Would it make any difference if the option were given to an employee of the company ?

(*b*) A cricket club granted a benefit match to a professional cricketer in the service of the club and the proceeds of the match were paid to him. Is this receipt taxable ?

(*c*) A husband pays his wife voluntarily pocket-money every month. Is it taxable ? Would it make any difference if such payments were made to her by her employer as such ?

(*a*) Under section 17(2), the value of any benefit or amenity granted by a company to an employee who is a director thereof is taxable in the hands of the director under the head "Salaries". The monetary value of the option would be the difference between the price paid for the shares and their market value at the time the option was granted. But if the option was allowed to all shareholders *qua* shareholders, and the director got the benefit merely as a shareholder, it would not be taxable.

In the case of any other employee, the said benefit will not be taxable unless his salary (received in cash) exceeds Rs. 18,000 per year or he is substantially interested in the company (*i. e.*, he holds equity shares carrying not less than 20% of the voting power).

(*b*) Since the match is played as a token of personal appreciation of the cricketer and not connected with his profession or vocation, the receipt is a casual receipt and would not be taxable.

(*c*) The pocket-money paid by a husband to his wife voluntarily and not out of any legally binding custom is not taxable. If, however, it is paid by the husband as an employer, it would be a receipt by way of addition to her remuneration and thus taxable.

(10) In the case of an employee, which of the following salaries would be liable to tax if he were (*i*) a resident, (*ii*) a person not ordinarily resident, and (*iii*) a non-resident for the previous year ended 31st March 1975 ?

(*a*) Salary earned in Delhi and paid there, Rs. 5,000.

(*b*) Salary earned in Nepal and paid in Delhi, Rs. 5,000.

(*c*) Salary earned in Delhi and paid in Nepal, Rs. 5,000.

(*d*) Salary earned in Nepal and paid there, Rs. 5,000.

(*e*) Salary earned and paid in Nepal but brought to Delhi during the previous year, Rs. 5,000.

(*f*) Salary earned and paid in Nepal in the year ended 31st March 1974 but remitted to Delhi in March 1975, Rs. 5,000.

	Resident	Not ordinarily resident	Non-resident
	Rs.	Rs.	Rs.
(*a*)	5,000	5,000	5,000

(*b*)	5,000	5,000	5,000
(*c*)	5,000	5,000	5,000
(*d*)	5,000	—	—
(*e*)	5,000	—	—
(*f*)	—	—	—

Deductions in Computing Total Income

If a salaried individual wants to make provision for his old age, there are three methods of saving available to him, namely : making contributions to a provident fund (including a superannuation fund), purchasing life insurance policy, and depositing money in a cumulative deposit account in a post-office.

Deduction in respect of life insurance premia, contributions to provident fund, etc. Under section 80C, in computing the total income of an individual or a Hindu undivided family an outright deduction is to be made of an amount equal to the whole of the first Rs. 2,000 of the qualifying savings *plus* 50% of the next Rs. 3,000 *plus* 40% of the remainder of such savings. The qualifying savings consist of the following :

(*a*) Where the assessee is an individual, any sum paid by him in the previous year *out of his income chargeable to tax* as premium on a policy of insurance (including a contract for a deferred annuity) on the life of the assessee or on the life of his or her spouse or on the life of his or her child.

(*b*) Where the assessee is a Hindu undivided family, any sum paid by it in the previous year *out of its income chargeable to tax* as premium on a policy of insurance (including a contract for a deferred annuity) on the life of any member (male or female) of the family.

The amount of premium referred to in (*a*) and (*b*) above should not exceed 10% of the sum insured under a policy exclusive of any bonus additions.

Payments made under contracts of deferred annuities will qualify for tax concession only if the contract does not contain a provision for the exercise by the insured of an option to receive the cash payment in lieu of the payment of the annuity.

(*c*) Any sum deducted by Government from the salary of a Government servant for securing to him a deferred annuity or for making provision for his wife or children, *not exceeding one-fifth of his salary*. This includes contributions made by a Government servant to the provident fund maintained by Government.

(*d*) An individual employee's own contributions to a provident fund to which the Provident Funds Act of 1925 applies.

(*e*) An individual's own contributions to the Public Provident Fund set up by the Central Government.

(*f*) An individual's own contributions, out of his income chargeable to tax, for participation in the "Unit-linked Insurance Plan" of the Unit Trust of India. The contributions must be made by the assessee himself as a member of the plan and not by his spouse or children.

(*g*) An individual employee's own contributions to a recognised provident fund, *not exceeding one-fifth of his salary or Rs. 8,000 whichever is less*. Salary for this purpose includes dearness allowance if the terms of employment so provide, but it does not include any other allowances or perquisites.

(*h*) An individual employee's own contributions to an approved superannuation fund.

(*i*) Where the assessee is an individual, any sum deposited by him, out of his income chargeable to tax, in the previous year in a 10-year or a 15-year cumulative deposit account in the post-office.

(*j*) An association of persons or a body of individuals consisting only of husband and wife and resident in the Union Territories of Dadra and Nagar Haveli and Goa, Daman and Diu and governed by the Portuguese personal law of "community of property", is entitled to the same deduction, as in the case of an individual, in respect of the following sums, namely :

1. Sums paid to effect or to keep in force an insurance or a contract for deferred annuity on the life of either spouse or on the life of any of their children ;
2. Sums deposited in a 10-year or 15-year account under the Post-Office Savings Bank (Cumulative Time Deposits) Rules, 1959 ;
3. Sums paid as contributions to the Public Provident Fund ; and
4. Contributions made by any one member of such association or body for participation in the Unit-linked Insurance Plan.

Overall Limit. In addition to the limits imposed on certain qualifying payments (as stated above), there is the following overall limit in respect of all the above payments qualifying for deduction in computing the total income of an assessee :

(*a*) In the case of an individual being an author, playwright, artist, musician or actor, the limit is 33⅓% of his professional income plus 30% of his other income, subject to a maximum of Rs. 25,000.

(*b*) In the case of any other individual not falling under (*a*), the limit is 30% of his gross total income or Rs. 20,000 whichever is less.

(*c*) In the case of a Hindu undivided family, the limit is 30% of its gross total income or Rs. 30,000 whichever is less.

The expression "total income" means the total amount of income for which an assessee is chargeable on the basis of his residence, and which has been computed in accordance with the provisions of law as explained in this chapter and in the following chapters. The "Gross Total Income" means the total income before making any deduction therefrom on account of life insurance premium, etc.

Provident Funds

The provident funds, of which a salaried employee may be a member, are of four kinds, namely :

(1) Statutory Provident Fund.

It is a provident fund established under the Provident Funds Act, 1925. Such provident funds are maintained by local authorities, universities, colleges, etc.

Where an employee is a member of a statutory provident fund, only his own contributions thereto are included in his income from salary and no note is taken of his employer's contributions and interest on the accumulated balance to the member's credit in the fund.

An employee's own contributions to such a provident fund qualify for deduction in computing his total income. When the employee leaves the service, the sum received is the accumulated balance at his credit in the fund is not included in his total income.

(2) Public Provident Fund.

It is a provident fund instituted by the Central Government for the benefit of the public. Self-employed persons such as doctors, lawyers, accountants, actors, traders and even pensioners have now the facility of saving through a provident fund on a voluntary basis and with substantial tax benefits.

Subject to a minimum of Rs. 100 and maximum of Rs. 15,000 per year, a person is free to subscribe in multiples of Rs. 5 at any time, in any amount and in any number of instalments but not more than once each month. Subscriptions will earn interest at 5% p. a. from 1-4-1970. Subscriptions are accepted by branches of the State Bank of India and its subsidiaries.

Full withdrawals are allowed after 15 years but in the event of the death of the subscriber, full repayment will be made, even within this period, to his nominee or legal heirs. Facility of partial withdrawals and loans within limits are also available.

Balances in the Fund are not liable to attachment by any court.

A person subscribing to the public provident fund has the same tax concessions as a member of a statutory provident fund.

(3) Recognised Provident Fund.

It is a provident fund which has been recognised by the Commissioner of Income-Tax in accordance with the provisions of the Income-Tax Act and includes a provident fund established under the Employees' Provident Fund Act, 1925.

A recognised provident fund consists of contributions of employees, interest thereon, contributions of the employer and interest thereon. It may also consist of amount transferred from the individual account of an employee in a recognised provident fund maintained by his former employer and the interest in respect thereof.

The term "salary" in relation to a recognised provident fund includes dearness allowance if the terms of employment so provide but excludes all other allowances and perquisites.

Transferred Balance. When a provident fund is recognised for the first time in a particular year, the existing balance to the credit of an employee on the date of recognition, which is carried into the recognised provident fund, is called the transferred balance. The amount of the transferred balance (less the employee's own contributions included therein) is deemed to be the employee's salary income of the year in which recognition takes place.

Tax Concessions. The provident fund contributions made by the employer up to 10% of the employee's salary are not included in the salary income of the employee but any excess is to be so included.

The interest credited to the provident fund account of an employee is not included in the salary income of the employee, if the amount of such interest does not exceed one-third of the employee's salary and the prescribed rate of 6% per annum. Any interest which exceeds these two limits is to be included in the employee's income from salary.

An employee's own contributions to a recognised provident fund qualify for deduction in computing his total income.

The accumulated balance of provident fund account due to an employee on his retirement is to be excluded from his total income (*i*) if he has rendered continuous service with his employer for a period of five years or more, or (*ii*) if he has not rendered such continuous service, the service has been terminated by reason of the employee's ill-health or by the contraction or discontinuance of the employer's business or by any other reason beyond the control of the employee.

The accumulated balance due to an employee will not be included in his total income if such balance is transferred to the credit of his individual account in any other recognised provident fund maintained by the employer with whom the employee obtains re-employment.

Where the accumulated balance due to an employee includes any amount transferred from any other recognised provident fund maintained by a former employer of the employee, then in computing the period of continuous service of five years, the service rendered by the employee with such former employer will also be taken into account.

(4) Unrecognised Provident Fund.

It is a provident fund which is not a provident fund described above. The contributions made by an employee to an unrecognised provident fund are subject to tax, but the periodical contributions made by the employer to the employee's provident fund are not taxable year after year in the hands of the employee.

A payment of the accumulated balance from an unrecognised provident fund made to an employee (less the employee's own contributions and interest thereon) is, however, taxable in the hands of the employee in the year of receipt as income from salary, but he is entitled to apply to the Commissioner for relief under section 89(1).

However, the interest on the employee's contributions to an unrecognised provident fund is not exempt from tax. It does not fall under the head "Salaries" as it is not a profit in lieu of salary, but it is income falling under that head "Income from Other Sources".

Approved Superannuation Funds

Approved superannuation funds are governed by rules contained in Part B of the Fourth Schedule to the Income-Tax Act, 1961. In order that a superannuation fund may receive and retain approval, it must satisfy the conditions laid down in rule 3.

According to section 2(6), an approved superannuation fund means a superannuation fund which has been and continues to be approved by the Commissioner of Income-Tax in accordance with the rules contained in Part B of the Fourth Schedule.

An employee's own contributions to an approved superannuation fund qualify for deduction in computing his total income.

Any of the following payments made for an approved superannuation fund are excluded from the total income of an employee who is a member of such fund :

(*a*) On the death of a beneficiary.

(*b*) In lieu of or in commutation of an annuity payable on the retirement of an employee or on his becoming incapacitated.

(*c*) By way of refund of contributions on the death of a beneficiary.

(*d*) By way of refund of contributions to an employee on his leaving the service otherwise than by retirement or through incapacity to the extent of contribution made prior to 1st April 1962 and any interest thereon.

Deduction of Tax at Source.

This is explained in a subsequent chapter dealing with collection and recovery of tax.

Illustrations

(1) P is employed as a professor in a college of the Delhi University drawing a monthly salary of Rs. 1,000, out of which he contributes 10% to a provident fund to which the Provident Funds Act of 1925 applies.

During the year ended 31st March 1975, he paid Rs. 2,500 as premium on his life policy for Rs. 20,000 and on 1st June 1974 he opened a 15-year cumulative time deposit account at the post-office by depositing Rs. 100 per month.

Assuming that he has no other source of income, compute his total income for the assessment year 1975-76.

	Rs.
Salary	12,000
Less Standard deduction for expenditure being 20% of Rs. 10,000 and 10% of Rs. 2,000	2,200
Gross Total Income	9,800
Deduction for provident fund contribution, life insurance premium and cumulative time deposit as calculated below	2,470
Total Income	7,330

Provident fund contribution	1,200
Life insurance premium limited to 10% of sum assured	2,000
Cumulative time deposit for 10 months	1,000
	4,200

Applying the overall limit of 30% of gross total income of Rs. 9,800 (subject to the ceiling of Rs. 20,000) the amount qualifying for deduction is Rs. 2,940 and the amount of deduction is as under :

	Rs.
Whole of first Rs. 2,000	2,000
50% of Rs. 940.	470
	2,470

(2) X is in receipt of a monthly salary of Rs. 500 and a dearness allowance of Rs. 100. He contributes 10% of his salary and dearness allowance to a provident fund to which his employer contributes 12%. He is provided with a rent-free unfurnished house by his employer and he was paid Rs. 1,000 as bonus.

The amount of interest credited to his provident fund account for the year at 6% p. a. amounted to Rs. 400.

He paid Rs. 2,000 as premium on a policy on the life of his minor daughter for Rs. 15,000. He has no other source of income.

Work out the amount of his total income for the assessment year 1975-76 if the provident fund in question is (*a*) a provident fund to which the Provident Funds Act of 1925 applies, (*b*) a recognised provident fund and (*c*) an unrecognised provident fund.

			Rs.
(*a*)	Salary and D. A.		7,200
	Bonus		1,000
	Value of free house (10% of Rs. 8,200)		820
			9,020
	Less Standard deduction (20% of Rs. 7,200)		1,440
	Gross Total Income		7,580
	Deduction for P. F. contribution (Rs. 720) and insurance premium (Rs. 1,500) : First	2,000	
	50% of Rs. 220	110	2,110
	Total Income		5,470

(*b*)	Salary and D. A.		7,200
	Bonus		1,000
	Value of free house		820
	Employer's contribution to provident fund being 2% of Rs. 7,200		144
			9,164
	Less Standard deduction as in (*a*)		1,440
	Gross Total Income		7,724
	Deduction for P. F. contribution and insurance premium as calculated in (*a*)		2,110
	Total Income		5,614
	Rounded off		5,610

(*c*)	Salary and D. A.		7,200
	Bonus		1,000
	Value of free house		820
			9,020
	Less Standard deduction as in (*a*)		1,440
	Gross Total Income		7,580
	Deduction for insurance premium		1,500
	Total Income		6,080

Note : In (*a*) and (*b*) no tax is payable as the total income does not exceed Rs. 6,000.

(3) B, a resident individual working as an engineer in a mill at Kanpur, gives the following particulars of his income and other benefits from his employer for the year ended 31st March 1975 :

	Rs.
Salary (out of which Rs. 10,000 being salary for two months was paid to him in Italy where he had gone on employer's business)	60,000
His own contribution to recognised provident fund	7,500
Equal amount contributed by employer	7,500
Interest credited to provident fund at 8% p. a.	8,000
Entertainment allowance paid since 1954 by the same employer	5,000

His employer provided him with a rent-free furnished house belonging to the former, the gross municipal valuation of which is Rs. 15,000 per annum. The following expenses were met by the employer : (*a*) Pay of *mali* Rs. 1,200 ; (*b*) Pay of sweeper Rs. 720 ; (*c*) Pay of cook and bearer Rs. 1,800 ; (*d*) Repairs to house Rs. 5,000.

Compute his total income for the assessment year 1975-76.

		Rs.
Salary as such		60,000
Employer's contribution to P. F. in excess of 10% of salary		1,500
Interest on P. F. in excess of 6% p. a.		2,000
Value of free furnished house :		
Municipal valuation being fair rental value	15,000	

12½% of Rs. 60,000	7,500	
Excess over 25% of Rs. 60,000	—	7,500
Value of other perquisites :		
Pay of sweeper 75%	540	
Pay of cook and bearer	1,800	2,340
Entertainment allowance		5,000
		78,340
Less Standard deduction for expenditure (maximum allowable)	3,500	
Entertainment allowance being less than 1/5 of salary or Rs. 7,500	5,000	8,500
Gross Total Income		69,840
Deduction for provident fund contributions (Rs. 7,500) being less than 1/5 of salary or Rs. 8,000 :		
First	2,000	
50% of Rs. 3,000	1,500	
40% of Rs. 2,500	1,000	4,500
Total Income		65,340

Notes :

1. Salary earned outside India is taxable as the assessee is resident.
2. Repairs to house belonging to the employer is not a perquisite given to B.

(4) M, chief accountant of Kaycee Ltd., has furnished the following particulars in respect of his income for the previous year ended 31st March 1975 :

	Rs.
Duty pay for 11 months at Rs. 2,000 per month	22,000
Leave salary for June 1974	2,000
Dearness allowance at Rs. 400 per month	4,800
Contribution to recognised provident fund	3,000
Employer's contribution to provident fund	3,000
Interest credited at 10% p. a. to provident fund	2,000
Contribution to Public Provident Fund	1,000

The dearness allowance does not enter into computation of his retirement benefits.

He is provided by the company with rent-free furnished accommodation.

The following payments were made by him during the previous year :

(*a*) Rs. 1,500 premium on his life policy for Rs. 10,000.
(*b*) Rs. 1,200 placed in a 15-year cumulative time deposit at the post-office.
(*c*) Profession-tax paid Rs. 250.

Compute his total income for the assessment year 1975-76.

	Rs.
Salary for the year	24,000
Dearness allowance	4,800
Employer's contribution to provident fund in excess of 10% of Rs. 24,000.	600
Interest on P.F. in excess of 6% p.a.	800
Value of rent-free furnished house at 12½% of Rs. 24,000	3,000
	33,200

Less Standard deduction for expenditure (Rs. 2,000+Rs. 1,400)			3,400
Gross Total Income			29,800
Deductions :			
Contribution to recognised provident fund		3,000	
Contribution to public provident fund		1,000	
Insurance premium limited to 10% of sum insured		1,000	
15-year time deposit at post-office		1,200	
Qualifying Amount		6,200	
Deduction : First	2,000		
50% of Rs. 3,000	1,500		
40% of Rs. 1,200	480		3,980
Total Income			25,820

(5) P, the managing director of a limited company in Bombay since 1-4-1958, was getting a salary of Rs. 3,000 per month from 1-4-1974 and was provided with a rent-free furnished house by the company. In the three years ended 31-3-1974 his salary was Rs. 2,700, Rs. 2,800 and Rs. 2,900 per month respectively.

Owing to ill-health he resigned his post from 1-1-1975, on which date the company paid him, in view of his past services, four months' salary (*i. e.*, up to 30-4-1975) and also a gratuity of Rs. 30,000. He vacated the rent-free house on 1-1-1975.

While in service he was getting from the company a conveyance allowance of Rs. 250 per month and an entertainment allowance of Rs. 300 per month. The entertainment allowance received by him before 1-4-1955 was only Rs. 100 per month.

Compute his salary income for the assessment year 1975-76.

			Rs.
Salary for 9 months			27,000
Advance salary for 4 months			12,000
Value of rent-free furnished house being 12½% of salary plus taxable amount of entertainment allowance, *i.e.*, 12½% of Rs. 28,800			3,600
Entertainment allowance for 9 months			2,700
Gratuity as calculated below			7,600
			52,900
Deductions :			
Standard deduction for expenditure (maximum) as he received a conveyance allowance		1,000	
For entertainment allowance limited to the amount drawn before 1-4-1955, *i.e.*, at Rs. 100 per month for 9 months		900	1,900
Salary Income			51,000

Notes :

1. It is assumed that the whole amount of conveyance allowance (Rs. 3,000) was spent by P in the performance of his duties.
2. The exempted amount of gratuity is limited to Rs. 30,000 or 20 months' salary, whichever is less. It is calculated as follows :

	Rs.
Average monthly salary for three preceding years	2,800
Exempt amount of gratuity is Rs. 1,400 for each year of completed service, that is, for 16 years	22,400

Therefore the taxable amount of gratuity is Rs. 30,000 − Rs. 22,400 = Rs. 7,600.

(6) James Ltd. set up its business in India on 1-12-1972 and Jacob (an Englishman who had been continuously in India since 1959) was employed as the manager of its office in Bombay from the same date.

From the following particulars compute the total income of Jacob for the assessment year 1975-76 :

1. Jacob's salary was Rs. 2,500 per month. For the previous year ended 31-3-1975 he was also paid a bonus of Rs. 5,000 and a commission of Rs. 11,000. His previous employers (Smith & Co. of Bombay) were paying him an entertainment allowance of Rs. 4,000 per annum and the same practice was continued by James Ltd. who paid him a like sum.
2. Jacob was also provided with a rent-free furnished house by James Ltd. The annual municipal valuation of the house was Rs. 14,000 and the cost of furniture, refrigerator etc. was Rs. 10,000.
3. The company provided Jacob with a motor-car for his private use as well as for use in the performance of his duties.
4. The company paid Jacob's gas bills of Rs. 400.
5. Jacob contributed Rs. 7,000 towards provident fund (recognised), the company contributing a similar amount. He also paid Rs. 3,000 as premium on his life policy.

It is obvious that Jacob is resident in India for the previous year ended 31-3-1975. Therefore his total income for the assessment year 1975-76 will be as under :

	Rs.
Salary as such	30,000
Bonus	5,000
Commission	11,000
Employer's contribution to provident fund in excess of 10% of Rs. 30,000	4,000
Entertainment allowance (*a*)	4,000
Value of free furnished house (*b*)	6,250
Gas bills paid by employer	400
	60,650
Less Standard deduction for expenditure (maximum allowable as he uses the company's motor-car)	1,000
Gross Total Income	59,650
Deduction for provident fund contribution and insurance premium (*c*)	5,100
Total Income	54,550

Notes :

(*a*) No deduction is to be allowed for entertainment allowance as the assessee did not receive it regularly from his *present* employer from a date before 1-4-1955.

(*b*) The value of free furnished house is calculated as under :

	Rs.
Annual municipal valuation	14,000
Add 15% of cost of furniture (Rs. 10,000)	1,500
Fair Rental Value	15,500
12½% of Rs. 50,000 (salary including bonus, commission and entertainment allowance)	6,250
Amount by which Rs. 15,500 exceeds 37½% of Rs. 50,000	Nil
	6,250

(*c*) Provident fund contribution limited to 1/5 of salary	6,000
Life insurance premium	3,000
Qualifying Amount	9,000
Deduction allowable being Rs. 2,000 + Rs. 1,500 + Rs. 1,600	5,100

CHAPTER 5

Interest on Securities

Under section 18, the following amounts *due to an assessee* in the previous year are chargeable to income-tax under the head "Interest on Securities" :

(1) Interest on any security of the Central or a State Government ; and

(2) Interest on debentures or other securities for money issued by or on behalf of a local authority, a company or a statutory corporation.

An assessee will also be charged to income-tax in respect of any interest on securities received by him in a previous year if such interest had not been charged to Income-Tax for any earlier previous year.

The word "securities" is not defined in the Income-Tax Act. It is, however, plain that a mere debt is not a security unless the payment of it is in some way secured. The nature and form of security may differ in various cases, but it must be something beyond the mere liability of the debtor.

Securities issued by a foreign government are outside the ambit of this section, and the interest thereon would be taxed either as income from business or profession or as income from other sources. The shares of a company cannot be called securities for money ; therefore, dividends from shares are taxed as income from other sources.

Interest on securities is a separate head of income dealt with by this section. Therefore, even if the securities are held as a trading asset or dealt with in the course of business, *e. g.*, by a banker or a dealer in securities, the interest must be charged under section 18 and computed in accordance with the provisions of that section, and not as business profits.

Interest on securities issued by the Government of India accrues in India even if it is enfaced for payment abroad.

Basis of Charge. Under the Indian Income-Tax Act, 1922, tax was payable on interest on securities in respect of the interest receivable by an assessee, and the word "receivable" was interpreted to mean "received", and it was held in some cases that interest on securities became income only when actually received and not when it was due or capable of being received by the assessee.

Under the present Act, interest on securities is assessable on the basis of its becoming due. However, interest on securities will be chargeable when received if it has not been charged already in a previous year, *i. e.*, under the "due" principle.

Relief under Section 89(2). Where, by reason of any portion of income from interest on securities being received in arrears, an assessee's total income is

assessed at a rate higher than that at which it would otherwise have been assessed, the Income-Tax Officer shall, on an application made to him in this behalf, grant such relief as may be prescribed.

Tax-free Government Securities. Interest on tax-free government securities is included in the total income of an assessee but a rebate of income-tax is allowed thereon at the average rate or at 27·5% whichever is less.

There are, however, certain government securities such as post-office cash certificates, national plan certificates, etc., the interest on which is excluded from the total income. A list of such securities is given in a subsequent chapter dealing with computation of total income.

Tax-free Debentures. Where tax-free debentures are issued by a company, the company pays the tax to Government on behalf of the debenture-holders on the amount of interest paid to them, but the debenture-holders are to be charged to income-tax not only on the actual amount of interest due to them but also on the amount of income-tax to be borne by the company, because the income-tax borne by the company is a part of the debenture-holders' income from debentures.

Illustration

A company has issued 1,000 6½% tax-free debentures of Rs. 1,000 each. X holds 100 such debentures. What is his income from interest on securities, if the rate of income-tax to be deducted at source from such interest is 23% ?

When the rate of income-tax to be deducted at source is 23% and the interest actually received by X on his tax-free debentures is Rs. 6,500, his taxable income from interest on securities will be :

$$\frac{6,500 \times 100}{77} = \text{Rs. } 8,442$$

Deductions.

Section 19 relates to deductions in general ; section 20 relates to deductions in the case of banking companies ; and section 21 relates to amounts not deductible.

Under section 19, the income chargeable under the head "Interest on Securities" is to be computed after making the following deductions :

(1) Collection charges. The assessee is entitled to an allowance in respect of any reasonable sum expended by him for the purpose of realising the interest. An assessee who collects the interest himself on his own behalf cannot charge a fee for his labours and claim to deduct it from the interest income.

(2) Interest on money borrowed for investment. A deduction is allowed in respect of any interest payable (whether paid or not) on money borrowed by the assessee, for the purpose of investment in securities. To entitle the assessee to the deduction, the money must have been borrowed for the purpose of investment in securities.

An assessee cannot claim a deduction in respect of the interest paid by him on moneys borrowed for the specific purpose of investment in tax-free government securities. However, where the moneys are borrowed for the general purposes of the assessee's business or investments and it is not possible to allocate a borrowing to any particular investment, no part of the interest may be disallowed or deducted from the interest on tax-free securities (*56 ITR 77*).

In the case of a banking company, the amounts of the above two deductions is determined in accordance with the provisions of section 20. Under this section a banking company is permitted a deduction from interest on securities for a proportionate part of its business overhead expenses and the

interest paid by it on moneys borrowed including deposits received. Since interest on securities is taxable under the specific head (section 18), even where the securities are held as stock-in-trade by a banking company, a part of the business expenditure is attributed to the earning of such interest.

The expenses deducted under section 20 shall not again form part of the deductions admissible for the purpose of computing the income of the banking company under the head "Profits of Business".

Amount not Deductible. Under Section 21, where interest on moneys borrowed for purposes of investment in securities is payable outside India, but is chargeable under the Act in the hands of the lender, it is not a permissible deduction unless :

(*a*) The interest is on a loan issued for public subscription before 1st April 1938 ; or

(*b*) Tax has been paid or deducted under section 193 in respect of such interest ; or

(*c*) There is a person in India who may be charged as an agent under section 163 in respect of such interest.

It is possible that there may be a loss under this head, if the interest paid on a loan taken to buy securities exceeds the interest on securities. Such a loss can be set off against income under other heads.

Deduction of Tax at Source. This is explained in a subsequent chapter dealing with collection and recovery of tax.

Purchase and Sale of Securities Cum-interest.

Interest on securities is not considered as accruing from day to day, but it accrues on certain fixed dates. When securities are purchased cum-interest the price paid includes net accrued interest from the last date of interest payment to the date of purchase, but the purchaser is chargeable to tax on the whole amount of interest due to him on the next interest date, and he is not entitled to any deduction in respect of the net accrued interest paid by him to the seller.

For the same reason, the seller of securities cum-interest is not chargeable on the amount he receives from the purchaser as net accrued interest.

The general rule is that for income-tax purposes the interest is the income of the owner of securities on the date when interest falls due for payment. This rule is, however, subject to the provisions of section 94 (explained in a subsequent chapter dealing with computation of total income). This section hits those who seek to avoid tax by systematic sales of securities cum-interest.

The above general rule also applies when the interest becomes due after a person's death. A part of such interest for the period up to the date of the death cannot be treated as the income of the deceased.

Net Accrued Interest. This expression means the amount of interest accrued on securities but not due from the last date of interest payment to the date of purchase or sale *minus* the appropriate tax to be deducted therefrom at source.

Illustrations

(1) X Ltd., whose accounting year ends on 31st March, held on 1st April 1974 Rs. 10,000 3% government securities, interest on which is payable on 1st January and 1st July.

On 1st October 1974 it sold all these securities cum-interest. Work out the amount of net accrued interest it will receive from the purchaser, if the rate of income-tax to be deducted at source is 23%.

The last interest payment date before the sale of securities was 1st July 1974. The interest accrued but not due on these securities for 3 months from 1st July to 1st October 1974 is Rs. 75 and after deducting 23% income-tax therefrom, the net accrued interest which X will receive from the purchaser is Rs. 57·75.

(2) Y is a dealer in securities. His Profit and Loss Account has been credited with interest on securities Rs. 3,13,600 (net) after including interest received on sale of securities Rs. 4,000 (net) and after deducting interest paid to the seller on purchase of securities Rs. 2,400 (net).

Work out his income from interest on securities which is to be included in his total income, the rate of income-tax deductible at source being 23%.

	Rs.
Amount (net) credited to Profit and Loss Account	3,13,600
Add Interest paid on purchase of securities	2,400
	3,16,000
Less Interest received on sale of securities	4,000
Net Interest on securities	3,12,000
Gross interest on securities	94,05,15

Therefore, the income from interest on securities to be included in the total income of Y is Rs. 4,05,195.

Profit or Loss on Sale of Securities.

Where an assessee carries on the business of buying and selling shares and securities, he holds them as a trading asset, *i. e.*, as stock-in-trade, and any profit or loss resulting from an actual sale thereof is a revenue profit or loss taxable under section 28. For the purpose of computing the profit or loss of his business, the shares and securities in hand at the close of each accounting year must be valued as stock-in-trade on a uniform basis. The method of valuing stock-in-trade is considered in a later chapter.

On the other hand, where an assessee holds shares and securities as an investment and not as a trading asset, any profit or loss resulting from an actual sale thereof made *for the purpose of effecting a change of investment will be a capital profit or loss.*

Where shares and securities are exchanged under a scheme of amalgamation or conversion, the transaction amounts to realisation and reinvestment. Therefore, the assessee would be assessable on any profit deemed to have been made by him on such exchange or conversion if the assessee's business is such that any profit made by him on the realisation of securities is part of the profit of his trade.

Where the owner of an ordinary investment chooses to realise it and obtains a greater price for it than what he originally paid for it, the excess is not revenue profit ; but the excess will be assessable to income-tax where what is done, is not merely a realisation or change of investment but an act done in what is truly the carrying on of a business. No hard and fast rule can be laid down to distinguish trading or business transactions from the operations of a prudent investor. The number of transactions is not the sole determining criterion or test, though a systematic and habitual dealing in shares may be an important element which has to be taken into consideration for determining whether the transactions were business transactions within the meaning of the Income-Tax Act. The essential test in such cases is whether the sales and purchases were made not with the intention of investing one's capital but with the object of selling the shares in order to make a profit.

The mere fact that in a particular year the assessee was held to be not a dealer in shares and that the profits made by him were not assessed as profits from business will not prevent his being treated as a dealer in shares and the profits made during a subsequent year being treated as profits from business *(30 ITR 203)*. There is no such thing as *res judicata* in income-tax matters.

Illustrations

(1) A's investments during the year ended 31st March 1975 consisted of the following :

(*a*) Rs. 40,000 3½% government securities.
(*b*) Rs. 20,000 5% municipal debentures.
(*c*) Rs. 60,000 4½% port trust bonds.

His bank charged Rs. 40 as commission for collecting interest and he paid Rs. 700 as interest on a loan which he had taken for the purpose of purchasing the port trust bonds.

Calculate his income from interest on securities.

	Rs.	Rs.
Interest due for the year on all investments		5,100
Less Bank commission for collecting interest	40	
Interest on loan	700	740
Income from interest on securities		4,360

(2) On 1st April 1974 X held the following investments :

(*a*) Rs. 90,000 3% government loan.
(*b*) Rs. 80,000 5% improvement trust debentures.
(*c*) Rs. 30,000 5% debentures of a company.

On 1st August 1974 he purchased Rs. 20,000 3% government loan at 92½% cum-interest, interest being payable on 1st June and 1st December.

The bank commission for collecting interest was Rs. 75. What is his income from interest on securities for the previous year ended 31st March 1975 ?

	Rs.
Interest on securities held on 1-4-1974	8,200
Interest on government loan purchased on 1-8-1974 for half-year due on 1-12-1974	300
	8,500
Less Bank commission	75
Income from interest on securities	8,425

(3) On 1st April 1974 Y's investments were as follows :

(*a*) Rs. 60,000 4% U. P. State loan.
(*b*) Rs. 30,000 5% improvement trust debentures.
(*c*) Rs. 20,000 5% debentures of a sugar mill company.
(*d*) Rs. 15,000 9% preference shares in a company.

On 1st September 1974 he sold his sugar mill debentures at a profit of Rs. 750 and purchased Rs. 40,000 4% port trust bonds, having borrowed Rs. 20,000 for this purpose from his bank at 9 per cent per annum. The bank commission for buying and selling securities was ½% and for collecting interest Rs. 50.

Find out his income from interest on securities for the previous year ended 31st March 1975, such interest being payable in each case on 1st January and 1st July.

	Rs.	Rs.
Interest on 4% U. P. State loan for one year		2,400
Interest on 5% improvement trust debentures for one year		1,500
Interest on 5% sugar mill debentures for half-year due on 1-7-1974		500
Interest on 4% port trust bonds for half-year due on 1-1-1975		800
		5,200
Less Interest collection charges	50	
Interest on bank loan for 7 months	1,050	1,100
Income from interest on securities		4,100

The bank commission for buying and selling securities is not allowable as a deduction, as it is capital expenditure.

As the securities are held as an investment, the profit on the sale of sugar mill debentures is a capital gain.

Dividend on preference shares is not taxable under the head "Interest on Securities".

(4) An assessee company received some income by way of interest on securities, the tax deduction certificates of these securities show as follows :

(*a*) Gross interest payable Rs. 800.
(*b*) Tax deducted at source Rs. 184.

The assessee claims deduction of Rs. 92 paid to the person from whom he purchased the securities, as net accrued interest to date of purchase.

Calculate the amount assessable under the head "Interest on Securities" as well as the amount (out of the amount of tax deducted at source) for which credit will be given in his assessment.

Rs. 92 net accrued interest up to the date of purchase paid to the vendor is really a part of the purchase price and therefore capital expenditure. The amount of Rs. 92 cannot be deducted and the income from this source is Rs. 800. The amount assessable under the head "Interest on Securities" will therefore be Rs. 800, and the amount of tax deducted at source for which credit will be given will be Rs. 184.

National Savings Certificates.

Under section 112A, where the total income of a non-company assessee includes any interest on National Savings Certificates (First Issue) and National Savings Certificates (First Issue)—Bank Series, the tax payable by him on his total income shall be :

(*a*) the amount of income-tax payable on the total income as reduced by the amount of such inclusion *plus*
(*b*) the amount of income-tax calculated on the amount of such interest at the average rate of income-tax applicable to the total income as reduced by such interest, capital gains and compensation for loss of agency.

CHAPTER 6

Income from House Property

Under section 22, income-tax is payable by an assessee on the annual value of property consisting of buildings or land appurtenant thereto, of which he is the owner. Such property is called house property.

If the house property is occupied by the assessee for the purposes of his own business or profession, and the profits of such business or profession are assessable to tax, the annual value of such property is not taxable under this section and no notional rent is allowed to the assessee in respect of the premises in computing the income of his business or profession.

Where a portion of the house property, owned by an assessee and used for purposes of his business, is let out to the employees of the business *whose residence there is necessary for the efficient conduct of the business*, the rent collected from such employees has to be assessed as income from business and not under the head "Income from House Property", and depreciation and other expenses (such as repairs, fire insurance, ground rent, etc.) relating to the property so let out are an admissible charge to the profit and loss account.

As a separate head of charge is provided for income from house property, rents from house property cannot be taxed under any other head even if property is let in the course of business and the income derived from such property forms part of the profits of a trading concern.

Where immovable property consists of only land on which no building has been erected, any income derived from such land will not be taxed as income from house property, but will be taxed as income from other sources.

It is only the owner of house property, who is liable to pay tax under this head, even if he is not the owner but is only the lessee of the land on which the building stands. The person who builds a house upon the land of another person, remains the owner of the house. But the person who is the lessee of a building is not assessable as owner under this section. If he derives any income from subletting or reletting such income is taxable as income from other sources.

A dispute regarding the title to house property cannot of itself hold up an assessment even if a suit has been filed. The Income-Tax Officer has *prima facie* the power to decide whether the person sought to be taxed is the owner of the property.

Deemed Owner of House Property.

According to section 27, the following persons are deemed to be the owner of house property for the purpose of charging income-tax under the head "Income from House Property" :

(1) An individual, who transfers otherwise than for adequate consideration any house property to his or her spouse, not being a transfer in

connection with an agreement to live apart, or to a minor child not being a married daughter, shall be deemed to be the owner of the house property so transferred.

This provision is intended to remedy a situation like this. After transferring the ownership of a residential property to his wife or minor child without adequate consideration, the transferor may continue to reside in it along with the transferee. As the income of an owner-occupied residential property is limited to 10 per cent of the total income of the owner, namely, the wife or the minor child who usually has much less income, there is escapement of proper tax liability.

(2) The holder of an impartible estate is deemed to be the individual owner of all the house properties comprised in the estate. The law relating to impartible estates is explained in a subsequent chapter dealing with the assessment of Hindu undivided families.

(3) A member of a co-operative housing society, to whom a building built by the society is allotted or leased under a house-building scheme of the society, is deemed to be the owner of that building.

Annual Value.

Under section 22, tax is chargeable not in respect of and actual rent received but in respect of the annual value of house property.

According to section 23 (1), the annual value of any house property shall be deemed to be the sum for which the property might reasonably be expected to let from year to year.

What the law contemplates by "annual value" is not the actual rent received by the owner of the house property, but a notional rent which is to be gathered from what a hypothetical tenant would pay for the property. If actual rent is received, that would be an important factor for the taxing authorities to consider, but that would not in every case be the proper annual value as contemplated by the Act. The house may have been let cheap or dear ; the lease may be ten years old or a thing of yesterday ; personal relations or business relations may have led to exceptional terms as to rent. Municipal valuation also is not the only test that should be applied in determining the annual value.

The annual value of house property is ascertained by taking into consideration all relevant facts, such as rent received, the terms of the lease, the municipal valuation, rent paid for similar property in the locality, and so on.

Annual Value in Different Circumstances. The annual value of house property, as determined under section 23(1), is subject to adjustment in the following circumstances :

(1) Where the property is in the occupation of a tenant, the taxes levied by any local authority in respect of the property shall, to the extent such taxes are borne by the owner, be deducted in determining the annual value of the property.

(2) Where a building consisting of one or more residential units, the erection of which is begun after 1-4-1961 and completed before 1-4-1970, is let out to tenants for residential purposes, the annual value of each such unit for a period of *three* assessment years from the date of its completion is to be reduced by the full amount of it or by Rs. 600 whichever is less.

Where a building consisting of one or more residential units, the erection of which is begun after 1-4-1961 and completed after 31-3-1970, is let out to tenants for residential purposes, the annual value of each such unit for a period of *five* assessment years from the date of its completion is to be reduced by the full amount of it or by Rs. 1,200 whichever is less.

This tax concession granted for three or five assessment years may be called "tax-holiday benefit".

In both these cases a loss cannot be returned in respect of each such unit.

The above tax benefit is not available in respect of a house occupied by the owner for his residence.

(3) Where the property is in the occupation of the owner for purposes of his own residence, its annual value shall first be determined after deducting local taxes, as in the case of property let, and then shall be further reduced by one-half of the amount so determined or by Rs. 1,800 whichever is less.

In a case where the assessee has more than two residential houses, this concession will be available only in respect of each of two such houses which the assessee at his option may specify in this behalf. The annual value of any other residential house or houses will be determined as if they were let.

However, if the so reduced annual value of the self-occupied property exceeds 10% of the total income of the owner, the annual value is deemed to be 10% of the total income. The total income for this purpose is to be computed in the following manner :

(*i*) Without including therein the income of such property ; and

(*ii*) Before making any deductions on account of life insurance premium, etc., as given in a subsequent chapter dealing with deductions in computing total income.

Where a house belonging to an assessee is occupied free of rent by any of his relatives (son, uncle, brother-in-law, etc.), the house cannot be said to be self-occupied.

Where a house property is owned and used jointly as a dwelling-house, the deduction of Rs. 1,800 is allowed only jointly and not separately to each joint owner.

(4) Where the property reserved by the owner for purposes of his own residence consists of only one residential house, which is neither actually occupied by the owner nor actually let to a tenant and no other benefit therefrom is derived by the owner, the annual value of such property, if the property was unoccupied during the whole of the previous year, should be taken to be nil, and if it was occupied for a part of the previous year, it should be computed proportionately. *But in no case can a loss be returned in respect of such property.*

Such reserved house property may not be occupied by the owner by reason of his employment, business or profession being carried on at any other place.

Note : Given below is an important illustration which should be studied very carefully.

Illustration

In the following cases compute the "annual value" of house property for the assessment year 1975-76, the previous year ending on 31st March 1975 :

(1) A built a house in 1959 and has let it to a tenant for residential purposes on a monthly rent of Rs. 300, the municipal taxes paid being Rs. 300.

(2) B purchased a house on 31-3-1974 and the next day he let it to a tenant for residential purposes on a monthly rent of Rs. 300, the municipal taxes paid being Rs. 300.

(3) C built a house on 31-3-1974 and the next day he let it to a tenant for running a hotel on a monthly rent of Rs. 300, the municipal taxes paid being Rs. 300.

(4) E built a house in July 1972 and let it to a tenant for residential purposes on a monthly rent of Rs. 300, the municipal taxes paid being Rs. 300.

(5) G built a house on 1-7-1974 and let it to a tenant for residential purposes on a monthly rent of Rs. 100, the municipal taxes paid being Rs. 60.

(6) H purchased a house in 1971 which he occupies for his own residence, the municipal valuation thereof being Rs. 3,000 and the municipal taxes paid being Rs. 300.

(7) J owns three houses A, B and C, the last having been constructed on 1-7-1974. The municipal valuation of these houses is Rs. 8,000, Rs. 6,000 and Rs. 4,000 respectively and the municipal taxes paid in respect thereof are Rs. 700, Rs. 500 and Rs. 300. He uses all the three houses for his own residence but he has selected houses A and B for the purpose of self-occupation concession.

(8) K has only one residential house at Agra. He is employed in Bombay where he lives in a rented house. During the previous year he was on long leave and occupied his Agra house for four months. He did not derive any other benefit from the Agra house, the municipal valuation of which is Rs. 4,000 and the municipal taxes paid are Rs. 400.

		Rs.
(1)	Annual value on the basis of rent	3,600
	Less Municipal taxes paid	300
	Annual value in this case	3,300

No tax-holiday benefit because the house was constructed before 1-4-1961.

		Rs.
(2)	Annual value on the basis of rent	3,600
	Less Municipal taxes paid	300
	Annual value in this case	3,300

No tax-holiday benefit as the house was purchased and not constructed.

		Rs.
(3)	Annual value on the basis of rent	3,600
	Less Municipal taxes paid	300
	Annual value in this case	3,300

No tax-holiday benefit as the house was not let for residential purposes.

		Rs.
(4)	Annual value on the basis of rent	3,600
	Less Municipal taxes paid	300
		3,300
	Less Statutory allowance	1,200
	Annual value in this case	2,100

The five-year period of tax-holiday will expire with the assessment year 1977-78.

			Rs.
(5)	Annual value on the basis of rent for 9 months		900
	Less Municipal taxes paid		60
			840
	Less Statutory allowance		840
	Annual value in this case		Nil

The tax-holiday benefit will be available for four more assessment years.

			Rs.
(6)	Annual value being municipal valuation		3,000
	Less Municipal taxes paid		300
			2,700
	Less Self-occupation allowance		1,350
	Annual value in this case		1,350

		Rs.	Rs.
(7)	Annual value of house A being municipal valuation	8,000	
	Less Municipal taxes paid	700	
		7,300	
	Less Self-occupation allowance	1,800	5,500
	Annual value of house B being municipal valuation	6,000	
	Less Municipal taxes paid	500	
		5,500	
	Less Self-occupation allowance	1,800	3,700
	Annual value of house C being municipal valuation for 9 months	3,000	
	Less Municipal taxes paid	300	2,700
	Annual value in this case		11,900

			Rs.
(8)	Annual value being municipal valuation		4,000
	Less Municipal taxes paid		400
			3,600
	Less Self-occupation allowance		1,800
			1,800
	Annual value (proportionate for four months) in this case		600

Deductions.

Under section 24 (1), the income chargeable under the head "Income from House Property" shall be computed after making the following deductions from the annual value as determined in the manner explained above :

(*i*) **Repairs.** A fixed allowance of one-sixth of the annual value is granted for repairs, where the property is either in the occupation of the owner or is let to a tenant and the owner has undertaken to bear the cost of repairs.

Where the tenant undertakes to bear the cost of repairs the allowance for repairs is restricted to the difference between the annual value and the rent paid but not exceeding *one-sixth* of the annual value.

This allowance is granted irrespective of whether anything has been spent for repairs or not and irrespective of any vacancies.

Illustration

An assessee owns a bungalow, the annual value of which according to municipal records is Rs. 6,000. It is let out on an annual rent of Rs. 5,000 to a tenant who has also undertaken to bear the cost of repairs. The municipal taxes paid amounted to Rs. 600. What is the admissible allowance for repairs ?

	Rs.
Municipal valuation being taken as annual value	6,000
Less Municipal taxes	600
Annual value in this case	5,400
Allowance for repairs restricted to the difference between the annual value and the rent paid being less than one-sixth of annual value.	400

(*ii*) **Insurance Premium.** Premium paid for insurance against the risk, of damage to or destruction of property through any cause, *e.g.*, fire, earthquake, lightning, civil commotion, etc.

(*iii*) **Interest on Mortgage.** This deduction was withdrawn from 1st April 1969. Any interest payable on the mortgage of house property is allowable as a deduction under (*vi*) below only where the funds raised are utilised for acquiring, constructing, repairing, renewing or reconstructing the property.

(*iv*) **Annual Charge.** Where the property is subject to an annual charge, the amount of such charge is allowed as a deduction provided it is not a capital charge or a charge created by the assessee voluntarily.

The expression "annual charge" does not include any tax in respect of property levied by local authority or by Government.

An "*annual charge*" means a charge to secure an annual liability, while a "*capital charge*" means a charge to secure the discharge of a liability of a capital nature, *e. g.*, the payment of debt. Thus, if a debt is secured by a charge on house property, it is a capital charge ; but if the interest on the debt is secured by a charge on house property, it is an annual charge.

The only condition that has to be satisfied is that there is an annual charge (not being a charge created by the assessee voluntarily or a capital charge) which is valid and legal and which can be enforced against the owner of the property on which the charge has been fixed. An assessee (a Hindu undivided family) was under an obligation to pay Rs. 500 a month to a widow for maintenance, and this obligation was imposed by a decree of the court, which gave to the widow a charge on the joint family house property in respect of the maintenance allowance. This sum of Rs. 6,000 is a permissible deduction as an annual charge.

Where the charge on the property is a capital charge, only the amount of interest thereon is allowed as a deduction ; but where the charge is an annual charge, the amount of the charge itself is allowed as a deduction.

The distinction between the two terms "mortgage" and "charge" which appear in the above paragraphs is as follows :

A mortgage is the transfer of interest in specific immovable property for the purpose of securing payment of a debt. Where the principal amount secured is Rs. 100 or upwards, a mortgage can be created only by a registered instrument signed by the mortgagor and attested by two witnesses.

Where the immovable property of one person is made security for the payment of money to another, the latter person is said to have a *charge* on the property. A charge may be created by an act of parties or by operation of law. A charge does not contemplate transfer of an interest in the immovable property as is the case in a mortgage.

(*v*) **Ground Rent**. Where the property is subject to a ground rent, the amount of such ground rent is allowed as a deduction.

(*vi*) **Interest on Borrowed Capital**. Interest on money borrowed (whether on the mortgage of house property or otherwise) where the funds raised are utilised for acquiring, constructing, repairing, renewing or reconstructing the property.

(*vii*) **Land Revenue**. Any land revenue *or any other tax* levied by a State Government paid in respect of the property is allowed as a deduction.

(*viii*) **Collection Charges**. The amount allowed for collection charges is restricted to 6 per cent of the annual value or the actual expenditure, whichever is less. Legal expenses incurred in recovering rent from tenants are included in collection charges.

(*ix*) **Vacancy Allowance**. Where the building remains vacant, a deduction of a part of the annual value proportionate to the period of vacancy is permitted as vacancy allowance. This allowance is primarily available in the case of property which is let, but it may also apply to a house which is not let but which is dismantled and shut up by the owner. Where an assessee owns a house and keeps it ready for his own occupation or the occupation of his guests, the house cannot be said to be vacant merely because it was not occupied for a certain period. The expression "occupied" does not mean "used".

(*x*) **Unrealised Rent**. According to rule 4 of the Income-Tax Rules, 1962, a deduction in respect of unrealised rent is allowed where :

(*a*) the tenancy is *bona fide* ;
(*b*) the defaulting tenant has vacated or steps have been taken to compel him to vacate the house property ;
(*c*) the defaulting tenant is not in occupation of any other house of the assessee ;
(*d*) the assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfies the Income-Tax Officer that legal proceedings would be useless ; and
(*e*) the annual value of the house property to which the unpaid rent relates has been included in the assessed income of the previous year during which that rent was due and tax has been duly paid on such assessed income.

The deduction to be allowed on this account shall not exceed the income from house property computed without making this deduction.

Note : The following allowances are permissible in respect of expenditure incurred though not actually paid :

(*a*) Amount of any annual charge.
(*b*) Amount of any ground rent.
(*c*) Interest on money borrowed for acquiring, constructing, repairing, renewing or reconstructing the property.

Loss under this Head. A loss may be shown under the head "Income from House Property" if the aggregate of the permissible allowances exceeds the annual value of the property, and the assessee would be entitled to set off such a loss under section 71 against his income under other heads. There are, however, two cases (referred to earlier) in which a loss cannot be returned under this head.

Amounts not Deductible.

According to section 25, the allowances mentioned in (*iv*) and (*vi*) above (namely, any annual charge or interest) will not be granted, if they are payable outside India and are chargeable under the Act, unless tax has been deducted therefrom or the owner of the property agrees to be taxed as an agent of the non-resident to whom such payments have been made.

Foreign House Property.

The income from foreign house poperty is assessable only in the case of residents in India. In cases where such foreign income is chargeable, the method of computation for arriving at the annual value and the deductions permissible therefrom would be as set out above.

Property owned Jointly

Under section 26, where a house property is owned jointly, and the shares of the co-owners are definite and ascertainable, they are not assessed as an association of persons, but the share of each part-owner is assessed on him as part of his total income.

House Property Income not Liable to Tax.

The following income from house property is not chargeable to income-tax :

(1) Income from property in the near vicinity of agricultural land occupied by the cultivator as a dwelling-house, storehouse or as an out-house—section 2(1)(c) read with section 10(1).
(2) Income from property held in trust wholly for charitable or religious purposes—section 11(1)(a).
(3) Income from property used by the assessee for purposes of his business or profession—section 22.
(4) Income from one residential house which is not actually occupied by the owner for the whole of the previous year by reason of his employment, business or profession being elsewhere—section 23(3).
(5) Income from letting godowns or warehouses derived by a co-operative society—section 80P.
(6) Income from house property derived by a co-operative society, whose total income does not exceed Rs. 20,000 and which is not a 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—section 80P.
(7) Income derived from letting godowns or warehouses by any authority constituted under any law for marketing of commodities—section 10(29).

Illustrations

Note :

In determining the annual value of house property, which is let out to tenants, it has been assumed that the property was constructed before 1-4-1961, unless otherwise stated.

(1) X is the owner of a big ancestral house which he uses for his own residence and of which the municipal valuation is Rs. 4,000. During the year ended 31-3-1975 he paid Rs. 500 municipal tax and Rs. 250 property tax levied by the State Government. His other income from money-lending business is Rs. 15,000.

Compute his income from house property for the assessment year 1975-76.

		Rs.
Annual value of residential house		4,000
Less Municipal tax		500
		3,500
Less Self-occupation allowance		1,750
Annual value in this case		1,750
But it is limited to 10% of his other income of Rs. 15,000		1,500
Less One-sixth for repairs	250	
Property tax levied by State Government	250	500
Income from house property		1,000

(2) An assessee is the owner of two houses, namely :

(*a*) A kothi, the annual value of which according to municipal records is Rs. 12,000 but which is let out on rent for Rs. 10,000 a year to a tenant who has undertaken to bear the cost of repairs. Municipal taxes paid amounted to Rs. 500.

(*b*) A shop, the annual value of which according to municipal records is Rs. 5,000. It is however let out on an annual rent of Rs. 3,600 to a tenant who has undertaken to bear the cost of repairs. Municipal taxes paid amounted to Rs. 200.

Calculate the assessee's income from house property for the assessment year 1975-76.

	Rs.	Rs.
Annual value of kothi under section 23(1)	12,000	
Less Municipal-taxes	500	
Annual value in this case	11,500	
Less Allowance for repairs as per section 24(1)(i)(b), being the difference between the annual value and rent paid but not exceeding one-sixth of annual value	1,500	10,000
Annual value of shop under section 23(1)	5,000	
Less Municipal taxes	200	
Annual value in this case	4,800	
Less Allowance for repairs as per section 24(1)(i)(b), being limited to one-sixth of annual value	800	4,000
Income from house property		14,000

According to section 24(1)(i)(b), where the tenant undertakes to bear the cost of repairs, the allowance for repairs is restricted to the difference between the annual value and the rent paid but not exceeding one-sixth of the annual value.

(3) A lawyer, whose previous year ends on 31st March, is the owner of some property. From the following information, compute his income from house property for the assessment year 1975-76 :

(*a*) Annual value of his residential house according to municipal valuation is Rs. 15,000, one-fifth of the house being used for professional office purposes. Expenses incurred in connection with this house were : Repairs Rs. 3,000 ; ground rent Rs. 200 ; house tax Rs. 800 ; conservancy tax Rs. 200 ; water tax Rs. 500.

(*b*) Annual value of a house on hillside, six miles distant from a hill-station and therefore not in demand for occupation. It has always remained vacant except for a year in 1971 when the military requisitioned and occupied it on an annual rent of Rs. 6,000. Expenditure on this house consisted of repairs Rs 1,000 and upkeep Rs. 6,000.

Residential house (4/5 portion) :

		Rs.
Annual value on the basis of municipal valuation		12,000
Less Municipal taxes (4/5)		1,200
		10,800
Less Statutory allowance		1,800
Annual value in this case		9,000
Less One-sixth for repairs	1,500	
Ground rent (4/5)	160	1,660
Income from house property		7,340

It is assumed that the annual value (Rs. 9,000) of the self-occupied portion does not exceed 10% of total income.

House on hillside :

This house has always remained vacant except for a year in 1971. Being distant from the hill-station and out of way, it is not in demand for occupation. Therefore, it cannot be said that it might reasonably be let from year to year for any sum at all. Its annual value is therefore nil. Allowances for repairs and vacancy, being certain fractions of annual value will be nil, and there is no provision in section 24 for any allowance for upkeep of the house. Hence, the income from this house is nil.

(4) The particulars of the house properties owned by an assessee are as follows :

(*a*) He owns a house whose annual value according to municipal records is Rs. 6,000. It is however let out on rent for Rs. 5,400 a year to a tenant who has also undertaken to bear the cost of repairs. The municipal taxes paid in respect of this house amount to Rs. 250.

(*b*) The annual value of his residential house is Rs. 12,000. He paid Rs. 500 for ground rent, Rs. 700 for premium to insure the property against the risk of damage or destruction and Rs. 1,000 for municipal taxes.

His income from business amounted to Rs. 55,800.

Calculate his income from house property and his total income for the previous year ended 31st March 1975.

	Rs.	Rs.
Annual value of house let	6,000	
Less Municipal taxes	250	
Annual value in this case	5,750	
Less Allowance for repairs being the difference between the annual value and the rent paid	350	5,400

			Rs.
Annual value of residential house		12,000	
Less Municipal taxes		1,000	
		11,000	
Less Statutory allowance (maximum)		1,800	
Annual value in this case		9,200	
Limited to 10% of his other income of Rs. 55,800 + Rs. 5,400 = Rs. 61,200		6,120	
Less One-sixth for repairs	1,020		
Ground rent	500		
Insurance premium	700	2,220	3,900
Income from house property			9,300
1. Income from house property			9,300
2. Business profit			55,800
Total Income			65,100

(5) A house built by a co-operative society was taken on lease under a house-building scheme by an assessee who is a member of the society, and it was used for self-occupation, its fair annual rent being Rs. 1,500. He paid Rs. 140 as municipal taxes in respect of this house. Interest of Rs. 1,000 was due to the society for the year.

What is the income of the assessee from this house property ?

Under section 27(iii), a member of a co-operative society to whom a building is leased under a house-building scheme of the society is deemed to be the owner of that building.

The income of the assessee from house property will therefore be as follows :

			Rs.
Annual value on the basis of rental value			1,500
Less Municipal taxes			140
			1,360
Less Allowance for self-occupation			680
Annual value in this case			680
Less One-sixth for repairs	113		
Interest due to Society	1,000		1,113
Loss from house property			– 433

(6) A is the owner of a house property in Delhi, which has been let out for Rs. 90,000 a year. The municipal tax payable by A in respect of this property is Rs. 5,000 but he has taken an agreement from the tenant stating that the tenant would pay this tax direct to the municipality. The landlord however bears the following expenses on the tenant's amenities : water charges Rs. 1,000 ; lift maintenance Rs. 1,000; salary of gardener Rs. 1,200 ; lighting of stairs Rs. 800.

The landlord claims the following deductions : repairs Rs. 30,000 ; land revenue Rs. 1,000 ; collection charges Rs. 2,000.

Compute the income from house property.

			Rs.
Rent realised			90,000
Add Tax paid by the tenant on behalf of landlord			5,000
			95,000
Less Value of tenant's amenities provided by the landlord :			
Water charges	1,000		
Lift maintenance	1,000		
Salary of gardener	1,200		
Lighting of stairs	800		4,000
Annual value under section 23(1)			91,000
Less Municipal taxes			5,000
Annual value in this case			86,000
Less One-sixth for repairs	14,333		
Land revenue	1,000		
Collection charges being less than 6% of annual value	2,000		17,333
Income from house property			68,667

(7) From the following particulars furnished by X, compute his total income for the assessment year 1975-76 :

				Rs.
1. Income from salary (after standard deduction)				11,400
2. Income from house property :				
Rents receivable : Property B		6,000		
Property C		7,200	13,200	
Less Expenses :				
Municipal taxes :				
Property A	600			
Property B	600			
Property C	700	1,900		
Repairs to property :				
Property A	400			
Property C	300	700		
Interest on mortgage of :				
Property B		1,200		
Insurance premium :				
Property A	100			
Property B	150			
Property C	200	450		
Collection charges		2,400	6,650	6,550
				17,950

(*a*) The assessee has settled in Bombay for the purpose of his employment where he resides in a rented house.

(*b*) All the three properties are at Calcutta. Property A is retained for self-occupation. Property B and C were let out.

(*c*) The annual values of properties A, B and C are Rs. 3,000, Rs. 6,000 and Rs. 7,200 respectively.

(*d*) The assessee was on leave for 4 months during the previous year ended 31st March 1975. During that period he resided in property A. No other benefit was derived from that property.

(*e*) Rs. 20,000 raised on mortgage of property B was utilised for purchase of agricultural land, income wherefrom is exempt from income-tax.

			Rs.
1.	Salary income		11,400
2.	Income from house property as calculated below		9,087
	Total Income		20,487
	Rounded off		20,490

The income from house property has been computed as under :

(*a*)	Properties B and C let out :			
	Annual value (Rs. 6,000+Rs. 7,200)			13,200
	Less Municipal taxes (Rs. 600+Rs. 700)			1,300
	Annual value in this case			11,900
	Less One-sixth for repairs		1,983	
	Insurance premium (Rs. 150+Rs. 200)		350	
	Collection charges limited to 6% of Rs. 11,900		714	3,047
				8,853
(*b*)	Property A (self-occupied) :			
	Annual value		3,000	
	Less Municipal taxes		600	
			2,400	
	Less Statutory allowance		1,200	
	Annual value in this case		1,200	
	Proportionate annual value for four months		400	
	Less One-sixth for repairs	66		
	Insurance premium	100	166	234
	Income from house property			9,037

The interest on the loan taken on the mortgage of property B is not an admissible deduction, because the funds raised were not used for repairing, constructing, purchasing or renewing that property.

(8) During the financial year 1974-75 Amar Nath owns four houses. Their municipal valuations are Rs. 5,000, Rs. 6,000, Rs. 5,500 and Rs. 10,000 respectively and the municipality levies 10% tax. The first house is occupied by him for this residence. Ram Nath is residing in the second house at a monthly rent of Rs. 600. The third house is occupied by a business house at an annual rent of Rs. 6,600. In the fourth house Amar Nath is carrying on his own business which has yielded a net taxable income of Rs. 15,145. The second and third houses were constructed during the financial year 1972-73.

He claims the following deductions :

Interest on mortgage of the first house Rs. 200.

Rs. 600 paid as salary to a gardener in respect of the third house.

Compute the taxable income from house property for the previous year ended 31st March 1975.

Income from House Property

			Rs.	Rs.
First house :				
Annual value on the basis of municipal valuation			5,000	
Less Municipal taxes (10%)			500	
			4,500	
Less Self-occupation allowance			1,800	
Annual value in this case			2,700	
But it is limited to 10% of his other income of Rs. 24,187			2,418	
Less One-sixth for repairs	403			
Mortgage interest	200		603	1,815
It is assumed that the mortgage loan was taken to repair the residential house.				
Second house :				
Annual value on the basis of rent received			7,200	
Less Municipal taxes (10% of Rs. 6,000)			600	
			6,600	
Less Statutory allowance			1,200	
Annual value in this case			5,400	
Less One-sixth for repairs			900	4,500
Third house :				
Annual value on the basis of rent received after deducting Rs. 600 gardener's salary			6,000	
Less Municipal taxes (10% of Rs. 5,500)			550	
Annual value in this case			5,450	
Less One-sixth for repairs			908	4,542
Fourth house :				
As it was used for carrying on the assessee's own business, its income is not taxable under the head "Income from House Property".				
Income from house property				10,857

The statutory allowance of Rs. 1,200 is not admissible in respect of the third house because it is not for residential purposes ; and this allowance in respect of the second house will be available for two more assessment years, namely : 1976-77 and 1977-78.

(9) Compute the income from house property of Anil and Sunil from the following information for the year ended 31st March 1975 :

(*a*) Anil and Sunil are brothers and they have inherited equally the house property from their father.
(*b*) Rent realisable from the property is Rs. 27,000 per annum.
(*c*) Municipal taxes (to be borne by the landlord) are Rs. 9,000 per annum.
(*d*) The property is on a leasehold plot of land and the annual lease rent is Rs. 3,000.
(*e*) Rent collector is paid Rs. 100 per month.
(*f*) Property was mortgaged for taking a loan of Rs. 50,000 at 10% per annum for the purpose of partnership business of Anil and Sunil. The loan was taken on 1st October 1974.
(*g*) One of the flats in the building fetching monthly rent of Rs. 500 was vacant for two months.

(C. A. Inter, Nov. 1974)

Where a house property is owned jointly and the shares of the co-owners are definite, the co-owners are not assessed as an association of persons, but the share of each co-owner is to be included in his total income.

The income from house property will be as follows :

		Rs.
Rent realisable being annual value under section 23(1)		27,000
Less Municipal Taxes		9,000
Annual Value in this case		18,000
Less Deductions :		
One-sixth for repairs	3,000	
Ground rent	3,000	
Collection charges limited to 6% of annual value after deducting the annual value of vacant flat for 2 months *i. e.*, 6% of Rs. 18,000–Rs. 666=Rs. 17,334	1,040	
Vacancy allowance as calculated below	666	7,706
Income from house property		11,294
Share of each co-owner to be included in his total income		5,647

Notes :

1. It is assumed that the house property was constructed before 1-4-1961.
2. The amount of vacancy allowance is calculated as under :

Annual Value of vacant flat at Rs. 500 per month	6,000
Less Municipal Taxes being one-third	2,000
Annual value in this case	4,000
Proportionate annual value for 2 months	666

3. No deduction is allowable for interest on borrowed money because the loan was not taken for acquiring, constructing, repairing, renewing or reconstructing the house property.

CHAPTER 7

Profits of Business or Profession

The income under the head "Profits and Gains of Business or Profession" is to be computed in accordance with the provisions of sections 28 to 43A.

According to section 2(36), profession includes vocation. A profession is an occupation requiring purely intellectual skill or manual skill controlled by the intellectual skill of the operator, *e. g.*, lawyer, accountant, engineer, surgeon, author, etc.

A vocation is only a way of living or a sphere of activity for which one has special fitness. It is not necessary that such activity should be one indulged in for earning a livelihood before it can be called vocation. Nor can it be said that a person cannot have more than one vocation. A vocation does not involve any organised or systematic activity like business.

A practice of religion may amount to a vocation. Therefore, customary offerings made to the head of a faith by his devotees would be taxable.

Business means any activity carried on for earning profits. The word business is a word of wider importance than the word profession, and the word vocation is a word of still wider significance than business. What does not amount to profession may amount to business, and what does not amount to business may amount to vocation. As the profits from these sources are taxed under the same head, it is not necessary to consider whether a particular case is business, profession or vocation.

According to section 2(13), business includes any trade, commerce or manufacture or any adventure in the nature of trade, commerce or manufacture. Not only income derived from trade but also income derived from any adventure in the nature of trade is treated as business income.

Adventure in the Nature of Trade. What are the tests for determining whether a transaction is to be taken as an adventure in the nature of trade ? It is not possible to give a categorical answer to the question. The answer depends very much upon the facts and circumstances of each case.

The general principles to be adopted in deciding this question have been summed up by the Supreme Court *(35 ITR 609)*. These principles are :

(1) Was the purchaser a trader and were the purchase of the commodity and its resale allied to his usual trade or business or incidental to it ? Affirmative answers to these questions may furnish relevant data for determining the character of the transaction.
(2) What is the nature of commodity purchased and resold and in what quantity was it purchased and resold ? If the commodity purchased is generally the subject-matter of trade and if it is

purchased in very large quantities, it would tend to eliminate the possibility of investment for personal use, possession or enjoyment.

(3) Did the purchaser by any act subsequent to the purchase improve the quality of the commodity purchased and thereby made it more readily resaleable ?

(4) What were the incidents associated with the purchase and resale ? Were they similar to the operations usually associated with trade or business ?

(5) Are the transactions of purchase and sale repeated ?

(6) In regard to the purchase of the commodity and its subsequent possession by the purchaser, does the element of pride of possession come into the picture ? A person may purchase a piece of art, hold it for some time, and if a profitable offer is received, may sell it. During the time that the purchaser had its possession he may be able to claim as aesthetic satisfaction ; and if such a claim is upheld, that would be a factor against the contention that the transaction is in the nature of trade.

(7) Was the purchase made with the intention to resell it at a profit ? The presence of such an intention is no doubt a relevant factor and unless it is offset by the presence of other factors, it would raise a strong presumption that the transaction is an adventure in the nature of trade.

These and other considerations are set out and discussed in judicial decisions which deal with the character of transactions alleged to be in the nature of trade. In considering these decisions it would be necessary to remember that they do not purport to lay down any general universal test.

The Supreme Court has also held that, where a transaction is not in the line of the business of the assessee but is an isolated or single instance of a transaction, the onus is on the taxing authorities to prove that the transaction is an adventure in the nature of trade (*37 ITR 242*).

Artificial Transactions.

If an assessee resorts to artificial transactions with a view to avoid tax, the profit arising out of such transactions is to be included in his income.

A limited company carrying on the business of manufacture and sale of cotton cloth, sold a certain number of bales of cloth to a charitable trust, of which the managing director of the company was the trustee, at the rate of Re. 1 per yard, and on the same day the trust sold these bales to a customer of the company at the rate of Rs. 1·25 per yard through a broker of the company. It was not the business of the trust to buy and sell goods.

It was held that there was really a sale by the company to the customer, the trust having been deliberately interposed in order to make it appears that the profit arising out of the transaction was earned only by the trust and not by the company.

Therefore, the interposition of the trust was a sham affair and the company was liable to tax on the profit arising out of the transactions (*52 ITR 818*).

Charging Provision.

Under section 28, the following kinds of income are chargeable to income-tax under the head "Profits and Gains of Business or Profession".

(1) Business or Professional Income. The profits and gains of any business or profession which was carried on by the assessee *at any time* during the previous year are assessed under this head.

All revenue receipts arising from business or profession are chargeable even if they are of a casual and non-recurring nature.

The illegality of a business, profession or vocation does not exempt its profits from tax ; the revenue is not concerned with the taint of illegality in the income or its source.

Illegal business is business within the meaning of the Income-Tax Act and if profits from illegal business are assessable to tax, there is no reason for refusing to take into account losses from illegal business (*69 ITR 1*). Likewise expenses necessarily incurred in carrying on an illegal business must be allowed as a deduction.

(2) Compensation Receivable. Compensation or other payment due to or received by the following persons is assessable as business income :

(*a*) A person, by whatever name called, managing the whole or substantially the whole of the affairs of an Indian company, in connection with the termination of his management or the modification of the terms and conditions relating thereto.

Note : With effect from 3rd April 1970, the managing agency system has been abolished in India.

(*b*) A person, by whatever name called, managing the whole or substantially the whole of the affairs in India of any other company, in connection with the termination of his office or the modification of the terms and conditions relating thereto.

(*c*) A person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person, in connection with the termination of the agency or the modification of the terms and conditions relating thereto.

(3) Management Compensation. Several laws have been enacted in recent years for taking over the management of industrial undertakings, mines, insurance companies etc., pending their final takeover by Government. These laws provide for the payment of compensation in respect of the vesting in the Government (or in any corporation owned or controlled by the Government) of the management of the business of the industrial undertakings etc.

Any compensation or other payment due to or received by any person for the vesting in the Government (or in any corporation owned or controlled by the Government) of the management of the business or property of a tax-payer will be chargeable to income-tax as profits or gains of a business.

(4) Income of Trade Associations. A trade association is not the same thing as a trading association. A trade association means an association of businessmen for the protection or advancement of their common interests, *e. g.*, a chamber of commerce.

A trade, professional or similar association (even though of mutual character) performing specific services for its members is deemed to carry on business in respect of those services and the income arising therefrom is liable to tax accordingly. This provision does not apply to social clubs and therefore the surplus accruing to a social club even from specific services rendered to members would be governed by the general principles relating to mutual concerns. Further, this provision taxes the profit accruing only from specific services rendered by an association to its members ; any surplus arising to a mutual association in other ways (*e. g.*, from members' entrance fees and periodic subscriptions) would not be taxable.

Under section 44A, in the case of a trade, professional or similar association, the amount of any deficit (excess of expenditure incurred for the advancement of the common interests of the members of the association over the receipts from the members) will be allowed as a deduction in computing

the income of the association assessable under the head "Profits and Gains of Business or Profession" subject to the following conditions :

(*a*) The association does not distribute its income to its members except as grants to affiliated associations ; and

(*b*) The deficit allowed as a deduction should not exceed 50% of its total income before the deduction.

If there is no assessable income from business or the deficiency exceeds such income, the whole or the balance of the deficiency may be allowed as a deduction in computing the income of the association under any other head.

The provisions of sections 44A do not apply to an association or institution established in India for control of the professions of law, medicine, accountancy, engineering or architecture, the income of which is excluded from total income under section 10(23A).

(5) Value of Benefit or Perquisite. The value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession is chargeable as income from business or profession. Thus payments voluntarily made by persons who are under no obligation to pay anything at all would be income receipts in the hands of the recipient, if they are received in the course of business or in the exercise of a profession. For example, an amount paid to a lawyer by a person who was not a client but who had benefited by the lawyer's professional services to another, would be taxable as being a benefit obtained in the exercise of a profession.

Benefits and perquisites received by an employee fall within the definition of salary and are taxable as salary. But the value of benefits and perquisites arising from business or the exercise of a profession by the assessee will be included in his business or professional income. The nature of the source from which the benefit or perquisite arises is important, because if it arises from employment it has to be assessed as salary and if it arises from business or profession it has to be assessed as business income.

(6) Speculation Business. Explanation 2 to section 28 provides that where speculative transactions carried on by an assessee are of such a nature as to constitute a business, the speculation business shall be deemed to be distinct and separate from any other business.

According to section 43(5), a speculative transaction means a transaction in which a contract for the purchase or sale of any commodity (including stocks and shares) is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips. Where actual delivery of goods or transfer of scrips takes place, the transaction is not a speculative transaction, however highly speculative it may be in fact. Where the original intention is not to gamble in differences, but in fact the contract is settled by payment of the difference, it is a speculative transaction.

Speculative transactions in different commodities and in different markets are to be treated as one business.

The following hedging transactions are, however, to be treated as ordinary business and not as speculation business :

(*a*) A contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or selling business in order to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him.

(*b*) A contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations. *Bona fide* hedging transactions, entered into by a dealer or investor in stocks and shares against the holding of his stocks and shares is allowed provided that the hedging transactions are up to the amount of his holdings, even though these transactions may extend to other types of stocks and shares not held by him. *In fact, the hedging in such cases has necessarily to be in stocks and shares other than those held by him.*

(*c*) A contract entered into by a member of a forward market or a stock exchange in the course of any transactions in the nature of jobbing or arbitrage to guard against loss which may arise in the ordinary course of his business as such member.

Hedging transactions entered into with parties outside India are at par with similar transactions within India. Hedging transactions in connected commodities, for instance, one type of cotton against another type of cotton, one variety of oilseeds against another, gold against silver and *vice versa* or one type of grain against another should be treated as hedging transactions, *provided the total of such hedging sales does not exceed the actual stock and purchase transactions.*

Distinction between Speculation and Hedging. The essential difference between speculative and hedging transactions is that in the case of speculative transactions it is not necessary to hold stocks of the commodity dealt in by the persons concerned. Purchases or sales can be effected without the existence of the stocks with either the buyer or the seller. The main purpose of such transactions is to make a profit or loss on account of the fluctuations in the prices without effecting any delivery of the commodity.

In the case of hedging, the existence of stock is a necessary condition, and the purpose behind the transaction of future purchase or sale is to guard against loss through price fluctuations.

The following are examples of speculation and hedging transactions :

Example of Speculation. *A* has no shares in hand. He enters into a contract on 1-1-1975 with *B* to buy from *B* 100 shares in a particular company at Rs. 125 per share, the delivery to be taken before 31-1-1975. His intention is not to take delivery of these shares but to make a profit on their sale if the price goes up before the date of delivery. Suppose on 20-1-1975 the price of these shares becomes Rs. 150 per share. *A* then sells away his 100 shares, and thus makes a profit of Rs. 2,500. This is a speculative transaction.

Example of Hedging. *A* holds 100 shares of Rs. 100 each in X Co. Ltd. He feels that the price of these shares may go down in the future, and in that event he may suffer a loss on his holding. In order to guard against this loss, he makes a forward sale of 100 shares of Rs. 100 each in Y Co., Ltd. If there is actually a fall in the price in future, he will no doubt incur a loss on his holding of 100 shares in X Co. Ltd., but this loss will be made up by the profit on 100 shares in Y Co. Ltd., which he had sold in anticipation and which he will now buy in order to settle the transaction. This forward sale of 100 shares in Y Co. Ltd., against his holding of 100 shares in X Co. Ltd. is a hedging transaction. It was entered into with the sole purpose of guarding against loss through future price fluctuations in respect of his existing holding.

(7) Illegal Business. If a business is illegal, neither the profits earned nor the losses incurred would be enforceable in law ; but that does not take the profits out of the taxing statute. Similarly, the taint of illegality of the business cannot detract from the losses being taken into account for computation of the amounts which can be subjected to tax. The tax-collector cannot be heard to say that he will bring the gross receipts to tax ; he can only tax profits of a trade or business. That cannot be done without deducting losses and legitimate expenses of the business (*82 I T R 794*).

General Principles.

The general principles, which govern the income taxable under section 28, may be summarised as follows :

(1) It is the person carrying on a business who is liable to pay tax under section 28. It is significant to notice the difference in language in section 22 and section 28. Section 22 deals with tax under the head "Income from House Property" and that tax is payable by an assessee who is the owner of the house property. So, in the case of house property, what is emphasised by law is ownership. In the case of income from the business or Profession, chargeable under the head "Profits and Gains of Business or Profession," what is emphasised is not the ownership of the business or profession, but the fact of the business or profession being carried on by the assessee. However, it is not necessary that the assessee should physically or with his own hands carry on a business or profession before he becomes liable to pay tax under section 28, but he must have the right to carry on the business or profession and it must be carried on in the exercise of that right.

(2) In computing the profits of a business or profession, losses of a speculative business can be set off only against similar profits. Speculative transactions in different commodities or in different markets are regarded as one.

(3) The tax chargeable under section 28 is not on the separate profits of each distinct business or profession, but on the aggregate of the profits of all the businesses and professions carried on by the assessee. Where the assessee carries on several businesses, he is entitled to set off losses in one business against profits in another, even if one business is carried on by him singly and the other in partnership.

(4) The business or profession should have been carried on by the assessee at any time during the previous year though not necessarily throughout the year. If it was carried on in the previous year, its profits would be taxable, although it may not be carried on in the assessment year. If the business or profession was carried on during some part of the previous year but not throughout that year. the source of income would be in existence in the year and the profits would be taxable though collected in that year after the closure of the business or profession. In such a case, if the accounts are maintained on accrual basis, no difficulty can arise because the profits must necessarily accrue during the time the business or profession was being carried on and after its closure there remains nothing to accrue. On the other hand, if the accounts are kept on the cash basis, the profits which are received during the previous year but after the closure of the business or profession, would still be profits liable to tax on the receipt basis.

As an exception to the above rule, section 176(4) however enacts that if a *profession* is discontinued, the professional gains received in any year subsequent to the year of discontinuance would still be taxable as the income of the year of receipt. It must be noted that section 176(4) applies only to professions, which include vocations, and not to businesses.

(5) Profits made in winding up a business or profession by merely realising the assets are not taxable, because no business is carried on in that case. But the profits would be assessable if the process of winding up is such as to involve the carrying on of a trade. When a business is closed and its stock-in-trade is sold, the profit resulting therefrom is taxable, because there is no distinction for income-tax purposes between an ordinary sale and a realisation sale, the object in either case being to dispose of the goods at a profit. But when there is a sale of the whole business and a transfer of all the assets (including stock-in-trade) for a single unapportioned consideration, there cannot be said to be any profit realised on the sale of stock-in-trade which is sold with all the other assets.

(6) Under section 28, it is not only the legal ownership but also the question of beneficial ownership that has to be looked into. The courts can also go into the question of beneficial ownership and decide who should be held liable for the tax after taking into account the question as to who is, as a matter of fact, in receipt of the income which is going to be taxed.

(7) The profits to be taxed under section 28 are the real profits which from the commercial point of view mean a gain to the person carrying on the business, not profits from any narrow, technical or legalistic point of view. For the purpose of income-tax, a transaction must be looked at from a commercial point of view in order to determine whether it has resulted in profits (*47 ITR 565*).

(8) For income-tax purposes, each year is a self-contained accounting period, the income-tax authorities can only take into consideration the income made in that year, and they are not concerned with potential profits which may be made in another year any more than they are concerned with losses which may occur in the future. An assessee cannot be taxed on fictional sales and he cannot be taxed on prospective profits.

(9) Where goods are sold at less than their market value, in the absence of evidence to show either that the sales were sham transactions or that the market prices were in fact paid by the purchasers, the mere fact that the goods were sold at concessional rate to benefit the purchasers at the expense of the vendor would not entitle the Department to assess the difference between the market price and the price paid by the purchasers, as the income of the vendor (*45 ITR 369*).

(10) Income-tax authorities cannot ignore the ordinary principles of commercial expediency simply because they are not codified anywhere. What the Income-Tax Act purports to tax is business profits, and business profits are the true profits of a business as ascertained according to commercial principles. There may be an expenditure or there may be a loss which may not be an admissible loss under any of the provisions of the Income-Tax Act and yet such an expenditure or loss would have to be allowed in order to determine the true profits of a business, and it is the duty of every one who has anything to do with taxing business people to understand what are the principles of commercial expediency. Unless one understands these principles, it is difficult to make proper assessment on a business or on a businessman (*31 ITR 153*).

Trade Losses. There is a distinction between business expenditure and business loss. Expenditure or disbursement means something or other which a trader pays out ; it is something which comes out of his pocket. A loss is something different. That is not a thing which he expends or disburses. That is a thing which, so to speak, comes upon him *ab extra*. Non-capital expenditure incurred for the purposes of the business would fall for deduction under the omnibus section 37. But business losses, though they fall outside the purview of any of the sections 30 to 37, are allowable on ordinary commercial principles of computing profits, provided (*i*) the losses are of a non-capital nature, and (*ii*) they are not merely connected with the trade but are really incidental to the trade itself.

In order that a loss might be deductible, it must be a loss in the business of the assessee and not a payment relating to the business of somebody else which under the provisions of the Income-Tax Act was deemed to be and become the liability of the assessee. A loss is allowable if it "springs directly from and is incidental to" the business of the assessee ; it is not sufficient that it fell on the trader in some other capacity or was merely connected with his business. This is according to the decision of the Supreme Court (*41 ITR 545*).

Whether a loss is a revenue loss or a capital loss has already been discussed in a preceding chapter dealing with capital and revenue.

Computation of Income from Business or Profession

According to section 29, the income chargeable under the head "Profits and Gains of Business or Profession" is to be computed in accordance with the provisions contained in section 30 to 43A, which provide for the deduction of the following expenses from the gross income :

Section 30—Rent, rates, taxes, repairs and insurance for buildings.
31—Repairs and insurance of machinery, plant and furniture.
32—Depreciation.
33—Development rebate.
33A—Development allowance.
33B—Rehabilitation allowance.
34—Conditions for depreciation and development rebate.
35—Expenditure on scientific research.
35A—Expenditure on patents and copyrights.
35B—Export markets development allowance.
35C—Agricultural development allowance.
35D—Amortisation of preliminary expenses.
35E—Amortisation of prospecting expenditure.
36—Other deductions, namely :
Insurance of stocks and stores.
Bonus or commission to employees.
Interest on capital borrowed.
Contributions towards a recognised provident fund or an approved superannuation fund.
Contributions towards an approved gratuity fund.
Loss on animals.
Bad debts.
Amount carried to a special reserve created by a financial corporation.
Expenditure on family planning.
37—General.
38—Building, etc., partly used for business or not exclusively so used.
39—Managing agency commission.

Section 40 expressly provides that certain expenses shall not be deducted in computing the income from business or profession.

Section 40A provides that expenses and payments are not deductible in certain circumstances.

Section 41 enumerates certain deemed profits.

Section 42 deals with some special provisions for deductions allowable in the case of oil mining concerns.

Section 43 gives the definitions of certain terms and expressions used in the computation of income from business or profession.

Section 43A contains special provisions in connection with devaluation.

Admissible Deductions.

Sections 30 to 37 expressly provide for certain allowances to be deducted from gross receipts and sections 40 and 40A expressly prohibit certain deductions. Before dealing with these express allowances and prohibitions, some general principles governing the deductions may be considered. These are :

(1) The list of allowances enumerated in sections 30 to 37 is not exhaustive ; an item of loss or expenditure not falling within any of the express

deductions may be allowed if it is deductible on ordinary principles of commercial accounting. This is according to the decisions of the Supreme Court in *Badridas Daga v. C.I.T.*, and *Calcutta Co. Ltd. v. C. I. T.*

(2) When a claim is made for a deduction for which there is no specific provision in sections 30 to 37, whether it is admissible or not will depend on whether, having regard to accepted commercial practice and trading principles, it can be said to arise out of the carrying on the business or profession and to be incidental to it. The loss for which a deduction is claimed must be one that springs directly from the carrying on of the business or profession and is incidental to it, and not any loss sustained by the assessee even if it has some connection with his business or profession. If that is established, then the deduction must be allowed, provided there is no prohibition against it, express or implied, in the Income-Tax Act (*37 ITR 10*).

(3) The expression "profits and gains" in section 28 has to be understood in its commercial sense, and there can be no computation of such profits and gains until the expenditure which is necessary for the purpose of earning the receipts is deducted therefrom—whether the expenditure is actually incurred or the liability in respect thereof has accrued even though it may have to be discharged at some future date (*37 ITR 1*). This is that was held by the Supreme Court in *Calcutta Co. Ltd. v. CIT.*

(4) In the case of a new business, the accounting year commences on the date when the business is set up. There may be a period between the setting up of a business and its actual commencement. Expenditure incurred prior to setting up cannot be allowed as it falls outside the accounting year ; but expenditure incurred after the business is set up may be allowed even if it is incurred before the business has actually commenced.

(5) A partner of a firm is entitled to claim a deduction from his share of the firm's profit in respect of expenditure incurred by *him* wholly and exclusively for the purpose of earning his share of profits, since it is the true profits and gains, ascertained on ordinary principles of commercial accounting which are taxable under the head "Business or Profession". Section 67(3) expressly provides for a deduction, in computing a partner's share of the firm's profits, in respect of interest paid by him on capital borrowed for the purpose of investment in the firm.

This deduction is available to a partner whether the firm is registered or unregistered.

(6) An anticipated loss in a future year or period, however inevitable it may be thought to be, is not and cannot be a loss on the trading of the present year, upon which it has not in fact fallen. The only exception to this rule is the valuation of stock-in-hand at cost or market value whichever is lower.

(7) Profits should be computed in accordance with the method of accounting regularly employed by the assessee, provided the true profit can be deducted from such method. The various methods of accounting adopted by business and professional men are explained in the chapter dealing with income from other sources.

(8) In the case of a single transaction of purchase and resale, in determining the profit made by an assessee in such a transaction, expenditure incurred by him in respect of that transaction during the years prior to the year of account cannot be disallowed on the ground that it was not incurred in the year of account. If the real profit made by the assessee in the transaction from a commercial point of view can only be arrived at by taking into consideration the expenditure incurred in the prior years also, credit must be given to the assessee in respect of such expenditure (*32 ITR 92*).

(9) Deductions can be permitted only in respect of those expenses and losses which are incurred in the relevant accounting year. For the purpose of

computing yearly profits, each year is a separate self-contained period of time in regard to which profits earned or expenses and losses incurred before its commencement are irrelevant. Similarly, expenditure incurred subsequent to the accounting year cannot be allowed as a deduction.

(10) A deduction can be allowed only in respect of expenditure which is incurred for the purpose of the assessee's own business. If an assessee carries on several distinct businesses, the profits of each business must be computed separately. If one business is assessable under the Act while another is not, the expenditure relating to the non-taxable business cannot be deducted in computing the profits of the taxable business.

While the profits of each distinct business must be computed separately, the profits of all the branches of one business may be computed together. If the result of the various businesses is a loss, it can be set off against income under any other head, any loss remaining after such set-off may be carried forward for 8 years and set off against the future profits of the assessee from any business.

(11) No deduction can be claimed from the income in respect of diminution or exhaustion of a wasting capital asset (*e. g.*, a mine) from which the income is derived. There is an exception to this principle provided by section 42 which in certain circumstances grants special allowance in respect of depletion of mineral oil to a person carrying on the business of prospecting, extracting or producing mineral oils in association with the Central Government.

(12) Expenditure relating to a business or profession, which was discontinued before the commencement of the accounting year, cannot be deducted from the profits of a separate existing business. The general rule is that the expenses of a dead business become capital losses.

(13) Where part of the income of an assessee is either excluded (*e.g.*, agricultural income) or is exempt under any provision of the Income-Tax Act, it is not permissible to disallow the proportionate part of the expenditure attributable to such excluded income or exempt income (*82 ITR 452*).

Deductions Expressly Allowed

In computing the income from a business or profession, the following deductions are expressly allowed by sections 30 to 37 :

Note : In regard to admissible deductions, the word "paid" means actually paid or incurred according to the method of accounting on the basis of which the profits or gains are computed. Thus "paid" means actually paid where the cash method of accounting is employed by the assessee, while it means expenditure incurred whether paid or not paid where the mercantile system of accounting is adopted.

1. Expenses for Premises.

Under section 30, in respect of rent, rates, taxes, repairs and insurance for premises used for the purposes of the business or profession, the following deductions are allowed :

(*a*) Where the premises are occupied by the assessee as a tenant, the rent paid for such premises ; and if he has undertaken to bear the cost of repairs to the premises, the amount paid on account of such repairs.

Where the premises are occupied by the assessee otherwise than as a tenant (*e. g.*, being the owner thereof), the amount paid by him on account of current repairs to the premises.

(*b*) Any sum paid on account of land revenue, local rates or municipal taxes.

(*c*) The amount of any premium paid for insurance against risk of damage or destruction of the premises.

Where a portion of the building owned by the assessee and used for purposes of his business is let out to employees of the business whose residence there is necessary for the efficient conduct of the business, the rent collected from the employees is assessed as income from business and not as income from house property because the portion so let out is really used for business purposes.

If the premises are owned by the owner of the business, no allowance on account of rent is permitted, because the owner is not liable to pay tax on the income of the house property.

The phrase "current repairs" means such repairs required to keep the assets in a serviceable condition as are rendered necessary by ordinary wear and tear and are by their nature recurrent at comparatively short intervals. It also includes minor replacement of parts provided such replacements are not of such an extensive nature as to change the identity of an asset.

2. Expenses for Machinery etc.

Under section 31, in respect of repairs and insurance of machinery, plant or furniture used for the purposes of the business or profession, the following deductions are allowed :

(*a*) The amount paid on account of current repairs thereto.

(*b*) The amount of any premium paid for insurance against risk of damage or destruction thereof.

3. Depreciation.

Under section 32, a deduction is allowed in respect of depreciation of building, machinery, plant and furniture. The law relating to depreciation is discussed fully in a subsequent chapter.

Note : Under section 38, where any building, machinery, plant or furniture is not exclusively used for the business of the assessee but is also used for other purposes, the allowance would not be the full allowance due under sections 30, 31 and 32, but would be confined to an amount proportional to the business user. This section cuts down the allowance where the user is only partly for business purposes.

4. Development Rebate and Development Allowance.

Under sections 33 and 33A, a deduction is allowed for development rebate or development allowance, the law relating thereto being considered fully in a subsequent chapter.

5. Expenditure on Scientific Research.

Scientific research means any activities for the extension of knowledge in the fields of natural or applied science including agriculture, animal husbandry or fisheries.

Under section 35, the following deductions are allowed in respect of expenditure on scientific research :

(*i*) Revenue expenditure laid out by the assessee himself on scientific research *related to his business*. Such expenditure should be incurred on scientific research carried on by the assessee or on his behalf. Payment made to obtain the benefit of research conducted by another person on his own account is not allowable under this section, though it may be allowable under section 37.

Expenditure incurred within three years immediately preceding the commencement of the business on payment of salary to

research personnel engaged in scientific research related to the business carried on by the tax-payer or on material inputs for such research will be allowed as deduction in the year in which the business is commenced. This deduction will be available only in respect of expenditure incurred after 31-3-1973 and will be limited to the amount certified by the prescribed authority.

(*ii*) Any sum paid to an approved scientific research association or to an approved university, college or other institution to be used for scientific research, *whether the research is related to the assessee's business or not.*

Where the tax-payer pays after 31-3-1973 any sum to an approved scientific research association, university, college or other institution for sponsored research related to his business, he will be allowed a weighted deduction equal to one and one-third times the sum so paid. This deduction will be admissible only where the scientific research is undertaken under a programme approved by the prescribed authority. Similar deduction will also be available in respect of expenditure incurred on sponsored research within the three years immediately preceding the commencement of the business.

(*iii*) Any sum paid to an approved university, college or other institution to be used for research in social science or statistical research *related to the class of business carried on by the assessee.*

(*iv*) Capital expenditure on scientific research *related to the business of the assessee*, is spread over five consecutive previous years if it was incurred before lst April 1967. But if such capital expenditure is incurred on or after that date, the whole of it is deductible in the very year in which it is incurred.

The capital expenditure to be so deducted is the amount incurred in the previous year in which the business commenced as well as the amount so incurred within three years immediately preceding the commencement of the business.

Other Provisions. The following other provisions apply to the deduction mentioned in (*iv*) above :

(1) Where an asset representing capital expenditure (incurred before 1st April 1967) ceases to be used in a previous year for scientific research, and the realisable value of the asset at the time of cessation together with the deductions already allowed falls short of the said expenditure, then an amount equal to the deficiency will be allowed as a deduction for that previous year.

(2) If the asset mentioned in (1) is sold (without having been used for other purposes) in the year of cessation, and the sale price together with the deductions already allowed falls short of the said expenditure, then an amount equal to the deficiency will be allowed as a deduction for that previous year.

(3) If the asset mentioned in (1) is sold (without having been used for other purposes) in a previous year subsequent to the year of cessation, and the sale price falls short of the realisable value of the asset taken into account in the year of cessation, then an amount equal to the deficiency will be allowed as a deduction for the previous year in which the sale takes place.

(4) Where a deduction is allowed for any previous year in respect of an asset representing capital expenditure on scientific research, no deduction is admissible for depreciation for the same previous year in respect of that asset.

(5) Where the asset mentioned in (1) above is used in the business after it ceases to be used for scientific research related to that business, depreciation will be admissible in respect thereof.

(6) Where on account of the absence or insufficiency of the assessable profits of a business, the full or a part of the deduction on account of capital expenditure on scientific research cannot be allowed, the amount of the deduction not so allowed can be carried forward *indefinitely*, to be claimed in subsequent assessments, subject to the condition that, if there is a business loss also carried forward, such business loss will be set off first before allowing such deduction.

(7) Where in a scheme of amalgamation, the amalgamating company transfers to the amalgamated company (which is an Indian company) any asset representing capital expenditure on scientific research, the amalgamating company will not be allowed any deduction on account of any deficiency arising on the transfer, but the amalgamated company will be entitled to write off the capital cost of such assets against its profits as if the amalgamation did not take place.

(8) Under section 41(3), where an asset representing capital expenditure on scientific research is sold, without having been used for other purposes, and the sale proceeds together with the deductions already allowed exceed the amount of the capital expenditure, then the excess or the amount of the deductions so made, whichever is less, will be chargeable to income-tax as the income of business of the previous year in which the sale takes place, *whether the business is in existence in that year or not.*

Illustration

The accounting year of a firm ends on 31st December. The capital expenditure incurred by it on scientific research related to its business amounted to Rs. 1,00,000. Work out the amount of deemed profit liable to tax under section 41(3) in the following cases :

(*a*) The assets representing capital expenditure on scientific research were sold in the previous year, without having been used for any other purpose, for Rs. 70,000 and the deductions allowed in respect thereof amount to Rs. 60,000.

(*b*) The assets representing capital expenditure on scientific research were sold in the previous year, without having been used for any other purpose, for Rs. 1,10,000 and the deductions allowed in respect thereof amounted to Rs. 40,000.

(*a*) The sale proceeds together with the deductions already allowed (Rs. 70,000+ Rs. 60,000) exceed the amount of capital expenditure by Rs. 30,000. Therefore, Rs. 30,000 being the lesser of the excess or the amount of deductions, will be the amount of deemed profit under section 41(3).

(*b*) The sale proceeds together with the deductions already allowed (Rs. 1,10,000+Rs. 40,000) exceed the amount of capital expenditure by Rs. 50,000. Therefore, Rs. 40,000 being the lesser of the excess or the amount of deductions, will be the amount of deemed profit under section 41(3).

Definitions. According to section 43(4), the meanings of "expenditure on scientific research" and "scientific research related to a business" are as follows :

Expenditure on scientific research. This includes all expenditure incurred for the prosecution, or the provision of facilities for the prosecution of, scientific research, but it does not include any expenditure incurred in the acquisition of rights in, or arising out of, scientific research.

Scientific research related to a business. This includes any scientific research which may lead to or facilitate an extension of that business and also any scientific research of a medical nature which has special relation to the welfare of workers employed in that business.

6. Expenditure on Patent Rights and Copyrights.

Under section 35A, the capital expenditure incurred by an assessee after the 28th February 1966 in acquiring patent rights or copyrights for the purposes of his business is allowed to be deducted in computing the profits of his business, in equal instalments, over a period of 14 years or over the period of the unexpired life of patent rights or copyrights (as reckoned from the previous year in which such rights were acquired) whichever is less.

Where the patent rights or copyrights come to an end during a previous year, an allowance will be made in respect of that previous year for such part of the cost of acquisition of the rights as remains unallowed. Similarly, where the rights are sold during a previous year and the capital sum received on the sale falls short of the cost of acquisition remaining unallowed, the amount of the shortfall will be allowed as a deduction in computing the profits of the previous year in which the sale takes place. Conversely, where the capital sum received on the sale exceeds the cost of acquisition remaining unallowed, the excess (up to the total amount of the allowance made in earlier years) will be chargeable to income-tax as the income of the business for the previous year in which the sale takes place, *whether the business is in existence in the year or not.*

Where only a part of the rights is sold for an amount which is less than the capital cost remaining unallowed, the amount of the allowance to be made in respect of the previous year in which such sale takes place and subsequent previous years will be recomputed. The recomputation will be made by reducing the capital cost remaining unallowed by the sale proceeds, and the balance will be allowed in equal instalments for the relevant previous year and subsequent previous years.

Where in a scheme of amalgamation, patent rights or copyrights are transferred by the amalgamating company to the amalgamated company (which is an Indian company), the provisions relating to the grant of 'terminal allowance' and the 'balancing charge' will not apply to amalgamating company, but the amalgamated company will be entitled to write off the capital cost of such assets against its profits as if the amalgamation did not take place.

7. Export Markets Development Allowance.

Section 35B provides that any assessee (other than a foreign company or a non-resident) who incurs the following revenue expenditure for development of export markets, will be entitled to a weighted deduction of an amount equal to one and one-third times the amount of such expenditure :

(1) on advertising or publicity outside India for the goods, services or facilities which the assessee deals in or provides in the course of its business,

(2) on obtaining information regarding foreign markets for such goods, services or facilities,

(3) on distribution, supply or provision outside India of such goods, services or facilities,

(4) on maintenance of a branch office or agency outside India for promoting sales of such goods, services or facilities,

(5) on preparation and submission of tenders for the supply or provision outside India of such goods, services or facilities and activities incidental thereto,

(6) on furnishing to a person outside India samples or technical information for the promotion of the sale of such goods, services or facilities,

(7) on travelling outside India for the promotion of sales outside India of such goods, services or facilities, and

(8) on performance of services outside India in connection with the execution of any contract for the supply outside India of such goods, services or facilities.

This allowance is available in respect of expenditure incurred by the tax-payer directly or in association with any other person. If an assessee enters into any joint export promotion arrangements with others, he would be entitled to a weighted deduction in respect of his share of the pooled expenses.

This allowance is admissible irrespective of the question whether the assessee has exported any goods during the relevant year or whether he has earned any profit out of exports.

The weighted deduction in respect of export markets development allowance in the case of domestic companies in which the public are substantially interested is to be increased from one and one-third times the amount of the qualifying expenditure to one and one-half times the amount of such expenditure incurred after 28-2-1973.

8. Agricultural Development Allowance.

Under section 35C, companies which use the products of agriculture, animal husbandry or dairy or poultry farming as raw material for their industry or process such products, are eligible for a weighted deduction with reference to expenditure incurred by them in providing any goods, services or facilities under specified heads to a cultivator, grower or producer of the products of argriculture, etc.

This weighted deduction will be equal to one and one-fifth times the amount of the qualifying expenditure. In computing the expenditure with reference to which the weighted deduction is allowable, any amount received by the company in consideration of or as compensation for the goods, services or facilities provided by it will be excluded.

This deduction will be available with reference to qualifying expenditure incurred after the 29th February 1968, whether it is incurred by the company directly or through an approved association or body.

9. Amortisation of Preliminary Expenses.

Section 35D allows the amortisation of preliminary expenses incurred by an assessee, being an Indian company or other non-company resident person. The provisions of this section are as follows :

(1) The amortisation consists in a deduction, in the computation of the business profits of the assessee, of an amount equal to one-tenth of the qualifying expenditure incurred after 31st March 1970 for each of the 10 years beginning with the year in which the business of the assessee commences or the year in which the extension of the industrial undertaking of the assessee is completed or the new industrial unit commences production or operation.

(2) The preliminary expenses qualifying for such amortisation are as follows :

(*a*) Expenditure in connection with (*i*) preparation of feasibility report, (*ii*) preparation of project report (*iii*) conducting a market survey or any other survey necessary for the business of the assessee, and (*iv*) engineering services relating to the business of the assessee provided that this work is done by the

assessee himself or by a concern approved in this behalf by the Central Board of Direct Taxes.

(*b*) Legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting-up or conduct of the business of the assessee.

(*c*) In the case of a company, (*i*) legal charges for drafting the memorandum and articles, (*ii*) expenditure on the printing of memorandum and articles, (*iii*) fees for registering the company, and (*iv*) share and debenture issue expenses being underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus.

(*d*) Such other items of expenditure as may be prescribed.

(3) The maximum limit over the amount of expenditure eligible for amortisation is 2·5 per cent of the "project cost", that is to say, the actual cost of the fixed assets which are shown in the books of the assessee as on the last day of the previous year in which the business of the assessee commences.

In the case of extension of the industrial undertaking or setting-up of a new industrial unit, the project cost would mean the actual cost of the fixed assets which are shown in the books of the assessee as on the last day of the previous year in which the extension is completed or the new unit commences production or operation, in so far as such fixed assets have been acquired or developed in connection with the extension of the industrial undertaking or the setting-up of the new industrial unit.

In the case of an Indian company, the company will have the option to claim the amortisation of preliminary expenses up to a limit of 2·5 per cent of the capital employed in its business. The capital employed will comprise the issued share capital, debentures and long-term borrowings as on the last day of the previous year in which the business of the company commences or in which the extension is completed or the new unit commences production or operation. In the case of extension or setting-up of a new unit, only the capital, debentures and long-term borrowings issued or obtained for that purpose will be taken into consideration.

(4) Where the undertaking of an Indian company which is eligible for amortisation of its preliminary expenses is transferred to another Indian company in a scheme of amalgamation before the expiry of the 10-year period of amortisation, the expenditure remaining unamortised will be allowed to be amortised against the profit of the transferee company over the remainder of the 10-year period.

(5) Any expenditure which is allowed to be amortised under this section will not be allowable as a deduction under any other provisions of the Income-Tax Act.

(6) In the case of resident non-company assessees (other than a co-operative society), the above concession is available on condition that their accounts for the relevant years in which the expenditure was incurred are audited by a chartered accountant and a report of such audit in a form prescribed for the purpose is furnished along with the return of income for the first year in which the amortisation is claimed.

Illustration

An Indian company incorporated on 1-9-1972 incurs the following expenses before setting up its business :

		Rs.
(*a*)	Legal charges for drafting the memorandum and articles of association	2,500
(*b*)	Printing cost of memorandum and articles	5,000
(*c*)	Registration fees for incorporation	15,000
(*d*)	Cost of issuing prospectus	3,000
(*e*)	Underwriting commission for issuing shares	20,000
(*f*)	Expenses for obtaining long-term loans	45,000
(*g*)	Directors' fees	2,500
(*h*)	Employees' remuneration	8,000
(*i*)	Miscellaneous office expenditure	6,000
(*j*)	Installation cost of plant and machinery	35,000
(*k*)	Rent of office premises	7,200
(*l*)	Payment to engineer supervising erection of plant	8,000
(*m*)	Legal charges regarding a foreign collaboration agreement for factory layout	12,000
(*n*)	Cost of preparing a project report	18,000
(*o*)	Expenses incurred on market survey	7,500

The company closed its first year of account on 31st December 1972 and went into production on 1st January 1973.

Its share capital, debentures and long-term loans as on 31st December 1972 and on 31st December 1973 were the same as follows :

	Rs.
Share Capital	25,00,000
Debentures	15,00,000
Long-term Loans	20,00,000

The actual cost of the fixed assets on the two dates was Rs. 40,00,000 and Rs. 50,00,000 respectively.

Discuss the admissibility or otherwise of the above-noted items and the extent thereof in the income-tax assessments of the company. (*C. A. Final, May 1972*).

In this case, the company was incorporated on 1-9-1972 but it started production on 1st January 1973. Therefore its first accounting year for income-tax purposes is the year ended 31st December 1973.

Under section 35D, an Indian company is allowed to write off one-tenth of the amount of qualifying preliminary expenses for each of the ten years beginning with the year in which the business of the company commences. The maximum limit over the amount of expenditure eligible for write-off is 2·5 per cent of the project cost *i.e.*, the cost of the fixed assets, but the company has the option to claim the write-off of preliminary expenses up to a limit of 2·5 per cent of the capital employed in the business. The capital employed will comprise share capital, debentures and long-term loans.

The qualifying amount of preliminary expenses eligible for write-off is as under :

	Rs.
Legal charges for drafting the memorandum and articles of association	2,500
Printing cost of memorandum and articles	5,000
Registration fees for incorporation	15,000
Cost of issuing prospectus	3,000
Underwriting commission for issuing shares	20,000
Legal charges for foreign collaboration agreement	12,000
Cost of preparing the project report	18,000
Expenses incurred on market survey	7,500
	83,000

One-tenth of Rs. 83,000 is Rs. 8,300 which is well below the following ceiling limits :

(*i*) Rs. 1,25,000 being 2·5 per cent of Rs. 50,00,000 cost of fixed assets as on 31-12-1973, and

(*ii*) Rs. 1,50,000 being 2·5 per cent of Rs. 60,00,000 capital employed as on 31-12-1973.

Therefore the company will be allowed a deduction of Rs. 8,300 in computing its taxable income from business for the accounting year ended 31-12-1973 relevant to the assessment year 1974-75. The same deduction will be allowed for each of the nine subsequent assessment years.

The installation cost of plant and machinery and the payment to engineer supervising erection of plant will be added to the cost of plant and machinery for which depreciation will be allowed.

The other expenses incurred up to 31-12-1972 will not be allowed as a deduction since they were incurred before the date on which production commenced.

10. Amortisation of Expenditure on Prospecting for Minerals.

Section 35E allows a deduction for expenditure on prospecting etc., for certain minerals to an assessee being an Indian company or other resident non-company person. The provisions of this section are as follows :

(1) In the case of an assessee engaged in the mining industry other than mineral oil and natural gas, this section provides for amortisation against his profits over a 10-year period of the expenditure incurred by him after 31st March 1970 on the prospecting for or for development of mines or other natural deposits of minerals specified in Part A of the Seventh Schedule and the groups of associated minerals specified in Part B of that Schedule.

(2) The expenditure qualifying for amortisation will be the expenditure incurred by the assessee in prospecting for and development of any mine or other natural deposit of any of the minerals during the five-year period ending with the year in which the commercial production of the mineral for which prospecting was undertaken is established.

The expenditure qualifying for amortisation will not however include :

(*a*) expenditure on the acquisition of the site of the source of the mineral or the rights in or over the site ;

(*b*) expenditure on the acquisition of the deposits or any rights in or over the deposits ; or

(*c*) expenditure of a capital nature on any building, machinery, plant or furniture for which depreciation is admissible to the assessee.

Further, where any part of the prospecting or development expenditure is met directly or indirectly by any other person or authority or where the assessee realises any sale, salvage, compensation or insurance moneys in respect of any property or rights brought into existence as a result of the expenditure, the amount of the expenditure so met by any other person or authority and also the sale etc., moneys will be deducted in arriving at the amount of expenditure qualifying for amortisation.

(3) The expenditure qualifying for amortisation will be allowed as a deduction in ten equal annual instalments beginning with the year in which the assessee starts commercial production of the mineral for which prospecting was undertaken by him.

However, where the profits arising from the commercial exploitation of the mineral in respect of which the expenditure was incurred (including the profits derived from commercial production of the same mineral already established by the assessee) fall short of the annual instalment during any year, the amount of the shortfall will be carried forward and added on to the annual instalment for the next year and allowed as a deduction to the extent of the

profits derived by the assessee from the commercial production of the mineral in that year, and so on up to a period of 10 years reckoned from the initial year of commercial production.

(4) Where the undertaking of an Indian company which is eligible for the benefit of this section is transferred to another Indian company in a scheme of amalgamation within the 10-year period of amortisation, the transferee company will be entitled to the benefit of amortisation of the expenditure remaining unallowed over the unexpired part of the 10-year period.

(5) Where any deduction is claimed by and allowed to an assessee under this section in respect of prospecting and development expenditure for any assessment year, no deduction will be allowed for that expenditure under any other provisions of the Income-Tax Act for the same or any other assessment year.

(6) In the case of resident non-company assessees (other than a co-operative society), the above concession is available on condition that their accounts for the relevant years in which the expenditure was incurred are audited by a chartered accountant and a report of such audit in a form prescribed for the purpose is furnished along with the return of income for the first year in which the amortisation is claimed.

11. Other Deductions.

Under section 36, the following further deductions are allowable in computing the profits and gains of a business or profession :

(i) Insurance Premium. The amount of any premium paid in respect of insurance against risk of damage or destruction of stocks or stores used for the purposes of the business or profession. Premiums paid for insurance against the risk of damage or destruction of buildings, machinery, and furniture are allowable as a deduction under sections 30 and 31. Premiums for any other insurance may be allowed under section 37.

(ii) Bonus or Commission to Employees. Any amount paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission.

Any bonus or commission paid to employees for services rendered is allowable as a deduction on the following conditions, namely :

(*a*) That it should not have been payable to them as profit or dividend if it had not been paid as bonus or commission. In order to derive an assessee of the benefit of this deduction, it is necessary that the *same* sum should be paid by way of bonus or commission as would otherwise have been payable to the employees as profit or dividend. Thus, where the shareholders of a private company are also its employees and receive a bonus by reference to their salaries and not by reference to their shareholdings in the company, the bonus would be an admissible deduction, for in such a case the employees may get more or less by way of bonus than they would have got by way of dividend. *Where a particular amount was paid by way of bonus to an employee it would not be an admissible deduction if the same amount would have been paid to him as dividend or profit.*

(*b*) That the amount of bonus or commission should be reasonable having regard to the pay of the employee and the conditions of his service, the profits of the business for the year in question and the general practice in similar business. In determining the reasonableness of the amount of bonus or commission, all these three factors should at the same time be taken into consideration. It is not sufficient to take one or two of these factors into consideration. (*24 ITR 566*).

Whether the payment of bonus or commission is voluntary or contractual, such an emolument is a permissible deduction only if the emolument is of a reasonable amount. Payments on account of bonus or commission are normally allowed as a deduction unless there are grounds for suspecting that the amount of bonus or commission has been fixed with a view to avoidance of tax by the employer.

It is settled law that the reasonableness of the payment has to be judged not on the subjective standard of the assessing authorities but from the point of view of commercial expediency. In deciding whether remuneration paid to an employee by way of commission constitutes a reasonable expenditure, all the circumstances specifically referred to above, judged from the view of a normal prudent businessman, must be taken into account (*30 ITR 734*).

Bonus payable to workmen, as a result of an industrial dispute, is an allowable deduction under section 37 and not under section 36(1)(ii).

(iii) Interest on Borrowed Capital. The amount of the interest paid on capital borrowed for purposes of the business or profession.

There is no scope for the application of the test of reasonableness to a case of payment of interest under section 36. The rate of interest cannot therefore be scaled down by the income-tax authorities (*58 ITR 462*).

Interest on capital borrowed and employed in the business is allowable even if its payment is contingent upon the earning of profits. The borrowing must however be genuine and not bogus. If, for instance, debentures are issued by a private company to another company and this latter company issues in turn its own debentures to the near relatives of the shareholders of the former private company, the borrowing is merely a fake in order to avoid tax.

Section 40 prohibits allowance on account of (*a*) interest liable to tax but payable outside India, on which tax has not been paid or deducted at source and in respect of which there is no person in India who may be treated as an agent, and (*b*) interest paid by a firm to a partner on his capital or on his loan.

In deciding whether a claim for interest on capital borrowed for purposes of business can be allowed, the fact that the assessee had ample resources at his disposal and need not have borrowed is not a relevant matter for consideration. The matter to be decided is whether the amount of interest paid was in fact in respect of capital borrowed for purposes of the business (*51 ITR 835*).

In order that an assessee may be entitled to claim an allowance in respect of interest paid on borrowed capital, what is required is (*a*) that the money must have been borrowed by the assessee for purposes of his business, and (*b*) he must have paid as interest the amount claimed as an allowance. If these conditions are satisfied, the income-tax authorities are bound to allow the amount which has in fact been paid as interest ; they have no power to reduce the quantum paid as interest to anything considered reasonable by them (*31 ITR 803*).

The interest paid on capital borrowed for expanding a business is allowable although the assets brought into existence with the help of the borrowed capital may not be actually used for the purpose of the business in the relevant accounting year (*34 ITR 265*). It is immaterial whether the borrowing is for the purpose of acquiring capital assets or stock-in-trade or for paying trading debts.

Where a money-lending firm borrowed money for interest and advanced it to its partners without charging any interest, it could not be said that the firm had borrowed the money for the purposes of its business, and the interest paid by the firm on the borrowing would not be allowable as a deduction from the income of the firm (*58 ITR 525*).

A partner of a registered firm is entitled to claim deduction of interest paid by him on capital borrowed for the purpose of the partnership from his share of the profits of the partnership. Section 28 is applicable to the income a partner receives from a registered firm (*40 ITR 195*).

(iv) Contributions to Provident and Superannuation Fund. Any sum paid by the assessee as an employer by way of contribution towards a recognised provident fund or an approved superannuation fund, subject to such limits as may be prescribed.

Contribution made by an employer to an unrecognised provident fund or an unapproved superannuation fund are allowed as a deduction under section 37 as explained later on.

(v) Contributions to Gratuity Fund. Any sum paid by the assessee as an employer by way of contribution towards an approved gratuity fund created by him for the exclusive benefit of his emloyees under an irrevocable trust.

An approved gratuity fund means a gratuity fund which has been and continues to be approved by the Commissioner in accordance with the rules contained in Part C of the Fourth Schedule in the Income-Tax Act, 1961.

(vi) Loss on Animals. Loss on the sale of dead or useless animals used for the purposes of the business or profession otherwise than as stock-in-trade.

(vii) Bad Debts. An allowance is granted in respect of the bad debts of a business or profession and in respect of irrecoverable loans of a banking or money-lending business. A bad debt presupposes the existence of a debt, and if there never was any debt owing to the assessee, no allowance can be claimed for bad debts.

The following four conditions govern the grant of an allowance in respect of bad debts and irrecoverable loans :

(1) The debt or loan must be in respect of a business or profession which is carried on by the assessee in the relevant accounting year, and the debts must be in respect of and incidental to the business or profession.

No allowance can be claimed in respect of the bad debts of a business which had been discontinued before the commencement of the accounting year, nor can the bad debts of a discontinued business be deducted from the profits of a separate existing business.

Even though there may be a change of ownership in a business, if the identity of the business is not in any manner broken or interrupted but the business as a whole is continued, then the successor is entitled to write off the trading debts in the year of account when they become irrecoverable even though the debts may be due from its customers in respect of the dealings of a period prior to the change of ownership, and it is immaterial whether the change of ownership was brought about by transfer *inter vivos* or by operation of law (*80 ITR 483*).

Generally speaking, where a firm is dissolved or a joint family business is disrupted on partition and the debts due to the partnership or family business are divided between the partners or the members of the family, what the partners or members get by way of a share in the asset of the old business becomes capital in their hands and if any of the debts become irrecoverable the loss would be capital loss. But where a firm or a joint family is carrying on money-lending business and one of its members upon dissolution or partition carries on his own separate money-lending business, and his share of the loans advanced by the firm or joint family is taken over and adopted by him as the stock-in-trade of his own separate business, he would be entitled to an allowance if and when any of the loans so taken over becomes thereafter irrecoverable. This is according to a decision of the Supreme Court (*20 ITR 59*).

When there is a change in the constitution of a firm, a bad debt of the old firm is an allowable deduction in the case of the new firm, if, after the change in constitution, the old firm was not dissolved but continued as an entity and the business was carried on under the same name and with the same assets and liabilities (*58 ITR 9*).

Where a debt due to the assessee is not incidental to the business *e. g.*, if it arises out of motives of business relationship, no allowance can be claimed in respect of such a debt and the loss must be treated as capital loss. The loss incurred by a money-lender who stands surety for another cannot be allowed as a bad debt of his business (*36 ITR 147*).

(2) The debt must have been taken into account in computing the income of the accounting year or of an earlier accounting year. This condition would be satisfied only if the mercantile system of accounting is followed, because in such a case tax is charged on profits which may not have been realised. If the accounts are maintained on cash basis, no question can arise of any allowance for bad debts, because unless a debt is actually realised it would not be included in the profits.

However, there may be a bad debt which is incidental to business but which is not deductible because it was not taken into account in computing the income. Such a bad debt is still allowable as a business loss on ordinary principle of commercial accounting. For instance, the loss sustained by an assessee owing to the insolvency of the bank with which he maintains an account for the purposes of his business, would be a bad debt in respect of and arising out of the business. The bad debt would not be deductible under section 36, because such a debt would not be taken into account in computing income. But such a bad debt would be allowable as a loss incidental to business.

In the case of a banking or money-lending business, the assessee is entitled to an allowance in respect of irrecoverable loans advanced in the ordinary course of business, whatever the method of accounting employed may be, because money is the stock-in-trade of a banker or money-lender, and the loss of stock-in-trade is always a trading loss.

(3) The amount of the debt or loan which is claimed as a bad debt must have become bad in the accounting year.

A debt or loan, which had in fact become irrecoverable before the commencement of a particular year cannot properly be deducted in ascertaining the profits of that year, because the loss has not been sustained in that year.

The expression "bad debts" refers to debts of which the chance of recovery is nil. So long as there is any ray of hope for the recovery of a debt it cannot be said that it has become irrecoverable. Where the debts are owing by close relations who are solvent and the assessee abstains from recovering them, he cannot claim to deduct them as bad debts. The age of a debt is a relevant matter to be taken into consideration, but a time-barred debt is not necessarily bad ; nor is a debt which is not time-barred necessarily good. But in the absence of other evidence, a debt may be assumed to become bad when it becomes time-barred.

(4) The debt or loan must be written off as irrecoverable in the accounts of the assessee for that accounting year in which the claim for a deduction is made for the first time.

It is a condition precedent to allowance of a bad debt that the assessee must write off the debt as irrecoverable in his accounts in the year in which he claims a deduction for the first time in respect of that debt.

Express provision is made for cases where the Income-Tax Officer holds the writing off of the debt to be too early or too late. If he holds that the debt has been prematurely written off, the debt may be allowed as a deduction in a subsequent year though it would not be written off in such subsequent year. If he holds that the debt had become bad in earlier accounting year, not falling beyond a period of *four* years immediately preceding the accounting year, he must rectify the assessment of such earlier year and allow the deduction for that year.

The writing-off of a bad debt is a technical term. When a bad debt is written off, a debit entry is made in the profit and loss account, but there are two methods of making the corresponding credit entry : namely, either in the debtor's account or in the suspense account. The first method will be employed where it is desired to close the account of the debtor, while the second method is employed where there are some chances of recovery howsoever remote they may be (*24 ITR 53*).

Final Adjustment in the Year of Recovery. The allowance for bad debts is necessarily based on an estimate. Ultimately a larger or smaller portion of the debt or loan may be recovered. Therefore, the following provisions apply in such cases :

(*a*) If the amount ultimately recovered on a debt is less than the difference between the debt and the amount allowed as a bad debt, the deficiency is deductible in the previous year in which the ultimate recovery is made.

(*b*) Where a deduction has been allowed in respect of a bad debt, then, if the amount subsequently recovered on any such debt is greater than the difference between the debt and the amount so allowed, the excess is deemed to be profits of the business or profession of the previous year in which it is recovered *whether the business or profession in respect of which deduction was allowed is in existence in that year or not.*

Illustration

B, a dealer in hardware, wrote off in his accounts for the year 1972 a sum of Rs. 25,000 as bad debts. The Income-Tax Officer allowed out of this sum only Rs. 10,000 in the assessment for the year 1973-74. The business was closed down by B in 1973 due to recurring losses. In 1974 the debtor whose debt of Rs. 25,000 had been written off as bad paid to B Rs. 18,000 out of his debt.

The Income-Tax Officer proposes to tax this sum of Rs. 18,000, but B contends that the business having been closed in 1973 no tax could be charged on the recovery.

Discuss the rival contentions indicating whether the sum is assessable and, if so, whether fully or in part only, as also the year of assessment and the head of income.

(*C. A. Final, Nov. 1968*)

Under section 41(4), where a deduction has been allowed in respect of a bad debt and the amount subsequently recovered on any such debt is greater than the difference between the debt and the amount so allowed, the excess is deemed to be the profit of the business or profession of the previous year in which it is recovered, whether the business or profession in respect of which the deduction was allowed is in existence in that year or not.

Rs. 3,000 is the excess of the amount recovered (Rs. 18,000) over the difference (Rs. 15,000) between the debt and the bad debt allowed.

Therefore Rs. 3,000 will be assessable as income from business in the assessment year 1975-76.

Thus the contentions of both the Income-Tax Officer and the assessee are not correct.

(viii) Transfer to Special Reserve. Approved financial corporations which provide long-term finance for industrial or agricultural development in India are eligible for a deduction, in the computation of their business profits, on account of the amount carried by them during the previous year to a special reserve account. The limit on this deduction is as follows :

(*a*) In the case of a financial corporation or a joint financial corporation established under the State Financial Corporations Act 1951—40% of the gross total income.

(*b*) In the case of any other financial corporation : (*i*) where the paid-up share capital does not exceed Rs. 3 crores—25% of gross total income and (*ii*) where the paid-up share capital exceeds Rs. 3 crores—10% of gross total income.

(ix) Expenditure on Family Planning. Expenditure which is *bona fide* incurred by a company for the purpose of promoting family planning amongst its employees is allowed as a deduction in the computation of its income from business.

However, where such expenditure is of a capital nature, it will be allowed as a deduction over a period of five years (including the previous year in which it is incurred) in equal amounts.

The "other provisions" applicable to expenditure on scientific research also apply to expenditure on family planning.

12. General Deductions.

Under section 37, any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of the capital expenditure or personal expenses of the assessee) laid out or expended wholly and exclusively for the purposes of the business or profession is allowed in computing the income from business or profession.

This section allows the deduction of any expenditure laid out wholly and exclusively for the purposes of the business or profession and covers the bulk of the outgoings of a business.

It is not necessary that the expenditure allowable in a particular year should result in any profit at all in that year. In every trade, much of the expenditure is designed to produce results wholly or partly in subsequent years ; but still such expenditure is allowed as a deduction for the year in which it is incurred. A payment made to an employee may be an admissible deduction although it may not be in respect of services rendered in the trading year. Similarly, rent paid for premises taken on lease for a term of years after the business has ceased to be carried on there, would be allowed under section 37.

The following conditions must be satisfied in order that a particular item of expenditure may be allowed under this section :

(1) The expenditure should not be of the nature described in sections 30 to 36. If an allowance is specifically dealt with by one of these sections, it cannot be claimed under section 37 which is the residuary section.

(2) It should have been incurred in the accounting year.

(3) It should be in respect of a business which was carried on by the assessee and the profits of which are to be computed and assessed, and it should be incurred after the business is set up.

(4) It should not be in the nature of personal expenses of the assessee.

(5) It should not be in the nature of capital expenditure. Capital expenditure is not allowed as a deduction from profits. The law grants an allowance in respect of capital expenditure by way of depreciation.

(6) It should have been laid out or expended wholly and exclusively for the purposes of the business or profession *i. e.*, for the purpose of enabling a person to carry on a business or profession and to earn profits.

The expenditure claimed as a deduction under section 37 should be an expenditure and not a sharing of profits. A payment may be a payment of a share of profits *simpliciter* or a payment may be an item of expenditure calculated with reference to the profits. If the payment falls in the former class it is not allowable as a deduction.

Thus, section 37 is limited in scope. It does not permit all those deductions which a prudent businessman would make in ascertaining his net profits.

According to the Supreme Court (*38 ITR 601*) it is a question of fact in each case whether the amount which is claimed as a deduction under section 37 was laid out wholly and exclusively for the purposes of business. In deciding whether a payment is a deductible expenditure, one has to take into consideration the question of commercial expediency and the principles of ordinary commercial trading. If the expense is incurred for fostering the business of another only or was wholly gratuitous or for some improper purpose outside the course of business, the expense is not deductible.

As regards section 37, the Bombay High Court has consistently taken the following view :

(*a*) The amounts spent by a businessman for commercial expediency are permissible deduction. For example, where a bank decides not to recover loans from customers whose ornaments, pledged with the bank had been lost by dacoity, the amount of the unrecovered loans is an allowable deduction.

(*b*) That it is not for the income-tax authorities to tell a businessman how to conduct his business ; that must be left to the businessman himself.

(*c*) When a claim is made under section 37, all that the assessing authority is concerned with is to test every expenditure and to determine whether it is incurred for the furtherance of the business.

(*d*) That any moneys spent in the interest of the business or any moneys spent in the course of the business and which are incidental to the business are allowable under this section.

The Income-Tax Officer's jurisdiction to disallow an expenditure will arise only when the payment is not real or is not laid out wholly or exclusively for the purpose of the business. But, once it is found that an expenditure has really been incurred wholly and exclusively for the purpose of the business, it is not for the revenue to go into the question of reasonableness while construing the question of allowance under section 37 (*94 ITR 173*).

Entertainment Expenditure. In the case of *any* assessee, no expenditure is allowable which exceeds the aggregate amount computed as under :

(*a*) On the first Rs. 10 lakhs of the profits computed before making any deduction for development rebate or development allowance or entertainment expenditure—at $\frac{1}{2}$% or Rs. 5,000 whichever is higher.

(*b*) On the next Rs. 40 lakhs of the profits computed as above—at $\frac{1}{4}$%.

(*c*) On the next Rs. 120 lakhs of the profits computed as above—at $\frac{1}{8}$%.

(*d*) On the balance of the profits computed as above—Nil.

According to the above limits, the maximum amount of allowable entertainment expenditure is Rs. 30,000. In order to prevent the circumvention

of these limits in cases where entertainment expenditure is incurred through employees of the business or profession out of their entertainment allowance or "expense accounts" operated by them, such expenditure has been brought within the purview of the limits.

With a view to curbing lavish expenditure on entertainment, entertainment expenditure *incurred in India* after 28-2-1970 will be disallowed altogether in computing the profits of business or profession. Entertainment expenditure incurred *outside India* will continue to be admissible as a deduction subject to the limits stated above.

Expenditure on Advertisement, etc. Any expenditure incurred by *any* assessee on advertisement, maintenance of residential accommodation or travelling by an employee or *any other person* (*e. g.*, a director of a company) is allowed as a deduction only to the extent and subject to such conditions as may be prescribed.

Expenditure on Guest Houses. Any expenditure incurred by a tax-payer on the maintenance of a guest house after 28th February 1970 will not be allowed as a deduction in computing his business or professional income. Similarly no depreciation will be allowed in respect of the building used as the guest house and assets therein. The amount to be disallowed will be calculated after setting off amounts, if any, received by the tax-payer from persons using the guest house.

For the purposes of this provision, accommodation hired or reserved by the tax-payer in a hotel for a period exceeding six months will be treated as a guest house.

In the case of a tax-payer having in his employment not less than 100 whole-time employees throughout the relevant previous year, the expenditure incurred on the maintenance of a "holiday home" exclusively for the use of his employees while on leave will not however be disallowed.

Legal and Illegal Expenditure. Though section 37 does not in express terms say so, it impliedly refers to expenditure laid out for the purpose of carrying on a business or profession *lawfully*. If certain expenses became necessary by reason of the business or profession being carried on unlawfully, such expenses are not allowable. Thus costs and penalties incurred by an assessee in proceedings launched against him for breaches of law (*e. g.*, for breaches of customs, excise and other regulations) are disallowed on the ground that such expenditure is not incurred for the purpose of earning the profits of the business.

However, losses and all legitimate expenses incurred in an illegal business are allowed as deductions in computing the income from an illegal business (*82 ITR 794*) as deductions in computing the income from an illegal business. Such expenses stand on a different footing from penalties and fines incurred for breaches of the law.

Examples of Expenditure Allowed or Disallowed under Section 37

The following are examples of expenditure allowed or disallowed under section 37 :

Legal Expenses.

Legal expenses incurred (*i*) in the normal course of the business, (*ii*) to avoid a business liability, *e. g.*, for alleged breach of a trading contract, (*iii*) to defend the assessee's title to his assets, *e. g.*, land, buildings, etc. or (*iv*) to secure the termination of a disadvantageous trading relationship, *e. g.*, removal of an undesirable employee, are all allowable as being incurred for the purposes of the business.

Lawyers' and accountants' fees for services in connection with assessment proceedings before Income-Tax Officers and with appeals are allowable in full. These expenses may not be apparently related to the assessee's trading activities, but they are justifiably necessary for increasing the assessee's net profits or for the carrying on of the business with larger funds at the disposal of the assessee. From this point of view such expenses are expenses "for the purpose of the business" in the wider sense (*77 ITR 575*).

Legal expenses incurred by a director of a company in defending a suit brought to challenge the validity of his election to the directorship are allowable, as they are incurred to save his income from director's fees.

Legal expenses incurred in defending an action in which there are allegations reflecting upon the assessee's business integrity are not allowable, as they are in the nature of capital expenditure.

Legal expenses incurred by a partner in proceedings for dissolution of the partnership and rendition of accounts cannot be deducted as expenditure laid out for the purpose of partnership business ; but legal costs incurred by a company in resisting a winding-up petition in order to prevent extinction of its business would be allowable.

Expenses incurred in *civil* litigation are allowable if they were incurred by the assessee *as a trader* and were incidental to his business or profession. On the other hand, expenses incurred in *criminal* proceedings are not allowable as they are not incurred for a business purpose.

Legal expenses incurred in connection with a litigation relating to acquisition of capital asset for a business are capital expenditure ; but expenses incurred for protection of capital assets of a business which had already been acquired are allowable as business expenditure.

Expenses of Raising Loans.

According to a decision of the Supreme Court (*60 ITR 52*), the expenses (including cost of stamps, registration fees, lawyer's fees, etc.) incurred in connection with the raising of loans (long-term or short-term) are an admissible deduction, as such expenses are not in the nature of capital expenditure but are laid out for the purpose of the business. But expenses incurred in connection with the issue of shares are not allowable.

Compensation Payments.

Compensation payable by the assessee as a result of negligence in carrying on his business is allowable.

Money paid as compensation to an agent for termination of agency is an allowable deduction, as the payer is relieved of future annual payments of commission.

Compensation paid for the cancellation of a contract, if it was one for goods and not for any capital asset, is an admissible deduction.

Payments to Employees.

It is a well-established principle that, even if a certain amount is actually paid to an employee, and the agreement under which it is paid is proved to exist, it is nevertheless open to the Department to find upon the other facts and circumstances that only a part of such payment should be allowed as expenditure wholly and exclusively incurred for purposes of the assessee's business (*37 ITR 533*).

Remuneration paid to employees is allowable if the payment is made wholly and exclusively for purposes of the business.

The full salary paid by an assessee to his employees for the period they were in jail as under-trial prisoners in a criminal case, cannot be allowed as

expenditure incurred wholly for purposes of the assessee's business. But the portion of the amount so paid which represents salary for the period of leave to which they are entitled, is an allowable deduction.

Remuneration paid to the employees of a branch office for a period during which the business is not carried on at the branch would not be allowable if the contract of service could have been terminated when business ceased to be carried on there (*34 ITR 64*).

Pensions, gratuities and other voluntary payments made to employees, in order to retain the services of the staff and to increase their efficiency, are deductible as being wholly and exclusively laid out for the purpose of the trade. But a gratuity paid to a single employee when it was not the practice of the employer to grant such a benefit in any circumstances was held by the Supreme Court to be not deductible (*44 ITR 551*).

An ex-gratia payment to a retiring employee is voluntary and for past services. Unless the expenditure is incurred in the future interest of the business, it cannot be said that the payment is laid out for the purposes of the business. It is therefore not admissible as deduction.

Voluntary pensions and lump sum payments made by a company to its employees on its winding up are not allowable as being made for the purpose of the trade.

Payments of retrenchment compensation and payments in lieu of notice made by an employer under a *legal* obligation and before the cessation of business are allowable as being for the purpose of business.

Bonus payable to workmen as a result of an industrial dispute is an allowable deduction in the previous year in which the liability accrues. Such liability may accrue either under an agreement between an employer and his workmen or under an award made by an industrial tribunal or under the Bonus Act.

Compensation paid by an employer to an employee for loss of office is allowable provided the business continues.

Compensation paid to managing director for premature termination of his services would be deductible if the company had acted on business considerations, and the department cannot disallow the payment or a part thereof on the ground that the claim for compensation would not have succeeded in a court of law (*36 ITR 114*).

A payment made to get rid of an employee in the interest of the trade is deductible as being for purposes of the business.

A payment made to an employee in consideration of his agreeing not to compete with the employer is capital expenditure.

Where the managing agents of a company give up the whole or a part of the managing agency commission on grounds of commercial expediency, the amount so given up would be allowable as expenditure incurred for the purpose of the managing agency business (*38 ITR 601*).

Presents given to employees by way of gifts, and not as perquisites for services rendered, are not allowable.

Bona fide expenditure of a revenue nature incurred for the welfare of employees is treated as an allowable expenditure.

Miscellaneous Expenditure.

Premiums for insurance of buildings, machinery, plant, furniture, stocks or stores are allowable under sections 30, 31 and 36. Premiums paid for other insurances are deductible under section 37. Such other insurance may be (*i*) against loss of profits consequent upon damage by fire ; (*ii*) on the life of an employee who personally influences the business and whose death would cause

a diminution of profits ; or (*iii*) against accident to employees as well as to cover the risk of liability under the Workmen's Compensation Act.

Contributions to an unrecognised provident fund made by an employer are allowable if the fund is constituted as an irrevocable trust and if no part of the employer's contributions can be recovered by him. If the fund remains under the control of the employer, no contributions made by him would be allowed as a deduction, but the actual payments of the employer's contributions and the full amount of interest paid to employees leaving the service would be allowed in the year in which such payments are made, provided that income-tax is deducted from such payments.

Contributions to an unapproved superannuation fund by an employer are allowable if the fund is constituted as irrevocable trust and if no part of the employer's contributions can be recovered by him. If the fund remains under the control of the employer, no contributions made by him would be allowed as a deduction, but actual payments of pensions to ex-employees or to their widows or children would be allowed when the pensionary payment is a fixed and recurring one. No claim on account of pensions will however be entertained when they are paid to persons who have or who at any time had a share in the business or profession.

Subscriptions given by a business or profession are allowed if their payment is compulsory or commercially expedient and of benefit to the payer.

Expenses incurred on the occasion of Dusehra, Diwali, mahurat or other customary day of opening new accounts are allowed up to a reasonable amount having regard to the size of the business.

Sales-tax is an admissible deduction but not wealth-tax or estate duty.

Donations given to political parties or for a political cause are not an admissible deduction. They may be for the purpose of advancing the trade of the assessee ; but they are not incurred wholly and exclusively for the purpose of the business.

Expenditure Expressly Disallowed

Section 40 expressly provides that the following expenses shall *not* be deducted in computing the income from business or profession :

(*a*) **In the Case of Any Assessee.**

(*i*) Any interest chargeable under the Income-Tax Act which is payable outside India, unless the interest is on a loan issued for public subscription before 1st April 1938, or tax has been paid or deducted at source in respect of such interest, or there is a person who may be charged as an agent in respect of such interest.

(*ii*) Any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed as a proportion of any such profits or gains. All cesses are, however, allowed as business expenses because they are of small amounts and though sometimes computed on the basis of profits, they are really of the nature of revenue expenditure.

(*iia*) Any wealth-tax chargeable under the Wealth-Tax Act or any tax of a similar nature chargeable in any country outside India.

(*iii*) Any payment which is chargeable under the head "Salaries," if it is payable outside India and if the tax has not been paid thereon deducted therefrom at source.

(*iv*) Any payment to a provident or other fund established for the benefit of employees of the assessee unless the assessee has made effective arrangement to secure that tax shall be deducted at source from any payments made from the fund which are chargeable to tax under the head "Salaries".

(*b*) **In the Case of Any Firm.**

Any payment of interest, salary, bonus, commission or remuneration made by the firm to any partner of the firm.

This is an absolute prohibition, and there is no distinction between payment by way of interest, salary, bonus, commission or remuneration made to a partner as a partner and such payments made to him in a different character, *e. g.*, as the proprietor of an independent business.

The hotel charges of the partners of a firm in respect of a tour undertaken for the purpose of procuring business for the firm are not allowable as a deduction.

Interest paid to partners of a firm on their capitals or loans cannot be deducted. There is, however, nothing in the Income-Tax Act which excludes from the computation of the income of the firm any amount paid as interest by a partner for money borrowed by him from the firm.

Payments other than interest, salary, bonus, commission or remuneration made by a firm to its partners, are not prohibited. Thus, rent paid by a firm to a partner who owns the premises in which the firm carries on business and in respect of which the firm is a tenant of the partner, is admissible as a deduction. So also a rebate allowed to a partner on grounds of commercial expediency is an admissible deduction. Rebate differs from commission. Commission is of the nature of recompense or reward for services. Rebate, on the other hand, is a remission or a payment back and of the nature of a deduction from the gross amount (*19 ITR 594*).

A Hindu undivided family, an association of persons or a body of individuals is not affected by this prohibition, because they are not partnerships. Reasonable remuneration paid to a member of a Hindu undivided family, an association of persons or a body of individuals for services rendered to its business is allowable.

(*c*) **In the Case of Any Company.**

Expenditure incurred by a company on the provision of any remuneration or benefit or amenity to a director or to a person who has a substantial interest in the company or to a relative of the director or of such person and also the expenditure or allowance in respect of any assets of the company which are used by such persons for their own purposes or benefit, are *not* allowable as a deduction to the extent such expenditure or allowance is, in the opinion of the Income-Tax Officer, excessive or unreasonable. The deduction in respect of such expenditure and allowance taken together is subject to the *ceiling limit of Rs. 72,000 in a year* in respect of any one director or such person.

Where the scale of remuneration of a director of a company has been approved by the Company Law Administration, there is no question of the disallowance of any part thereof in the income-tax assessment of the company on the ground that the remuneration is excessive or unreasonable.

In exercising his power to disallow any such remuneration, the Income-Tax Officer must apply his mind to the nature of the business of the company, the actual work done by the directors or other persons substantially interested in the company, the quantum of income earned by the company, the necessity to pay the remuneration to such persons and to other allied considerations in order to form an opinion whether or not the payment is reasonable or excessive. The mere *ipse dixit* of the officer unrelated to the criteria laid down in the statute would not be a considered opinion, but dogmatic assertion, and the statute does not permit the department to adopt such a course (*51 ITR 386*).

(*d*) **In the Case of a Banking Company.**

The amounts which have been allowed as a deduction in computing its income chargeable to income-tax under the head "Interest on Securities".

(*e*) **General.**

In addition to the above expenses which are expressly disallowed under section 40, the following expenses, losses and allowances are also not allowable as deductions in computing the income from business or profession :

(*a*) Drawings of proprietor or partners.
(*b*) Private or personal expenses of the proprietor.
(*c*) Expenditure in the nature of capital. *Any capital expenditure disallowed as deduction from profits may, however, be entitled to depreciation allowance.*
(*d*) Any provision for bad debts or for taxation.
(*e*) Amounts transferred to reserves except the amount transferred to a special reserve created by approved financial institutions.
(*f*) Expenditure in the nature of charity or presents.
(*g*) Income-tax and other taxes on income. Sales-tax is allowable but wealth-tax is not.
(*h*) Past losses charged to Profit and Loss Account.
(*i*) Depreciation in excess of the admissible amount.
(*j*) Any other expenditure not incurred wholly and exclusively for the purposes of the business or profession.

Restriction on Deduction of Certain Expenses

Tax liability is sometimes artificially reduced by diverting profits to relatives and associate concerns in the form of excessive payments for goods and services. Claims are also made for deduction of expenses in large amounts shown to have been paid in cash, often with a view to frustrating investigation as to the identity of the recipients and the genuineness of the claim. Section 40A is intended to plug these loopholes. The provisions of this section are as follows :

(1) Certain allowable expenditure may be disallowed. Under section 40A (1), expenditure which is allowable under any other provision of the Income-Tax Act relating to the head "Business or Profession" may be disallowed under this section.

(2) Payments to relatives. Under section 40A(2), expenditure incurred in a business or profession for which payment has been or is to be made to the tax-payer's relatives or associate concerns is liable to be disallowed in computing the profits of the business or profession to the extent the expenditure is considered to be excessive or unreasonable.

The reasonableness of any expenditure is to be judged having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession or the benefit derived by or accuring to the tax-payer from the expenditure.

Such portion of the expenditure which, in the opinion of the Income-Tax Officer is excessive or unreasonable according to the above criteria is to be disallowed in computing the profits of the business or profession.

The categories of persons, payments to whom fall within the purview of the provision comprise :

(*a*) any relative of the tax-payer, or where the tax-payer is a company, firm, association of persons or Hindu undivided family, any director of the company, partner of the firm or member of the association or family, and also relatives of such director, partner or member ;

(*b*) persons who have a substantial interest in the business or profession of the tax-payer and relatives of such persons ; and where such person is a company, firm, association of persons or Hindu undivided family, the directors, partners and members, and their relatives ; and

(*c*) persons in whose business or profession the tax-payer has a substantial interest directly or indirectly.

The term "relative" means, in relation to an individual, the husband, wife, brother or sister or any lineal ascendant or descendant of that individual.

A person is deemed to have a substantial interest in a business or profession if, in a case where the business or profession is carried on by a company, the person beneficially owns shares in the company (other than preference shares) carrying not less than 20% of the voting power and, in any other case, where the person is beneficially entitled to not less than 20% of the profits of the business or profession.

The above provision is applicable to all categories of expenditure incurred in business and professions, including expenditure on purchase of raw materials, stores or goods, salaries to employees and also other expenditure on professional services or by way of brokerage, commission, interest, etc.

Where payment for any expenditure is found to have been made to a relative or associate concern, it is necessary for the Income-Tax Officer to scrutinise the reasonableness of the expenditure with reference to the criteria stated above. The Income-Tax Officer is expected to exercise his judgement in a reasonable and fair manner. It is to be borne in mind that the provision is meant to check evasion of tax through excessive or unreasonable payments to relatives and associate concerns, and it should not be applied in a manner which will cause hardship in *bona fide* cases.

The above provision is not applicable in the case of a company in respect of any expenditure relating to remuneration, benefits and amenities to directors of the company, persons substantially interested in the company or to relatives of such director or person. The provisions of section 40(c)(i), as already explained before, govern the admissibility of such expenditure.

(3) Payments exceeding Rs. 2,500. Under section 40A(3), it is provided to disallow expenditure in business or profession for which payment is made in an amount exceeding Rs. 2,500 otherwise than by a crossed cheque or a crossed bank draft.

This provision is applicable to all categories of expenditure incurred in businesses and professions in respect of which a deduction is permissible in computing the taxable income of the payer. Therefore the provision does not apply to the advancement of loans or repayment of the principal amount of any loan, as these do not constitute expenditure deductible in computing taxable income.

However, in the following cases and circumstances, this provision will not be operative :

(*i*) Payments which, under a contract entered into by the tax-payer before 1st April 1969, have to be made in legal tender.

(*ii*) Payments to the cultivator, grower or producer of the products of agriculture, horticulture, apiculture, animal husbandry (including hides and skins) dairy or poultry farming, fish or fish products or the products of a cottage industry run without the aid of power.

(*iii*) Payments made in a village or town not served by any bank to persons ordinarily residing or carrying on any business or profession in any such village or town.

(*iv*) Payments made to the Reserve Bank of India, State Bank of India, other banking institutions including co-operative banks and land mortgage banks, agricultural credit societies, Life Insurance Corporation, Unit Trust of India and specified financial institutions.

(*v*) Certain categories of payments made through the banking system, *e. g.*, letter of credit, mail or telegraphic transfers, inter-bank book adjustments and bills of exchange made payable only to a bank.

(*vi*) Payments of terminal benefits such as gratuity or retrenchment compensation payable to low-paid employees or members of their families.

(*vii*) Where the tax-payer establishes that the payment could not be made by a crossed cheque or draft due to exceptional circumstances and also furnishes evidence as to the genuineness of the payment and the identity of the payee.

Where a tax-payer makes a payment in an amount exceeding Rs. 2,500 by a crossed cheque or draft, no person shall be allowed to raise, in any suit or other proceeding, a plea based on the ground that the payment was not made or tendered in cash or in any other manner.

(4) Salary of employees. Under section 40A(5)(a), expenditure incurred by a tax-payer on payment of salary to an employee will not be allowed as a deduction to the extent it exceeds Rs. 5,000 for each month or part thereof for the period of employment of the employee *in India* during the relevant previous year. Similarly salary paid to a former employee will not be allowed as a deduction to the extent it exceeds Rs. 60,000 for the year.

The expression "salary" for this purpose will have the same meaning as for purposes of section 17 *except* that it will not include perquisites and the sum transferred from the account of the employee in an unrecognised provident fund to a recognised provident fund.

The above restriction does not apply to the salary paid to a research worker engaged in scientific research.

(5) Perquisites to employees. Under section 40A(5)(b), the total expenditure incurred by a tax-payer in providing any perquisites (whether convertible into money or not) to an employee and the amount of expenditure or allowance (such as depreciation allowance) in respect of the assets of the tax-payer used by the employee for his own purposes or benefit will not be allowed as a deduction to the extent it exceeds 20% of the salary payable or an amount calculated at the rate of Rs. 1,000 for each month or part thereof comprised in the period of employment of the employer *in India* during the relevant previous year whichever is less.

However, in computing the total amount of benefits to an employee, the following items are not taken into account :

(*i*) The value of any travel concession or assistance granted by the tax-payer to an employee who is a citizen of India (and his spouse and children) in connection with his proceeding to any place in India, whether on leave or after retirement from service.

(*ii*) Passage moneys or the value of any free or concessional passage granted by the tax-payer to an employee who is not a citizen of India (and his spouse and children) in connection with his proceeding to his home country out of India, whether on leave or after retirement from service.

(*iii*) The employer's contribution to the employee's account if any recognised provident fund or approved superannuation fund or for the employee's benefit to an approved gratuity fund.

(*iv*) Where the tax-payer is a company, expenditure incurred by it for the purpose of promoting family planning amongst its employees.

The ceiling limit over the deductible amount of expenditure in respect of salary and perquisites etc. will not apply in the following cases :

(*i*) Payments to an employee in respect of any period of his employment outside India.

(*ii*) Payments to a foreign technician who is entitled to exemption from tax on his remuneration.

(*iii*) Payments to an employee whose income chargeable under the head "Salaries" does not exceed Rs. 7,500 per annum.

In order to prevent any circumvention of the above restrictions by converting "contracts of service" "into contracts for service", it is provided that expenditure incurred by a tax-payer in payments of fees for services rendered by a person who at any time during the 24 months immediately preceding the relevant accounting year was his employee, will not be allowed as a deduction to the extent it exceeds Rs. 60,000 in a year. In a case where the assessee also incurs in relation to such person any expenditure on payment of salary (*i. e.*, pension etc.), the deduction in respect of the expenditure on payment of fees and that on payment of salary will be limited to Rs. 60,000 in the aggregate.

Illustration

During the previous year ended 31st December 1974, X Ltd. incurred the following expenditure in respect of an employee drawing a salary of Rs. 6,000 per month :

(*a*) Rent for a furnished house provided free to the employee Rs. 800 per month.

(*b*) Contribution to the recognised provident fund at 10%.

(*c*) Travel concession for the employee and his wife in connection with his proceeding on leave to his home district in India Rs. 2,000.

(*d*) Provision of gas and electricity at the employee's residence Rs. 1,200.

(*e*) Maintenance of an air-conditioner at his residence Rs. 600. The company claimed depreciation of Rs. 600 in respect of the air-conditioner.

Discuss the allowance of the amounts involved in the computation of the company's profits of its business.

(*C. A. Final, May 1970*)

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(1) Under section 40A(5)(a)(i), expenditure incurred by a tax-payer on payment of salary to an employee is not allowed as a deduction in excess of Rs. 5,000 per month. Therefore only Rs. 60,000 will be allowed as a deduction.

(2) Under section 40A(5)(a)(ii), the expenditure incurred by a tax-payer in providing any perquisites to an employee together with the amount of expenditure or allowance in respect of the assets of the tax-payer used by the employee for his own benefit, is not allowed as a deduction in excess of 20% of the employee's salary or Rs. 1,000 per month whichever is less.

However, in computing the total amount of benefits to an employee, the value of any travel concession granted to the employee and the employer's contribution to the recognised provident fund are not to be taken into account.

Therefore in this case the total amount of other benefits is as under :

	Rs.
Value of free furnished accommodation at Rs. 800 per month	9,600
Provision of gas and electricity	1,200
Maintenance charges of air-conditioner	600
Depreciation of air-conditioner owned by the company	600
	12,000

The amount allowable for perquisites will be Rs. 12,000 (that is to say, Rs. 14,400 being 20% of salary of Rs. 72,000 or Rs. 12,000 being Rs. 1,000 per month, whichever is less).

Therefore the total amount allowable as a deduction in the computation of business profits will be as follows :

	Rs.
Contribution to recognised provident fund	7,200
Travel concession	2,000
Salary	60,000
Perquisites	12,000
	81,200

(6) **Provision for Gratuity**. No deduction will be allowed in respect of any reserve created or provision made for the payment of gratuity to the employees on retirement or on termination of employment for any reason. However this restriction will not apply to any provision made for the purpose of payment of a sum by way of contribution to an approved gratuity fund or for the purpose of payment of any gratuity that has become payable during the previous year.

Deemed Profits

In the following cases, money or other benefit received is deemed to be profit of business or profession, *irrespective of whether the business or profession is continued or not in the year in which the amount becomes chargeable.*

(1) Under section 41(1), where in computing income from business or profession, an allowance or deduction has been made in a past assessment year in respect of any loss, expenditure or trading liability incurred by the assessee, and subsequently the assessee has received any amount in respect of such loss or expenditure or has obtained some benefit in respect of such trading liability by way of remission or cessation thereof, the amount received by him or the value of the benefit accruing to him is deemed to be the profit of the year of receipt or accrual. This provision creates a liability to tax only in the cases where an allowance or deduction has already been granted. In other words, the law merely taxes as income what it had earlier allowed as a deduction.

For example, if a trader transfers to the credit of his profit and loss account unclaimed credit balances amounting to Rs. 8,000 which includes a deposit of Rs. 5,000 from a person who is no longer traceable, only Rs. 3,000 can be deemed to be his income, because no deduction would have been allowed in any past assessment on account of the deposit of Rs. 5,000.

As regards trading liabilities, it is only upon "remission or cessation" that this provision comes into operation. When a liability becomes barred by the law of limitation, there is neither remission nor cessation of the liability. Therefore if the amount of a trading debt was allowed as an expense to an assessee, the amount cannot be taxed under section 41(1) as the income of the year in which the debt due by the assessee becomes time-barred, even if the amount is credited to the profit and loss account (*62 ITR 34*).

According to the Supreme Court, the Income-Tax Act does not contain any provision making a successor in business or the legal representative of an

assessee, to whom an allowance has already been granted, liable to tax under section 41(1) in respect of the amount remitted and received by the successor or the legal representative (*82 ITR 624*).

(2) Under section 41(2), where any building, machinery, plant or furniture, owned by the assessee and used for the purposes of his business or profession, is sold, discarded, demolished or destroyed, and the moneys payable in respect thereof together with the amount of any scrap value exceed the written-down value, so much of the excess, *as is equal to the amount of depreciation allowed*, is chargeable as income of the business or profession of the previous year in which the moneys payable become due.

Where any expenses (*e. g.*, commission on sale) are incurred in connection with the sale of a fixed asset, such expenses are allowed as revenue expenditure, as the profit on sale is to be taxed as business income.

Where an assessee handed over a business asset to the partnership in which he is a partner, he cannot be said to have sold the same to the partnership, as the firm is not a legal entity apart from the partners who constitute it. The same would be true about an exchange. There being neither sale nor exchange, section 41(2) would not be applicable in such cases and the difference between the written-down value of the asset and the valuation of the asset for the purpose of the partnership will not be chargeable to income-tax (*92 ITR 87*).

This is further explained and illustrated in a subsequent chapter dealing with depreciation.

(3) Under section 41(2A), where any structure or work referred to in section 32(1A) is sold, discarded, demolished, destroyed or surrendered, the amount by which the moneys payable exceed the written-down value of the structure or the work shall be chargeable to tax as income from the business or profession of the previous year in which the moneys become due, even if the business or profession for the purpose of which the structure or work was constructed or done is no longer in existence in that year.

(4) Under section 41(3), where an asset representing capital expenditure on scientific research is sold, without having been used for any other purpose, and the proceeds of sale together with the total amount of the deductions made exceed the amount of the capital expenditure, the excess or the amount of the deductions so made whichever is less, is chargeable as income of the business or profession of the previous year in which the sale takes place.

(5) Under section 41(4), where a deduction has been allowed in respect of a bad debt and the amount subsequently recovered on any such debt is greater than the difference between the debt and the amount so allowed, the excess is deemed to be the income of the business or profession of the previous year in which it is recovered. This has already been explained and illustrated in this chapter.

(6) Under section 35A(4), where patent rights or copyrights are sold during a previous year and the capital sum received on the sale exceeds the cost of acquisition remaining unallowed, the excess (up to the total amount of the allowance made in earlier years) will be chargeable to income-tax as the income of the business for the previous year in which the sale takes place.

Losses of Defunct Business. In cases where a receipt is deemed to be profit of a business under section 41 after the business has ceased to exist, any unabsorbed loss which arose in that business during the previous year in which it ceased to exist, may be set off against the income chargeable under this section.

Devaluation Concessions

Where an assessee had acquired any capital asset from a country outside India for the purposes of his business or profession on deferred payment terms

or against a foreign loan before the date of the devaluation of the rupee (6th June 1966), he has incurred an additional rupee liability in meeting the instalments of the cost of the asset or of the foreign loan, falling due for payment after the date of devaluation. Therefore, in order to provide relief to assessees in such cases section 43A has made the following provisions :

(1) The original actual cost of the asset is allowed to be written up by the amount of additional rupee liability for the purpose of claiming depreciation for the assessment year 1967-68 and subsequent assessment years.

(2) Similar increase in the original actual cost will be allowed in respect of (*i*) capital asset acquired for use on scientific research related to the class of business carried on by the assessee, (*ii*) patent rights or copyrights acquired from abroad, or (*iii*) any capital assets acquired by a company for the purpose of promoting family planning amongst its employees.

(3) Where a capital asset acquired from abroad before the date of devaluation is sold or otherwise transferred by an assessee after the date of devaluation, the capital gain or loss will be computed with reference to the original cost of the asset as written up by the additional rupee cost.

(4) Where there is a decrease in the additional rupee liability of an assessee (due to the devaluation of the currency of the foreign country), the cost of acquisition of the asset will be correspondingly reduced for the above purposes.

(5) Where the whole or any part of the additional rupee liability is met by another person, liability so met shall not be taken into account for the above purposes.

(6) The provisions of section 43A will not be taken into account in computing the actual cost of an asset for the purpose of development rebate.

Omission of Income from Profit and Loss Account

If any income chargeable to tax is not shown in the profit and loss account (*e. g.*, interest derived from sinking fund investments transferred direct to the sinking fund account and not through the profit and lost account, or an exceptional profit made during the accounting year but transferred direct to a reserve account or to the proprietor's capital account and not through the profit and loss account), such income should be included in the total income of the assessee under the appropriate heads.

Cash Credits. In the case of dishonest assessees, false cash credits are passed in a personal account, particularly the account of a female relative of a partner or even of the proprietor himself in order to conceal profits. Therefore, under section 68, where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Income-Tax Officer, satisfactory, the sum so credited *may* be charged to income-tax as the income of the assessee of *that previous year*.

Where there is evidence to show that the amount of such credit belongs to some other person, the Income-Tax Officer has the power to assess that other person. Therefore, the fact that the explanation offered by the assessee is not satisfactory should not invariably force the Income-Tax Officer to treat it as the income of the assessee. This is why the word '*may*' is used in this section.

If a cash credit stands in the assessee's name in his books, the burden of proof is upon him to show that the item of receipt is not of an income nature. In such a case the assessee has to prove positively the source and nature of the amount shown in the item and if he fails to furnish satisfactory explanation the Income-Tax authorities are entitled to draw the inference that the receipt is of an income nature. But the position is different in regard to a sum which is shown in the assessee's books in the name of a third party. In

such a case the onus of proof is not upon the assessee to show the source or nature of the amount of the cash credit. The onus shifts to the department to show by some material that the amount standing in the name of the third party does not belong to him but belongs to the assessee (*23 ITR 344*).

There is no presumption in law that an amount standing in the name of the assessee's wife belongs to the husband. In the absence of evidence to the contrary, the money standing in the name of the assessee's wife must be presumed to belong to her and the assessee cannot be taxed in respect of such an amount. The onus of proof in such a case will not be on the assessee but will be on the department to show by at least some material that the amount standing in the name of the assessee's wife does not belong to her but belongs to the assessee (*24 ITR 16*).

Unexplained Investments. According to section 69, where in the financial year immediately preceding the assessment year the assessee has made investments which are not recorded in the books of account, and the assessee offers no explanation about the nature and source of the investments or the explanation offered by him is not, in the opinion of the Income-Tax Officer; satisfactory, the value of the investments *may* be deemed to be the income of the assessee of *such financial year.*

Where there is evidence to show that the amount of the unexplained investments belong to some other person, the Income-Tax Officer has the power to assess that other person. Therefore, the fact that the explanation offered by the assessee is not satisfactory should not invariably force the Income-Tax Officer to treat it as the income of the assessee. This is why the word '*may*' is used in this section.

Under section 69A and 69B, where in the financial year immediately preceding the assessment year an assessee is found to be the owner of any money, bullion, jewellery or any other valuable article, which are not recorded fully in his books of account, the unrecorded amount of such property is deemed to be the income of *that financial year*, if the assessee's explanation is not satisfactory.

Omission of Expenditure from Profit and Loss Account

Where any admissible business expenditure is not debited to profit and loss account, but is met out of some reserve or provision made for the purpose (*e. g*, *bona fide* bad debts written off debited to Provision for Bad Debts Account or labour welfare expenses met out of Welfare Reserve Account). such business expenditure should be deducted in computing the income from business or profession.

Partly Agricultural and Partly Business Income

According to rule 7 of the Income-Tax Rules, 1962, where the income of an assessee (*e. g.*, a sugar mill company having its own agricultural farms) is derived partly from agriculture and partly from business, then that part which is chargeable under the head "Profits and Gains of Business or Profession" is to be determined by deducting the market value of any agricultural produce which has been raised by the assessee or received by him as rent in kind and

(*a*) which has been utilised as raw material in such business ; or

(*b*) the sale receipts of which are included in the accounts of the business. But no further deduction is to be made in respect of any expenditure incurred by the assessee as a cultivator or receiver of rent in kind.

For this purpose, the market value shall be deemed to be :

(*i*) where the agricultural produce is sold in the market, the value calculated according to the average price at which it has been so sold during the year previous to that in which the assessment is made ; or

(*ii*) where the agricultural produce is not ordinarily sold in the market in its raw state, the cost of production plus a reasonable rate of profits as determined by the Income-Tax Officer.

Tea Grown and Manufactured. According to Rule 8 of the Income-Tax Rules, 1962, income, derived from the sale of tea grown and manufactured by the assessee *in India* is computed as if it were income derived from business, but only 40 per cent of the income so computed is deemed to be profit liable to tax the remaining 60 per cent being treated as agricultural income.

In computing such income an allowance is made in respect of all revenue expenditure ; but no capital expenditure incurred in connection with the extension of the estate is admissible as a deduction.

However, in order to encourage the extension of the area under tea cultivation with a view to having increased production and export of tea, a development allowance is granted, in addition to depreciation and development rebate, in respect of capital expenditure on planting and replanting of tea bushes.

Profits of Oil Mining Companies

Section 42 grants certain special allowances to an assessee who carries on business, in association with the Central Government, of prospecting for, extracting, or producing mineral oils.

This section does not apply except so far as it is rendered applicable by a provision specified in an agreement between the assessee and the Central Government for allowances which may be in lieu of or in addition to the allowances admissible in computing the income from business.

This section read with such an agreement with the Central Government would permit an assessee to claim allowances which may not on general principles be admissible. These special allowances may be in relation to the following :

(*a*) Expenditure by way or infructuous or abortive exploration expenses in respect of any area surrendered prior to the beginning of commercial production by the assessee.

(*b*) Expenditure incurred by the assessee, whether before or after the beginning of commercial production, in respect of drilling or exploration activities or services or in respect of physical assets used in that connection, except assets on which depreciation allowance is admissible.

(*c*) The depletion of mineral oil in the mining area in respect of the previous year in which production is begun and for such succeeding year or years as may be specified in the agreement.

Such allowances are to be computed and made in the manner specified in the agreement.

Valuation of Stock

The question of valuation of stock arises in the computation of business profits. In every-day business, it is very seldom that a trader is able to sell every bit of goods he purchases in a year. In computing the profit or loss for the year, it is therefore essential to take into account not only the sales but also the value of what remains on hand as stock, the cost of purchase in the year and the value of goods brought over from a preceding year.

The problem of the valuation of stock presents two facets ; (*i*) the quantum of stock ; and (*ii*) the rate at which the quantum is to be valued for purposes of income-tax. The trading stocks which remain on hand at the end of the year of account (*i. e.*, closing stocks) become at the beginning of the succeeding year the opening stocks for that year. The amount of the opening stocks cannot therefore differ from that of the corresponding closing stocks for the preceding year.

As regards the valuation of stocks, the income-tax authorities require that once a particular method of valuation is elected, the same method must be consistently followed from year to year, change being permissible only with the approval of the Income-Tax Officer. This is not expressly provided in the Act, but section 145 provides that profits shall be computed in accordance with the method of accounting regularly employed by the assessee. A "method regularly employed" would include the method of valuation of stock also. The courts have supported the view that a method of valuation once employed cannot be changed to suit the convenience of the assessee.

In view of the fact that section 145 is sufficient for insisting on proper and constant valuation of stock, there is no need of introducing any rules in this connection. Such rules might fetter the discretion now enjoyed by the Income-Tax Officer to make exceptions in deserving cases. Thus, when goods are damaged by fire, flood, white ants or other natural causes, it is the practice of the income-tax authorities to allow the trader to reduce the value of stock by a reasonable amount.

Under the approved methods of commercial accounting, stock may be valued at cost price, at market price, or at either cost or market price whichever is less. There is nothing in the income-tax law which either prescribes or supports any particular method of stock valuation. An assessee may adopt *any* method of stock valuation he chooses but he must stick to it. The other methods of valuation found in this country are (*a*) the valuation of the goods at one uniform rate irrespective of price fluctuations ; (*b*) the valuation of the goods at a rate reducing the cost or market rates by a certain percentage as margin of safety ; and (*c*) a valuation made at the discretion of the assessee without any definite system.

In regard to the valuation of stock on the basis of the cost or market value whichever, is lower, there are two ways in which this can be done, namely :

(*i*) The 'individual method' or 'pick and choose method'.
(*ii*) The 'global method'.

Under the former method, one has to take in respect of each article the cost or its market value whichever is lower and then to aggregate such lower figures. Under the latter method, one has to compare the aggregate of the cost of all articles with the aggregate of the market rate of all articles and to take the lower one.

Both these methods are acceptable for income-tax purposes. Thus :

Stock Inventory

Articles of Stock	Cost Price	Market Price	Lower of Cost or Market Price
	Rs.	Rs.	Rs.
A	1,500	1,600	1,500
B	3,700	3,300	3,300
C	6,800	6,300	6,300
D	7,500	9,000	7,500
E	4,500	4,400	4,400
	24,000	24,600	23,000

According to the individual method, the stock would be valued at Rs. 23,000 ; while according to the global method, it would be valued at Rs. 24,000.

When stock is valued at cost or market price whichever is lower, it is an exception to the general rule that a precautionary reserve for an anticipated loss is not allowable and that no unrealised loss can be set off against the profits of the year.

To sum up, the position as regards the valuation of stock-in-trade is as follows :

(*a*) The stock is usually valued at cost or market price whichever may be lower.

(*b*) Where any other method of valuing stock is adopted, it must be followed throughout.

(*c*) If the valuation of closing stock is disturbed, the opening stock must also be revalued on the same basis in order to arrive at the correct result of the year's working for purposes of income-tax assessment.

Some of the important legal decisions on the question of stock valuation are given below :

(1) The assessee is free to adopt his own method of accounting and, instead of valuing the stock at cost or market price whichever is lower, he may regularly employ the method of valuing it only at cost irrespective of fluctuations in the market value, or always at the market rate without regard to its cost. But whatever basis of valuation is adopted, it must be adhered to consistently ; a casual departure from the basis of valuation cannot be accepted (*14 ITR 100*).

(2) An assessee, who values his stock on cost or market price whichever is lower, may value his stock in one year according to "individual method" and in another year according to 'global method'. The Department cannot have any objection to the practice (*17 ITR 1*).

(3) Where an assessee converts a capital asset into stock-in-trade and starts dealing in it, it should be valued at its market value at the date of its conversion (*46 ITR 86*).

(4) Where stock-in-trade is entered in the books of account at cost, it must be taken out of the accounts also at cost when it is withdrawn from the business *e. g.*, for the personal use of the proprietor or when it is given away in charity, for under the income-tax law the State has no power to tax a potential future gain. This is according to the decision of the Supreme Court (*24 ITR 506*).

(5) It is settled law that an assessee has a right to value his closing stock at cost or market price whichever is lower. Where the goods are saleable only in certain foregin markets and there is no demand for the goods in such foreign markets, the assessee is entitled to value the goods at "nil" and he is not bound to show that he had made efforts to sell the goods in other foreign markets or in the local market before valuing stock at nil (*56 ITR 360*).

A company treated part of its stock as obsolete and part as slow-moving and valued them at 100% and 50% less than the cost price respectively. The stock was however valued at higher prices for purposes of obtaining overdraft from banks. Some of the articles were sold at a price higher than the cost price.

It was held that the method of valuation adopted by the assessee was a recognised method as it was followed regularly. The fact that occasionally some items were sold for a price higher than the cost price would not detract from the nature of the system. The figures furnished by the assessee for

obtaining bank overdrafts were not concerned with the actual stock valuation (*60 ITR 531*).

In connection with the valuation of stock, it may also be noted that if an asset is acquired by gift, bequest or succession, its cost to the assessee is not the original cost of it to his predecessor but its market value at the time of the gift, bequest, or succession as the case may be.

Illustration

What adjustment would be necessary for computing the taxable profits of a business for the assessment years 1974-75 and 1975-76 in the following cases, the accounting year being the calendar year ?

(*a*) A company has always valued its closing stock at cost, but in the year 1973 its opening and closing stocks, appearing in the Profit and Loss Account at Rs. 4,50,000 and Rs. 6,30,000 respectively, were valued at 10% below cost. The closing stock of 1974 was again valued correctly at cost.

(*b*) A company has always valued its closing stock at cost, but in the year 1973 its opening and closing stocks, appearing in the Profit and Loss Account at Rs. 6,30,000 and Rs. 4,50,000 respectively, were valued at 10% below cost. The closing stock of 1974 was again valued correctly at cost.

(*c*) A company has always valued its closing stock at cost, but in the year 1973 its closing stock, appearing in the Profit and Loss Account at Rs. 9,00,000 was valued at 10% below cost. The closing stock of 1974 was again valued correctly at cost.

(*d*) The opening and closing stocks of a company, values of which appear in its Profit and Loss Account for 1974 at Rs. 2,70,000 and Rs. 4,50,000 respectively, were valued at 10% less than their respective costs. The market prices thereof on 31st December 1973 and 31st December 1974 were higher than their costs.

(*e*) The opening and closing stocks of a company, values of which appear in its Profit and Loss Account for 1974 at Rs. 6,00,000 and Rs. 8,50,000 respectively, were valued at 20% below market price. The company's method of valuing the closing stocks is to value them at cost or market price whichever is lower. The market price was lower than cost on 31-12-1973 and 31-12-1974.

(*f*) Prior to 1973 a company always valued its stock at cost. In 1973 both the opening and closing stocks, appearing in its Profit and Loss Account at Rs. 4,50,000 and Rs. 3,60,000 respectively, were valued at 10% below cost. In 1974 the closing stock was again valued at cost.

(*a*) The closing stock of 1972 amounting to Rs. 5,00,000 was correctly valued at cost ; but, when it became the opening stock of 1973 it was valued at 10% less and shown in the Profit and Loss Account for 1973 at Rs. 4,50,000. It is obvious that in doing so Rs. 50,000 must have been debited to some Reserve Account.

By this deviation from the usual method of stock valuation, the figure of profit for 1973 shown by the Profit and Loss Account has been understated Rs. 20,000 as calculated below :

	Rs.
Undervaluation of closing stock (1/9th of Rs. 6,30,000)	70,000
Undervaluation of opening stock (1/9th of Rs. 4,50,000)	50,000
	20,000

Therefore, in computing the taxable profits of 1973 for the assessment year 1974-75 Rs. 20,000 should be added to the figure of profits shown by the Profit & Loss Account for 1973.

As a result of the undervaluation of the opening stock of 1974 the profit shown by the Profit & Loss Account of that year is overstated by Rs. 70,000. Therefore, in computing the taxable profits of 1974 for the assessment year 1975-76 Rs. 70,000 should be deducted from the figure of profits shown by the Profit & Loss Account.

(*b*) In this case also in revaluing the opening stock at 10% below cost, Rs. 70,000 must have been debited to some Reserve Account, but by this deviation from the usual method of stock valuation, the figure of profit shown by the Profit & Loss Account of 1973 has been overstated by Rs. 20,000 as calculated below :

	Rs.
Undervaluation of opening stock (1/9th of Rs. 6,30,000)	70,000
Undervaluation of closing stock (1/9th of Rs. 4,50,000)	50,000
	20,000

Therefore, in computing the taxable profits of 1973 for the assessment year 1974-75 Rs. 20,000 should be deducted from the figure of profits shown by the Profit & Loss Account for 1973.

As a result of the undervaluation of the opening stock of 1974 the profits shown by the Profit & Loss Account of that year is overstated by Rs. 50,000. Therefore, in computing the taxable profits of 1974 for the assessment year 1975-76 Rs. 50,000 should be deducted from the figure of profits shown by the Profit & Loss Account.

(*c*) The closing stock of 1973 is undervalued by Rs. 1,00,000 (1/9th of Rs. 9,00,000), and therefore the figure of profits shown by the Profit and Loss Account of 1973 is understated by Rs. 1,00,000,

In computing the taxable profits of 1973 for the assessment year 1974-75 Rs. 1,00,000 should be added to the figure of profits shown by the Profit and Loss Account for 1973.

As a result of the undervaluation of the opening stock of 1974 the profits shown by the Profit and Loss Account of that year is overstated by Rs. 1,00,000. Therefore, in computing the taxable profits of 1974 for the assessment year 1975-76 Rs. 1,00,000 should be deducted from the figure of profits shown by the Profit and Loss Account for 1974.

(*d*) As the opening and closing stocks have been valued at 10% below cost it appears that the company has always valued its stock on this basis. If this method of stock valuation has been regularly employed by the company, it is not necessary to make any adjustment in respect of stock valuation.

However, if the company valued its stock in the past at cost or market price whichever is less, but changed the mode of valuation in 1974, then by this deviation the figure of profits for 1974 has been understated by Rs. 20,000 as calculated below :

	Rs.
Undervaluation of closing stock (1/9th of Rs. 4,50,000)	50,000
Undervaluation of opening stock (1/9th of Rs. 2,70,000)	30,000
	20,000

Therefore, in computing the taxable profits for the assessment year 1975-76, Rs. 20,000 should be added to the figure of profits shown by the Profit and Loss Account for 1974.

(*e*) By this deviation from the usual method of stock valuation, the figure of profits for 1974 shown by the Profit & Loss Account has been understated by Rs. 62,500 as calculated on next page :

	Rs.
Undervaluation of closing stock (1/4th of Rs. 8,50,000)	2,12,500
Undervaluation of opening stock (1/4th of Rs. 6,00,000)	1,50,000
	62,500

According to the usual method, the stocks (both opening and closing) should have been valued at market price because it was lower than cost.

Rs. 62,500 will therefore be added to the profit of 1974.

(*f*) By departure from the usual method of stock valuation, the profits of 1973 have been overstated by Rs. 10,000 as calculated below :

	Rs.
Undervaluation of opening stock (1/9th of Rs. 4,50,000)	50,000
Undervaluation of closing stock (1/9th of Rs. 3,60,000)	40,000
	10,000

Therefore in computing the taxable profits of 1973 for the assessment year 1974-75 Rs. 10,000 would be deducted from the figure of profits shown by the Profit and Loss Account of 1973.

In 1974 the closing stock is properly valued but the opening stock appearing in the Profit & Loss Account is still undervalued by 10% with the result that the profits of 1974 are again overstated by Rs. 40,000 (1/9th of opening stock of Rs. 3,60,000). Therefore, in computing the taxable profits of 1974 for the assessment year 1975-76 Rs. 40,000 should be deducted from the figure of profits shown by the Profit & Loss Account for 1974.

Shares held as Stock-in-Trade. In the case of a dealer in shares and securities, the unsold stock thereof held at the close of an accounting year *must* be valued according to the principles laid down above. But the following points must be noted in this connection.

(1) Where bonus shares issued in respect of ordinary shares held in a company are received by an assessee who is a dealer in shares, their real cost to the assessee cannot be taken to be nil or their face value. They have to be valued by spreading the cost of the old shares over the old shares and the new issue (namely, the bonus shares) taken together if they rank *pari passu*. This is according to a decision of the Supreme Court (*74 ITR 62*).

(2) If an assessee purchases some shares as an investment but later on he converts these shares into his stock-in-trade and carries on a business in shares, the profit or loss on the sale of such shares will be the difference between their sale price and their market price on the day when they were taken as the stock-in-trade of the assessee, and not the difference between the sale price and the price at which the assessee had originally purchased the shares.

What is brought to tax as profits of a business is the real profits of the business, and to determine the real profits, the accounts of the business must be considered on commercial principles ; the capital appreciation of the shares from the date of purchase up to the date when they are taken as the stock-in-trade of the assessee's business, cannot be treated as profits of the business. What is being assessed to tax in a business is not any profits considered from a theoretical, academic or legalistic sense, but commercial profits, *i. e.*, profits which are made in a business by the carrying on of the business which a commercial man would accept as profits of that business. It is not the point of view of the department with regard to the profits which should prevail with the Court, but the point of view of the commercial man (*39 ITR 753* and *46 ITR 86*).

(3) Where the shares originally purchased as an investment are not converted into the stock-in-trade of an assessee's share business, the sale of such shares is only realisation of a capital asset and does not amount to conversion of the assessee's stock-in-trade. Therefore, the profit from the sale of such shares is not business income. What is originally a capital investment may be converted into stock-in-trade by the conduct of the assessee in dealing with it ; but evidence of such conduct must be cogent, clear, and unequivocal and the taxing authorities are not justified in inferring that capital has acquired the character of the stock-in-trade merely from the fact that the assessee has dealt with other shares as a trading commodity (*47 ITR 720*).

Important Note :

The following illustrations and those given in the next chapter should be worked out after studying the subsequent chapters dealing with depreciation and development rebate, capital gains, the computation of total income, and deductions in computing total income.

Illustrations

(1) Given below is the Profit & Loss Account of a limited company for the year ended 31st December 1974 :

	Rs.		Rs.
Cotton Account	57,08,975	Yarn Account	54,05,978
Stores Account	9,17,824	Cloth Account	48,12,056
Wages and Salaries	19,15,992	Waste Account	60,754
General Charges	14,504	Transfer Fees	3,108
Donations to Agra University	5,000	Rent of Bungalows and Chawls	28,951
Rates and Insurance	20,188	Interest from Government Securities (gross)	13,700
Brokerage	3,862	Sundry Receipts	3,000
Office Expenses	1,20,347		
Directors' Fees	4,500		
Audit Fees	2,500		
Research Expenditure	60,000		
Interest	1,05,925		
Repairs to Building and Machinery	62,278		
Law Charges	2,865		
Workmen's Welfare Expenses	27,592		
Contribution to Staff Provident Fund (Recognised)	37,500		
Managing Director's Commission	1,00,845		
Net Profit (subject to depreciation)	12,16,850		
	1,03,27,547		1,03,27,547

Compute the company's taxable profits and also its total income for the year after taking the following information into account.

(*a*) Rs. 2,700 of brokerage was paid for cotton and stores purchased and the balance was in respect of loans raised for the company's business.

(*b*) Rates Rs. 1,800, insurance Rs. 1,250 and repairs Rs. 2,872 were in respect of bungalows and chawls let to employees.

(*c*) Legal charges amounting to Rs. 950 were incurred in connection with the purchase of additional land.

(*d*) Two-thirds of the research expenditure is capital expenditure, which was incurred in July 1974.

(*e*) The amount of depreciation allowance is agreed at Rs. 2,75,850.

(*f*) General charges include Rs. 5,000 spent by the company for promoting family planning amongst its employees.

	Rs.	Rs.
Profits as per Profit & Loss Account		12,16,850
Add Inadmissible Expenditure :		
Donations	5,000	
Rates, insurance and repairs of buildings not used for business	5,922	
Legal charges being capital expenditure	950	
Capital research expenditure	40,000	51,872
		12,68,722
Less Income not taxable under business :		
Rent of Buildings	28,951	
Interest on securities	13,700	42,651
		12,26,071
Less Depreciation allowance	2,75,850	
Full amount of research capital expenditure	40,000	3,15,850
Taxable profits of business		9,10,221
Rent of bungalows and chawls let being annual value		28,951
Less Allowance for local taxes		1,800
		27,151
Annual value of property in this case	4,525	
Less One-sixth for repairs	1,250	
Insurance		5,775
Taxable income from property		21,376
1. Interest on securities gross		13,700
2. Income from house property		21,376
3. Business profits		9,10,221
Gross Total Income		9,45,297
Deduct 50% of donations		2,500
Total Income		9,42,797
Rounded off		9,42,800

Brokerage paid in respect of loans raised for the company's business is an admissible deduction.

(2) X is a practising chartered accountant. He also runs a private accountancy coaching institute. He keeps his accounts on a cash basis, and his summarised cash account for the year ended 31st March 1975 is as under :

	Rs.		Rs.
To Balance b/d	9,514	By Office Expenses	4,150
,, Audit Fees	14,750	,, Institute Expenses	902
,, Income from other accountancy work	5,475	,, Personal Expenses	3,519
,, Institute Fees	2,100	,, Membership and Certificate Fees	143

To Examiner's Fees	645	By Life Insurance Premium	1,250
,, Interest on investments (net)	4,000	,, Income-Tax	2,493
" Rent from Property (not subject to any local taxes)	4,300	,, Motor-car purchased	3,450
		,, Motor-car Expenses	420
		,, Insurance of Property	300
		,, Balance c/d	24,157
	40,784		40,784

Having regard to the following information, compute his total income for the previous year 1975-76 :

(*a*) Office expenses included Rs. 173 for the purchase of technical books for his office.

(*b*) One-third of motor-car expenses is in respect of his professional practice.

(*c*) His investments are all in Government securities.

(*d*) Depreciation allowance for motor-car and furniture is Rs. 1,142.

	Rs.	Rs.
Gross professional earnings :		
Audit Fees	14,750	
Income from accountancy work	5,475	
Institute Fees	2,100	
Examiner's Fees	645	22,970
Less Admissible Expenditure :		
Office Expenses	3,977	
Institute Expenses	902	
Membership Fees	143	
Motor-car Expenses (1/3)	140	
Cost of books being less than Rs. 750	173	
Depreciation	1,142	6,477
Income from profession		16,493
1. Interest on Securities gross, tax deducted at source being 23%		5,195
2. Income from house property :		
Annual value	4,300	
Less One-sixth for repairs	716	
	3,584	
Less Insurance	300	3,284
3. Income from profession		16,493
Gross Total Income		24,972
Deductions :		
Section 80C : for insurance premium	1,250	
Section 80L : interest on government securities	3,000	4,250
Total Income		20,722
Rounded off		20,720

The compulsory membership and certificate fees are an allowable deduction.

(3) Given below is the Profit & Loss Account of a sugar mill company for the year ended 30th June 1974 :

	Rs.		Rs.
Opening Stock of Sugar and Molasses	1,82,300	Sales	26,50,500
Cost of cane crushed	12,57,700	Sundry Receipts	7,700
Mfg. Expenses	7,98,500	Closing Stock of Sugar and Molasses	3,66,000
Wages and Salaries	2,00,000		
Repairs and Renewals	40,700		
Establishment Charges	41,600		
Commission on Sales	62,500		
Directors' Fees	3,600		
Auditors' Fees	1,000		
General Charges	17,800		
Managing Director's Remuneration	78,600		
Depreciation	1,30,700		
Provision for Taxation	1,00,000		
Balance c/d	1,09,200		
	30,24,200		30,24,200
General Reserve	15,000	Balance b/d	1,09,200
Proposed Dividends	80,000		
Balance carried to B/S	14,200		
	1,09,200		1,09,200

After taking the following information into consideration, compute the total income of the company for the assessment year 1975-76 :

(*a*) Cane crushed includes Rs. 1,54,000 being cost of cane grown on the company's own farm, the average market price of such cane being Rs. 1,96,000.

(*b*) Manufacturing expenses include Rs. 4,26,000 for excise duty, Rs. 67,000 capital expenditure on a new scientific research laboratory set up in July 1973 and Rs. 11,000 for its maintenance during the year.

(*c*) Establishment charges include Rs. 3,200 paid as compensation to an employee whom it was not desirable to keep in the service of the company.

(*d*) Sugar worth Rs. 1,000 was given away free to an orphanage.

(*e*) Rs. 15,000 (cost of additions to factory building in June 1974) has been charged to repairs and renewals.

(*f*) Admissible depreciation amounts to Rs. 98,200.

		Rs.
Profit as per Profit and Loss Account		1,09,200
Less Agricultural income (Rs. 1,96,000 – Rs. 1,54,000) included therein		42,000
		67,200
Add Value of sugar donated not shown in Profit and Loss Account		1,000
		68,200
Add Inadmissible Expenditure :		
Provision for Taxation	1,00,000	
Addition to factory building	15,000	
Excess depreciation	32,500	1,47,500
Total Income		2,15,700

Under section 80G, a charitable donation must be paid in cash ; but under executive instructions donations made out of stock-in-trade of a business concern are treated as having been made in cash if the value of the goods donated is included in the sales and a contra debit is made in the profit and loss account to represent the sum donated.

In this case no debit for the donation is made in the profit and loss account. Therefore no deduction in respect of the donation is admissible.

Compensation paid to an employee whom it is not desirable to keep in the service of the company is an allowable deduction, because his continuing in service is detrimental to the profiitable conduct of the company's business.

Capital expenditure incurred after 31st March 1967 on scientific research related to the business of the assessee is deductible in full in the very year in which it is incurred. It is assumed that the scientific research in this case is related to the business of the company.

(4) X is a general merchant. He earns a sizeable income from the illegal activity of smuggling goods on the Indo-Nepal border. For the assessment year 1975-76 his income from legal business has been computed at Rs. 8,000 but that from illegal business amounts to Rs. 60,000. In connection with the latter income he claims the following deductions :

(*a*) Rs. 5,000 paid as tips in small amounts on various occasions to the members of the border police who, in consequence, allowed him more or less a free hand in pursuing his illegal activities.

(*b*) Rs. 10,000 value of goods which were seized and forfeited by the land customs authorities.

(*c*) Rs. 2,000 cash penalty imposed by the above authorities for the breach of Land Customs Act.

Work out his total income for the assessment year in question.

The taint of illegality or wrong-doing associated with income is immaterial for the purpose of taxation under the Income-Tax Act. In other words the Income-Tax Act does not differentiate between legal and illegal sources of income. Illegal income is as much liable to tax as legal income.

In regard to the three items claimed as deductions from the amount of illegal income it must be pointed out that what section 28 taxes under the head "Profits and Gains of Business or Profession" is the real net profit from a business. Even an illegal business can be run only by incurring certain unlawful losses and expenses. If there is nothing in the Income-Tax Act to take illegal business out of the tax net, there is no prohibition against the allowance of illegal expenses or losses in computing the net profit of an illegal business.

If the assessee's income from illegal business is to be taxed, the correct amount of that income can be determined only by allowing the deduction of all the losses sustained and expenses incurred in the course of carrying on that business.

His total income for the assessment year 1975-76 will therefore be as follows :

			Rs.
Income from legal business			8,000
Income from illegal business		60,000	
Less Admissible expenses and losses :			
Tips to police	5,000		
Value of goods seized	10,000		
Penalty imposed	2,000	17,000	43,000
Total Income			51,000

(5) A Hindu undivided family, which carried on business on an extensive scale with a capital of about Rs. 20 lakhs, borrowed large funds during the relevant previous year for purposes of the business and paid interest amounting to Rs. 93,611. In the course of the year, moneys amounting to Rs. 1,77,984 were withdrawn from time to time for household expenses. Is the interest paid an allowable deduction in computing the taxable profits of the business ?

As the amounts were borrowed for the purposes of the business of the family and as no particular sum purporting to be borrowed on behalf of business was spent for household expenses and the family was entitled to withdraw from the capital supplied by it thereby depleting the capital, the fact that part of the amount borrowed was later on used for personal expenses did not deprive the assessee of the benefit of deduction of the entire interest paid on borrowed capital. Therefore, the whole amount of interest is an admissible deduction (*47 ITR 469*).

(6) Are the following expenses incurred by an assessee deductible in computing his taxable income from business ?

(*a*) Interest paid on account of inadequate advance payments of tax.
(*b*) Wealth-tax paid.
(*c*) Ex-gratia payment to a retiring employee.
(*d*) Secret payment to a labour leader for calling off a threatened strike.
(*e*) Donation to a political party.
(*f*) Cost of a transistor set presented to a paid selling agent.
(*g*) Cost of installing a new telephone.
(*h*) Sales-tax paid.

(*a*) Only interest on capital borrowed for purposes of business is admissible. Penal interest which an assessee pays on account of inadequate advance payments of tax is not of this character. The expenditure is also not admissible under section 37 because it is not incurred for the purpose of the business.

(*b*) Wealth-tax is a tax on the value of the net assets owned by an assessee. It is an incidence of the owning of property and it has no connection with the business. It is not therefore allowed as a deduction. It is expressly disallowed.

(*c*) The ex-gratia payment to a retiring employee is voluntary and for past services. Unless the expenditure is incurred in the future interests of the business, it cannot be said that the payment is laid out for the purpose of the business. It is therefore not admissible as a deduction.

(*d*) The secret payment to a labour leader for calling off a threatened strike can be allowed as it is laid out for the purpose of business provided the payment is proved. In practice, it is not possible to produce a receipt for such payment. Therefore it is disallowed.

(*e*) Donation to a political party is not an expenditure incurred wholly and exclusively for the purpose of the business and is not allowable.

(*f*) The cost of a transistor set is admissible as a deduction for it is a present to an employee.

(*g*) Under executive instructions, the cost of installing a new telephone is an admissible deduction.

(*h*) Sales-tax paid is an admissible deduction, as the payment is made for purposes of the business.

CHAPTER 8

New Industrial Undertakings, Etc.

Section 80J is intended to encourage the establishment of new industrial undertakings, shipping companies and new hotels in India.

Under this section, where the gross total income of an assessee (as defined in a subsequent chapter dealing with deductions from total income) includes any profits (as calculated for income-tax purposes, and not book profits) derived from an industrial undertaking or a ship or the business of a hotel, to which this section applies, then in computing his total income a deduction of 6% per annum of the capital employed therein will be allowed from such profits as reduced by the deduction under section 80H or 80HH, *i. e.*, deduction in case of new industrial undertakings employing displaced persons or established in backward areas. The amount of capital employed is to be computed in the prescribed manner as explained below.

This deduction is known as the 'tax-holiday' concession.

It is only if any taxable income remains after setting off the unabsorbed depreciation and carried-forward losses of past years that the question of granting deduction under this section would arise.

The deduction under this section is allowed in computing the total income (as computed without applying the provisions of section 64 and before making any deductions under sections 80C to 80G and 80K to 80TT). It means that this deduction is allowed before allowing any other deductions, *e. g.*, deduction in respect of inter-corporate dividends.

The benefit under this section is confined only to the profits from the new industrial undertaking and does not extend to the profits of any other business activity even though closely connected with that undertaking.

Where the assessee is a registered firm, deduction under this section can be claimed both by the firm and the partners.

Section 80K grants a deduction to the shareholder in respect of such part of the dividend paid by a company as is attributable to the company's profits deducted under this section.

Period of Deduction.

In the case of an industrial undertaking owned by a co-operative society, the period of the 'tax-holiday' is 7 years, and in other cases 5 years, from the year in which the undertaking commences production or operation. In the case of a ship or approved hotel, the period of the 'tax-holiday' is 5 years from the year in which the ship is brought into use or the hotel starts functioning.

The 'tax-holiday' concession is available in the case of industrial undertakings going into production or operation up to 31st March 1976 and

ships brought into use by an Indian company up to that date. There is no such time limit in the case of approved hotels run by Indian companies.

Applicability of the Section.

Industrial Undertaking. This section applies to any industrial undertaking which fulfils *all* the following conditions, namely :

1. It is not formed by the splitting up or reconstruction of a business already in existence. This condition does not apply in respect of any industrial undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such industrial undertaking as is referred to in section 33B in the circumstances and within the period specified in that section. However, an acquisition of a part of the machinery in second-hand from open market by an assessee would not disentitle him to exemption (*82 ITR 778*).
2. It is not formed by the transfer to a new business of a building (not being a rented building), machinery or plant previously used for any purpose. However, where a minor part (not exceeding 20% of the total assets) consists of second-hand items, the benefit of this section is not denied *in toto*, but the value of such assets is excluded in computing the capital employed.
3. It manufactures or produces articles or operates one or more cold storage plants in any part of India, and has begun to do so at any time within the period of 28 years from 1st April 1948.
4. In a case where the industrial undertaking manufactures or produces articles, it employs ten or more workers in a manufacturing process carried on with the aid of power, or employs twenty or more workers in a manufacturing process carried on without the aid of power.

Ship. This section applies to any ship where *all* the following conditions are fulfilled, namely :

1. It is owned by an Indian company and is wholly used for the purposes of the business carried on by it.
2. It was not, previous to the date of its acquisition by the Indian company, owned and used in Indian territorial waters by a person resident in India.
3. It is brought into use by the Indian company at any time within a period of 28 years from 1st April 1948.

Hotel. This section applies to the business of any hotel where *all* the following conditions are fulfilled, namely :

1. The business of the hotel starts functioning on or after 1st April 1961 and is not formed by the splitting up or reconstruction of a business already in existence or by the transfer to a new business of a building previously used as a hotel or of any machinery or plant previously used for any purpose. However, where the total value of the building, machinery or plant so transferred does not exceed 20% of the total value of the building, machinery or plant used in the business, the benefit of this section is not denied *in toto*, but the value of such assets is excluded in computing the capital employed.
2. The business of the hotel is owned and carried on by a company registered in India with a paid-up capital of not less than Rs. 5 lakhs.
3. The hotel is for the time being approved for the purpose of this section by the Central Government.

Note : The tax-holiday concession in respect of a new industrial undertaking is allowed to all assessees ; but the tax-holiday concession in respect of a ship or hotel is allowed only to Indian companies.

Computation of Capital Employed.

According to Rule 19A of the Income-Tax Rules, 1962, the capital employed in an industrial undertaking or the business of a hotel or in a ship shall be computed in the following manner :

(1) The aggregate of the amounts representing the values of the assets (except those purchased second-hand), as on the first day of the computation period, of the industrial undertaking or of the business of a hotel shall be ascertained as follows :

(*a*) In the case of assets entitled to depreciation, their written-down value.
(*b*) In the case of assets acquired by purchase and not entitled to depreciation, their actual cost to the assessee.
(*c*) In the case of assets acquired otherwise than by purchase and not entitled to depreciation, the value of the assets when they became assets of the business.
(*d*) In the case of book debts, the nominal amount of those debts.
(*e*) In the case of cash in hand and at bank, the amounts thereof.

(2) From the aggregate of the amounts as ascertained under (1) shall be deducted the aggregate of the amounts, as on the first day of the computation period, of borrowed moneys and debts due by the assessee (including amounts due towards any tax liability) not being—

(*a*) in the case of a company, the amount of its debentures, and
(*b*) in the case of any assessee (including a company) any moneys borrowed from an approved source for the creation of a capital asset in India.

(3) The resultant sum as determined under (2) shall be reduced by the value of any investments as determined under (1), the income from which is not taken into account in computing the profits of the business.

(4) The capital employed in a ship shall be taken to be the written-down value of the ship as reduced by the amounts owed by the assessee on the first day of the computation period on account of moneys borrowed or debts incurred in acquiring that ship.

Note : All additions to and deductions from assets and liabilities made during the computation period are to be ignored.

Carry-forward of Deficiency.

The deficiency in the tax-holiday deduction is the amount by which the profits derived from the industrial undertaking or ship or the business of a hotel in each year fall short of 6% per annum of the capital employed in the business.

As industrial enterprises are not generally in a position to have adequate profits in the initial years, they are often not able to avail in full of the benefit of the tax-holiday. In order to make the tax-holiday concession more meaningful in such cases, it is provided to allow carry-forward of the amount of the 'deficiency' in the profits during each of the five-year (or seven-year in the case of a co-operative society) period of the tax-holiday to the succeeding year in that period. The amount of the deficiency so carried forward from a year will be added to the amount of 6% of the capital employed in the succeeding year, and the assessee will be entitled to exemption from tax in that year on his or its profits to the extent of the aggregate of such deficiency and the amount of 6% of the capital employed.

When such deficiency is not fully absorbed by the fifth (or seventh) assessment year, the unabsorbed deficiency will be carried forward to the succeeding assessment year or years up to the 8th assessment year as reckoned from the initial assessment year.

Though the carry-forward and deduction of the deficiency is allowed up to the 8th assessment year, the tax-holiday deduction is allowed only for 5 (or 7) assessment years.

The carry-forward of deficiency is allowed only from the assessment year 1967-68 onwards.

Illustration

A new industrial undertaking, owned by a limited company, started operations on 1-1-1972. Its accounting year ends on 31st December. From the following information calculate the amount of deduction to be allowed under section 80J in computing the total income of the company for the assessment years 1973-74, 1974-75 and 1975-76 :

Accounting year	Capital employed Rs.	Profit Rs.
1972	20,00,000	60,000
1973	25,00,000	1,00,000
1974	30,00,000	2,00,000

Assessment year	Capital employed Rs.	Deduction due Rs.	Profit Rs.	Deduction allowed Rs.	Deficiency c/f Rs.
1973-74	20,00,000	1,20,000	60,000	60,000	60,000
1974-75	25,00,000	1,50,000			
		60,000			
		2,10,000	1,00,000	1,00,000	1,10,000
1975-76	30,00,000	1,80,000			
		1,10,000			
		2,90,000	2,00,000	2,00,000	90,000*

*This deficiency can be carried forward up to and including the assessment year 1980-81 (8 assessment years including the first assessment year).

Tax Concessions for Tourist Hotels

In order to attract foreign tourists to India, the following tax concessions have been granted to tourist hotels :

1. Under section 32(1)(v), an initial depreciation of 25% of the cost of hotel buildings erected after 31st March 1967 is allowed.

2. Under the Income-Tax Rules, depreciation at 15% (instead of 10%) is allowed for furniture used in a hotel ; and in the case of plant and machinery installed in a hotel an extra depreciation equal to one-half of the normal allowance is granted.

3. Under section 33(1), development rebate at a higher rate is allowed in respect of machinery or plant installed in hotels.

4. Under section 33(6), prohibition against grant of development rebate in respect of machinery or plant installed in office premises or residential accommodation, does not apply to approved hotels.

5. Under section 43, the cost of tourist taxies in excess of Rs. 25,000 is not to be ignored for computing depreciation.

6. Under section 80J (1), an approved hotel is entitled to the benefit of tax-holiday.

7. Under section 80J(6), in order to get the tax-holiday concession, the hotel company need not own the building, and the building may have been used formerly for ony purpose other than as a hotel.

Illustrations

(1) A limited company established on 1st January 1974 a new industry (for the manufacture of paper) to which section 80-J applies and it closed its accounts on 31st December 1974.

The capital employed in the undertaking has been computed at Rs. 4 lakhs. The cost of new machinery is Rs. 2 lakhs, or new furniture Rs. 10,000 and of new buildings (1st class) Rs. 1 lakh. The company also purchased a second-hand motor-car for Rs. 10,000 and new typewriters and other office appliances at a cost of Rs. 5,000.

The factory worked double-shift throughout the year :

The profit of the company for the year 1974, before allowing for depreciation and development rebate, amounted to Rs. 2 lakhs.

Compute the total income of the company for the assessment year 1975-76 and indicate the relief to which it is entitled, assuming that it has transferred to a development rebate reserve 75% of the amount of development rebate due.

	Rs.	Rs.
Profit before deducting depreciation and development rebate		2,00,000
Less Depreciation as calculated below	38,750	
Development rebate at 25% on Rs. 2,00,000 cost of new machinery	50,000	88,750
Gross Total Income		1,11,250
Less 6% per annum of Rs. 4 lakhs capital employed, being tax relief under section 80J		24,000
Total Income		87,250

Depreciation :

		Rs.
Buildings assumed to be factory buildings at 50% on Rs. 1,00,000		5,000
Machinery :		
Normal depreciation at 10% on Rs. 2,00,000	20,000	
Extra-shift allowance being half of normal depreciation	10,000	30,000
Furniture :		
10% on Rs. 10,000		1,000
Typewriters :		
15% on Rs. 5,000		750
Motor-car :		
20% on Rs. 10,000		2,000
		38,750

(2) A jute mill company, whose accounting year ends on 31st March, set up a new unit for the manufacture of sewing machines. The new unit started production on 1st October 1974, on which date new buildings costing Rs. 1,00,000, new machinery costing Rs. 4,50,000 and second-hand machinery costing Rs. 50,000 were brought into use.

The profits of the new unit computed under section 29 amounted to Rs. 1,20,000.

Compute the amount of capital employed in the new unit during the computation period (six months ended 31st March 1975), and state the amount of profits entitled to tax concession under section 80J.

	Rs.
Buildings as on 1-10-1974	1,00,000
New machinery on 1-10-1974	4,50,000
Capital employed	5,50,000

As the value of second-hand machinery is less than 20% of the total fixed assets used in the business, the benefit of section 80J is available, but the value of the second-hand item is to be excluded from the capital employed.

Under section 80J, Rs. 16,500, being 6% per annum for six months on Rs. 5,50,000 capital employed will be allowed as a deduction from Rs. 1,20,000 profit earned.

(3) The accounting year of a company, which is engaged in the purchase and sale of motor-cars, ends on 31st December. On 1st January 1973 it started a new industrial undertaking for the manufacture of motor-cars.

For the previous year 1973 the amount of unabsorbed depreciation in respect of the assets of the industrial undertaking amounted to Rs. 2,48,483.

The entire profits of the company for the year 1974 computed in accordance with section 29 but without allowing the unabsorbed depreciation brought forward from the preceding year, amounted to Rs. 4,44,462, of which Rs. 2,53,198 was derived from the industrial undertaking.

The capital employed by the company in the industrial undertaking in the year 1974 amounted to Rs. 20 lakhs.

Work out the amount of profits eligible for tax concession under section 80J for the assessment year 1975-76.

The profit of Rs. 1,91,264 (Rs. 4,44,462—Rs. 2,53,198), which is derived from trading activities, is not eligible for any tax concession under section 80J.

	Rs.
Profit from industrial undertaking	2,53,198
Less Unabsorbed depreciation c/f from 1973	2,48,483
	4,715

Under section 80J, the company is entitled to a deduction of Rs. 1,20,000 (6% per annum of Rs. 20 lakhs capital employed) from the profits of its industrial undertaking. But such profits are only Rs. 4,715. Therefore, Rs. 4,715 out of Rs. 1,20,000 will be deducted from the profits of 1974 leaving nothing to be taxed ; and at the same time the company is entitled to carry forward the deficiency of Rs. 1,15,285 (Rs. 1,20,000—Rs. 4,715) to the succeeding assessment year (1976-77) to be claimed as a deduction. This period of carry-forward is limited to the 8th year as reckoned from the year in which the undertaking commenced its operations, that is to say, up to the assessment year 1981-82.

(4) P. Co. Ltd. carries on the business of a new industrial undertaking within the meaning of section 80J of the Income-Tax Act, 1961. It commenced to manufacture articles in its accounting year 1972. For the year 1973 there were book profits out of which dividends were declared in the annual general meeting held on 30th June 1974. The assessment of the company for the year 1974-75 however, showed a loss.

One shareholder claims in his personal assessment that no tax is payable by him for the assessment year 1975-76 on the amount of dividend received from P. Co. Ltd. Discuss the claim.

(C. A. Final, Nov. 1967)

Under section 80K, where the gross total income of an assessee includes any dividend attributable to the company's "tax-holiday" profits (profits as ascertained for income-tax purposes and not book profits), the entire amount of such dividend is allowed as a deduction in computing his total income.

In this case, the assessment of the company for the assessment year 1974-75 shows a loss, and the company has no "tax-holiday" profits for the accounting year 1973.

Therefore, the shareholder's claim that no tax is payable by him for the assessment year 1975-76 cannot be accepted. The amount of dividend received by him from P. Co. Ltd. will not be allowed as a deduction under section 80K in computing his total income for the assessment year.

CHAPTER 9

Depreciation And Development Rebate

DEPRECIATION

The law relating to depreciation, development rebate and development allowance is found in sections 32, 33, 33A, 34, 38(2), 41(2), 43, 57(ii) and in Rule 5 of the Income-Tax Rules, 1962.

The term "depreciation" is not defined in the Income-Tax Act. It has its origin in accountancy. It means diminution in the value of a capital asset principally by reason of wear and tear. In computing the income of a business or profession, all revenue expenditure is deducted from the profits, but capital expenditure is altogether excluded. Therefore, an allowance for depreciation is granted in respect of fixed assets representing capital expenditure.

Under section 32(1), depreciation is allowed only in respect of buildings, machinery, plant and furniture, which are the property of the assessee and which are used for purposes of his business or profession. A building is deemed to be used for business purposes when it is used for the production of commodities or for storage or for distribution or for administration or as a welfare building or for housing employees whose residence there is necessary for the efficient conduct of the business.

Under section 43(3), the term "plant" includes ships, vehicles, books, scientific apparatus and surgical equipment used for the purposes of the business or profession.

In the case of buildings, depreciation is not allowable on the cost of the land on which a building is erected but only on the cost of the superstructure. The word "building" means structures and does not include the site. This is the decision of the Supreme Court (*65 ITR 377*).

It should be particularly noted that depreciation is allowed only on account of user. That is why no such allowance is permissible in the case of a capital asset lying idle. An asset will not, however, be regarded as lying idle when it is actually used or when it is intended to be used, but if certain machinery is not erected in the factory and is lying in store, then such machinery is lying idle.

If the user is partial, the depreciation allowance will also be partial. The partial user may be in regard to the purpose or in regard to the time.

Partial User as Regards Purpose. Where an asset (say, a motor-car) is not exclusively used for the purposes of the business or profession, being partly used for the private purpose of the proprietor, then, under section 38(2), the depreciation allowance for it will be a fair proportionate amount which the Income-Tax Officer may determine, having regard to the user of the asset for the purposes of the business or profession.

Partial User as Regards Time. Where an asset acquired during the previous year has been used at any time during that year for the purposes of the business or profession of the assessee, depreciation is allowed at the full prescribed rate.

However, before the assessment year 1970-71 where an asset was used for a part of the previous year depreciation was allowed as follows :

(*a*) If the asset was used for 180 days or more, depreciation was allowed at the full prescribed rate.

(*b*) If it was used for less than 180 days but more than 30 days, depreciation was allowed at half the prescribed rate.

(*c*) If it was used for 30 days or less, no depreciation was allowed at all.

According to section 34(2)(ii) and (iii), no depreciation allowance is granted in respect of buildings, machinery, plant, furniture, structure or work for the previous year in which such assets are sold, discarded, demolished or destroyed, because in those circumstances the necessary relief by way of terminal depreciation is available.

Who is Entitled to Depreciation ?

It is the owner of the capital assets who is entitled to claim allowance for depreciation. A lessee, who carries on business, having taken on lease buildings, machinery, plant or furniture, is not entitled to claim the depreciation allowance, because he is not the owner of such assets and further because the owner of such assets is entitled to claim depreciation under section 57(ii).

A person who carries on business is not entitled to depreciation allowance under section 32 or development rebate under section 33 in respect of assets which he has obtained on hire-purchase, if he has not become the owner of the assets under the hire-purchase agreement in the year of account (*47 ITR 756*).

Conditions for the Grant of Depreciation Allowance.

The following conditions must be satisfied before an assessee can be allowed depreciation on any asset :

(1) The asset must be building, machinery, plant, furniture, structure or work. The term 'plant' includes ships, vehicles, books, scientific apparatus and surgical equipment.

(2) The asset must be the property of the assessee concerned.

(3) The asset must have been used during the whole or part of the previous year for the purposes of the assessee's business, the profits of which are being charged. The words "used for the purposes of business" include passive as well as active use. Even if the asset is not used for business depreciation can be allowed if it consists of machinery, plant or furniture let on hire, or consists of a building let on hire along with machinery, plant or furniture if letting of the building is inseparable from letting of the said machinery, plant or furniture.

(4) The particulars regarding the asset as prescribed under the Rules must be duly furnished by the assessee.

(5) The aggregate of all the depreciation allowances made year after year (including initial depreciation, if any) must not exceed the original cost of the asset to the assessee.

Where a capital asset is transferred by a holding company to its subsidiary company or by a subsidiary company to its holding company or by a company to another company in a scheme of amalgamation, then in determining whether the aggregate of all deductions in respect of depreciation

exceeds the actual cost of the capital asset to the assessee, depreciation allowed in respect of the transferred asset to the transferring company shall also be taken into account.

(6) If the asset belongs to a company and is used for his own benefit by a director or a person having a substantial interest in the company or by a relative of such director or person, depreciation allowance will be granted only to the extent to which in the opinion of the Income-Tax Officer the allowance is not excessive or unreasonable having regard to the legitimate business needs of the company and the benefit derived by it therefrom.

Depreciation Allowances

Under section 32(1) and Rule 5 of Income-Tax Rules, the following deductions are allowed in respect of depreciation of buildings, machinery, plant or furniture owned by the assessee and used for the purposes of his business or profession :

(1) Normal Depreciation. Depreciation is allowed on buildings, machinery, plant or furniture at the prescribed rates on the written-down value or the asset. In the case of ocean-going ships (and not ships plying on inland waters), depreciation is, however, allowed on the actual cost instead of on the written-down value.

Where the actual cost of any machinery or plant does not exceed Rs. 750, the full amount of the actual cost is allowed as a deduction in the year in which such machinery is first put to use. Such new machinery is however entitled to development rebate.

No depreciation will be allowed in respect of any motor-car manufactured outside India acquired by the assessee after 28-2-1975, if used otherwise than in a business of running it on hire for tourists.

In the case of a motor-car acquired after the 31st March 1967 but before the 1st March 1975 at a cost exceeding Rs. 25,000 the excess of the cost over Rs. 25,000 will be ignored for computing depreciation allowance thereon, and depreciation allowance will be computed on a sum of Rs. 25,000 only. However, where a motor-car is acquired after 31st March 1967 and is used in a business of running it on hire for tourists, the actual cost thereof will not be limited to Rs. 25,000.

The meanings of 'actual cost' and 'written-down value' and the principal prescribed rates of depreciation are given later.

(2) Extra Depreciation. An extra depreciation equal to one-half of the normal depreciation is allowed in respect of plant and machinery installed by an assessee, being an Indian company, in premises used by it as a hotel approved by the Central Government.

(3) Extra-shift Depreciation. An extra-shift depreciation allowance equal to one-half of the normal depreciation is granted in respect of plant and machinery on account of double-shift working. An extra allowance equal to the normal depreciation (instead of one-half of the normal depreciation) is allowed on account of triple-shift working.

The calculation of the extra allowance for double-shift working and for triple-shift working should be made separately in the proportion which the number of days for which the concern worked double-shift or triple-shift bears to the normal number of working days during the previous year. For this purpose, the normal number of working days during the previous year shall be deemed to be :

(*a*) in the case of a seasonal factory or concern, the number of days on which the factory or concern actually worked during the previous year or 180 days whichever is greater ; and

(*b*) in any other case, the number of days on which the factory or concern actually worked during the previous year or 240 days whichever is greater.

Illustration

A non-seasonal factory worked 270 days during the previous year, out of which it worked triple-shift on 135 days and double-shift on another 90 days. What will be the quantum of extra-shift depreciation allowance ?

The extra-shift depreciation allowance for triple-shift working will be 135/270, *i.e.*, one-half of the normal depreciation, and that for double-shift working will be ½ of 90/270, *i.e.*, one-third of one-half of the normal depreciation.

(4) Terminal Depreciation. In the case of any buildings, machinery, plant or furniture which is sold, discarded, demolished or destroyed in the previous year (*other than the previous year in which it is first brought into use*), the amount of which the moneys payable in respect of such an asset together with the amount of any scrap value fall short of the written-down value thereof, is allowed as terminal depreciation, provided that such deficiency is actually written off in the books of the assessee. *The written-down value for this purpose is calculated after taking into account any initial depreciation allowed in respect of the asset.*

Thus the formula for arriving at the amount of terminal depreciation is x−(y+z)=terminal depreciation, where x stands for written-down value, y for money payable and z for scrap value.

No terminal depreciation can be allowed in respect of an asset purchased and sold in the same previous year. The difference between the purchase price and the sale price of such an asset would be a short-term capital loss, which can be set off against the ordinary income of the assessee.

Where a claim is made for terminal depreciation on the ground of discard, it should be made in the year in which the asset is actually put out of use. But this will not prevent a further allowance being claimed for the loss on a later actual sale of the discarded asset.

Terminal depreciation can be allowed only if the building, machinery, plant or furniture has been used for the purpose of the business or profession for at least a part of the accounting year. By contrast, section 41(2) levies a balancing charge when the receipt exceeds the written-down value of an asset even if the asset is not used in the accounting year and even if the business or profession is not in existence in that year.

However, where for the purpose of allowing a deduction by way of depreciation the excess of the actual cost of a motor-car over Rs. 25,000 is ignored, then, in computing the amount of the terminal depreciation in respect of such motor-car, the 'moneys payable' in respect thereof shall be taken to be such proportion of the sale proceeds, etc., as the amount of Rs. 25,000 bears to the actual cost of the motor-car.

For the purpose of calculating the amount of terminal depreciation, (*i*) the expression 'moneys payable' includes the sale price or any insurance, salvage or compensation money payable in respect of the assets and (*ii*) the word 'sold' includes a transfer by way of exchange or a compulsory acquisition under any law, but does not include a transfer in a scheme of amalgamation of any asset by the amalgamating company to the Indian amalgamated company.

According to section 34(2)(ii) no depreciation allowance is granted in respect of buildings, machinery, plant or furniture for the previous year in which such assets are sold, discarded, demolished or destroyed, because in those circumstances the necessary relief by way of terminal depreciation is available.

Illustrations

(1) A motor-car is purchased for the purpose of a business at a cost of Rs. 50,000. It is subsequently sold for Rs. 20,000. At the time of its sale, its written-down value (computed by deducting the depreciation allowed from the ceiling amount of Rs. 25,000) is Rs. 20,000. What is the amount of terminal depreciation, if any, on the sale of this motor-car ?

	Rs.
Written-down value of the motor-car	20,000
Amount of adjusted sale proceeds=25,000/50,000 of Rs. 20,000	10,000
Terminal Depreciation	10,000

(2) A firm, whose accounting year ends on 31st December, purchased a motor-car for Rs. 20,000 on 15-4-1971. The car was used partly for business purposes and partly for the personal purposes of partners. The Income-Tax Officer agreed to allow one-half of depreciation permissible. The car was sold for Rs. 6,000 on 1-5-1974.

Work out the amount of terminal depreciation allowable for the assessment year 1975-76.

	Rs.
Original cost of the motor-car	20,000
Less Depreciation for 1971 being half of 20%	2,000
	18,000
Less Depreciation for 1972 being half of 20%	1,800
	16,200
Less Depreciation for 1973 being half of 20%	1,620
	14,580
Written-down value on date of sale	6,000
Less Sale proceeds	
Terminal depreciation permissible	8,580
Depreciation to be allowed for the assessment year 1975-76 being one-half of Rs. 8,580	4,290

(5) Initial Depreciation. Initial depreciation is granted in the following cases :

(*i*) In the case of any building which has been newly erected after 31st March 1961 which is used for the following purposes, a sum equal to 20% of the actual cost of the building is allowed as initial depreciation in respect of the year of erection :

(*a*) Where it is used *solely* for the purpose of residence of persons employed in the business and the income of each such person chargeable under the head "Salaries" is Rs. 7,500 or less ; or

(*b*) Where it is used *solely* or *mainly* for the welfare of such persons as a hospital, creche, school, canteen, library, recreation centre, shelter, rest-room or lunch-room.

(*ii*) An initial depreciation of 25% of the actual cost of construction of a new building is allowed if the following conditions are fulfilled :

(*a*) The erection of the building is completed after 31st March 1967.

(*b*) The building is owned by an Indian company and is used for running a hotel.

(*c*) The hotel is for the time being approved in this behalf by the Central Government.

(*d*) The depreciation is allowed in respect of the previous year in which the erection of the building is completed or, if the building is first brought into use as a hotel in the immediately succeeding previous year, then in respect of that previous year.

(*iii*) In May 1971 the Central Government had issued a notification providing for the withdrawal of development rebate in respect of ships acquired or machinery or plant installed after 31-5-1974. In view of the need for continued encouragement of industries in certain selected sectors, it is now provided to allow initial depreciation in respect of machinery or plant installed in certain selected industries after 31-5-1974. The initial depreciation will be available in respect of the following categories of machinery or plant :

(*a*) New ships and aircraft acquired by a tax-payer engaged in the business of operating ships or aircraft.

(*b*) New machinery or plant (other than office appliances and road transport vehicles) installed for the purposes of business of generation or distribution of electricity or any other form of power.

(*c*) New machinery or plant (other than office appliances and road transport vehicles) installed for the purposes of business of construction, manufacture or production of any one or more of the articles or things specified in the Ninth Schedule such as iron and steel, electric motors, machine tools, fertilisers, commercial vehicles, ships, aircraft, tyres and tubes, paper, sugar, textiles and cement.

(*d*) New machinery or plant (other than office appliances or road transport vehicles) installed in a small-scale industrial undertaking for the purposes of business of manufacture or production of any other articles or things. An industrial undertaking will be regarded as a small-scale industrial undertaking if the aggregate value of machinery and plant installed therein, as on the last day of the previous year, does not exceed Rs. 7,50,000. For this purpose the value of the machinery or plant owned by the tax-payer shall be the actual cost thereof.

Initial depreciation is also allowed in respect of imported second-hand ships, aircraft, machinery or plant which were never owned or used in India before.

Office appliances and road transport vehicles as also machinery or plant installed in office premises or any residential accommodation do not qualify for initial depreciation allowance.

Initial depreciation in respect of ships, aircraft, machinery or plant is allowed at 20% of their actual cost. The initial depreciation is not deductible in computing the written-down value of the assets for the purpose of calcuating the amount of normal depreciation in subsequent years ; but it is to be taken into account in arriving at the written-down value for the purpose of calculating the amount of terminal depreciation or balancing charge.

No initial depreciation will be allowed in cases where any ship, aircraft, machinery or plant is sold in the previous year in which it was acquired or installed or in the year in which it was first put to use. This provision also applies to new hotel buildings erected by approved hotels.

Initial depreciation is ordinarily allowed in the year in which the ship or aircraft is acquired or the machinery or plant is installed. When however the ship, aircraft, machinery or plant is first put to use in the year immediately following the year in which it is acquired installed, the initial depreciation will be admissible for such immediately following year.

Depreciation on Hired Buildings.

Under section 32(1A), where an assessee incurs capital expenditure for the purposes of his business or profession at any time after 31st March 1970 on any structure or work constructed or done by him in relation to or by way of renovation or extension of or improvement to any building held by him under a lease or other right of occupancy and used for purposes of his business or profession, he will be entitled to depreciation allowance on such capital expenditure at the rates specified in the Income-Tax Rules.

When the structure or work is sold, discarded, demolished or destroyed or is surrendered as a result of the determination of the lease or other right of occupancy, the assessee will be entitled to a terminal allowance. This allowance will be to the extent of the shortfall of the moneys payable from the written-down value, provided that such deficiency is actually written off in the books of the assessee.

Balancing Charge or Deemed Profit

Under section 41(2), where any building, machinery, plant or furniture, which is owned by the assessee and which was or has been used for the purposes of his business or profession, is sold, discarded, demolished or destroyed, and the moneys payable in respect of such asset together with the amount of any scrap value exceeds the written-down value, so much of the excess *as is equal to the amount of depreciation allowed* (*including any initial depreciation*) will be deemed to be the profit of the year in which the moneys payable become due. Such deemed profit which is liable to tax is known as balancing charge.

But any excess of moneys payable plus the amount of any scrap value over the actual cost of the asset will be a capital gain.

Where the moneys payable in respect of the building, machinery, plant or furniture become due in a previous year in which the business or profession in which these assets were being used is no longer in existence, the above provision will apply as if the business or profession were in existence in that previous year.

Where, for the purpose of allowing a deduction by way of depreciation, the excess of the actual cost of a motor-car over Rs. 25,000 is ignored, then, in computing the amount of balancing charge in respect of such motor-car, the moneys payable in respect thereof shall be taken to be such proportion of the sale proceeds, etc., as the amount of Rs. 25,000 bears to the actual cost of the motor-car.

For the purpose of calculating the above deemed profit, the expressions 'moneys payable' and 'sold' have the same meaning as for the purpose of calculating the terminal depreciation.

Where an asset (say, a motor-car) is used partly for business purposes and partly for non-business purposes, and only a part of the depreciation permissible under the rules is allowed, the written-down value of the asset should be taken as the original cost less depreciation *actually allowed*, and the profit under section 41(2) should be the difference between the sale price and the correct written-down value. If only one-half of the depreciation is allowed, the original cost cannot be taken to be one-half (*74 ITR 480*).

If in the past assessments profits were merely estimated and no depreciation was computed, actually allowed or carried forward, no balancing charge can be levied (*58 ITR 642*).

Illustrations

(1) A motor-car is purchased for the purposes of a business at a cost of Rs. 50,000. It is subsequently sold for Rs. 44,000. At the time of its sale, its written-down value (computed by deducting the depreciation allowed from the ceiling amount of Rs. 25,000) is Rs. 20,000. What is the amount of balancing charge, if any, on the sale of this motor-car ?

	Rs.
Amount of adjusted sale proceeds being 25,000/50,000 of Rs. 44,000	22,000
Written-down value of the motor-car	20,000
Balancing charge	2,000

(2) A firm whose accounting year ends on 31st December, purchased a motor-car for Rs. 20,000 on 1-4-1971. The car was used partly for business purposes and partly for the personal purposes of partners. The Income-Tax Officer agreed to allow one-half of depreciation permissible. The car was sold for Rs. 17,000 on 1-5-1974.

Calculate the amount of profit chargeable to tax in the assessment year 1975-76.

The written-down value of the car on the date of sale (1-5-1974) was as follows :

	Rs.
Original cost	20,000
Less Depreciation for 1971	2,000
	18,000
Less Depreciation for 1972	1,800
	16,200
Less Depreciation for 1973	1,620
Written-down value	14,580
Sale price	17,000
Less Written-down value	14,580
Profit to be taxed	2,420

In calculating the written-down value, depreciation actually allowed (one half of 20%) has been taken into account.

When, as a matter of pure business reorganisation, a firm is converted into a private limited company and the partners of the firm become the share-holders in the company, holding shares in the same proportions as their shares in the firm, the transfer of the assets of the firm to the company is not a sale and the provisions of section 41(2) do not apply. The firm cannot be taxed on the difference between the price at which the assets are transferred and their written-down value, since virtually the transfer is by the firm to itself in its corporate character (*34 ITR 336*).

Unabsorbed Depreciation.

According to section 32(2), where on account of the absence or insufficiency of chargeable profits of any business or profession, the full or a part of the normal (including extra-shift) and initial depreciation allowance cannot be given, the balance of the depreciation allowance not so given is

known as unabsorbed depreciation. But the amount of depreciation which is disallowed for any other reason (*e. g.*, the required particulars not being furnished to the Income-Tax Officer) cannot be included in the term "unabsorbed depreciation".

The terminal depreciation for any previous year is not included in unabsorbed depreciation, but is to be allowed as a loss for that year.

The provisions of the Income-Tax Act relating to the treatment of unabsorbed depreciation are as follows :

(1) Under section 43(6) explanation 3, the amount of unabsorbed depreciation is deemed to be depreciation actually allowed.

(2) If the profits of a particular business are insufficient to absorb the depreciation allowable, the allowance can be set off against the profits of any other business, and in the absence of any such profits, it can be set off against the income chargeable under any other head for that year.

(3) If still some part of the depreciation allowance remains unabsorbed it may be carried forward to the following year and set off against that year's profits and so on for succeeding years. The carried-forward depreciation allowance is deemed to be part of, and stands on exactly the same footing as, the current depreciation for the assessment year. Therefore, the unabsorbed depreciation of past years can (unlike a carried-forward business loss) be set off against income chargeable *under any other head.*

(4) In cases where the assessee is a registered firm or an unregistered firm assessed as a registered firm, the above principles are to be applied in the individual assessment of its partners.

(5) The right of carry-forward of depreciation presupposes the continuance of business in the year in which the allowance is carried forward. The unabsorbed depreciation of a discontinued business cannot be set off against the profits of an existing business (*48 ITR 464*). Moreover, the business must be continued by the assessee himself. The unabsorbed depreciation allowance cannot be assigned to the transferee of the business (*11 ITR 323*).

(6) Where there is unabsorbed depreciation and also a business loss carried forward, such business loss should be set off first before allowing the unabsorbed depreciation, and it is only if any balance of profits remains that the depreciation allowance of past year should be set off against such balance of profits (*46 ITR 707*). This is to the benefit of the assessee, for the business loss can be carried forward only for 8 years, whereas the unabsorbed depreciation can be carried forward without any time limit. If there is no unabsorbed depreciation but there is only a carried forward business loss from an earlier year the current depreciation for the relevant accounting year must first be deducted from the business profits, and it is only if there is a balance of profits left that carried forward loss should be set off against it (*33 ITR 367*).

Actual Cost of an Asset.

There are three purposes for which it is necessary to ascertain the actual cost to the assessee of an asset in respect of which a deduction is to be allowed for depreciation :

(*i*) The actual cost is the basis of depreciation allowance in the case of ocean-going ships.

(*ii*) The written-down value is calculated by reference to the actual cost in the case of other depreciable assets.

(*iii*) The aggregate of all depreciation allowances must not exceed the actual cost of the depreciable assets to the assessee.

The additional rupee liability incurred on imported capital assets by reason of devaluation of the rupee will be taken into account in computing the

actual cost of an asset for the purpose of allowing depreciation for the assessment year 1967-68 and subsequent assessment years.

The actual cost of an asset to an assessee is what he in fact spends or lays out for acquiring the asset. Thus, the actual cost of a cinema building would include the payment made to a third party for assistance in preparing plans for the construction and for securing permits, priorities, import licence and foreign exchange for the materials (*48 ITR 859*).

Interest paid by a company on borrowed capital during the period of construction and capitalised (*i. e.*, added to the cost of capital assets acquired) is part of the actual cost of those assets. Such interest must be taken into consideration for the purpose of depreciation and development rebate (*61 ITR 799*).

Where an assessee acquires the business of another, the actual cost is the value at which the assets are taken over by him and not the cost of those assets to the previous owner of the business (*36 ITR 521*).

According to section 43(1), "actual cost" means the actual cost of an asset to the assessee, as reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority.

However, where the actual cost of an asset being a motor-car (except a motor-car used for tourists) acquired by the assessee after the 31st March 1967 but before 1-3-1975 exceeds Rs. 25,000, the excess of the actual cost over such amount is ignored and the actual cost thereof is taken to be Rs. 25,000.

The seven explanations appended to this section deem by a fiction of law a notional or artificial figure to be the actual cost in the following cases :

(1) Where an asset is used in the business after it ceases to be used for scientific research related to that business, the actual cost thereof is to be reduced by the amount of deductions allowed under section 35 or under any former income-tax law.

(2) Where an asset is acquired by the assessee by way of gift or inheritance, the actual cost will be the written-down value thereof as in the case of the previous owner or the market value thereof on the date of such acquisition whichever is less.

(3) Where before the date of acquisition by the assessee the assets were at any time used by any other person for the purposes of his business or profession, and the Income-Tax Officer is satisfied that the main purpose of the transfer of the assets to the assessee was to claim higher depreciation allowance, the actual cost to the assessee will be such an amount as the Income-Tax Officer may, with the previous approval of the Inspecting Assistant Commissioner, determine having regard to all the circumstances of the case.

(4) Where assets, which had once belonged to the assessee and had been used by him for the purposes of his business or profession and thereafter ceased to be his property by reason of transfer or otherwise, are re-acquired by him, the actual cost thereof to the assessee will be the *lower* of the following two amounts :

(*a*) Actual cost to him when he first acquired the assets, as reduced by the amount of all depreciation (including terminal depreciation), allowed to him or as increased by the amount of any balancing charge ; or

(*b*) The actual price for which the asset is re-acquired.

(5) Where a building previously the property of the assessee is brought into use for the purpose of the business or profession, the actual cost to the assessee will be the actual cost of the building as reduced by an amount equal to the depreciation, that would have been allowable had the building been used for the aforesaid purposes since the date of its acquisition by the assessee. The

rate of depreciation for this intervening period will be the rate in force on the date of introduction of the building into the business. The effect of this provision is that an assessee who brings into business use a building already depreciated in value cannot claim depreciation on the basis of its original cost.

(6) Where any capital asset is transferred by a holding company to its wholly-owned Indian subsidiary company or by a wholly-owned subsidiary company to its Indian holding company, the actual cost of the transferred asset to the transferee company will be the same as it would have been if the transferring company had continued to hold it for the purposes of its business.

(7) Where, in a scheme of amalgamation, any capital asset is transferred by the amalgamating company to the amalgamated company which is an Indian company, the actual cost of the transferred capital asset to the amalgamated company will be taken at the same amount as would have been taken in the case of the amalgamating company had it continued to hold the capital asset for the purposes of its own business.

Illustration

X purchased machinery on 1st January 1973 for Rs. 80,000 and used it for his business for the calendar years 1973 and 1974. The depreciation allowed to him in the relative assessments amounted to Rs. 8,000 and Rs. 7,200 respectively. X made a gift of the machinery to Y on 1st January, 1975 and Y started using it for his business immediately.

What is the actual cost of the machinery to Y, if its market value is (*i*) Rs. 70,000 and (*ii*) Rs. 60,000 as on 1st January 1975 ?

Where an asset is aquired by the assessee by way of gift or inheritance, the actual cost thereof is its written-down value as in the case of the previous owner or the market value thereof as on the date of such acquisition, whichever is less.

The written-down value of the machinery gifted to Y is Rs. 80,000—Rs. 15,200 =Rs. 64,800. Therefore, the actual cost of this machinery to Y is Rs. 64,800 in (*i*) and Rs. 60,000 in (*ii*).

Written-down Value

The written-down value of an asset means :

(*a*) In the case of an asset acquired in the previous year, the actual cost to the assessee ; and

(*b*) In the case of an asset acquired before the previous year, the actual cost to the assessee less *all* depreciation actually allowed (and not merely allowable) to him. Any allowance in respect of unabsorbed depreciation is deemed to be depreciation actually allowed. *However, for the purposes of calculating the normal depreciation and extra-shift allowance, initial depreciation (if any) allowed to the assessee is not to be deducted from the actual cost of the asset.*

When in the case of succession in business or profession, an assessment is made on the successor under section 170(2), the written-down value of any asset will be the amount which would have been taken as its written-down value if the assessment had been made directly on the person succeeded to.

Where, in a scheme of amalgamation, any capital asset is transferred by the amalgamating company to the amalgamated company which is an Indian company, the written-down value of the transferred asset to the amalgamated company will be taken at the same amount as would have been taken in the case of the amalgamating company had it continued to hold the capital asset for the purposes of its own business.

Wrong Figure of Cost. The original cost of a particular asset is a question of fact, and if the circumstances show that an assessee has arranged to put a wrong price on his assets, it is open to the income-tax authorities to

refuse to accept that price and to ascertain what the actual original cost was (*47 ITR 853*).

The Income-Tax Officer is not bound to base his calculation of the written-down value for the relevant assessment year on the written-down value accepted in the preceding year. If a wrong figure was taken in earlier years as the figure of actual cost, the Income-Tax Officer should determine for himself the actual figure of original cost in ascertaining the written-down value for the relevant assessment year (*48 ITR 859*). Likewise, any arrangement between the assessee and the department in one year to treat the value entered in the assessee's balance sheet as the original cost would not prevent the assessee from challenging the arrangement in any subsequent year and claiming depreciation allowance on the written-down value computed with reference to the actual cost.

Prescribed Rates of Depreciation

The rates of depreciation have been prescribed by Rule 5 of the Income-Tax Rules, 1962. Some of these rates are as follows :

Buildings :

First class buildings (2½%)
Second class buildings (5%)
Third class buildings (7½%)
Purely temporary erections such as wooden structures (100%)
Double of these rates will be taken for factory buildings excluding offices, godowns, officers' and employees' quarters.

Furniture and Fittings :

General rate (10%) applicable where there is no special rate.
Rate for furniture and fittings used in hotels, restaurants, and boarding houses, schools, colleges and other educational institutions, libraries, welfare centres, meeting halls, cinema houses, theatres and circuses, and for furniture and fittings let out on hire for use on the occasion of marriages and similar functions (15%).

Machinery and Plant (not being a ship) :

General rate (10%)	
Special rates :	
Accounting machines (NESA)	15%
Air-conditioning machinery (NESA)	15%
Artificial silk manufacturing machinery	15%
Building contractor's machinery (NESA)	15%
Calculating machines (NESA)	15%
Office machinery	15%
Surgical instruments (NESA)	15%
Tea factory machinery	15%
Typewriters (NESA)	15%
Cycles (NESA)	20%
Data processing machines including computers (NESA)	20%
Electrical machinery and X-ray apparatus (NESA)	20%
Motor-cars, motor-cycles, scooters and other mopeds (NESA)	20%
Printing machines	20%
Aeroplanes	30%
Motor-buses, motor-lorries, motor-taxis and motor-tractors (NESA)	30%
Ropeway structure (NESA)	30%

Rubber and plastic goods factories moulds (NESA)	40%
Flour mill and sugar works rollers	100%
Gas cylinders	
Match factories—wooden match frames	
Mines and quarries—tubs, winding ropes, haulage ropes and sand stowing pipes	

No extra shift allowance is allowed in respect of any item of machinery or plant against which the letters "NESA" are given.

DEVELOPMENT REBATE

Note : **No development rebate will be allowed in respect of ships acquired or plant and machinery installed after 31st May 1974.**

Under section 33(1), an assessee is entitled to a development rebate in respect of a new ship or new machinery or plant (other than office appliances or road transport vehicles) at the rates specified below, provided the asset is owned by the assessee and is *wholly* used for purposes of his business (but not a profession) carried on by him.

Thus, no development rebate is allowable in respect of plant and machinery used in a profession. But if a professional contemporaneously carries on a trade which is annexed to the exercise of his profession (*e. g.*, a doctor running a nursing home), he is entitled to claim development rebate on machinery and plant installed in that trade (*74 ITR 94*).

The development rebate is not part of the depreciation allowance. It is granted over and above the full recoupment of the actual cost by way of depreciation allowances.

The additional rupee liability incurred on imported capital assets by reason of devaluation of the rupee, will not be taken into account in computing the actual cost of the asset for the purpose of deduction on account of development rebate.

Rates of Development Rebate.

The development rebate is allowed at the following rates on the actual cost of a *new* asset to the assessee :

Ships.

In the case of a ship—40%.

Machinery or plant.

The rates of development rebate in respect of new machinery or plant have been fixed on the principle of selective support for industries which are of special importance for the industrial development of India and whose growth will also be helpful in promoting import substitution. These rates are as follows :

(1) Machinery or plant used for the construction, manufacture or production of articles specified in the Fifth Schedule :
   (*a*) If installed before 1-4-1970 — 35%
   (*b*) If installed after 31-3-1970 — 25%

(2) Machinery or plant installed after 31-3-1967 by an Indian company in approved hotel premises :
   (*a*) If installed before 1-4-1970 — 35%
   (*b*) If itstalled after 31-3-1970 — 25%

(3) Machinery or plant installed after 31-3-1967, being an asset representing capital expenditure on scientific research related to the business carried on by the assessee :

   (*a*) If installed before 1-4-1970 — 35%
   (*b*) If installed after 31-3-1970 — 25%

(4) Any other machinery or plant :
   (*a*) If installed before 1-4-1970 — 20%
   (*b*) If installed after 31-3-1970 — 15%

No development rebate shall be allowed in respect of any machinery or plant installed in any office premises or any residential accommodation (including a guest house), such as air-conditioners, room heaters, electric fans, refrigerators, etc. This provision does not apply in respect of any machinery or plant installed by an Indian company in any premises used as a hotel approved by the Central Government.

For the purpose of development rebate, the actual cost of an asset is to be determined in the same manner as for the purpose of depreciation except that the additional rupee liability incurred on imported capital assets by reason of devaluation of the rupee is not taken into account.

Year of Allowance of Development Rebate.

The development rebate is allowed as a deduction in computing the income from business in the year in which the ship is acquired or the machinery or plant is installed, provided the asset is used for the purposes of business in the year of acquisition or installation. But if the asset is first put to use in the immediately succeeding year, the rebate would be allowed in such succeeding year. If the asset is first put to use later than the year immediately succeeding the year of acquisition or installation, the right to development rebate would be completely lost.

Second-hand Assets.

Section 33(1A) makes the following provisions for the grant of development rebate in respect of second-hand assets :

(1) An assessee who, after the 31st March 1964, acquires any ship, which before the date of acquisition by him was used by any other person shall also be allowed as a deduction a sum by way of development rebate at such rate as may be prescribed, provided that the following conditions are fulfilled :

   (*a*) such ship was not previous to the date of such acquisition owned at any time by any person resident in India ;
   (*b*) such ship is wholly used for the purposes of the business carried on by the assessee ; and
   (*c*) such other conditions as may be prescribed.

(2) An assessee who instals any machinery or plant (other than office appliances or road transport vehicles) which before such installation by the assessee was used outside India by any other person shall also be allowed as a deduction a sum by way of development rebate at such rate as may be prescribed, provided the following conditions are fulfilled :

   (*a*) such machinery or plant was not used in India at any time previous to the date of such installation by the assessee ;
   (*b*) it is imported in India by the assessee from any country outside India ;
   (*c*) no deduction on account of depreciation or development rebate in respect of such machinery or plant has been allowed or is allowable in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee ;

(*d*) such machinery or plant is wholly used for the purposes of the business carried on by the assessee ; and

(*e*) such other conditions as may be prescribed.

Conditions for the Grant of Development Rebate.

According to section 34, the grant of development rebate is subject to the following conditions, namely :

(1) The ship, machinery or plant is owned by the assessee and is used *wholly* for purposes of his business (but not a profession).

(2) The particulars prescribed for the grant of depreciation allowance have been furnished to the Income-Tax Officer by the assessee in respect of the ship, machinery or plant.

(3) An amount equal to 75% of the development rebate to be *actually allowed* is debited to the profit and loss account of the relevant previous year and credited to development rebate reserve account. This requirement does not apply to an electricity supply company ; and in the case of a ship acquired after 28th February 1966, the percentage of 75 is reduced to 50. This reserve is to be utilised during the next 8 years for purposes of business only and no part of it can be distributed as dividend or profit or remitted outside India as profit or for creation of any asset outside India.

The above provision requires the assessee to create a reserve of an amount equal to 75% of the development rebate *actually allowed*, that is, not of that part of the rebate which, being unabsorbed, is carried forward to a subsequent year. It means that, although the books may show profits, if the assessment results in nil income or loss, there will be no obligation on the part of the assessee to create a reserve as a condition for carrying forward the development rebate (*92 ITR 241*).

There is no provision in the Income-Tax Act under which the transfer to the development rebate reserve should be made before the close of the accounting year. Such a transfer should however be made before the assessment is finalised by the Income-Tax Officer. The necessity for creation of the reserve account arises only when the trade results in profit which can be ascertained only after drawing up the profit and loss account (*69 ITR 425*).

If there is a shortfall in the required reserve, the assessee is not entitled to any development rebate. Where, however, the reserve is credited at 75% of the rebate on the assessee's own computation and the rebate actually allowable is found to be larger, a chance may be allowed to him to make good the deficiency of the reserve in the current year's books within the time allowed by the Income-Tax Officer.

Under executive instructions, development rebate is admissible in respect of each separate item of new machinery or plant. In cases where the reserve created is inadequate and there are several new items of plant and machinery, development rebate may be allowed in respect of as many items as possible regarding which the reserve created is sufficient. The items to which the development rebate reserve cannot be related are to be denied the benefit of development rebate.

Where the amount transferred to the development rebate reserve is found to be more than 75%, the excess cannot be taken into account in determining the sufficiency of the reserve in a subsequent year. The earlier excess may, however, be transferred to the profit and loss account in a succeeding year to enable the 75% reserve to be created in that later year.

(4) The ship, machinery or plant, in respect of which development rebate has been allowed must not be sold or otherwise transferred by the assessee to any person at any time before the expiry of 8 years from the end of

the previous year in which it was acquired or installed. This restriction does not, however, apply in the following cases :

(*a*) Where the ship, machinery or plant is sold or transferred to Government, a local authority, a statutory corporation or a government company ; or

(*b*) Where the sale or transfer of the assets takes place in connection with amalgamation of companies or succession of a firm by a company under certain conditions as explained below.

An infringement of this condition will lead to the disallowance of the development rebate already granted and to the revision of the assessment for the year in which the development rebate was originally given. This revision will be made under section 155 as a rectification of mistake.

Carry-forward of Development Rebate.

The provision regarding the carry-forward of unabsorbed development rebate is similar to the provision regarding the carry-forward of unabsorbed depreciation allowance, but with this difference that whereas unabsorbed depreciation can be carried forward indefinitely, unabsorbed development rebate can be carried forward only for a period of eight years.

Under section 33(2), if the total income (computed in the manner explained below) of an assessee for any previous year falls short of the full amount of the rebate allowable, the rebate to be allowed for that year would be limited to such total income, and the balance of the development rebate would be allowed to be carried forward for being allowed against the total income of the succeeding *eight* assessment years.

Where for any assessment year development rebate is to be allowed for more than one previous year and the total income for that assessment year is less than the aggregate of the amounts due to be allowed, the following procedure is to be followed :

(*a*) The development rebate for an earlier previous year will be followed before allowing the development rebate for the previous year relevant to that assessment year ; and

(*b*) Where the development rebate carried forward is for more than one earlier previous year, the amount carried forward from an earlier previous year will be allowed before any amount carried forward from a later previous year.

The total income for the above purpose is to be computed (*i*) before deducting any development rebate or development allowance, and (*ii*) before making any deduction on account of life insurance premium, etc.

Distinction between Unabsorbed Depreciation and Carried-forward Development Rebate. The following are the points of distinction between the two :

(1) Unabsorbed depreciation can be carried forward indefinitely ; but unabsorbed development rebate can be carried forward for only 8 assessment years.

(2) In computing the total income of a future assessment year, the unabsorbed depreciation carried forward from an earlier assessment year is to be deducted *after* deducting the current year's depreciation, whereas any out-standing development rebate carried forward from an earlier assessment year is to be deducted *before* deducting the current year's development rebate.

Amalgamation of Companies.

Under section 33(3), where development rebate has been allowed to the amalgamating company, the amalgamated company shall continue to fulfil the conditions mentioned in section 34(3) in respect of the reserve and the

period within which the assets cannot be sold ; and the balance of development rebate (if any) outstanding to the amalgamating company will be allowed to the amalgamated company, but in calculating the total period of 8 years' assessments for the carry-forward, the assessments of both companies will be included.

Succession to a Firm.

Under section 33(4), where a firm is succeeded to by a company (whether public or private) in the business carried on by it, as a result of which the firm sells or otherwise transfers to the company any ship, machinery or plant, the development rebate already allowed to the firm in respect of the asset transferred will not be withdrawn and the balance of development rebate (if any) will be available to the company, provided the company continues to fulfil the conditions specified above.

The provisions of this sub-section shall apply only where (*i*) all the property of the firm relating to the business immediately before the succession becomes the property of the company ; (*ii*) all the liabilities of the firm relating to the business immediately before the succession become liabilities of the company ; and (*iii*) all the shareholders of the company were partners of the firm immediately before the succession.

It is not necessary that all the partners of the firm should be shareholders of the company which succeeds to the firm ; but it is necessary that all the shareholders of the company should be partners of the firm immediately before the succession, any subsequent change in the shareholding of the company being immaterial.

Withdrawal of Development Rebate.

Under section 33(5), the Central Government, if it considers necessary or expedient so to do, may by notification direct that the deduction on account of development rebate shall not be allowed in respect of a ship acquired or machinery or plant installed after such date, not being earlier than three years from the date of such notification, as may be specified therein.

DEVELOPMENT ALLOWANCE

Under section 33A, an assessee carrying on the business of growing and manufacturing tea in India is entitled to a deduction, in the computation of his profits, of a 'development allowance' (in addition to development rebate) with reference to the actual cost of planting tea bushes at the following rates :

(1) In a case where tea bushes have been planted *after 31st March 1965* on land which had been previously abandoned or which is newly brought under plantation, 50% of the cost of such planting ; and

(2) In a case where tea bushes are planted at any time during the period from 1st April 1965 to 31st March 1970 on land which is already under plantation, in replacement of bushes which have become permanently useless, 30% of the actual cost of such planting.

The deduction for development allowance is to be allowed in two stages. Development allowance will, in the first instance, be computed with reference to that portion of the actual cost of planting or replanting which is incurred in the accounting year in which the land is prepared for planting or replanting and in the accounting year next following, and the amount so computed will be allowed as a deduction in respect of such accounting year next following. The development allowance will again be computed at the end of the four-year period with reference to the actual cost of planting or replanting, and if the allowance so computed exceeds the allowance already deducted

in respect of the second year, as stated above, the amount of the excess will be allowed as a deduction in respect of the fourth accounting year reckoned from the year in which the land is prepared for planting or replanting.

The 'actual cost' of planting comprises the cost of preparing the land, the cost of seeds, cuttings and nurseries, the cost of planting and replanting and the cost of upkeep thereof, for the previous year in which the land has been prepared for planting and the three succeeding previous years. However, where such cost exceeds Rs. 10,000 per hectare (Rs. 12,500 per hectare in respect of land situated in a hilly area declared as such by the Board), the excess amount is to be ignored for the purpose of grant of the development allowance.

Other conditions under which development allowance is admissible are similar to those under which deduction for development rebate is granted. Broadly, these conditions are :

(*a*) The development allowance will be granted only if an amount equal to 75% thereof is credited to a reserve account by debit to the profit and loss account, for being used for the purposes of the business over a period of 8 years, otherwise than for distribution of dividends or profits.

(*b*) The development allowance granted for a year will be withdrawn if the land is sold or otherwise transferred during the above-mentioned period of 8 years except if the transfer is made to Government, a local authority, a Government company or a statutory corporation, or is made in connection with an amalgamation or succession.

(*c*) The unabsorbed amount of development allowance in respect of an assessment year will be carried forward for being set off against the profits of subsequent years but not beyond 8 assessment years from the end of the relevant assessment year.

REHABILITATION CONCESSIONS

There are certain tax concessions granted for the purpose of facilitating the reconstruction of revival of the business of an industrial undertaking in India, which is discontinued on account of extensive damage to or destruction of its buildings, machinery, plant or furniture as a direct result of natural calamities (such as flood, typhoon, hurricane, cyclone, earthquake, etc.), riot or civil disturbance, accidental fire or explosion or enemy action.

An industrial undertaking means any undertaking which is mainly engaged in the business of generation or distribution of electricity or any other form of power or in the construction of ships, or in the manufacture or processing of goods or in mining.

The tax concessions referred to above are as follows :

(1) *Rehabilitation allowance.* Under section 33B, where such business is re-established, reconstructed or revived by the assessee within a period of *three* years from the end of the previous year in which it was discontinued, the assessee will be entitled to a deduction, by way of 'rehabilitation allowance' in the computation of his profits for the year in which the business is so re-established, reconstructed or revived. This rehabilitation allowance is equal to 60 per cent of the terminal depreciation admissible to the assessee in respect of the buildings, machinery, plant or furniture under section 32(1)(iii).

(2) *Carry-forward of unabsorbed loss.* According to the proviso to section 72(1), the unabsorbed business loss of the undertaking, which is discontinued in the circumstances stated above, will be carried forward and allowed to be set off against the profits of the re-established, reconstructed or revived business up to a period of 8 years as reckoned from the previous year

in which the business is re-established, reconstructed or revived by the assessee.

(3) *Tax-holiday concession.* There is a condition that a new industrial undertaking will not be eligible for the tax-holiday concession if it is formed by the splitting up or reconstruction of a business already in existence. But, according to section 80J(4), this condition will not apply in the case of an industrial undertaking which was discontinued and is subsequently reconstructed or revived in the circumstances stated above.

Important Note :

In the following illustrations it has been assumed that an amount equal to 75% of the development rebate has been debited to profit and loss account and credited to a development rebate reserve account, as this is a pre-requisite for the grant of development rebate.

Illustrations

(1) A limited company, engaged in the manufacture of tractors, closes its accounts on 31st March. Owing to a prolonged strike, its factory actually worked for 200 days in the year ended 31st March 1975 when there was double-shift working for 60 days and triple-shift working for another 100 days.

On 1st April 1974 the written-down value of its plant and machinery was Rs. 3,60,000.

Work out the amount of depreciation on plant and machinery allowable for the assessment year 1975-76.

	Rs.
Normal depreciation at 10% on Rs. 3,60,000	36,000
Double-shift allowance being one-half of 60/240 of normal depreciation	4,500
Triple-shift allowance being 100/240 of normal depreciation	15,000
Depreciation allowable	55,500

(2) A cotton mill company has furnished the following particulars for depreciation claim for the accounting year ended 31st December 1974 :

	Rs.	Rate
Buildings :		
First class Factory :		5%
W. D. V. on 1-1-1974	1,00,000	
Additions on 1-5-1974	50,000	
First class Non-factory :		$2\frac{1}{2}$%
W. D. V. on 1-1-1974	50,000	10%
Plant and Machinery :		
W. D. V. on 1-1-1974 of machinery installed in 1970	1,50,000	
Additions (New) on 1-5-1974	1,00,000	
Additions (Second-hand) on 1-5-1974	1,00,000	10%
Furniture :		
W. D. V. on 1-1-1974	10,000	
Additions on 21-12-1974	5,000	

Work out the amount of development rebate and depreciation allowance for the assessment year 1975-76 and also the W. D. V. as on 1-1-1975.

	Rs.
Development Rebate :	
25% on Rs. 1,00,000 being cost of new machinery installed on 1-5-1974	25,000

Depreciation Allowance :

	Normal Depreciation Rs.	W. D. V. on 1-1-1975 Rs.
Factory Buildings :		
5% on Rs. 1,50,000	7,500	1,42,500
Non-factory Buildings :		
$2\frac{1}{2}$% on Rs. 50,000	1,250	48,750
Plant and Machinery :		
10% on Rs. 3,50,000	35,000	3,15,000
Furniture :		
10% on Rs. 15,000	1,500	13,500
	45,250	

(3) A paper merchant, whose accounting year ends on 31st March, completed the construction of a new building for his business on 1st October 1971 at a cost of Rs. 20,000. The depreciation for the assessment year 1974-75 was unabsorbed to the extent of Rs. 500.

Calculate the amount of depreciation allowance for the assessment year 1975-76, the rate of depreciation being 5%.

Assessment year			Rs.
1972-73	Normal at 5% on Rs. 20,000		1,000
1973-74	Normal at 5% on Rs. 19,000		950
1974-75	Normal at 5% on Rs. 18,050	902	
	Less Unabsorbed c/f	500	402
1975-76	Normal at 5% on Rs. 17,148 (Rs. 18,050—Rs. 902)	857	
	Unabsorbed c/f from 1974-75	500	1,357

Therefore the depreciation allowance for 1975-76 is Rs. 1,357.

(4) A person set up a new business on 1st May 1974 and for this purpose he purchased machinery for Rs. 20,000 from another person who was closing down his business and installed it in his own building which was constructed at a cost of Rs. 10,000 in April 1971.

The prescribed rates of depreciation for machinery and buildings are 10% and $2\frac{1}{2}$% respectively. His accounting year ends on 31st March.

If in his assessment for 1975-76 the assessee claims development rebate on machinery and depreciation on the cost of building and machinery, how would you allow the claim ?

As the machinery installed by him is not new, the assessee is not entitled to any development rebate in respect thereof. But the depreciation allowable for the assessment year 1975-76 will be as under :

	Rs.
Building :	
Normal depreciation at $2\frac{1}{2}$% on Rs. 9,270 taken to be the cost of building as calculated below	232
Machinery :	
Normal depreciation at 10% on Rs. 20,000	2,000
Depreciation allowance	2,232

Depreciation cannot be allowed on the cost of building (Rs. 10,000), because where a building previously owned by an assessee is brought into use for purposes of his business, the actual cost thereof to the assessee is the actual cost of the buiilding as reduced by an amount equal to the depreciation that would have been allowable had the building been used for business purposes since the date of its acquisition by the assessee. The effect of this provision is that an assessee who brings into business use a building already depreciated in value cannot claim depreciation on the basis of its original cost.

		Rs.
Original cost in April 1971		10,000
Less Depreciation allowable for 1972-73 at 2½%	250	
,, ,, ,, 1973-74 at 2½%	243	
,, ,, ,, 1974-75 at 2½%	237	730
Written-down value on 1-5-1974		9,270

(5) Machinery owned by a limited company, whose accounting year ends on 31st December, cost Rs. 50,000. It was discarded in September 1974, its scrap value being then estimated at Rs. 10,000. The depreciation actually allowed in respect of this machinery up to and including the assessment year 1974-75 was Rs. 27,000. The discarded machinery was actually sold in May 1975 for Rs. 8,000.

What is the amount of terminal depreciation in respect of this machinery and what would be the position if the discarded machinery were sold for Rs. 12,000 instead of Rs. 8,000 ?

On the basis of the scrap value of Rs. 10,000, a terminal depreciation of Rs. 13,000 can be claimed in the assessment year 1975-76 and on the basis of the sale price of Rs. 8,000 a further terminal allowance of Rs. 2,000 can be claimed in the assessment year 1976-77.

If the discarded machinery is sold for Rs. 12,000, there would be a taxable profit of Rs. 2,000 for the assessment year 1976-77 because on the basis of the scrap value of Rs. 10,000 a terminal depreciation of Rs. 13,000 was claimed in the assessment year 1975-76.

(6) Machinery cost Rs. 1,00,000. Its written-down value is Rs. 40,000. What would be the position as regards terminal depreciation, if it were sold for Rs. 30,000 ; Rs. 40,000 ; Rs. 70,000 ; Rs. 1,00,000 or Rs. 1,20,000 ?

(*a*) When sold for Rs. 30,000, there is a terminal depreciation of Rs. 10,000.

(*b*) When sold for Rs. 40,000, there is no terminal depreciation and no taxable profit.

(*c*) When sold for Rs. 70,000, there is no terminal depreciation, but there is a taxable profit of Rs. 30,000.

(*d*) When sold for Rs. 1,00,000 there is no terminal depreciation, but there is a taxable profit of Rs. 60,000.

(*e*) When sold for Rs. 1,20,000 there is no terminal depreciation, but there is a taxable profit of Rs. 60,000 and a capital gain of Rs. 20,000.

(7) Machinery cost Rs. 1,00,000. Its written-down value is Rs. 40,000. It is insured and is destroyed leaving a scrap value of Rs. 10,000. What would be the position as regards terminal depreciation, if the insurance moneys received were Rs. 20,000; Rs. 30,000 ; Rs. 60,000 ; Rs. 90,000 and Rs. 1,10,000 ?

After adding the scrap value to the amount of insurance money received, the position as regards terminal depreciation would be as follows :

(*a*) When insurance moneys received are Rs. 20,000, there is a terminal depreciation of Rs. 10,000.

(*b*) When insurance moneys received are Rs. 30,000, there is no terminal depreciation and no taxable profit.

(*c*) When insurance moneys received are Rs. 60,000 there is no terminal depreciation, but there is a taxable profit of Rs. 30,000.

(*d*) When insurance moneys received are Rs. 90,000, there is no terminal depreciation, but there is a taxable profit of Rs. 60,000.

(e) When insurance moneys received are Rs. 1,10,000 there is no terminal depreciation, but there is a taxable profit of Rs. 60,000, and a capital gain of Rs. 20,000.

(8) A firm of cloth merchants, whose accounting year ends on 31st December, acquired a tailoring business on January 14th 1974, found it difficult to run that business, and closed it in July 1974. In October 1974 the sewing machines were sold at a loss of Rs. 15,000.

Is the loss of Rs. 15,000 an admissible deduction in computing the firm's income from business for the assessment year 1975-76 ?

According to section 32(1)(iii), this loss of Rs. 15,000 is not allowable as a deduction by way of terminal depreciation, because the sewing machines were acquired and sold in the same previous year.

This is a short-term capital loss which can be set off against the assessee's ordinary income.

(9) The accounting year of a paper mill company ends on 31st December and the following are details of its depreciable assets :

Assets	W. D. V. on 1-1-1974 Rs.	Additions in 1974 Rs.	Depreciation Rate
Mill building (1st class)	15,47,380		5%
Godowns (2nd class)	2,15,740		5%
Mill Machinery	33,17,695	4,45,970	10%
Motor-trucks	45,700		30%
Furniture	25,170		10%

One godown (whose written-down value on 1-1-1974 was Rs. 1,15,600) was completely destroyed by fire in May 1974 and Rs. 1,00,000 was received from the insurance company in respect thereof.

Work out the amount of development rebate and depreciation allowable for the assessment year 1975-76, assuming that additional machinery was installed on 1st May 1974.

	Rs.
Development Rebate :	
25% on Rs. 4,45,970 being cost of new machinery	1,11,492
Depreciation allowance :	
Mill Buildings : 5% on Rs. 15,47,380	77,369
Godowns : 5% on Rs. 1,00,140 (Rs. 2,15,740—Rs. 1,15,600)	5,007
Mill Machinery : 10% on Rs. 33,17,695 + Rs. 4,45,970 = Rs. 37,63,665	3,76,367
Motor-trucks : 30% on Rs. 45,700	13,710
Furniture : 10% on Rs. 25,170	2,517
	4,74,970
Normal depreciation	
Terminal depreciation on godown destroyed being Rs. 1,15,600—Rs. 1,00,000	15,600
Depreciation allowable	4,90,570

(10) For the assessment year 1975-76, the previous year being the calendar year, calculate the amount of depreciation admissible in respect of the following assets of Hind Cement Co. Ltd. :

(*a*) Building (1st class), construction completed on 1-1-1974 and used for business from 1-2 1974. Total cost (including cost of land Rs. 50,000) Rs. 3,00,000.

(*b*) Plant and Machinery :
Old—W. D. V. on 1-1-1974 (used for whole year) Rs. 2,00,000.
New machinery purchased on 1-11-1974 Rs. 1,50,000.
Four new different units of machinery of Rs. 600 each purchased on 15-12-1974.

(*c*) New motor-truck purchased on 1-8-1974 Rs. 40,000.

(*d*) New motor-car purchased on 22-12-1974 Rs. 32,000.

	Rs.
Normal Depreciation :	
Building (assumed to be factory building) :	
5% on Rs. 2,50,000 (Rs. 3,00,000 – cost of land Rs. 50,000)	12,500
Machinery :	
10% on Rs. 2,00,000 + Rs. 1,50,000 = Rs. 3,50,000	35,000
Motor-truck :	
30% on Rs. 40,000	12,000
Motor-car :	
20% on only Rs. 25,000	5,000
Initial Depreciation :	
20% on Rs. 1,50,000	30,000
Depreciation admissible	94,500

Notes :

1. No depreciation will be allowed on the four units of Rs. 600 each, as the actual cost will be allowed to be written off.
2. The company is entitled to initial depreciation in respect of new machinery, because it is engaged in a Ninth Schedule industry.

(11) A company which has adopted the calendar year as its year of account, went into voluntary liquidation on 30-10-1973 but it continued to carry on business till 15-12-1973.

On 10-3-1974, the liquidator of the company sold the company's fixed assets for the following amounts :

	Rs.
Buildings	1,80,000
Machinery	8,00,000
Furniture	11,000

The cost and the written-down values of these assets for income-tax purposes were :

	Cost	Written-down Value
	Rs.	Rs.
Buildings	2,00,000	1,50,000
Machinery	7,50,000	3,00,000
Furniture	15,000	15,000

Is there any income liable to tax for the assessment year 1975-76 ?

	Buildings Rs.	Machinery Rs.	Furniture Rs.
Cost	2,00,000	7,50,000	25,000
Written-down Value	1,50,000	3,00,000	15,000
Depreciation Allowed	50,000	4,50,000	10,000
Sale Price	1,80,000	8,00,000	11,000
Profit or Loss	+ 30,000	+ 5,00,000	– 4,000

According to section 41(2), there is a deemed profit of Rs. 30,000 on the sale of buildings and deemed profit of Rs, 4,50,000 (to the extent of depreciation allowed) on the sale of machinery. There is also a capital gain of Rs. 50,000 on the sale of machinery.

For the assessment year 1975-76 this deemed profit of Rs. 4,80,000 (Rs. 30,000 + Rs. 4,50,000) will be taxed as the income from business, even though there was no business in existence in the previous year 1974 in which the sale of these assets took place, because the explanation to section 41(2) so provides.

In addition to this income from business there is the capital gain of Rs. 50,000 liable to tax for the assessment year 1975-76.

There is a loss of Rs. 4,000 on the sale of furniture, but it is a capital loss which will be set off against the capital gain of Rs. 50,000, in the assessment for 1975-76.

(12) Z Ltd. is an Indian company, which carries on the business of manufacture of iron and steel. It closes its accounts every year on 31st December.

It purchased for Rs. 15 lakhs one new steel rolling plant for its factory on 1st January 1971. It was installed and brought into use on 1st July 1971. Out of the cost of this plant a sum of Rs. 5 lakhs was met from the grant received from the Government exclusively for the purchase of the plant.

This plant was destroyed by fire which broke out in the company's factory on 1st June 1974. It was insured with an insurance company and Z Ltd. received a claim of Rs. 3 lakhs on 15th October 1974. Z Ltd. also realised Rs. 5,000 from the sale of scraps.

Work out the profit under section 41(2) or loss under section 32(1)(iii) of the Income-Tax Act, 1961.

	Rs.
Written-down value on the date of destruction as calculated below	7,29,000
Less Amount received from insurance company and from sale of scraps (Rs. 3,00,000 + Rs. 5,000)	3,05,000
Loss or terminal depreciation	4,24,000

For the purpose of calculating the above amount of terminal depreciation for the assessment year 1975-76. the written-down value of plant destroyed is arrived at as follows :

	Rs.
Total cost to the assessee after deducting the amount of grant received from Government	10,00,000
Depreciation at 10% for 1971	1,00,000
Written-down value on 1-1-1972	9,00,000
Depreciation at 10% for 1972	90,000
Written-down value on 1-1-1973	8,10,000
Depreciation at 10% for 1973	81,000
Written-down value on 1-1-1974	7,29,000

As the plant was used in 1971 depreciation for that year is allowed in full at 10%.

(13) A new machine purchased at a cost of Rs. 4,00,000 on 1-1-1970 and installed and brought into use (working single shift throughout) immediately, is compulsorily acquired by the Government on 31-7-1974. If the calendar year be the previous year of the assessee, the rates of depreciation and development rebate be 10% and 20% respectively and the compensation received from the Government be Rs. 4,50,000, what is the effect of the acquisition by the Government in the assessment concerned ?

The compulsory acquisition of machinery by the Government is deemed to be a sale thereof and its effect in the assessment for the assessment year 1975-76 will be as follows :

(1) The Written-down value of machinery on 1-1-1974 (1970 being the year of acquisition) would be as under :

	Rs.
Actual cost of machinery	4,00,000
Less Depreciation for 1970	40,000
W. D. V. on 1-1-1971	3,60,000
Less Depreciation for 1971	36,000
W. D. V. on 1-1-1972	3,24,000
Less Depreciation for 1972	32,400
W. D. V. on 1-1-1973	2,91,600
Less Depreciation for 1973	29,160
W. D. V. on 1-1-1974 for assessment year 1975-76	2,62,440

The amount of capital gain and the profit chargeable to tax would be as under ;

	Rs.
Amount received from the Government	4,50,000
Less Actual cost of machinery	4,00,000
Capital gain (short-term) to be taxed	50,000
Actual cost of machinery	4,00,000
Less W. D. V. on 1-1-1974	2,62,440
Balancing charge equal to depreciation allowed	1,37,560

Rs. 1,37,560 would be taxed as income from business. Rs. 50,000 is short-term capital gain because the interval between the purchase and sale of machinery is less than 60 months. This capital gain will also be taxed as ordinary income.

(2) A development rebate of Rs. 80,000 in respect of the machinery would have been allowed in the assessment year 1971-72. The machinery is transferred before the expiry of 8 years from the end of the year 1970. But the development rebate would not be withdrawn because the transfer is made to the Government.

Chapter 10

Capital Gains

Under section 45(1), any profits or gains arising from the transfer of a capital asset effected in the previous year are chargeable to income-tax under the head "Capital Gains", and are deemed to be the income of the previous year in which the transfer took place. To attract liability to tax under this section it is sufficient if profits have arisen, that is to say, if the assessee has a right to receive the profits ; it is not necessary that the assessee should have actually received them.

Short-term and Long-term Capital Gains. For the purpose of levying tax on capital gains, they have been divided into two categories, namely : short-term capital gains and long-term capital gains. A short-term capital gain is one which results from the disposal of a capital asset within a period of 60 months from the date of its acquisition. Before 1-4-1974 this period was only 24 months. Any capital gain which is not a short-term capital gain would be a long-term capital gain.

Transfer. Transfer, in relation to a capital asset, includes the sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law.

Compulsory acquisition by the Government constitutes a transfer. A lease of land would be a transfer and the salami or nazrana paid for the lease would be assessable as capital gains. The section also applies to capital gains arising from the relinquishment of a capital asset. The share of a partner in a partnership concern is property and therefore a capital asset. Compensation received by one partner from another partner for relinquishing all his rights in the partnership is a capital gain.

Capital Asset. The-term "capital asset" means property of any kind (movable or immovable) held by an assessee, whether or not connected with his business or profession, but it does not include :

(*a*) any stock-in-trade, consumable stores or raw materials held for the purposes of his business or profession :

(*b*) personal effects, that is to say, movable property (including wearing apparel and furniture but excluding jewellery) held for personal use by the assessee or any member of his family dependent on him ;

(*c*) agricultural land in India ; or

(*d*) 6½% Gold Bonds 1977, 7% Gold Bonds, 1980 or National Defence Gold Bonds, 1980 issued by the Central Government.

If a person purchases a piece of agricultural land with the object of putting up a building thereon, and sells the land with the buildings at a profit, the profit so realised is a capital gain liable to tax, because he did not hold the land as agricultural land.

Leasehold rights in mines are a capital asset, and any profit realised on the sale of such rights is a capital gain (*43 ITR 460*).

Agricultural Land in Urban Areas. However, it is provided to bring within the scope of taxation capital gains arising from the transfer of agricultural land situated within the limits of any municipality or cantonment board of a town which has a population of not less than 10,000 according to the latest census for which the relevant figures have been published.

The Central Government is also empowered to bring within the scope of the levy by notification capital gains arising from transfer of agricultural land situated outside the limits of any such municipality or cantonment board up to a maximum distance of 8 kilometres, where this is considered necessary having regard to the extent of and scope for urbanisation of that area and other relevant considerations.

Agricultural land which is situated in rural areas will continue to be outside the scope of the above-mentioned provision. Accordingly, no liability to tax will arise in respect of gains derived from transfer of agricultural land in rural areas.

Date of Accrual of Capital Gain. A capital gain accrues on the date on which the title to property passes to the buyer. Title to movable property passes to the buyer according to the Indian Sale of Goods Act, while title to immovable property passes to the buyer when the sale deed has been duly registered.

Capital Gains on Liquidation of a Company.

The treatment of capital gains arising on the liquidation of a company is as follows :

(1) Under section 46(1), a company is not regarded as having made any capital gains if it merely distributes its assets in specie among its shareholders on liquidation.

(2) Capital gains made by the liquidator of a company on sale of the company's assets with the object of distributing the sale proceeds among the shareholders are assessable in the hands of the company (*26 ITR 351*)

(3) Under section 46(2), where a company distributes its assets in specie among its shareholders, the shareholder may be chargeable to capital gains tax in respect of the money received or the market value of other assets distributed in specie on liquidation, as reduced by the amount assessed as dividend under section 2(22)(e). That is to say, the excess of the money received or such market value over the cost of acquisition of shares in the company will be taxed as capital gain.

Under section 55(2)(iii), where the shareholder subsequently sells the capital asset which he had received earlier from the company in liquidation, he would be assessable on the excess of the sale price realised over the market value of the asset on the date of distribution by the company in liquidation, if he had already been assessed to capital gains tax under section 46(2) on the basis of such market value at the time of distribution. Where no such capital gains tax has been assessed on the shareholder under section 46(2) and he subsequently sells the asset received on the liquidation of the company, he is assessable on the basis of cost for which the company had acquired the asset as increased by the cost of any improvement incurred by the company or the shareholder—section 49(iii) (c).

(4) Where the liquidator of a company sells the company's assets and distributes the sale proceeds among the shareholders, and a shareholder receives from the liquidator a sum in excess of the cost of acquisition of his shares in the company, such excess amount is not a capital gain in the hands

of the shareholder, because there is no sale, exchange, relinquishment or transfer of a capital asset (*73 ITR 50*).

Transactions Not Regarded as Transfer.

Under section 47, the following transactions are not regarded as transfer and therefore any capital gain arising therefrom is not taxable under the head "Capital Gains" :

(1) Any distribution of capital assets on the total or partial partition of a Hindu undivided family.

(2) Any distribution of capital assets on the dissolution of a firm, body of individuals or other association of persons.

(3) Any transfer of a capital asset under a gift or will or an irrevocable trust.

(4) Any transfer of a capital asset by a company to a wholly-owned Indian subsidiary company.

(5) Any transfer of a capital asset by a wholly-owned subsidiary company to its Indian holding company.

(6) Any transfer of a capital asset, in a scheme of amalgamation, by the amalgamating company to the amalgamated company which is an Indian company.

(7) Any transfer by a shareholder, in a scheme of amalgamation, of a share or shares held by him in amalgamating company, in consideration of the allotment to him of any share or shares in the amalgamated company, which is an Indian company.

As regards (4), (5) and (6), the transferring company is exempted from the capital gains tax, but the transferee company would be entitled to depreciation only on the basis of the written-down value of the assets in the case of the transferring company, irrespective of the actual consideration paid by the transferee company.

Where goodwill does not appear as an asset in the accounts of a business and it is sold along with other assets to another person, the consideration received for goodwill is not a capital gain and is not liable to tax (*80 ITR 500*).

Mode of Computation of Capital Gains

According to section 48, the income chargeable under the head "Capital Gains" is to be computed by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset, the following amounts, namely :

(*i*) Expenditure incurred wholly and exclusively in connection with such transfer ; and

(*ii*) The cost of acquisition of the capital asset and the cost of any improvements thereto.

The provisions relating to "cost of acquisition", "full value of consideration" and "cost of improvements" are as follows :

Cost of Acquisition.

(1) Under section 49(1), where the capital asset becomes the property of the assessee in any of the following modes, the cost of acquisition is the cost for which the previous owner of the property acquired it, as increased by the cost of any improvement incurred by the previous owner or the assessee :

(*a*) On any distribution of assets on the partition of a Hindu undivided family ;

(*b*) Under a gift or will ;

(*c*) By succession, inheritance or devolution ;

(*d*) On any distribution of assets on the dissolution of a firm, body of individuals or other association of persons ;

(*e*) On any distribution of assets on the liquidation of a company ;

(*f*) Under a transfer to a revocable or an irrevocable trust ; or

(*g*) Under a transfer by a holding company to its wholly-owned Indian subsidiary company or by a wholly-owned subsidiary company to its Indian holding company.

(*h*) Under a transfer in a scheme of amalgamation by the amalgamating company to the Indian amalgamated company.

(2) Under section 43A, in computing the capital gains arising to the assessee on the sale or transfer of a capital asset acquired by him from abroad on deferred payment terms or against a foreign loan, the additional rupee liability incurred by him in repaying the instalments of the cost or the foreign loan after the date of devaluation of the rupee, will be added to the original actual cost of the asset.

(3) Under section 49(2), where the capital asset, being a share or shares in an amalgamated company which is an Indian company, became the property of the assessee in consideration of the transfer of a share or shares held by him in the amalgamating company, in a scheme of amalgamation, the cost of acquisition to him of the shares in the amalgamated company shall be taken to be the cost of acquisition to him of the shares in the amalgamating company.

(4) Under section 55, where the cost for which the previous owner acquired the property cannot be ascertained, the cost of acquisition to the previous owner means the fair market value on the date on which the capital asset became the property of the previous owner.

Where the capital asset became the property of the assessee before 1st January 1954, the assessee is given the option to adopt, instead of the actual cost of the capital asset, its fair market value as on 1st January 1954. This means that all capital appreciation in the value of the asset, which took place before this date, is left untaxed.

Where the capital asset became the property of the assessee by any of the modes specified in section 49, and the capital asset became the property of the previous owner before 1st January 1954, the assessee is given the option to adopt, instead of the cost of the asset to the previous owner, its fair market value as on 1st January 1954.

Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation and the assessee has been assessed to income-tax under the head "Capital Gains" in respect of that asset under section 46, the cost of acquisition means the fair market value of the asset on the date of distribution.

The cost of acquisition to an assessee of any shares received by him from a company in lieu of his original holding on the conversion or reconversion of the stock or shares into shares or stock or conversion of one kind of shares into another kind, will be calculated with reference to the cost to the assessee of the original shares or stock held by him.

(5) Under section 55A, with a view to ascertaining the fair market value of a capital asset, the Income-Tax Officer may refer the valuation of the capital asset to a Valuation Officer where he considers it necessary to do so. A Valuation Officer is appointed by the Central Government.

(6) Under section 50, if the asset is one in respect of which the assessee has obtained depreciation allowance in any year, the cost of acquisition is taken

to be the written-down value as adjusted (*i. e.*, as diminished by any terminal depreciation or as increased by any balancing charge).

As already stated above, the assessee has the option of substituting the fair market value as on 1st January 1954 in place of the original cost. In case the assessee exercises this option, the fair market value on the 1st January 1954 should be reduced by the amount of depreciation, if any, allowed to the assessee *after* the said date, disregarding any earlier depreciation allowance, and the resulting figure should be diminished or increased by any adjustment on account of terminal depreciation or balancing charge—section 55(1)(a).

Illustration

Work out the amount of income chargeable under the head "Capital Gains" in the assessment year 1975-76 in the following cases :

(*a*) X is in business as a manufacturer. His accounting year ends on 31st December. On 1st November 1974 he sold for Rs. 60,000 some machinery which had cost Rs. 40,000 and in respect of which Rs. 15,000 had been allowed as depreciation.

(*b*) X was in business as a manufacturer, making up his accounts on 31st December. On 31st December 1973 he closed down his business. In March 1974 he sold for Rs. 60,000 some machinery which had cost Rs. 40,000 and in respect of which Rs. 15,000 had been allowed as depreciation.

(*c*) X is in business as a manufacturer. His accounting year ends on 31st December. On 1st November 1974 he sold for Rs. 20,000 some machinery which had cost Rs. 40,000 and in respect of which Rs. 15,000 had been allowed as depreciation.

(*d*) X is in business as a manufacturer. His accounting year ends on 31st December. On 1st November 1974 he sold for Rs. 60,000 some machinery which had been purchased in 1953 for Rs. 40,000, its fair market value on 1st January 1954 being Rs. 50,000. Depreciation allowed in respect of this machinery after 1st January 1954 amounted to Rs. 22,000.

(*a*) The written-down value of machinery sold is Rs. 40,000—Rs. 15,000= Rs: 25,000. Thus there is a profit of Rs. 35,000. Therefore, in the assessment year 1975-76 Rs. 15,000 out of Rs. 35,000 will be taxed as a balancing charge, while Rs. 20,000 will be taxed as a capital gain.

For the purpose of computing the capital gain of Rs. 20,000, the written-down value of Rs. 25,000, as increased by the balancing charge of Rs. 15,000, becomes the cost of acquisition.

(*b*) There is a profit of Rs. 35,000 on the sale of machinery in March 1974. Even though the sale took place after the discontinuance of the business, yet in the assessment year 1975-76 Rs. 15,000 out of Rs. 35,000 will be taxed as a balancing charge while Rs. 20,000 will be taxed as a capital gain.

For the purpose of computing the capital gain of Rs. 20,000, the written-down value of Rs. 25,000, as increased by the balancing charge of Rs. 15,000, becomes the cost of acquisition.

(*c*) The written-down value of machinery sold is Rs. 25,000, and the sale proceeds amount to Rs. 20,000. Thus there is a loss of Rs. 5,000, the whole of which will be allowed in the assessment year 1975-76 as terminal depreciation. The written-down value of Rs. 25,000 as diminished by this allowance, becomes the cost of acquisition. Therefore, the capital gain in this case is nil.

(*d*) Assuming that the fair market value of the asset as on 1st January 1954 (*i. e.*, Rs. 50,000) is taken into account at the option of the assessee, its cost of acquisition will be :

	Rs.
Fair market value on 1-1-1954	50,000
Less Depreciation allowed	22,000
	28,000
Add Amount taxed as balancing charge	22,000
	50,000
Cost of acquisition	10,000
Capital gain to be taxed	60,000
Sales price	

(7) Under section 51, where any capital asset was on any previous occasion the subject of negotiations for its transfer, any option or other money received and retained by the assessee in respect of such negotiations shall be deducted from the cost for which the asset was acquired or the written-down value or the fair market value, as the case may be, in computing the cost of acquisition.

Full Value of Consideration.

As a general rule, the sale price of a capital asset is the full value of consideration for its transfer ; but according to section 52 there are two exceptions to this rule. These exceptions are :

(1) Under section 52(1), the Income-Tax Officer is entitled, in computing capital gains, to ignore the actual consideration received for the transfer and to substitute a notional consideration based on the fair market value of the asset on the date of the transfer if the following conditions are fulfilled :

(*a*) The transferee should be a person who is directly or indirectly connected with the assessee ; *and*

(*b*) The Income-Tax Officer should have reason to believe that the transfer was affected with the object of avoidance or reduction of the liability of the assessee to capital gains tax.

This provision applies only where the object of the transfer is avoidance or reduction of the assessee's liability to capital gains tax.

(2) Under section 52(2), even in cases where the object of the transfer of a capital asset is not avoidance of tax, if in the opinion of the Income-Tax Officer the fair market value of the asset on the date of the transfer exceeds the full value of the consideration declared by the assessee in respect of the transfer by not less than 15 per cent of the value so declared, the capital gain in respect of such asset shall be computed with reference to such fair market value.

This provision does not apply to cases where the capital asset is transferred to the Government or where the full value of the consideration for the transfer is determined or approved by the Central Government or the Reserve Bank of India.

In both the above cases the Income-Tax Officer can take action only after obtaining the previous approval of the Inspecting Assistant Commissioner.

Cost of Improvements.

Where the capital asset became the property of the previous owner or the assessee before 1st January 1954 and the fair market value of the asset on that day is taken as the cost of acquisition at the option of the assessee, the cost of improvements means all expenditure of a capital nature incurred in making any additions or alterations to the capital asset on or after that date by

the previous owner or the assessee and in any other case, it means all such expenditure incurred by the assessee after the asset became his property, and where the asset became the property of the assessee by any of the modes specified in section 49, it means all such expenditure incurred by the previous owner.

The cost of improvements does not include any expenditure which is deductible in computing the income chargeable under the head "Interest on Securities", "Income from House Property", "Profits or Gains of Business or Profession", and "Income from Other Sources".

Illustrations

(1) X was in practice as a chartered accountant who had built up valuable goodwill by personal efforts. He sold his practice to Y who paid Rs. 25,000 for goodwill. Is X liable to any capital gains tax ?

Goodwill is a capital asset and there is a sale of it. But goodwill did not cost anything to X in terms of money ; it was built up by his personal efforts. The cost of acquisition of goodwill is thus incapable of determination. The liability to tax on capital gain arises only in respect of those capital assets which have a cost of acquisition. Therefore Rs. 25,000 received by X for the value of goodwill is not liable to tax as a capital gain (*89 ITR 88*).

(2) Y, an investor in shares, converted his investment acquired at a cost of Rs. 5 lakhs in 1960 into stock-in-trade in January 1975. The market value of the shares then was Rs. 8 lakhs. The shares were ultimately disposed of for Rs. 10 lakhs in the same year.

The Income-Tax Officer indicates his intention of taxing the difference of Rs. 5 lakhs, whereas the assessee contends that the taxable profit is Rs. 2 lakhs. Alternatively, the Income-Tax Officer contends that the other Rs. 3 lakhs, being the difference of Rs. 8 lakhs and Rs. 5 lakhs is liable to capital gains tax.

Examine the merits of the claims. (*C. A. Final, May 1973*)

When Y was an investor the shares in his hands were a capital asset. When an investor converts a capital asset into stock-in-trade and starts dealing in it, it should be valued at its market value as on the date of its conversion (*46 ITR 86*). Thus the cost of stock-in-trade is Rs. 8,00,000 and it is sold for Rs. 10,00,000. Therefore the taxable profit is Rs. 2,00,000 and the contention of the assessee is correct.

The difference of Rs. 3,00,000 between the market value of shares on the date of their conversion into stock-in-trade and their cost cannot be taxed as a capital gain because there was no sale of the shares. Therefore the contention of the Income-Tax Officer to tax Rs. 3,00,000 as a capital gain is wrong.

Capital Gains Excluded from Total Income

In the following cases, capital gains are exempt from tax, that is to say, they are not included in the total income of an assessee :

(1) Under section 47, any capital gain arising in transactions which are not regarded as transfer is to be excluded from the total income of the transferor.

(2) Under section 53, a capital gain arising from the transfer of one or more house properties, *income of which is chargeable under section 22*, will not be included in the total income of the assessee provided :

(*a*) the aggregate sale price does not exceed Rs. 25,000, and

(*b*) the aggregate fair market value of all such house properties owned by the assessee immediately before the transfer does not exceed Rs. 50,000.

House property chargeable under the head "Income from House Property" is house property which is not occupied by the assessee for the purpose of his business or profession, the profit of which are assessable to tax. Therefore, capital gain on the sale of house property or any part of it, used for the assessee's own business or profession would *not* be exempt under this section (*26 ITR 351*).

(3) Under section 54, where a capital gain arises from the transfer of a house, used for two years before the date of the transfer as a residence by the assessee or one of his parents, and the assessee has within a year before or after that date purchased, or has within two years from that date constructed a house for his residence, then only the excess of the capital gain over the cost of the new house is chargeable to tax as the income of the previous year in which the transfer took place.

But if the new house is transferred within three years of its purchase or construction, not only the capital gain arising therefrom but also the exempted capital profit arising from the transfer of the old house will be charged to tax as the income of previous year in which the transfer of the new house takes place.

This provision is intended to encourage investment in new house properties, but it is made impossible for a person to misuse this concession by selling the new property within a period of three years of its purchase or construction.

Illustrations

(1) X sold his house used for his residence since 1966 for Rs. 1,00,000 in April 1971. The cost of acquisition of the house to X was Rs. 20,000. He constructed another house for his residence at a cost of Rs. 60,000 in June 1972. This house was again sold in December 1974 for Rs. 90,000. His previous year ends on 31st March.

Indicate the manner in which the capital gains, if any, will be dealt with in his assessments for the assessment years 1972-73 and 1975-76. (*C. A. Final, May 1973*)

Under section 54, where a capital gain arises from the sale of a house used for two years before the date of sale as a residence by the assessee, and the assessee has, within a year before or after that date purchased or has, within two years from that date, constructed a house for his residence, then only the excess of capital gain over the cost of the new house is chargeable to tax as the income of the previous year in which the sale took place.

But if the new house is sold within three years of its purchase or construction, not only the capital gain arising therefrom but also the exempted capital gain arising from the transfer of the old house will be charged to tax as the income of the previous year in which the new house is sold.

The capital gain on the sale of the old house is Rs. 1,00,000—Rs. 20,000= Rs. 80,000 out of which Rs. 60,000 equal to the cost of the new house is exempt and only Rs. 20,000 will be included in the gross total income for the assessment year 1972-73.

As the new house has been sold within three years of its construction, not only the capital gain of Rs. 30,000 arising from its sale but also the exempted capital gain of Rs. 60,000 arising from the sale of the old house will be included in the gross total income for the assessment year 1975-76.

(2) In the following cases, state the amount of capital gain chargeable to tax, assuming that the house in question has been used by X for his own residence for over ten years and that his previous year ends on 31st March :

(*a*) On 1-7-1973 X sold his house costing Rs. 1,00,000 for Rs. 1,50,000, but on 1-2-1973 he had purchased another house for his residence for Rs. 75,000. Assume that the house purchased on 1-2-1973 is sold on 15-2-1975 for Rs. 90,000.

(*b*) On 1-7-1973 X sold a house costing Rs. 1,00,000 for Rs. 2,00,000 and he built a house for his residence on 1-3-1975 at a cost of Rs. 75,000. Assume that the new house is sold for Rs. 90,000 on 15-12-1977.

(*c*) On 1-7-1973 X sold a house costing Rs. 1,00,000 for Rs. 1,50,000 and on 1-12-1973 purchased another house for his residence for Rs. 40,000. Assume that the house purchased on 1-12-1973 is sold on 1-1-1977 for Rs. 50,000.

(*d*) On 1-7-1973 X sold a house costing Rs. 1,00,000 for Rs. 2,00,000 and he built a house for his residence on 1-3-1975 at a cost of Rs. 1,20,000. Assume that the new house is sold for Rs. 1,10,000 on 1-5-1977.

(*e*) On 1-7-1973 X sold a house costing Rs. 1,00,000 for Rs. 2,00,000 and he built a house for his residence on 1-3-1975 at a cost of Rs. 1,20,000. Assume that the new house is sold for Rs. 1,10,000 on 1-5-1978.

(*a*) There is no chargeable capital gain for the assessment year 1974-75 but for the assessment year 1975-76 there will be a chargeable capital gain of Rs. 65,000 (*i. e.*, Rs. 50,000 old exempted capital gain plus Rs. 15,000 new capital gain).

(*b*) The capital gain is Rs. 1,00,000 but the cost of building the new house is only Rs. 75,000. Therefore, Rs. 25,000 of this capital gain is chargeable to tax in the assessment year 1974-75 and Rs. 90,000 (Rs. 75,000 old exempted capital gain plus Rs. 15,000 new capital gain) will be the capital gain chargeable in the assessment year 1978-79.

(*c*) The capital gain is Rs. 50,000 but another house is purchased for only Rs. 40,000, Therefore, Rs. 10,000 of this capital gain is chargeable to tax in the assessment year 1974-75. The capital gain chargeable in the assessment year 1977-78 will be Rs. 10,000 being the capital gain on the sale of the new house. As the new house is sold more than three years after its purchase, the old exempted capital gain will not be brought to tax.

(*d*) There is no chargeable capital gain for the assessment year 1974-75 as the capital gain is less than the cost of the new house. But for the assessment year 1978-79 there will be a chargeable capital gain of Rs. 90,000 (Rs. 1,00,000 old exempted capital gain minus Rs. 10,000 capital loss on the new house).

(*e*) There is no chargeable capital gain for the assessment year 1974-75 as the capital gain is less than the cost of the new house ; nor will there be any capital gain chargeable in the assessment year 1979-80 since the new house is sold at a loss more than three years after its construction. For the assessment year 1979-80 there is a short-term capital loss of Rs. 10,000 under the head "Capital Gains" which will be set off against his income under another head or carried forward for 8 years.

(4) Under section 54B, where a capital gain arises from the transfer of agricultural land used for two years before the date of transfer by the assessee or a parent of his for agricultural purposes, and the assessee has within a period of two years after that date purchased any other agricultural land, then the capital gain is to be dealt with as follows :

(*a*) If the cost of new agricultural land is less than the amount of capital gain, the excess of capital gain over the cost of the new land will be chargeable as the income of the previous year. If such new land is transferred within a period of three years of its purchase, its cost for the purpose of computing capital gain will be taken as nil.

(*b*) If the cost of new agricultural land is more than the amount of capital gain, the capital gains tax will not be charged. If such new land is transferred within a period of three years of its purchase, its cost for the purpose of computing capital gain will be reduced by the amount of earlier capital gain.

This means that the earlier exempted capital gain will be charged to tax if the new land is transferred within three years of its purchase.

(5) Under section 54C, where any jewellery held for personal use is transferred and other jewellery for personal use is acquired within six months of such transfer, any capital gain arising from the transfer will not be liable to tax if the whole of the full value of the consideration for the transfer is used in acquiring the new jewellery.

Where only a part of such consideration is used in acquiring the new jewellery, a proportionate part of the capital gain will not be liable to tax.

(6) Under section 54D, where any capital gain arises from the transfer by way of compulsory acquisition of a capital asset, being land or building forming part of an industrial undertaking belonging to the assessee, which in the two years immediately preceding the date of transfer was being used by the assessee for the purposes of the business of the said undertaking, and the assessee has, within a period of three years after, that date, purchased or constructed any other building for the purpose of shifting the said undertaking or setting up another industrial undertaking, then the capital gain will not be charged to tax to the extent that it has been utilised for purchasing or constructing such building. Where the amount of the capital gain exceeds the cost of acquisition or construction, only the excess will be chargeable to tax.

This concession will however be forfeited if the assessee transfers such land or building within a period of three years from the date of its purchase or construction.

Computation of Tax on Capital Gains

The provisions governing the computation of tax on capital gains are as follows :

(1) **Short-term Capital Gains**. Such capital gains are treated like ordinary income in the case of all assessees.

(2) **Long-term Capital Gains of Non-company Assessees**. The Tax on such gains is explained and illustrated in a subsequent chapter dealing with deductions in computing total income.

(3) **Long-term Capital Gains of Companies**. The tax on such gains is explained in a subsequent chapter dealing with the assessment of companies.

Set-off and Carry-forward of Capital Losses

The law governing the set-off and carry-forward of capital losses is explained in a subsequent chapter dealing with computation of total income.

Chapter 11

Income from Other Sources

Section 56 is the residuary head of income. Under this section, income of every kind which is not to be excluded from the total income shall be chargeable to income-tax under the head "Income from Other Sources", if it is not chargeable to income-tax under any of the five heads.

Where there is a specific head for a particular income, this section cannot be called in aid. Section 56 can be resorted to only when none of the specific heads is applicable to an income. If a certain item of income is taxable under one of the specific heads, the charge under that head exhausts the taxability of the income and no part of such income can be brought to charge again. For example, the excess of actual rents realised over the annual value of house property cannot be taxed under section 56 as income from other sources, after the tax has been levied on the annual value under section 22.

In particular, the following income is chargeable to income-tax under the head "Income from Other Sources" :

(*i*) Dividends ;

(*ia*) Any annuity due, or the commuted value of any annuity paid, under the annuity deposit scheme ;

(*ib*) Winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort and from gambling or betting.

(*ii*) Income from machinery, plant or furniture belonging to the assessee and let on hire, if the income is not chargeable as income from business or profession ; and

(*iii*) Where an assessee lets on hire machinery, plant, or furniture belonging to him and also buildings, and the letting of the buildings is inseparable from the letting of the said machinery, plant or furniture, the income from such letting, if it is not chargeable as income from business or profession.

These five examples of income chargeable under the head "Income from Other Sources" are given in section 56(2). The following are further examples of such income :

1. Annuities granted under a will. An annuity payable by an employer to an employee is however chargeable under the head "Salaries".
2. Any fees and commission received by an employee from a person other than his employer.
3. All interest other than interest on securities, if it is not chargeable as income from business.

4. Income from land not attached to buildings (and not being agricultural income) *e. g.*, rent from vacant land in urban areas let out for storing materials.
5. Any ground rent received.
6. Income derived from sub-letting of house property.
7. Income from royalties, directors' fees, etc.
8. Income derived from markets, ferries, fisheries, etc.
9. Agricultural income derived from land situated outside India.
10. Interest received by an employee on his own contributions to an unrecognised provident fund.

Deemed Income.

Under section 59, the following provisions apply in computing the income under the head "Income from Other Sources" as they apply in computing the profits of business or profession :

(1) Where in computing the income chargeable under the head "Income from Other Sources" an allowance or deduction has been made in a past assessment in respect of any loss, expenditure or trading liability incurred by the assessee, and subsequently the assessee has received, whether in cash or in any other manner, any amount in respect of such loss or expenditure or has obtained some benefit in respect of such trading liability by way of remission or cessation thereof, the amount received by him or the value of the benefit accruing to him is deemed to be the income of the year of receipt or accrual.

(2) Where any building, machinery, plant or furniture, belonging to the assessee and let on hire, is sold, discarded, demolished or destroyed and the moneys payable in respect thereof (*i. e.*, sale price, insurance, salvage or compensation money) together with the amount of any scrap value exceed the written-down value, so much of the excess as *is equal to the amount of depreciation allowed* would be chargeable as income from other sources of the previous year in which the moneys payable became due, irrespective of whether the letting of these assets is continued or not in that previous year.

It is only when the primary letting is of machinery, plant or furniture and together or along with such letting there is a letting of buildings, the two lettings being inseparable from each other, then the income of the buildings will be computed under the "Income from Other Sources" and the deductions allowable under that head will be available.

(3) Where any structure or work referred to in section 32(1A) is sold, discarded, demolished, destroyed, or surrendered, the amount by which the moneys payable exceed the written-down value of the structure or the work shall be chargeable to tax as income from other sources of the previous year in which the moneys become due.

Illustration

A company obtained on lease a plot of land, put up a residential building thereon and furnished it with furniture and fixtures. The company let it out to a tenant to be used as a hotel, and under the lease deed the lessee agreed to pay a monthly rent of Rs. 5,950 for the building and Rs. 5,000 for the furniture and fixtures. Under what head of income is the rent assessable ?

What was let out by the company was the building and for making it fit for running a hotel, furniture and fixtures were installed therein. The lease was not primarily of furniture and fixtures. Therefore section 56(2)(*iii*) did not apply.

The income of the company from the building has to be computed under the head "Income from House Property", and the income from furniture and fixtures under the head "Income from Other Sources" (*38 ITR 85*).

Deductions.

According to section 57, the income chargeable under the head "Income from Other Sources" shall be computed after making the following deductions, namely :

(1) In the case of dividends, any reasonable sum paid by way of commission to a banker or any other person for the purpose of realising such dividend on behalf of the assessee, is allowed as a deduction.

(2) In the case of income referred to in (*ii*) and (*iii*) above, *i. e.*, income from letting of machinery, plant, etc. deductions on account of the following are allowed in the same way as in computing income from business or profession :

(*a*) Current repairs to buildings.
(*b*) Premium for insurance of buildings.
(*c*) Repairs on machinery plant or furniture.
(*d*) Premium for insurance of machinery, plant or furniture.
(*e*) Depreciation of buildings, machinery plant or furniture.

(3) Any other expenditure (not being capital expenditure) is also allowable as a deduction if it is laid out or expended wholly and exclusively for the purpose of earning such income.

The various deductions allowed in computing the income of a business or profession cannot be imported wholesale in computing the income from other sources ; yet the tax under this head is not upon gross receipts but upon income properly so called and therefore such deductions are allowed as are necessary to ascertain the true income.

Section 57 does not say that the deduction of expenses is permissible only when income has been earned or profit made. All that it speaks of is that the expenditure must have been laid out solely for the purpose of earning income.

In an account year a company purchased shares in another company for Rs. 25 lakhs and for this purpose took a loan of Rs. 20 lakhs. In the same year it paid Rs. 65,000 interest on this loan, but there was no income at all from the shares. It was held that the interest paid by the assessee company on moneys borrowed for the purchase of shares is entitled to be set off against its other income, because the shares were purchased for the purpose of earning income in the form of dividends (*36 ITR 329*).

Amounts not Deductible.

Under section 58, the following amounts shall not be deductible in computing the income chargeable under the head "Income from Other Sources" :

(1) In the case of any assessee :

(*i*) Any personal expenses of the assessee.

(*ii*) Any interest chargeable to tax, which is payable outside India unless the interest is on a loan issued for public subscription before 1st April 1938, or tax has been paid or deducted at source in respect of such interest or there is a person who may be charged as an agent in respect of such interest.

(*iii*) Any payment which is chargeable under the head "Salaries" if it is payable outside India and if the tax has not been paid thereon nor deducted therefrom at source.

(2) In the case of a company :

Those items of expenditure incurred by a company, which are disallowed in computing the income from business, are also disallowed in computing the income from other sources.

Restriction on Deduction of Certain Expenses.

The provisions of section 40A, which restricts the deduction of certain expenses or payments, also apply for the purpose of computation of income from other sources.

Winnings from Lotteries Etc.

The provisions of law relating to the taxation of winnings from lotteries etc., are as follows :

(1) The definition of 'income' has been extended specifically to provide that winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever will be regarded as income for income-tax purposes.

(2) Winnings from lotteries etc., will be chargeable to tax under the head "Income from Other Sources". Accordingly expenditure (not being in the nature of capital expenditure) incurred wholly and exclusively for the purpose of earning such income will be allowed as deduction in computing the taxable income.

(3) Winnings from State and other lotteries in the case of non-corporate tax-payers will be taxed on a concessional basis. That is to say, the whole of the income by way of lottery winnings will be allowed as deduction in computing the total income where the gross total income of the assessee does not exceed Rs. 10,000 or where the winnings do not exceed Rs. 5,000. In other cases, a deduction equal to Rs. 5,000 *plus* 50% of the balance will be allowed in computing the total income.

(4) Other casual and non-recurring receipts, which are in excess of Rs. 1,000 in a year, will be included in the total income in the case of all categories of assessees and charged to tax at the normal rates. The exemption of the first Rs. 1,000 of income will not however be available in respect of capital gains, receipts arising from business or the exercise of profession, vocation or occupation or receipts by way of addition to remuneration of an employee.

(5) Losses from lotteries, crossword puzzles, races, card games etc., will be allowed to be set off only against the income from the same source. For this purpose, each of the following sources will be regarded as a separate and distinct source :

(*a*) Lotteries,
(*b*) Crossword puzzles,
(*c*) Races including horse races,
(*d*) Card games,
(*e*) Other games of any sort, and
(*f*) Gambling or betting.

Thus, while losses from bridge may be set off against winnings from any other card game, these will not be set off against income from any other source.

Losses relating to the above sources incurred in one year will not be allowed to be carried forward to be set off against income of a subsequent year *except* in one case, namely : owners of race horses will be allowed to carry forward and set off the loss incurred by them on the maintenance of race horses against their income from the source "races including horse race" in the next *four* assessment years.

(6) Income-tax will be deductible at source from winnings from lotteries and crossword puzzles at the prescribed rates if the payment in respect thereof exceeds Rs. 1,000.

(7) Income by way of winnings from lotteries, crossword puzzles, races including horse races, card games, other games or from gambling or betting will not be included in the total income for purposes of payment of advance tax.

Method of Accounting

Under section 145, the income chargeable under the head "Profits and Gains of Business or Profession" or "Income from Other Sources" shall be computed in accordance with the method of accounting regularly employed by the assessee.

The choice of the method of accounting lies with the assessee. No uniform method of accounting is prescribed for all tax-payers. An assessee may adopt such system of accounting as is best suited for his purposes, the only restrictions imposed by section 145 being :

(*a*) The method of accounting employed must be one that clearly reflects the income of the assessee ; and

(*b*) The method of accounting must be one that is regularly employed by him.

Under the proviso to section 145(1), in any case where the accounts are correct and complete to the satisfaction of the Income-Tax Officer, but the method employed is such that in the opinion of the Income-Tax Officer, the income cannot be properly deduced therefrom, then the income shall be computed upon such basis and in such manner as the Income-Tax Officer may determine.

The words "in the opinion of the Income-Tax Officer" do not confer a mere discretionary power, but impose a statutory duty on the Income-Tax Officer to examine in every case the method of accounting employed by the assessee and (*i*) to see whether or not it is regularly employed ; and (*ii*) to determine whether income, profits and gains of the assessee can properly be deduced therefrom. The decision as to the method of accounting is to be arrived at first by the Income-Tax Officer after a careful scrutiny of the accounts whether they be simple or complicated, and the power is to be reasonably and judiciously exercised, which excludes any subjective or arbitrary decision by the Income-Tax Officer ; but the power so exercised is not clothed with finality and is not excluded from review by the Appellate Assistant Commissioner (*33 ITR 182*).

The charge on income accruing or received in India cannot be avoided by any method of accounting. This point is of particular significance in the case of non-residents.

If the assessee's method of accounting is improper in the sense that the real profits cannot be deduced therefrom, the Income-Tax Officer must reject the method, but he cannot merely on that ground reject the account books (*26 ITR 159*).

The system of accounting adopted by an assessee cannot be rejected under the proviso to section 145(1) on the ground only that the gross profits disclosed in his books are low and compare unfavourably with those of others in the same line of business (*42 ITR 370*).

Under section 145(2), where the Income-Tax Officer is not satisfied about the correctness or completeness of the accounts of the assessee or where no method of accounting has been regularly employed by the assessee, the Income-Tax Officer is empowered to make a best judgment assessment under section 144 or an assessment under section 143(3) on the basis of all relevant material he may have gathered.

While the method of accounting may be rejected under the proviso to section 145(1), the account books themselves may be rejected under section 145(2).

The accounts would be rejected as unreliable if important transactions are omitted therefrom or if proper particulars and vouchers are not forthcoming and the accounts show an abnormally low rate of profit.

In cases where no method of accounting has been regularly employed by the assessee or where the assessee's method of accounting or account books

are rejected, the Income-Tax Officer may, by exercising his judgment reasonably and judiciously, compute the profits by applying a flat rate of profit to turnover, gross receipts, capital employed etc., or he may compute the profits on any other reasonable basis.

Change in Accounting System.

When an assessee desires to change his method of accounting and makes such a request, the Income-Tax Officer, if he is prepared to allow the change, should take steps to secure that no profits escape taxation on account of the change. Whether a method of accounting has been regularly employed is a question of fact ; but it is open to the assessee to change his method, though not from year to year. In doing so, he should satisfy the income-tax authorities that he is making the change in good faith and not with a view to defrauding the revenue.

Systems of Accounting.

While section 145 leaves it to the discretion of the Income-Tax Officer to decide whether a particular system of accounting should be accepted or whether a change in the system of accounting should be allowed, the discretion of the Income-Tax Officer in this matter can be questioned in the course of an appeal against the assessment. There are three systems of accounting that may be adopted by the assessees :

(1) Cash System. Under this system, a record is kept of actual receipts and actual payments, entries being made only when money is actually collected or disbursed. This system is quite inadequate for the needs of a trading concern where there may be a number of credit transactions. The income of a business cannot be computed correctly under this system. It is therefore unusual for a trader to calculate his profits on this system.

This system may very well be adopted by a professional man such as a doctor, an accountant or a lawyer, where nearly all transactions are for cash and also by non-trading concerns such as a club, a school, a college, etc., whose object of keeping accounts is to make sure that all income that should be received has been received and that the actual income received has been properly accounted for.

However, if a trader adopts the cash system of accounting and wishes to calculate his profit or loss therefrom, the difference between the value of the opening and closing stocks should be taken into account in doing so, so that a proper and even distribution of his profits over a series of years may be secured (*23 ITR 122*).

Where the cash system of accounting is employed, the accounts are said to be kept on a cash basis.

(2) Mercantile Accountancy System. This is also known as the book profit system of accounting. Under this system, a record is kept of all transactions, both cash and credit, and the net profit or loss is calculated after taking into account all the income and all the expenditure relating to the year, whether such income has been actually received or not and whether such expenditure has been actually paid or not. That is to say, the profit computed under this system is the profit actually earned, though not necessarily realised in cash or the loss computed under this system is the loss actually sustained, though not necessarily paid in cash. The distinctive feature of this method of accounting is that it brings into credit what is due immediately it becomes legally due and before it is actually received and it brings into debt expenditure for which a legal liability has been incurred before it is actually disbursed.

Under the mercantile system of accounting deduction can be claimed in respect of a liability which has definitely arisen in the accounting year although the liability may have to be discharged at a future date and the cost

of discharging it may be indefinite and may have to be estimated. This is the decision of the Supreme Court (*37 ITR 1*).

Where the mercantile system of accounting is employed, the accounts are said to be kept on the accrual basis.

(3) Mixed System of Accounting. Besides the cash system and the mercantile system, there may be several hybrid or mixed systems of accounting. That is to say, a trader may record one set of transactions on the cash basis and for another set he may follow the mercantile method. Thus, purchases and sales of goods may be recorded on the mercantile basis and income and expenses on the cash basis. An assessee can adopt a mixed system of accounting so long as he regularly employs it.

The income chargeable and the deductions allowable for any previous year are to be determined according to the method of accounting regularly employed by an assessee.

Note : Even where a cash system of accounting is regularly employed by an assessee, any income which is deemed to be received in any particular previous year will be taxed as the income of that previous year. Thus, a dividend received by a shareholder is deemed to be the income of the previous year in which it was actually declared by the company irrespective of the fact that it is paid in the next previous year.

Maintenance of Accounts.

One of the main difficulties facing an Income-Tax Officer is that of ascertaining the correct income of an assessee. The task is very considerably simplified if the assessee produces accounts regularly and properly kept and, if possible, audited by a chartered accountant. But in the case of many individuals, as also in the case of small traders, the plea often put forward is that no accounts worth the name have been maintained. It is, therefore, sometimes suggested that a legal obligation should be imposed on all persons, at least on those who do business, to keep proper accounts. In the present state of illiteracy in India, this suggestion is however impracticable. Still, the income-tax authorities are not wholly without remedy in the case of a trader who does not keep any accounts.

Even if it may not be practicable to impose an obligation on all assessees to maintain proper accounts, the maintenance of such accounts should, wherever possible, be encouraged. The assessees are discouraged from maintaining accounts when they find that such accounts as have been kept are treated with scant respect by the income-tax authorities.

Where accounts have been kept, it practically becomes necessary for assessees, under the provisions of section 147, to preserve their accounts for many years, as they may receive a notice for revision of the assessments under that section. It is equally prudent to preserve primary and subsidiary accounts for the same period.

In respect of accounts relating to large business, it will be a useful safeguard for the income-tax department if the accounts are examined and certified by a chartered accountant. It is not desirable to make audit of accounts compulsory except in the case of businesses with large incomes.

The prescribed return of total income (which every assessee has to fill up) requires that if the accounts are kept on the mercantile accountancy system, a copy of the profit and loss account and balance sheet should be attached to the return and that, if the accounts are kept on any other system, the name and description of the system is to be stated and a copy of any statement, which corresponds to the profit and loss account in the mercantile system, is to be attached to the return. In the case of a company, a copy of the auditor's report is also to be attached to the return.

CHAPTER 12

Taxation of Dividend Income And Rights Shares

Dividend Income

Under Section 56(2), dividends are taxable under the head "Income from Other Sources", even if they are derived from shares held as stock-in-trade.

General Provisions regarding Dividend.

(1) Under section 8, for the purpose of inclusion in the total income of an assessee :

(*a*) any dividend (other than an interim dividend) declared by a company or distributed or paid by it shall be deemed to be the income of the previous year in which it is so declared, distributed or paid, as the case may be, the words "distributed or paid" being used in view of the extended definition of the term dividend as explained below ; and

(*b*) any interim dividend shall be deemed to be the income of the previous year in which the amount of such dividend is unconditionally made available by the company to the member who is entitled to it. For example, if an interim dividend is declared by the directors of a company in March 1974 but is paid in April 1974 it will be the income of the previous year ended 31st March 1975.

Arrears of dividends for past years, which are declared by the company in one accounting year, are all taxable as the income of the year in which they are declared.

(2) If a company has declared a dividend and the amounts payable to the shareholders as dividend have been credited or paid to the shareholders, but subsequently the company passes another resolution to the effect that the dividend was wrongly declared out of capital and should be treated as loans to the respective shareholders, it has been held by the Supreme Court (*46 ITR 640*) that under section 8 the liability to pay tax attaches as soon as a dividend is declared, distributed or paid and the Income-Tax Act contains no provision for altering the incidence of liability to pay tax on the dividend, and therefore the amounts credited as dividend to the shareholders should be assessed as their income, in spite of the second resolution of the company. The Income-Tax Act does not contemplate an inquiry whether the dividend is properly paid, credited or distributed.

(3) What is taxable as dividend need not necessarily be paid in money ; it may be paid in money's worth by the delivery of goods or securities or shares in another company.

When dividend is paid in the form of property or in the form of shares of a limited company, such property or shares cannot be valued at the market rate and the quantum of dividend determined at a rate higher for purposes of income-tax than the rate at which the dividend was declared (*74 ITR 687*).

(4) Non-observance by the company of the requirements of company law for the declaration or payment of dividend, or the fact that the dividend is received from a foreign corporation which is not a company within the meaning of the Income-Tax Act, do not affect the shareholder's liability to tax in respect of the dividend.

(5) In grossing up dividends, only the amount of tax deducted at source under the Income-Tax Act, 1961, and not the tax paid to any foreign State, is to be added (*21 ITR 28*).

(6) Under section 9(1)(iv), a dividend paid by an Indian company outside India is deemed to accrue or arise in India. The expression "Indian company" means a company registered in India under the Indian company law. The words "by an Indian company" automatically exclude dividends declared by any other kind of company. Thus, dividends received by a non-resident shareholder from a non-resident company operating in India are exempt from Indian income-tax.

(7) The whole of the dividend is taxable in the hands of the shareholder, even though a part of it may have been derived from non-taxable income of the company (*e. g.*, agricultural income), since the profits of a different nature lose their identity when they are merged in a general pool of profits. Any distribution made by a company out of its non-taxable profits would be a revenue receipt chargeable as dividend in the hands of a shareholder.

However, in computing the total income of an assessee, the following deductions are allowed from gross total income of the assessee :

(1) Full amount of dividend attributable to the tax-holiday profits of a company running a new industrial undertaking or shipping or hotel business.

(2) Dividend received by an individual or a Hindu undivided family from Indian companies (along with certain other investment income) up to Rs. 3,000.

(3) 60% of dividend received by an Indian company from any other Indian company.

(4) 65% of dividend received by a foreign company from an Indian company.

(5) Full amount of dividend received by an Indian company or any other resident assessee from a foreign company on shares, allotted for supply of technical know-how or technical services.

Shares Sold Cum-Dividend.

A dividend accrues not from day to day but only when it is declared. When shares are sold cum-dividend a short time before its declaration, the whole dividend is to be included in the total income of the person who happens to be the shareholder on the date of its declaration, that is to say, who is registered as a shareholder of the company on that date. The principle is that there is no apportionment by time in the case of dividends. The whole dividend is taxable in the hands of the person who is entitled to it as being on the register of members at the time when the dividend is declared, irrespective

of whether he was the owner of the shares throughout the period for which the dividend is declared or not. This principle also applies when the dividend becomes payable after a shareholder's death. A part of such dividend, apportioned to the period up to the date of the death, cannot be treated as the income of the deceased, but the whole dividend must be treated as income of the estate received by the legal representative.

The above principles are subject to the provision of section 94 which hits those who seek to avoid tax by systematic sales of shares cum-dividend. Under that section the Income-Tax Officer may, in certain circumstances, deem the income from shares to accrue from day to day and tax the seller on that basis.

Definition of Dividend.

The definition of dividend given in section 2(22) is an exclusive and not an exhaustive definition. The ordinary meaning of dividend is the receipt by a shareholder of part of the profits of the company of which he is the shareholder.

Section 2(22) merely extends the definition of dividend so as to include therein five items of distribution by a company which normally may not be regarded as dividend. These five instances of dividend are all cases of distribution or payment out of or to the extent of *accumulated profits* of the company. These five items are :

(*a*) **Distribution entailing release of company's assets.** Dividend includes any distribution by a company, which is out of accumulated profits, whether capitalised or not and which entails a release by the company to its shareholders of any of its assets. A distribution of accumulated profits, whether capitalised or not, which does not entail a release by the company of its assets, would not be dividend.

Bonus Shares. When a company capitalises its accumulated profits and issues bonus shares to its shareholders, there is no release of any of the company's assets. Therefore, bonus shares are not included in the term dividend when they are issued to equity shareholders, but as stated below bonus shares issued to preference shareholders are deemed to be dividend liable to tax.

As stated above, bonus shares are not taxable as dividend when they are allotted to equity shareholders. But whenever such bonus shares are paid off (*e. g.*, on redemption of preference shares, on reduction of capital or in liquidation), the distribution to the holders of bonus shares would be dividend

For example on 1-1-1973 X Ltd. had allotted to its equity shareholders fully paid preference shares of Rs. 100 each by way of bonus shares. Y was one such shareholder who was allotted preference shares by way of bonus shares. On 1-4-1974 his holding of such bonus preference shares was sold by him to Z who paid Rs. 100 per share as purchase price.

On 31-12-1974 the company redeemed the preference shares at a premium of 10%.

Discuss Z's liability under the Income-Tax Act in respect of the amount received on redemption.

(*C. A. Final, Nov. 1972*)

When a company capitalises its accumulated profits and issues bonus shares (whether equity or preference) to its equity shareholders, there is no release of any of the company's assets. Therefore the bonus shares are not treated as dividend when they are issued to equity shareholders. But whenever the bonus shares are paid off (*e. g.*, on redemption of preference shares, on reduction of capital or in liquidation), the amount paid to the holders of bonus shares will be deemed as dividend liable to income-tax.

Assuming that Z is an investor, he holds the bonus shares as an investment on the date of redemption of preference shares. Therefore the amount (including the 10% premium) paid to him by the company would be deemed dividend under section 2(22) (*a*) because there is release of the company's assets and it would be liable to tax in his hands.

The purchase price paid by Z is capital expenditure. His dividend income would be chargeable to tax under section 56(2)(i) as income from other sources, and in computing the taxable income from dividend the purchase price paid by Z to Y would not be deductible under section 57 because the payment is capital expenditure.

(*b*) **Bonus debentures etc.** A distribution of bonus debentures, debenture stock or deposit certificates in any form, by a company to its shareholders, is dividend in the hands of shareholders, to the extent to which the company possesses accumulated profits whether capitalised or not. *The same is the case with bonus shares issued to preference shareholders of a company.*

(*c*) **Distribution on liquidation of a company.** A distribution made to the shareholders of a company on its liquidation is dividend in the hands of the shareholders, to the extent to which the distribution is attributable to the accumulated profits of the company, whether capitalised or not.

The distribution on liquidation out of the accumulated profits of any past year and even out of the current profits of the year of liquidation but up to the date of liquidation, is taxable as dividend (*60 ITR 83*). However, any distribution out of the profits of the company after the date of liquidation would not be dividend (*56 ITR 393*).

Note : The treatment of capital gains arising on the liquidation of a company has been explained in a preceding chapter dealing with capital gains.

(*d*) **Distribution on reduction of capital.** A distribution to its shareholders by a company on the reduction of its share capital is dividend to the extent of its accumulated profits, whether such accumulated profits have been capitalised or not.

The date of the appropriate resolution of the company, and not the date of distribution among the shareholders, fixes the date for ascertaining the quantum of accumulated profits (*57 ITR 1*).

(*e*) **Loans of shareholders, etc.** The following three types of payment made by a company (in which the public are not substantially interested) to its shareholders (who have a substantial interest in the company, *i. e.*, who own beneficially at least 20% of the equity share capital) are dividend in their hands :

(*i*) A payment by way of an advance or a loan.
(*ii*) Any payment on behalf of a shareholder.
(*iii*) Any payment for the individual benefit of a shareholder.

The company must possess accumulated profits at the time it makes the payment, and the payment is deemed to be dividend only to the extent of such profits.

This provision applies to a shareholder being a person who has a substantial interest in the company. Therefore the person should be a shareholder *and* he should beneficially own at least 20% of the equity share capital. A shareholder means a person in whose name the shares stand in the share register of the company (*43 ITR 352*). Therefore if a person is merely the beneficial owner of shares, without being the registered shareholder, this provision would not apply to him (*58 ITR 271*).

It is also provided that any subsequent dividend paid by a company would not be taxable to the extent to which it is set off by the company against any loan or other monetary benefit which has been treated as a dividend.

Such a loan would be a dividend even if it is repaid before the end of the accounting year (*82 ITR 485*).

The loan or other payment is taxable as dividend in the year in which the loan is paid to the shareholder or the payment is made by the company on behalf or for the benefit of the shareholder.

According to the Supreme Court, where members of a Hindu undivided family acquired shares in a private company with the funds of the family, loans were granted by the company to the Hindu undivided family and there were accumulated profits in the hands of the company, only loans advanced to shareholders can be deemed to be dividends. The Hindu undivided family is not a shareholder and therefore the loans given to it cannot be deemed to be its income (*83 ITR 170*).

Accumulated Profits. These include all profits of the company up to the date of distribution or payment for purposes of (*a*), (*b*), (*d*), and (*e*) above ; but for purposes of (*c*), accumulated profits mean profits up to the date of liquidation but not the profits made between the date of liquidation and the date of distribution of the shareholders.

For the purposes of the artificial categories of dividend which are created by this definition, accumulated profits do not include any capital gains except those which are taxable as such. Thus accumulated profits would not include capital gains made during a period when they were not taxable under the 1922 Act.

Loans advanced to shareholders can be held to be dividend only if the company is found to be in possession of accumulated profits at the relevant dates. The phrase "accumulated profits" does not mean the total of the assessed income arrived at after disallowing expenditure in fact incurred. Such profits should be calculated by deducting all expenditure actually incurred by the company, though not allowed for income-tax purposes (*80 ITR 463*).

Exceptions. The extended definition of 'dividend' does not, however, include the following :

(1) A distribution on liquidation of the company or on reduction of its capital is not dividend if it is made in respect of any share
   (*i*) which has been issued for full cash consideration, and
   (*ii*) which is not entitled in the event of liquidation to participate in the surplus assets, *e. g.*, preference shares.

(2) A distribution on liquidation of the company or on reduction of its capital is not dividend, if it is attributable to bonus shares allotted to equity shareholders after 31st March 1964 and before 1st April 1966.

(3) Any advance or loan made to a shareholder by a company in the ordinary course of its business is not dividend, if the lending of money is a substantial part of the business of the company.

(4) A dividend paid by a company is not dividend, if it is set off by the company against any sum previously paid by it and treated as dividend, to the extent to which it is so set off.

Sale of Bonus Shares.

For the purpose of ascertaining the profit or loss on the sale of bonus shares, their cost is to be determined according to the following method laid down by the Supreme Court (*74 ITR 62*) :

The proper method is to spread the cost of the old shares over the old shares and the new shares (*i. e.*, bonus shares) taken together if they rank *pari passu*. This principle applies whether the assessee is an investor who makes a capital gain or is a dealer in shares who makes a business profit.

For example, on 1-4-1969 X (an investor) bought 500 equity shares in a company at Rs. 18 per share. In December 1974 he received 100 bonus shares in respect

or his holding of 500 shares. In March 1975 he sold all the bonus shares and his 200 old shares at Rs. 28 per share. Work out the amount of his profit or loss.

	Rs.
Cost of his original holding of 500 shares at Rs. 18 per share	9,000
Therefore the cost of all his shares is also the same	9,000
The cost of each of 600 shares is	15
Sale proceeds of 300 shares at Rs. 28 per share	8,400
Less Cost of 300 shares at Rs. 15 per share	4,500
Profit	3,900

Now this Rs. 3,900 is capital gain, of which Rs. 2,600 in respect of old shares is long-term and Rs. 1,300 in respect of bonus shares is short-term.

Dividend paid out of Capital Profits.

If a company pays its normal dividend (but not a deemed dividend) out of its capital profits realised upon the sale of its capital assets, the payment would be dividend income in the hands of shareholders, whether the payment is called dividend or bonus.

Dividend paid out of Capital Receipts.

Where a shareholder receives a dividend out of the capital receipts of the company (such as salami and land acquisition compensation), it is not liable to tax, because it is a capital receipt in his hands. The fact that the sum was distributed as "dividend" does not change the true nature of the receipt ; a receipt is what it is and not what it is called (*82 ITR 460*).

Dividend paid out of Agricultural Income.

Under section 235, relief was granted to shareholders of a company on that part of the dividend on their shares which was attributable to the paying company's agricultural income subjected to agricultural income-tax.

From 1-4-1972 this section has been deleted, because it is contrary to the concept underlying the present scheme of taxation of companies and their shareholders, under which no part of the Central income-tax borne by the company on its income is considered as having been paid on behalf of the shareholders. So far as the shareholder is concerned, the proximate source of the dividend is the investment in the shares and not the profits of the company.

Illustrations

(1) The Board of Directors of B Co. Ltd. announced on 31st January 1974 that an interim dividend of Rs. 10 per share would be paid. On 20th February 1974 however, they made a further announcement saying that they would pay the dividend only after 15th April 1974. The payment was actually made on 20th April 1974. One shareholder maintains the year to 31st March as his previous year. Will the dividend in question be treated as his income of the previous year ended 31st March 1974 or of the previous year ended 31st March 1975 ? Give reasons for your answer.

(C. A. Final. Nov. 1967)

An interim dividend is deemed to be the income of the previous year of a shareholder in which the amount of such dividend is unconditionally made available to him by the company, and this is so without regard to the method of accounting adopted by the shareholder. Therefore, in this case the interim dividend will be the income of the shareholder for the previous year ended 31st March 1975.

(2) An Indian company with a paid-up (for cash) share capital of Rs. 10,00,000 divided into 10,000 equity shares of Rs. 100 each went into liquidation on 30th June 1974. On that date its reserves created out of profits amounted to Rs. 7,00,000 and the balance to the credit of its profit and loss account was Rs. 50,000. The liquidator realised the assets at prices considerably in excess of their book values and after meeting and providing for all liabilities including the liability for taxation had a distributable sum of Rs. 26,50,000 which he duly distributed to the shareholders on 1st March 1975.

S, a holder of 500 shares acquired by him on 1st July 1965 at a cost of Rs. 60,000 approaches you for advice as to the treatment for income-tax purposes of the amount received by him from the liquidator. Discuss fully. (*C. A. Final, Nov. 1970*)

A distribution made to the shareholders of a company on its liquidation is dividend in the hands of the shareholders to the extent to which the distribution is attributable to the accumulated profits of the company, whether capitalised or not.

Where a shareholder receives from the liquidator of the company a sum in excess of the cost of acquisition of his shares in the company, such excess amount is not a capital gain because there is no sale, exchange, relinquishment or transfer of a capital asset by him.

In this case the paid-up share capital of Rs. 10,00,000 was all for cash and it did not include any capitalised profits of the company. Therefore the accumulated profits of the company as on the date of liquidation were Rs. 7,00,000+Rs. 50,000 =Rs. 7,50,000. Thus Rs. 7,50,000 out of Rs. 26,25,000 distributed to the shareholders is dividend in their hands chargeable to income-tax in the assessment year 1975-76.

Now the tax liability of S, in respect of the amount received by him from the liquidator, is as follows :

	Rs.
Amount received by him being 500/10,000 of Rs. 26,25,000	1,31,250
Amount taxable as dividend being 7,50,000/26,25,000 of Rs. 1,31,250	37,500
Balance not liable to income-tax	93,750

S received Rs. 93,750 on account of his 500 shares costing Rs. 60,000. But the excess of Rs. 33,750 is not a capital gain in his hands because there was no transfer of his shares to the company.

Relief to Charitable Institutions in respect of Dividends.

The provisions of section 236A which grant this relief are explained in a subsequent chapter dealing with assessment of charitable and religious trusts.

Deduction of Tax from Dividends.

This is explained in a subsequent chapter dealing with the collection and recovery of tax.

Rights Shares

Under section 81 of the Companies Act, 1956, where at any time after the expiry of two years from the formation of public company or at any time

after the expiry of one year from the first allotment of shares in that company, whichever is earlier, it is proposed (whether by the board of directors or by the company in general meeting) to increase the subscribed capital of the company by allotment of further shares (whether equity or preference shares), then :

(*a*) such further shares must be offered to the holders of the equity shares in the company in proportion to the capital paid up on those shares at that time ;

(*b*) the offer must be made by a notice specifying the number of shares offered and limiting a time (not being less than 15 days from the date of the offer) within which the offer must be accepted ;

(*c*) the equity shareholders to whom the offer is made must have the right to renounce the whole or part of the offer in favour of a third party, unless the articles of the company provide otherwise, and the notice must contain a statement of this right ; and

(*d*) after the expiry of the time specified in the notice or on receipt of an earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the board of directors may dispose of them, in such manner as they think most beneficial to the company.

The shares thus offered to the equity shareholders are known as "rights shares", because they are offered by virtue of a statutory right.

If the company, issuing the rights shares is a prosperous one, the market value of its old shares must be at a considerable premium, as for example, its existing shares of Rs. 100 each may be quoted at Rs. 213 per share. The rights shares are usually offered at a concessional rate. If the market value of the old shares is Rs. 213 per share, the rights shares may be issued at (say) Rs. 150 per share only. This is a valuable privilege the equity shareholders thus get from the company.

Value of Right. As soon as a company announces the issue of rights shares, the market price of its existing shares is quoted cum-rights (c. r.) and after the issue of rights shares, the market price becomes ex-rights (x. r.). The right included in the market quotation is the right to apply for rights shares at a cheaper rate.

The value of the right is therefore the difference between the cum-rights price and the ex-rights price. The value of the right can be calculated as explained in the following illustration.

Illustration

A company has a fully paid-up share capital of Rs. 10 lakhs in Rs. 100 shares. It makes a rights issue of 5,000 shares of Rs. 100 each at Rs. 150 per share in the proportion of one rights share for every two old shares held. On the announcement of the issue of these rights shares, the market quotation of the company's shares becomes Rs. 230 *cum-rights.*

Calculate the value of the right included in the market quotation.

	Rs.
Cum-rights price of a share	230
Cum-rights price of two shares which must be purchased in order to be entitled to a rights share at Rs. 150	460
Add the amount to be paid to the company for the rights share	150
Therefore, the ex-rights price of three shares will be	610
or the ex-rights price of a share is	203

Thus, the value of the right included in the *cum-rights* quotation will be Rs. 27 (that is to say, Rs. 230 *cum-rights* price minus Rs. 203 *ex-rights* price).

Taxation of Rights Shares

The value of the right attached to rights shares issued by a company is to be assessed to income-tax in the following manner :

(1) Where a shareholder, who is an investor, renounces his right to purchase the rights shares by selling it to another person for a price, the consideration received from the sale of the right is chargeable to tax as a short-term capital gain after deducting therefrom the depreciation in the value of his old shares caused by a fall in their market price on account of the issue of rights shares. In working out capital gain or loss, the principles to be applied are those which are a part of the commercial practice or which an ordinary man of business will resort to when making computation for his business purposes. This is the decision of the Supreme Court (*63 ITR 651*).

(2) Where a shareholder who is a dealer in shares, renounces his right to purchase the rights shares and transfers such a right to another person for a price, the full consideration received from the sale of the right is chargeable to tax as revenue profit without any deduction, because the fall in the market price of the old shares would be reflected in the valuation of his stock-in-trade. But if a dealer in shares values his stock-in-trade at cost, the amount of profit chargeable to tax will be the amount realised by the sale of the right as reduced by the amount of depreciation in the old shares on account of the rights issue of shares. For this purpose the market rates of the shares cum-rights and ex-right immediately before and after the issue of the rights shares should be ascertained (*81 ITR 413*).

(3) Where a shareholder himself subscribes to the rights shares and is a dealer in shares, the value of the right would be reflected in the valuation of his stock-in-trade and any profit ultimately resulting to him would be chargeable as revenue.

(4) Where a shareholder, who himself subscribes to the rights issue, is an investor and not a dealer in shares, the value of the rights exercised by him on a rights issue would not be charged to tax.

Illustrations

(1) An investor held 710 equity shares in a company. An offer was made to him by which he was entitled to apply for 710 new equity shares at a concessional price. He renounced his right to all the 710 shares for Rs. 45,000. On the issue of the rights shares, the value of his old shares depreciated by Rs. 37,500.

He thus made a short-term capital profit of Rs. 45,000 and at the same time the value of his old shares depreciated by Rs. 37,500.

It was held that he was chargeable to tax only on the short-term capital gain of Rs. 7,500, since the net capital gain would be represented by the amount realised by him from the sale of his rights after deducting therefrom the amount of depreciation in the value of his original shares.

(2) A Ltd. received fractional coupons on a "rights" issue by B Ltd. in which it held shares. It sold these coupons for Rs. 500. What profit, if any, is to be included in the total income of A Ltd. ?

It is assumed that A Ltd. is an investor and not a dealer in shares. Where a shareholder, who is an investor, sells his rights for a price, the consideration received from the sale of rights is chargeable to tax as a short-term capital gain after deducting therefrom the depreciation in the value of his old shares caused by a fall in their market price on account of the issue of rights share.

Therefore Rs. 500 less the amount of depreciation in the market value of the old shares is to be included as a short-term capital gain in the total income of A Ltd.

(3) A had received by way of gift from his father on 1-12-1969 one hundred shares on which he had received on 1-4-1974 one hundred shares as bonus shares from the company. On 1-11-1974 he sold the entire lot for Rs. 20,000. A's father had acquired the shares some time in 1953 for a price of Rs. 5,000 and on 1-1-1954 the market value per share was Rs. 80 whereas on 1-1-1956 it was Rs. 90.

Compute A's capital gain for the assessment year 1975-76 for which the previous year was the year ended 31-3-1975. Will he be entitled to any deduction in respect of such gain in computing his total income ?

Where a capital asset became the property of the assessee by way of gift and it had become the property of the previous owner before 1-1-1954, the assessee is given the option to adopt, instead of the cost of the asset to the previous owner, its fair market value as on 1-1-1954.

Therefore A's capital gain for the assessment year 1975-76 is Rs. 20,000—Rs. 8,000 being the value on 1-1-1954=Rs. 12,000. This is a short-term capital gain as the shares were sold before 60 months after the date of their acquisition.

A is not entitled to any deduction in respect of this capital gain in computing his total income. The deduction is available only in the case of long-term capital gains.

(4) X gifted to his wife 100 shares of a company on which she received 200 bonus shares from the company. She sold all the shares. Discuss whether and, if so, to what extent the gain on such sale can be included in the assessment of X.

Under section 64(1) (*iii*), in computing the total income of an individual there shall be included all such income (including capital gains) as arises directly or indirectly to the spouse of such individual from assets transferred to the spouse by such individual otherwise than for adequate consideration or in connection with an agreement to live apart. But this section does not apply to income arising from accumulated income from the asset transferred or to income from accretion to such asset.

The bonus shares received by the wife are an accretion to the shares transferred to her by her husband. The profit realised on the sale of all the shares is a capital gain, one-third of which relates to the shares transferred to her and two-thirds to the bonus shares. Therefore only one-third of the capital gain will be included in the total income of X.

CHAPTER 13

Computation of Total Income

This chapter deals with the following topics which are relevant to the computation of the total income of an assessee :

1. Definition of total income and its computation.
2. Aggregation of income.
3. Deductions to be made in computing total income.
4. Incomes which do not form part of the total income.
5. Incomes forming part of total income on which no income-tax is payable.
6. Income of other persons included in the assessee's total income.
7. Special provisions relating to avoidance of tax.
8. Set-off and carry-forward of losses.
9. Rounding-off of income.

The law relating to each of these topics is discussed in the following pages.

1. Definition of Total Income (Section 2) :

According to section 2(45), the total income of an assessee means the total amount of income for which he is chargeable on the basis of his residence, and which has been computed in the manner explained in the preceding chapters.

Therefore, the total income (as defined above) is to be computed in the following manner :

(1) Ascertain the residential status of the assessee and find out which income is chargeable in his hands including the income of any other person to be so charged.

Compute such income under the various heads of income after making the deductions allowed by law and total up the incomes so computed.

Then set off against this total the amount of loss (if any) computed under any head of income for the same previous year and also deduct from the business income of the previous year any past business loss carried forward from any of the preceding 8 previous years.

The result will then be the gross total income for the previous year.

(2) From the gross total income make the deductions allowed by law on account of certain payments and in respect of certain incomes (as explained in the next chapter), and the balance will be the legal total income, which should be rounded off to the nearest multiple of Rs. 10.

2. Aggregation of Income (Sections 66-69B) :

The following provisions govern the aggregation of income in order to arrive at the total income of an assessee :

(1) Under section 66, in computing the total income of an assessee, there shall be included all income on which no income-tax is payable, *i. e.*, on which a rebate of income-tax is allowed. This is explained later.

(2) Under section 67, the method of computing a partner's share in the income of the firm is laid down for the purpose of arriving at the total income of the partner. This is illustrated in a subsequent chapter dealing with the assessment of firms.

(3) Under section 68, any unexplained cash credit found in the accounts of an assessee for any previous year is to be included in his total income for that *previous* year.

(4) Under section 69, any unrecorded investments made by an assessee in the financial year immediately preceding the assessment year and not properly explained by him are added to his total income for that *financial* year.

(5) Under section 69A, if an assessee is not able to explain satisfactorily source of any money, bullion, jewellery or any valuable article found to be owned by him in any financial year, the money and the value of such bullion etc., may be deemed to be his income for such *financial* year.

(6) Under section 69B, where in any financial year the assessee has made any investment or is found to be the owner of any bullion, jewellery or other valuable article and the Income-Tax Officer finds that the amount expended on making such investment or acquiring such bullion etc., exceeds the amount recorded in this behalf in the books of account, the excess amount may be deemed to be the income of the assessee for such *financial* year unless the assessee is able to offer satisfactory explanation for the same.

Illustration

An assessee kept his accounts according to the calendar year. In his books for the year 1974 cash deposits of Rs. 25,000 were found credited to his personal account on 15th February 1974, the source of which was not satisfactorily explained.

Further, he was found to have made an investment of Rs. 20,000 in house property on 15th March 1974. This investment was not recorded in the account books. The assessee failed to satisfy the Income-Tax Officer regarding the source of this investment also.

The Income-Tax Officer included both the amounts of Rs. 25,000 and Rs. 20,000 in the assessment for 1975-76. Is the Income-Tax Officer correct ?

In the case of unexplained cash credits, section 68 provides that the previous year would be the previous year for which the accounts of the assessee have been kept. Therefore, the inclusion of Rs. 25,000 in the total income for the assessment year 1975-76 is correct.

On the other hand, the unrecorded investment of Rs. 20,000 in house property made on 15th March 1974 has been made out of income derived from an undisclosed source. According to section 69, the previous year for this income is the financial year ended 31st March 1974 and it should be assessed in the assessment year 1974-75. The Income-Tax Officer is not correct in assessing it in the assessment year 1975-76. In order to rectify this mistake, the assessment for 1974-75 should be reopened under section 147.

3. Deductions to be made in Computing Total Income (Sections 80D—80U) :

These deductions are discussed fully in the next chapter.

4. Incomes which do not Form Part of Total Income (Sections 10, 11 and 12) :

Under section 10, in computing the total income of a previous year of any person, the following incomes shall not be included :

(1) Agricultural income. What is agricultural income has already been explained in the first chapter.

(2) Any sum received by an individual as a member of a Hindu undivided family, where such sum has been paid out of the income of the family, or in the case of an impartible estate, where such sum has been paid out of the income of the estate belonging to the family. The meaning of an impartible estate is explained in a subsequent chapter dealing with the assessment of Hindu undivided families.

However, if a maintenance allowance is paid to a member of a Hindu undivided family, not as a member of the family, but in pursuance of some legal obligation like the decree of a court, such as allowance is liable to tax as the income of the recipient.

As an exception to the above provision, section 64(2) provides that, where an individual converts his separate property into property belonging to the Hindu undivided family of which he is a member, the income from the converted property, in so far as it is attributable to his interest in the property of the family, is deemed to arise to him.

(3) Casual income. What is casual income has already been explained in the first chapter.

(4) In the case of non-resident, (*i*) interest on such securities as the Central Government may by notification specify in this behalf and (*ii*) interest on the bonds (or premium received on their redemption) issued by the Central Government or by any industrial undertaking or financial corporation in India under a loan agreement with the International Bank of Reconstruction and Development or the Development Loan Fund of the U. S. A.

(4A) In the case of a non-resident, any income from interest on moneys standing to his credit in a non-resident account in any bank in India in accordance with the Foreign Exchange Regulation Act, 1947.

This exemption is intended to encourage the repatriation of foreign funds of non-resident Indians.

(5) The value of any travel concession or assistance provided by the employer to an Indian citizen for meeting expenditure on journeys performed by the assessee, his spouse and children and his dependent parents and brothers and sisters in connection with his proceeding to any place in India on leave or after retirement from service or after termination of service, is exempted from income-tax to the extent the value does not exceed the amount that would have been received by the assessee if he had proceeded to his home district in India.

The Board has however the power to prescribe exceptions to the condition that the exemption will be limited to the amount that would have been due to the assessee had he proceeded to his home district in India.

(6) In the case of an individual, who is not a citizen of India, the following amount, namely :

(*i*) Subject to such conditions as the Central Government may prescribe, passage moneys or the value of any free or concessional passage received by such individual from his employer or former employer for himself, his spouse and children in connection with his proceeding on home leave out of India or to his home country out of India after retirement from service in India or after the termination of such service.

(*ii*) The remuneration received by an ambassador or other official of the Embassy, High Commission or Legation of a foreign State in India.

(*iii*) The remuneration received by a consular officer of a foreign State in India.

(*iv*) The remuneration received by a trade commissioner or other official representative in India of the Government of a foreign State, provided corresponding officials of the Government of India in that country are given a similar concession.

(*v*) The remuneration received by a member of the staff of any of the officials referred to in (*ii*), (*iii*) and (*iv*) above, if the member is a subject of the country represented, is not engaged in any business, profession or employment in India (otherwise than as a member of such staff), and the country represented gives similar concession to the members of the staff of corresponding officials of the Government of India.

(*vi*) Remuneration received by him as an employee of a foreign enterprise (*e. g.*, technician deputed by a foreign firm to work in India) for services rendered by him during his stay in India, provided the following conditions are fulfilled ; *(a)* the foreign enterprise is not engaged in any trade or business in India ; *(b)* his stay in India does not exceed in the aggregate a period of 90 days in such previous year ; and *(c)* such remuneration is not liable to be deducted from the income of the employer chargeable under the Act.

(*vii*) Remuneration (chargeable under the head "Salaries") received by a foreign technician *employed* (*from a date before 1-4-1971*) by Government, a local authority, a statutory corporation or in any private business carried on in India for a limited period as specified below, *provided he was not resident in any of the four financial years immediately preceding the financial year in which he arrived in India :*

In the case of a technician who has special knowledge and experience in industrial or business management techniques, if his contract of service is approved by the Central Government within one year of his arrival in India, his remuneration for six months commencing from the date of his arrival is exempt.

In the case of any other technician, if his contract of service is approved by the Central Government, his salary for 36 months from the date of his arrival is exempt. Thereafter, his salary for a further period of 60 months will also be exempt if the tax thereon is paid by his employer and the perquisite represented by such tax payment will not be included in his salary income.

The extension of the period of exemption up to eight years will enable industrial undertakings in India to avail for a longer period of the services of foreign technicians who are holding important positions requiring specialised knowledge and skill and who have acquired experience of conditions of work in India.

Where the contract of service is not approved by the Central Government, there is no exemption for a technician having knowledge and experience of industrial or business management techniques ; but in the case of other technicians, the salary for only 365 days in all commencing from the date of arrival in India, is exempt.

For the purposes of (vii), a technician means a person who has specialised knowledge and experience in (*i*) constructional or manufacturing operations or in mining or in the generation or distribution of electricity or any other form of power ; or (*ii*) industrial or business management techniques, and who is employed in India in a capacity in which such specialised knowledge and experience are actually utilised.

(*viia*) Remuneration (chargeable under the head "Salaries") received by a foreign technician *employed (from a date after 31st March 1971)* by Government, a local authority, a statutory corporation, any approved scientific research institution or any private business carried on in India, is exempt from tax to the following extent :

His remuneration for 24 months from the date of his arrival in India is exempt from tax subject to a maximum of Rs. 4,000 per month. In addition, if the employer pays to Government the tax on the excess (if any) of the technician's remuneration over Rs. 4,000 per month for the said 24-month period, the amount of the tax so paid will not be charged to tax as a perquisite in the hands of the technician.

Further, if such a technician continues in employment in India after the expiry of the said 24 months and the tax on his remuneration is paid to Government by his employer, the amount of the tax so paid for a maximum period of 24 months following the expiry of the first-mentioned 24 months will not be charged to tax as a perquisite in the hands of the technician.

This exemption is available subject to the conditions that (*a*) the technician was not resident in India in any of the four financial years immediately preceding the financial year in which he arrives in India ; and (*b*) the contract of his service is approved by the Central Government, the application for such approval having been made to that Government before the commencement of such service or within six months of such commencement.

The condition that the technician should not have been resident in India in any of the four financial years immediately preceding the financial year in which he arrives in India, may be waived by the Central Government in the case of technicians who are employed in India for designing, erection or commissioning of machinery or plant or supervising activities connected therewith.

For the purpose of this exemption, "technician" means a person having specialised knowledge and experience in :

(*a*) constructional or manufacturing operations or in mining or in the generation of electricity or any other form of power, or

(*b*) agriculture, animal husbandry, dairy-farming, deep sea-fishing or ship-building

who is employed in India in a capacity in which such specialised knowledge and experience are actually utilised.

(*viii*) Salary of a non-resident who is not a citizen of India for services rendered in connection with his employment on a foreign ship where his total stay in India does not exceed 90 days in the previous year.

(*ix*) Salary income earned in India by visiting professors and teachers of foreign nationality, whose services are utilised in any university

or educational institution in India, is exempt. In order to be entitled to the exemption, the contract of service of the person concerned should be approved by the Central Government within one year from the commencement of service, and he should not have been resident in India in any of the four financial years immediately preceding the financial year in which he arrived in India. His salary for 36 months from the date of his arrival is exempt. Thereafter his salary for a further period of 24 months will also be exempt if the tax thereon is paid by the university or other educational institution concerned.

(*x*) Stipends or remuneration received by foreign students and professors from foreign Governments or institutions for carrying on research work in India under an approved programme, is exempt for 24 months for each such individual.

(7) Any allowance or perquisite paid or allowed outside India by the Government to a citizen of India for rendering service outside India.

(8) In the case of an individual who comes to India in pursuance of an agreement between the Government of India and the Government of a foreign State in connection with any co-operative technical assistance programme, the following income is exempt, if the terms of the agreement so provide :

(*a*) Remuneration received by him from the Government of that foreign State for such duties ; and

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

(9) The income of any member of the family of any such individual as is referred to in (8) above accompanying him to India, which accrues or arises outside India, and is not deemed to accrue or arise in India, in respect of which such member is required to pay any income or social security tax to the Government of that foreign State.

(10) Any gratuity received by an employee as already explained in a previous chapter dealing with salary income.

(10A) Any payment in commutation of pension as explained in a previous chapter dealing with salary income.

(11) Any payment from a provident fund to which the Provident Funds Act, 1925 applies or from any other provident fund set up by the Central Government and notified by it in this behalf, *e. g.*, Government provident fund or public provident fund.

(12) The accumulated balance due and becoming payable to an employee participating in a recognised provident fund, to the extent referred to in the chapter dealing with salaries.

(13) Any payment from an approved superannuation fund, to the extent referred to in the chapter dealing with salaries.

(13A) Any specific house rent allowance granted to an employee by his employer to such extent (not exceeding Rs. 400 per month) as may be prescribed. This has already been explained and illustrated in a previous chapter dealing with salary income.

(14) Any special allowance or benefit (not being an entertainment allowance and not being a perquisite taxable under the head "Salaries") specifically granted to meet expenses wholly, necessarily and exclusively incurred in the performance of the duties of an office or employment of profit, *to the extent to which such expenses are actually incurred for that purpose.*

Travelling allowance and sumptuary allowance are examples of this exemption.

Exemption from income-tax will not be available in respect of any allowance (such as city compensatory allowance) granted to the assessee for meeting his personal expenses at the place where the duties of his office or employment are ordinarily performed by him or at the place where he ordinarily resides.

This exemption applies even though there is no relation of employer and employee. In order that this exemption may be available, the following conditions must be satisfied :

(*a*) The allowance or benefit must have been specifically granted to meet expenses to be incurred by the employee or the other person in the performance of his duties ;

(*b*) The expenses must have been incurred wholly, necessarily and exclusively in the performance of such duties ; and

(*c*) The actual amount of expenses incurred (which alone is eligible for the exemption) must be proved by the assessee.

This provision is intended to check the abuse of persons getting large tax-free allowances which are really an additional source of income to them. Where the specific allowances are reasonable with reference to the nature of the duties performed by the assessee and are not unduly high compared to the remuneration received by him, the Income-Tax Officer may not call for details of expenses actually incurred by the assessee with a view to disentitle him from the exemption to some extent.

(15) The following interest and other payments :

(*i*) Monthly payments on 15-year annuity certificates issued by the Central Government.

(*ia*) Annual payment on national defence gold bonds, 1980.

(*ii*) Interest on treasury savings deposit certificates, post-office cash certificates, post-office national saving certificates, national plan certificates, 12-year national plan savings certificates and such other certificates issued by the Central Government as that Government may specify in this behalf, interest on deposits in post-office savings banks and bonus received in respect of deposits under the Post-Office Savings Bank (Cumulative Time Deposits) Rules, 1959.

Under this provision, the Central Government has specified the following certificates ; 10-year defence deposit certificates, 12-year national defence certificates and Government of India defence certificates.

(*iia*) Interest on Government of India five-year deposits up to the maximum amount permitted to be deposited. The Government of India five-year deposits are an ideal short-term investment yielding 5% tax-free interest. Deposits in multiples of Rs. 50 can be made at post-offices and branches of the State Bank of India and its subsidiaries. An individual can deposit up to Rs. 25,000 and two individuals jointly up to Rs. 50,000.

(*iii*) Interest on securities held by the Issue Department of the Central Bank of Ceylon.

(*iv*) Interest payable (*a*) by Government or a local authority on moneys borrowed by it from sources outside India ; (*b*) by an industrial undertaking in India on moneys borrowed by it under a loan agreement entered into with a foreign financial institution approved in this behalf by the Central Government ; or (*c*) by an industrial undertaking in India on any moneys borrowed or debt incurred by it in a foreign country in respect of the purchase outside India of raw materials or capital plant and machinery where the loan or debt is approved by the Central Government or (*d*) by specified financial institutions on moneys borrowed outside India at the rate of interest approved by the Central Government or (*e*) by any other financial institution or a banking company established in India on loans raised in foreign countries under approved agreements for the purpose of advancing loans to industrial undertakings in India.

(16) Scholarships granted to meet the cost of education.

(17) Any daily allowance received by members of Parliament or of a State Legislature or of any Committee thereof.

(17A) Awards for literary, scientific or artistic work as also for proficiency in games and sports instituted or approved by the Central Government.

(17B) Rewards given by the Central or State Governments for such purposes as may be approved by the Central Government in the public interest.

(18) Any payment made whether in cash or in kind by the Central Government or any State Government to recipients of gallantry awards instituted or approved by the Central Government.

(18A) Any *ex-gratia* payments made by the Central Government consequent on the abolition of the privy purse of former Indian Rulers.

(19) Omitted from 2-4-1973.

(19A) The annual value of any one palace in the occupation of a former Ruler if such annual value was exempt from income-tax before the Rulers of Indian States (Abolition of Privileges) Act of 1971 came into force.

(20) Income of local authorities. The profits made by a local authority from the supply of commodities or services outside its jurisdictional area are however taxable.

(20A) Income of the Housing Boards or other statutory authorities set up for the purpose of dealing with or satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages.

(21) Income of an approved scientific research association, where the income is applied solely to the purposes of that association.

(22) Any income of a University or other educational institution existing solely for educational purposes and not for purpose of profit.

(22A) Income of hospitals and other medical institutions, notwithstanding that such income is not fully spent during the year in which it is earned.

(23) Any income of an association or institution established in India having as its objects the control, supervision, regulation or encouragement in India of the games of cricket, hockey, football, tennis or such other games or sports as may be notified by the Central Government. The association or institution must be approved by the Central Government, its income must be applied solely to the object for which it is established, and no part of its income must be distributed in any manner to its members except as grants to any association or institution affiliated to it.

(23A) In the case of an association or institution established in India having as its object the control, supervision, regulation or encouragement of the profession of law, medicine, accountancy, engineering or architecture or such

other profession as the Central Government may specify, any income (other than income chargeable under the head "Interest on Securities" or "Income from House Property" or any income received for rendering specific services or income by way of interest or dividends derived from investments).

This exemption will be available where the association or institution has been approved in this behalf by the Central Government, and it applies its income to the objects for which it is established.

(23B) Income derived by institutions established for development of khadi and village industries from production, sale or marketing of khadi or products of village industries. This exemption will be available only to those institutions which are constituted as public charitable trusts or are registered under the Societies Registration Act of 1860 and which are approved for this purpose by the Khadi and Village Industries Commission.

(24) Investment income of a registered trade union *i. e.*, any income chargeable under the heads "Interest on Securities", "Income from House Property", and "Income from Other Sources".

(25) Incomes of provident and superannuation funds, namely :

(*i*) Interest on securities held by a provident fund to which the Provident Funds Act, 1925 applies and any capital gains of the fund arising from the sale of such securities.

(*ii*) Income received by the trustees on behalf of a recognised provident fund.

(*iii*) Income received by the trustees on behalf of an approved superannuation fund.

(*iv*) Income received by the trustees on behalf of an approved gratuity fund.

(26) In the case of a member of a scheduled tribe, residing in any tribal area or in the Union Territories of Manipur and Tripura, any income which arises to him (*a*) from any source in the Union Territories aforesaid, or (*b*) by way of dividend or interest on securities.

(26A) Any income accruing to any person from any source in the district of Ladakh or outside India in the previous year relevant to any assessment year commencing before 1-4-1975, where such person is resident in the said district in that previous year.

(27) Any income derived from a business of livestock breeding or poultry or dairy farming.

(28) Any amount adjusted or paid in respect of a tax credit certificate. A subsequent chapter deals with tax credit certificates.

(29) Any income derived from the letting of godowns or warehouses by an authority constituted under any law for the marketing of commodities (*e. g.*, marketing committees).

(30) In the case of an assessee who carries on the business of growing and manufacturing tea in India, the amount of any subsidy received from the Tea Board under any scheme for replantation or replacement of tea bushes notified by the Central Government is exempt. This exemption will be available if the assessee furnishes to the Income-Tax Officer with his return of income a certificate from the Tea Board as to the amount of subsidy received by him during the previous year.

Income of Charitable or Religious Trusts and Institutions

Besides the incomes which are excluded from the total income under section 10, sections 11, 12 and 13 provide that the income of certain charitable or religious trusts and institutions is also to be so excluded.

The law relating to the assessment of charitable or religious trusts and institutions is fully explained in a subsequent chapter dealing with that subject.

5. Incomes forming part of total income on which no income-tax is payable, *i. e.*, which are entitled to full or partial rebate of tax (Sections 86 and 86A) :

The following incomes included in the total income of an assessee are entitled to a full or partial rebate of income-tax :

(1) Under section 86(iii), a partner's share of profits from an unregistered firm on which income-tax is payable by the firm, when the unregistered firm is not assessed as a registered firm.

(2) Under section 86(v), a member's share of profits from an association of persons or a body of individuals (other than a Hindu undivided family, a company or a firm) on which income-tax has already been paid by the association or body.

(3) Under section 86A, income from interest on tax-free government securities included in the total income of an assessee is entitled to a rebate of income-tax at the average rate or at 27·5% whichever is less.

6. Incomes of Other Persons Included in the Assessee's Total Income (Sections 60-65) :

In the following cases, the income actually belongs to persons other than the assessee but, in order to prevent avoidance of tax, such income is included in the total income of the assessee :

(1) Transfer of Income. Under section 60, all income arising to any person by virtue of a transfer, whether revocable or not and whether effected before or after 1st April 1962, shall, where there is no transfer of the assets from which the income arises, be chargeable to income-tax as the income of the transferor and shall be included in his total income.

This means that, where there is a transfer of income only without a transfer of the corpus, such income is included in the total income of the transferor.

(2) Revocable Transfer of Assets. Under section 61, all income arising to any person by virtue of a *revocable* transfer of assets is deemed to be the income of the transferor and is included in his total income.

Transfer includes any settlement, trust, covenant, agreement or arrangement.

A transfer is deemed to be revocable if (*i*) it contains any provision for the retransfer of the income or assets to the transferor, or(*ii*) it gives the transferor a right to reassume power over the income or assets.

Section 62 provides an exception to the above rule. Section 61 does not apply to income arising to any person by virtue of a transfer which fulfils the following conditions, namely :

(*i*) The transfer is not revocable during the life-time of the beneficiary in the case of a trust or during the life-time of the transferee in the case of any other transfer.

(*ii*) The transferor does not derive any direct or indirect benefit from the income.

Where a transfer of assets has been made and that transfer has been made irrevocable, the income derived from such assets will be the income of the transferee except where such a transfer has been made to, or for the benefit of, the transferor's spouse or minor child.

Benami Transactions. Where a person buys property with his own money or enters into any other transactions for himself, but in the name of some other person, without any intention to benefit such other person, the transaction is called benami and the person in whose name the transaction is done is called benamidar.

The usual types of benami transactions frequently noticed in income-tax cases are :

(*a*) Transactions like deposits or loans in the names of nominees such as children, deities, close relatives, faithful employees, etc.

(*b*) Transfer of assets to benamidars.

(*c*) Sales of goods to benamidars at lower prices.

(*d*) Admission of nominees into partnership.

Tax is leviable on the person to whom the income accrues or by whom it is received ; no tax can be levied on a benamidar in whose name the business transactions are effected and who is not really entitled to the income (*1934 ITR 230*).

The normal presumption of law is that the apparent state of affairs is real, unless the contrary is proved. Therefore, the burden of proving that a transaction is a benami transaction is on the taxing authorities who must establish the benami nature of the transaction. The finding of the Appellate Tribunal that a transaction is a benami one is a finding of fact, but it would be set aside by the High Court if there is no evidence to support it. In *C. I. T. v. Gopaldas Hukumchand* the Bombay High Court set aside the finding of the Tribunal that the minor sons of the assessee, who were admitted to the benefits of a certain partnership (in which the assessee was not a partner), were mere nominees of their father.

Illustrations

(1) The assessee, a broker, had effected in an account year certain transactions in the names of A, B, C, D and E and made certain payments to them as profits. It was found that A, B and C were benamidars of R Ltd., while D and E are fictitious persons. In whose hands are these profits taxable ?

The payments made to A, B and C, who were the benamidars of R Ltd., were the profits of R Ltd., and not those of the assessee, and were to be taxed in the hands of R Ltd.

The payments made to D and E, who were fictitious and who did not exist, constituted the profits of the assessee and were to be taxed in his hands (*29 ITR 1,000*).

(2) A public company showed an income of Rs. 10,000 in its return of income. In the course of the assessment proceedings the Income-Tax Officer found that the company had contrived to suppress its profits by resort to various devices. One such device was the sale of goods worth Rs. 15,000 at cost price to a close relation of the company's managing director. This relation sold the same goods for Rs. 25,000 to a customer of the company. The Income-Tax Officer came to the finding that the relation was benamidar of the company and that the sale to him was fictitious. He, therefore, held that the profit of 10,000 pertained to the company and was assessable in its hands. The company contended that the profit had not been brought into its books as its income and had not been included in its balance sheet. This profit was therefore neither available for distribution nor was it distributed to the shareholders.

Is the Income-Tax Officer's decision correct ? Give reasons.

The Income-Tax Officer's decision is correct. If profits have been made by a company in fact, the company can be assessed to income-tax in respect of such profits, though they have not been brought into its books as its income and have not been included in its balance sheet nor distributed as dividend or added to the reserves.

What is taxed is the profit on certain sales really made by the company. As the sale to and resale by the benamidar have been found to be fictitious and the real transaction is a sale by the company to its customers, the Income-Tax Officer is right in taxing the profit on these transactions in the hands of the company (*31 ITR 28*).

(3) Spouse Partner. Under section 64(1)(i), in computing the total income of any individual there shall be included all such income as arises directly or indirectly to the spouse of such individual from the membership of the spouse in a firm carrying on a business in which such individual is a partner. The word 'spouse' means a party to a marriage, that is to say, husband or wife. Wife means a lawfully wedded wife.

The income should be clubbed in the hands of that spouse who has the greater income (exclusive of the share income of the firm). Where any such income is once included in the total income of either spouse, any such income arising in any succeeding year should not be included in the total income of the other spouse except where the Income-Tax Officer is satisfied after giving that spouse opportunity of being heard, that it is necessary to do so.

This provision would apply only when the firm carries on a business. It does not apply to cases where the husband and wife are partners in a firm which exercises a profession ; in such a case the husband and the wife would each be assessable separately in respect of his or her share of the firm's income.

The Gujrat High Court has held that in section 64 "income" does not include a loss and therefore the share of loss apportioned to a spouse or minor child in a partnership cannot be included in the individual's total income (*60 ITR 551*). But according to *Kanga & Palkhivala* (6th Edition, p. 526) this decision is incorrect. On general principles, income from membership in the firm would include a loss. The liability to assessment cannot alternate from year to year between the individual and the spouse depending on whether there is a profit or a loss.

Illustration

X is the karta of a Hindu undivided family. He invests Rs. 30,000 from the joint family funds in a partnership. In the same firm X's wife invests Rs. 20,000 which was given to her by her parents. There is an outsider Y in the firm who has invested Rs. 10,000. The Income-Tax Officer clubbed the share income of X and his wife and disallowed the interest payable to X's wife by the firm. Is the Income-Tax Officer's action correct ?

X represents a Hindu undivided family in the partnership. The capital invested by X's wife has nothing to do with the Hindu undivided family funds and she is a partner in her own right.

Since section 64 applies only to individuals and not to Hindu undivided families. Therefore, the income of X's wife cannot be clubbed with that of a Hindu undivided family of X.

The interest paid to X's wife by the firm is correctly disallowed while computing the income of the firm.

(4) Minor Child Admitted to Benefits of Partnership. Under section 64(1)(ii), in computing the total income of any individual, there shall be included all such income as arises directly or indirectly to a minor child (*i. e.*, a natural child and not an illegitimate, foster or adopted child) of such individual from the admission of the minor to the benefits of partnership in a firm in which such individual is a partner. The individual may be father or mother.

Where both the parents are members of the firm in which the minor child is a partner, the income of the minor child should be clubbed with that of the parent who has the larger income of the two (exclusive of the income

from the partnership). Where any such income is once included in the total income of either parent, any such income arising in any succeeding year should not be included in the total income of the other parent except where the Income-Tax Officer is satisfied, after giving that parent an opportunity of being heard, that it is necessary to do so.

What is to be included in the total income of an individual under (3) and (4) abone is the income of a spouse or a minor child arising directly or indirectly "from the membership of the spouse in the firm" or "from the admission of the minor to the benefits of partnership" in the firm, of which the individual is a partner. This provision covers the share of the profits of the firm received by the spouse in the capacity of a partner or by the minor child in his or her capacity as one admitted to the benefits of partnership. But the income received from the firm by the spouse or minor child under any other contract with the firm or in any other capacity (*e. g.*, as a lender or landlord) does not fall within this provision and is not to be included in the total income of the other spouse or parent.

Thus, interest paid by a firm to its members on their capital contributions would arise directly or indirectly from their membership of the firm. A partner cannot be an employee of the firm, and therefore any salary, bonus, commission or other remuneration paid by the firm to a partner for services rendered would be income arising from membership of the firm and would be included in the total income of his or her spouse (*33 ITR 538*).

It has been held that interest allowed by a firm on the accumulated profits of wife and minor son (who are partners in the firm) arises indirectly from membership of the firm.

It has, however, been held that only that portion of a minor's share in the firm's profits can be included in the parent's income as can be considered to arise from the admission of the minor to the benefits of a partnership. A minor, who was admitted to the benefits of a partnership in which his father was a partner, made voluntary deposits with the firm and received interest thereon. Such interest is not to be included in the income of his father, because it does not arise from his admission to the benefits of partnership (*77 ITR 84*). But interest paid by the firm to the minor on capital contributed by him has to be included in the parent's income (*47 ITR 458*).

Whether the amount standing to the credit of a minor admitted to the benefits of a firm is to be treated as capital contributed by him or as deposit depends primarily upon the intention with which it was introduced, *e. g.*, the partnership deed may provide that money credited in the name of a minor shall be deemed to be his deposit (*82 ITR 713*).

Section 64(1)(ii) would not apply where an individual gives his minor child a share in the profits of his business when there is no other sharer in the business. The reason is that admitting a minor to the benefits of partnership presupposes a partnership, and partnership presupposes at least two major partners. Therefore, a minor child cannot be said to have been admitted to the benefits of partnership when the parent and the child are the only sharers in the business. This is a case of application of income, and therefore the entire income of the firm would be included in the total income of the parent.

Child attaining Majority. When the minor child attains majority during the previous year, the provision mentioned in (4) above would cease to apply and the income would no longer be taxable in the hands of the parent.

Where a minor child is admitted to the benefits of partnership in a firm in which his parent is a partner, and remains a minor throughout the previous year, his shares of profits for that year would be included in the parent's income, notwithstanding that the assessment on the firm and the parent may be made after the child attains majority.

If the minor child admitted to the benefits of partnership attains majority in the course of the previous year and elects to become a partner before the end of that year, and under the terms of the partnership the profits are to be ascertained only at the end of the year, no part of the minor child's share of profits for that year can be included in the total income of the parent—not even a proportionate part computed up to the date when the child attained majority (*23 ITR 919*), because in such a case it is impossible to predict whether the partnership has made any profit or loss on any date prior to the close of the accounting year, and the child does not acquire any right to receive his share of income at any time during the previous year. *Income cannot accrue or arise to a person until he acquires a right to receive the same.*

If, on attaining majority, a minor who was admitted to the benefits of partnership elects not to become a partner in the firm, the accounts of the firm will have to be made up on the date when he severs his connection with the firm, and in that case his share of profit up to that date will be ascertained and will be included in the total income of his parent.

Note : If an individual is not a partner in the firm in which the spouse or minor child has a share, the spouse's or minor child's share of profits in such a firm cannot be included under section 64 in the individual's total income, though it may be so included under the general law if the spouse or the minor child is proved to be only a benamidar of the individual.

Section 64(1)(i) and (ii) applies irrespective of whether the individual's spouse or minor children are allowed a share in the firm without any contribution on their part to the capital of the firm or whether they bring their own capital (*61 ITR 647*).

(5) Assets Transferred to Spouse. Under section 64(1)(iii), in computing the total income of any individual, there shall be included all such income (including capital gains) as arises directly or indirectly to the spouse of such individual from assets transferred to the spouse by such individual otherwise than for adequate consideration, or in connection with an agreement to live apart.

Section 64(1), which deals with transfer of assets, speaks of income arising both directly and indirectly from such transfer. The expression "indirectly" should not be construed to include consequences or income arising which has too remote a connection with the assets transferred. The connection between the transfer of assets and income arising from it should be proximate. The income must arise as a result of the transfer and not in some manner connected with it.

Where an individual gifts a sum of money to his wife and the wife invests the sum in a firm and becomes a partner and receives a share of the profits of the firm, such share of profits arises primarily because the partnership makes a profit. Though that has a connection with the gift it does not arise as a result of the gift. Secondly, the income arises only because the other partners had agreed to take the individual's wife as a partner and had allowed her to contribute to the capital of the firm. This is also not a result of the gift. The income from share of profits in the firm arising to the individual's wife cannot therefore be included in the total income of the individual under section 64(1)(iii) (*92 ITR 130*).

Adequate Consideration. A transfer should not only be for good consideration but should also be for adequate consideration *i. e.*, consideration equal or nearly equal to the value of the assets transferred, in order that this section may not apply. Natural love and affection cannot constitute adequate consideration (*42 ITR 1*).

The expression "from assets transferred" would include a settlement or other transfer subject to restrictions and conditions as well as an absolute and unconditional gift of the assets (*27 ITR 506*). If an individual purchases

property in the name of his wife with his own money, it would be a transfer of assets.

The pocket money given by a husband to his wife from time to time will not be regarded as assets transferred, and if the wife over a period of years has saved some money out of the periodical allowances and has acquired an asset with it, then the income of such asset will be her separate income.

In order to attract the application of this section, the wife must be a lawfully wedded wife, and the relationship of husband and wife should subsist not only at the time of the accrual of income but also at the time when the transfer of assets is made. A transfer which takes effect before marriage is not made to the spouse and is not covered by this section, even though it may be made in consideration of a promise to marry or may be a gift subject to the subsequent condition of marriage.

If an individual transfers certain assets gratuitously to a would-be wife before marriage, then after the marriage the income from such assets is not includible in his total income, because the assets are not transferred by the husband to his wife. This is the decision of the Supreme Court (*49 ITR 97*).

It has been held that, when a Hindu governed by Mitakshara law makes an out-and-out gift to his wife by handing over cash, the gift would be her stridhan. This means that the ownership of the gift would vest in her as her stridhan. Nevertheless, the income thereof will be taxed in the hands of the husband under section 64(1)(iii).

This section does not apply to income from the income, whether accumulated or otherwise and whether in the same form in which it was originally earned or otherwise (*68 ITR 503*). Moreover, income arising from an accretion to the asset transferred (such as bonus shares received in respect of shares transferred) is outside the scope of this section (*36 ITR 577*).

Illustrations

(1) An assessee transferred property worth Rs. 3 lakhs to his brother in cosideration of a covenant by the brother to pay an annuity of Rs. 6,000 per annum to the assessee's wife. Is the annuity of Rs. 6,000 includible in the total income of the assessee ?

The assessee, by the deed of sale, exchanged the property sold for a capital asset, namely, the covenant of the purchaser to pay an annuity to the assessee's wife. The effect of the transaction was that an asset (*i. e.*, the covenant) was transferred indirectly by the husband to the wife and the wife was to enjoy the income arising out of this asset. Therefore, the annuity of Rs. 6,000 per annum received by the assessee's wife was includible in his total income (*54 ITR 440*).

(2) In the course of assessment proceedings for the year 1961-62, it is found that the assessee's wife purchased property worth Rs. 50,000 on 1st April 1960 fetching a rent of Rs. 500 per month. The assessee explains that he transferred to his wife 3% government securities of the face value of Rs. 1,00,000 in 1935. Besides this, she had some other stridhan property given by her parents at the time of her marriage. The accumulations of the income from interest on securities amounted to Rs. 36,000 and from stridhan property to Rs. 9,000 and these were utilised for the purchase of the building.

What income of the wife should be included in the husband's income ?

The income of the wife derived from Rs. 1,00,000 government securities amounting to Rs. 3,000 will be included in the total income of her husband. But the income which is derived by the wife from the house purchased by her out of the interest income derived by her from the government securities transferred to her by the

husband in 1935 is not assessable in the latter's hands under the provision of section 64(1)(iii).

The house was purchased by her for Rs. 50,000 which includes Rs. 36,000 income from government securities and Rs. 9,000 income from the stridhan property. Income derived from the investment of these two sums (amounting to Rs. 45,000) will not be included in the total income of the husband, but the balance of Rs. 5,000 is not explained and it is presumed to have come out of the assets transferred to the wife by the husband. The income from the house proportionate to the investment of Rs. 5,000 will therefore be assessed in the husband's hands. The annual value of the house is Rs. 6,000 and proportionate value, which will be included in the assessment of the husband, is Rs. 600 subject to usual deductions admissible under the head "Income from House Property".

(3) An assessee made a gift to his wife of shares in a limited company which were worth Rs. 69,730 at the time of the gift. The wife sold the shares subsequently making a capital gain of Rs. 70,860. The whole sale proceeds were invested and fetched an interest of Rs. 9,288 annually.

Are the capital gains of Rs. 70,860 and the interest of Rs. 9,288 received annually income arising from assets transferred to the wife to be included in the total income of the husband ?

Though the sum of Rs. 70,860 was capital gains arising from the sale of shares, it was still income arising from the assets transferred and was to be includible in the husband's total income.

But only such portion of interest as was attributable to Rs. 69,730 (namely : Rs. 4,606) could alone be treated as income arising from the assets transferred to the wife and the balance of the annual interest (namely : Rs. 4,682) was not liable to be included in the total income of the husband (*57 ITR 45*).

(6) **Assets Transferred to Minor Child**. Under section 64(1)(iv), in computing the total income of any individual, there shall be included all such income (including capital gains) as arises directly or indirectly to a legitimate minor child (not being a married daughter) from assets transferred to the minor child by such individual otherwise than for adequate consideration.

As in the case mentioned in (5) above, this section does not apply to income arising from accumulated income from the asset transferred or to income from an accretion to such an asset.

Where a business is transferred as a going concern by a father to his sons, the income from the business coming to the share of the minor sons would be taxable in the hands of the father (*39 ITR 553*).

Where the father retired from a partnership and his minor son was admitted with the same share to the benefits of partnership after it was reconstituted, and the amount standing to the credit of the father in the firm was transferred to the credit of the son, there was in substance an indirect transfer of the father's interest in the firm to the minor son whose share of profit was therefore assessable in the father's hands (*49 ITR 903*).

Where the assessee borrows money to make a gift of it to his minor son, he is entitled to deduct the interest paid on the loan from the income arising from the money gifted which is included in his total income (*60 ITR 804*).

Note : Where house property is transferred to the spouse and the transfer is otherwise than for adequate consideration or in connection with an agreement to live apart, or where house property is transferred otherwise than for adequate consideration to a minor child not being a married daughter, the transferor is deemed under section 27(i) to be the owner of the house property so transferred and is assessable accordingly under section 22.

On the other hand, where the wife constructs a house out of moneys gifted by her husband, the income from the house property assessable in the hands of the husband is that computed on the basis of the wife being the owner, and therefore if she resides in the house, the ceiling prescribed by section 23(2) should be determined with reference in her total income (*58 ITR 411*).

(7) Assets Transferred for Benefit of Spouse or Minor Child. Under section 64(1)(v), in computing the income of any individual, there shall be included all such income as arises to any person or association from assets transferred otherwise than for adequate consideration to the person or association of persons by such individual, to the extent to which the income from such assets is for the immediate or deferred benefit of his or her spouse or minor child (not being a married daughter) or both.

Where the assets are so transferred, the whole of the income thereof need not be reserved for the benefit of the spouse or the minor child or both ; a portion of the income of the assets transferred may be reserved for any other person. Therefore, the income to be included in the total income of the transferor will be only the portion reserved for the immediate or deferred benefit of the spouse or a minor child (not being a married daughter) or both.

A simple instance of the type of cases covered by this provision would be a transfer of assets to trustees under a deed of trust for the benefit of the settler's spouse or minor children. In such a case, the settler would be taxed in respect of the income arising to the trustees.

Similarly, if a Muslim individual creates of waqf under the Musalman Waqf Validation Act of 1913 and transfers certain assets to God Almighty for the benefit of his wife and children, the income of the wife and minor children is to be included in his total income, because the word 'person', according to section 2(31), includes an artificial juridical person like God.

Even if the settler makes a declaration of trust for the benefit of his or her spouse or minor child, under which he or she is the sole trustee section 64(1)(v) would still apply, for in such a case there is a constructive transfer from the individual in his or her personal capacity to himself or herself in his or her capacity as the trustee (*33 ITR 383*).

Section 64 applies to income arising from assets transferred to or for the benefit of an individual's spouse on minor child, to capital gains arising from the transfer of such assets and to income arising from new assets into which the assets originally transferred might have been converted : *but the section does not apply to income arising from accumulated income or from accretions to such assets.* If an individual transfers shares to his wife, bonus shares received by the wife in respect of her shareholding would not be assets transferred to the wife but would be accretions to the assets transferred. Therefore, the dividend on the bonus shares cannot be included in the husband's income (*36 ITR 577*).

According to the Supreme Court, where income from a trust is made exigible to tax in the hands of the settler, it cannot be brought to tax in the hands of the beneficiary or trustee, because the income is already charged to tax in the hands of the settler (*73 ITR 626*).

According to the Supreme Court, an assessee can only be taxed on the income from a trust fund created for the benefit of his wife or minor child or both if in the relevant year of account the wife or the minor child or both have derived some benefit under the trust deed, that is, the wife or the minor child either has received the income or the income has accrued to them or they have a beneficial interest in the income. It follows that if no income accrues or no benefit is derived and there is no income at all so far as the wife or minor child is concerned, then the income or benefit which is non-existent cannot be included in the income of the assessee (*83 ITR 416*).

Cross Transfers. The Supreme Court has held that cross transfers, *e.g.*, transfer of assets by A for the benefit of B's wife and a transfer of assets of equal or nearly equal value by B for the benefit of A's wife, which are so intimately connected as to form parts of a single transaction, are covered by section 64(1)(iii) and (iv), though the two transfers may not be mutual, *i. e.*, each transfer may not constitute consideration for the other in the technical sense (*49 ITR 107*). This decision rested on the ground that such cross transfers were caught by the word "indirectly" in section 64(1)(iii) and (iv). Since the words "directly or indirectly" do not occur in section 64(1)(v) which deals with trusts created for the benefit of the settler's spouse or minor child, this decision does not apply to cross trusts (*64 ITR 588*).

Note : Section 61 and 64 are not mutually exclusives. While section 61 deals with transfers generally, section 64 deals with a particular class of transfers, namely transfers to one's spouse or minor child. A case of a transfer to a spouse or minor child which does not fall within section 64 may attract the operation of section 61 and *vice versa* (*42 ITR 1*). An important point of difference between the two sections is that whereas the application of section 61 is confined to revocable transfers of assets, section 64 applies to both irrevocable and revocable transfers.

Recovery of Tax. Under section 65, where the income of any person arising from any asset or from membership of a firm is included in the total income of the assessee, the person in whose name such asset stands or who is a member of the firm, shall be liable, on service of notice of demand by the Income-Tax Officer in this behalf, to pay that portion of the tax levied on the assessee which is attributable to the income so included. Where an asset is held jointly by more than one person, they are jointly and severally liable to pay the tax which is attributable to the income so included.

This section leaves it to the discrection of the Income-Tax Officer to recover the tax either from the person assessed in respect of another's income or from such other person to whom the income really belongs.

(8) Converted Property. Under section 64(2), where an individual converts at any time after 31st December 1969 his separate property into property belonging to the Hindu undivided family of which he is a member by impressing such property with the character of property belonging to the family or by throwing such property into the common stock of the family, the consequences of such conversion would be as follows :

(*a*) The individual is deemed, notwithstanding anything contained in any other provisions of the Income-Tax Act or any other law, to have transferred the converted property to the members of the family for being held by them jointly.

(*b*) The income from the converted property, in so far as it is attributable to the interest of the individual in the property of the family, will be deemed to arise to the individual and not to the family.

(*c*) The income from the converted property, in so far as it is attributable to the interest of the spouse or any minor son of the individual in the property of the family, will be deemed to arise to the spouse or the minor son from assets transferred by the individual indirectly to the spouse or the minor son, and such income will be includible in the total income of the individual.

The same will be the position in regard to the income which may arise to the spouse or the minor son of the individual from the whole or any part of the converted property which may be allotted to them in the event of a partition of the Hindu undivided family.

The term "property" includes any interest in property (movable or immovable), the proceeds of sale of the property, and any money or investment

which represents such sale proceeds and also any property converted from one species into another by any method.

The "interest of the individual in the property of the family" and the "interest of the spouse or the minor son of the individual in the property of the family" mean respectively the proportion in which the individual or the spouse or minor son would be entitled to share the property of the family if there were a total partition of the family as on the last day of the previous year of the family relevant to the assessment year for which the individual is to be assessed.

(*d*) Where the income referred to above is included in the total income of an individual, it will be excluded from the total income of the family or of the spouse or the minor son of the individual.

(*e*) The above provision would be applicable for the purpose of the computation of the total income of an individual for the assessment year 1971-72 and subsequent years.

Illustration

A Hindu undivided family consists of A, his wife B, his elder son C (23 years old), his younger son D (15 years old) and his unmarried daughter E (12 years old).

Apart from his share in the joint family property, A is the owner of separate house property valued at Rs. 80,000 which he got as a gift from his *nanaji*. On 1st July 1974 he converted his separate property into the joint family property. The taxable income from this converted property for the year has been computed at Rs. 16,000.

During the previous year ended 31st March 1975, A received Rs. 3,000 at his share from the joint family income and he earned a salary of Rs. 1,000 per month from a company of which he is the managing director. He also received from the company a conveyance allowance of Rs. 150 per month.

Compute the total income of A for the assessment year 1975-76.

The share of A, B, C and D in the joint family property is one-fourth each. The income from house property for the three months ended 30th June 1974 is Rs.4,000, while its income for the post-conversion 9 months is Rs. 12,000.

The total income of A for the assessment year 1975-76 will be as follows :

		Rs.
1.	Salary (*Less* standard deduction of Rs. 1,000)	11,000
2.	Income from house property for 3 months	4,000
3.	Income from Other Sources :	
	Own share of income from converted property	3,000
	Wife's share of income from converted property	3,000
	Minor son's share of income from converted property	3,000
	Total Income	24,000

Note : Rs. 3,000 balance of income from converted property will be included in the total income of the Hindu undivided family.

7. Special Provisions Relating to Avoidance of Tax (Sections 92 to 94) :

The provisions contained in sections 92 to 94 are designed to prevent avoidance of tax. These provisions are considered as follows :

There is a distinction between "avoidance of tax" and "evasion of tax". Tax avoidance refers to arrangements by which a person, acting within the letter of the law, reduces his true tax liability, infringing in the process both the spirit and the intent of the law. Courts of law have upheld the right of a tax-payer to secure reduction in his liability by making use of the loopholes in

the law, and tax avoidance, therefore, has acquired legal sanction and is not regarded as disrespectable. Tax evasion, on the other hand, denotes down-right defrauding of revenue through illegal acts and deliberate suppression or falsification of the facts relating to one's true tax liability.

Whatever be the method an assessee adopts—whether it is avoidance or evasion—the consequence of his action is the same, namely : loss of revenue to the State and an increase *pro tanto* in the burden of tax on the other tax-payers who do not resort to such practices.

The methods that could be adopted for combating avoidance are different from those required for eliminating evasion. Avoidance could be checked only by plugging the loopholes in the law and by a careful drafting of all new legislation. Evasion, on the other hand, has to be fought by making the enforcement machinery stronger and stricter in its administration and by the levy of deterrent punishment whenever a tax-evader is caught. It is quite likely that, in the process of tracking down cases of evasion, some inconvenience might be caused to the assessee, but it is inevitable under the circumstances. While the dishonest should not be allowed to escape, the Department should at the same time so conduct itself as not to create an impression in the minds of honest assessees that their words are not believed and that they are subjected to needless harassment (*Tyagi Committee's Report*, p. 147).

The provisions of the Income-Tax Act, 1961, aim at preventing both avoidance and evasion of tax. The provisions of sections 92 to 94, which are designed to prevent avoidance of tax, are briefly as follows :

(1) Artificial Arrangement between a Resident and a Non-resident or a Person Not-ordinarily Resident. Business may be carried on by a person who is not resident or not ordinarily resident in India with a person resident in India. Owing to the close connection between them, the business may be so arranged that the resident makes either no profits or loss than the ordinary profits in that business. Such an arrangement would deprive the Indian revenue of the full share of the tax which would otherwise be payable by the resident.

In such cases, section 92 provides that the resident would be chargeable in respect of the profits which might reasonably be expected to be derived from that business but for the artificial arrangement. The Income-Tax Rules prescribe the method of determining the quantum of reasonable profits in respect of which the resident may be charged in such cases.

Such notional profits should not be separately assessed but should be added to the other income of the resident.

In *Mazagaon Dock Ltd. v. C. I. T.* (*34 ITR 368*), the Supreme Court has held that the subject of charge under section 92 is the business of the resident and not the business of the non-resident. In that case two non-resident companies, engaged in the business of plying ships, had entered into an arrangement with a resident company which was their subsidiary and which was engaged in the business of ship repairing. According to the arrangement, the resident company was to repair the ships of the non-resident companies without charging any profit. It was held that the dealings between the parties formed concerted and organised activities of a business character and the non-resident companies carried on business with the resident company and the provisions of section 92 were attracted.

(2) Transfer of Assets Abroad. The principal kind of device for tax avoidance, which section 93 is designed to prevent, is the floatation of dummy company outside India to take over the assets of a wealthy tax-payer in India. Thus, a man with a large income in India transfers his assets to a private company of which he is substantially the only shareholder and which is registered

abroad. The company, being registered outside India, cannot be caught under section 104 which imposes additional income-tax on undistributed profits (as explained in a subsequent chapter dealing with assessment of companies). The transferor himself does not receive income or dividends from the company but he receives loans. He is never asked to repay those loans because virtually he is the company. In this way he receives in the form of loans precisely the same money which he would have received in the form of dividends, and therefore he avoids all tax which is payable on the income.

An analysis of the provisions of section 93 brings out the following ingredients :

(*a*) There must be transfer of assets ;

(*b*) By reason of that transfer, income traceable to those assets becomes payable to a person non-resident or not ordinarily resident in India ;

(*c*) The resident by means of the transfer alone or in conjunction with associated operations, acquires a right to enjoy such income ;

(*d*) The income from those assets, if it was the income of the resident, would be chargeable to income-tax ; and

(*e*) In that event the income of the non-resident, would be deemed to be the income of the resident for all the purposes of the Income Tax Act.

This section is wide enough to cover a variety of transactions including cases where assets are transferred to a person not resident or not ordinarily resident and the transferor indirectly gets the income under the guise of obtaining loans or repayment of loans.

Where any person has been charged to tax on income deemed to be his income under this section and that income is subsequently received by him whether as income or in any other form, it shall not again be deemed to form part of his income.

Illustration

X, a resident, owned a big block of house property in Nepal, which yielded him an annual income of Rs. 1,00,000 as computed under section 24 ; but in his return of income for the previous year ended 31st March 1974 he did not declare any income from house property.

In the course of assessment proceedings for 1974-75 he contends before the Income-Tax Officer that his income from house property was nil for the previous year as the entire property had been sold by him to another person on 1st April 1973.

Probing fully into the entire transaction, the Income-Tax Officer found that the purchaser was a company which was newly floated in Nepal with a subscribed capital of Rs. 20,00,000 the whole of which had been contributed by X himself out of his accumulated Nepal income. The purchase price of the property had also been fixed at Rs. 20,00,000.

What action should the Income-Tax Officer take in this case ?

This is a case of tax avoidance by transferring assets to a non-resident. Therefore, the Income-Tax Officer must include Rs. 1,00,000 (income from assets transferred) in the total income of X for the assessment year 1974-75 because the conditions, laid down in section 93 are fulfilled.

(3) Bond-washing Transactions. Section 94 is designed to prevent avoidance of tax by means of certain transactions in securities. For this purpose the term "securities" includes stock and shares and term "interest" includes dividends.

Under section 94 (1), where the owner of any securities sells them and buys back the same securities or similar securities, and as a result thereof any interest becoming payable in respect of the securities, is receivable by any other person, such interest is deemed to be the income of the owner and not the income of the other person. For this purpose, securities are deemed to be similar if they entitle their holders to the same rights against the same persons as to capital and interest and the same remedies for the enforcement of those rights, notwithstanding any difference in the total nominal amounts of the respective securities or in the form in which they are held or in the manner in which they can be transferred.

As already stated in a preceding chapter dealing with interest on securities, the interest on securities does not accrue from day to day but it falls due on certain definite dates, and similarly dividend on shares accrues not from day to day but only when it is declared. Therefore, the holder of securities on those dates is the person chargeable to tax in respect of interest or dividend. But if he transfers the securities cum-dividend just before the due date of interest or dividend, he would become free from the tax liability. The extra sale price received by selling cum-dividend would be merely a capital profit in his hands. Now, if the transferee should, at the same time, by reason of his having little or no income otherwise, be exempt from tax in respect of the interest or dividend, the tax is wholly or partly avoided. After the due date of interest or dividend, the transferor can repurchase the same or similar securities and put himself in his original position with impunity. This is known as a "bond-washing" transaction.

In the case of a dealer in securities, who buys and sells back securities in the above circumstances, no account shall be taken of such transactions in computing his profit from business.

In order to attract the applicability of section 94(1), it is not enough that there is mere incidental escapement of tax liability as a result of the transaction entered into by the assessee. The avoidance of tax liability must be the end intended to be achieved by the assessee in entering into the transaction and must be a deliberate act. The transaction must be a concerted action directed to the end of the avoidance of liability for tax. If however, the transaction is entered into for a different purpose and is not intended to achieve avoidance of liability for tax, it would not be hit by the section even if as a result of the transaction tax liability is in fact avoided. The section being punitive in character must be construed strictly and if two constructions are possible one which favours the tax-payer must be preferred as against the other which throws a greater burden upon him (*69 ITR 186*).

(4) Systematic Transactions in Securities. Under section 94(2), where a person has beneficial interest in any securities and he enters into systematic transactions relating to them, resulting in avoidance of tax which would have been payable but for such transactions, the full year's income from the securities is deemed to be the income of such person.

While section 94(1) deals with the case of sale and repurchase of securities or shares so as to avoid receipt of income and consequent liability to tax, section 94(2) counteracts another device, namely : systematic sales of securities cum-interest or of shares cum-dividend resulting in avoidance of tax in respect of the interest or dividend.

The provisions of section 94(1) or 94(2) shall not apply if the owner or the person having a beneficial interest in the securities proves to the satisfaction of the Income-Tax Officer (*a*) that there has been no avoidance of tax or (*b*) that the avoidance of tax was exceptional and not systematic and there has been no such avoidance of tax by the assessee in three preceding years.

Section 94(6) gives the Income-Tax Officer power to call for any particulars in respect of securities which he considers necessary. Failure to comply

with any of these requisitions will make the assessee concerned liable to pay an initial penalty up to Rs. 500 plus a further penalty of like amount for every day of default after the imposition of the initial penalty, as provided in section 270.

8. Set-off and Carry-forward of Losses (Sections 70—80) :

The provisions of law governing the set-off of losses and the carry-forward and set-off of business losses are as follows :

(1) Set-off under the Same Head of Income. Under section 70, if the net result in respect of any source under any head is a loss, that loss may be set off against income from another source under the same head. Income under each head is computed by lumping together the incomes from various sources which fall under the same head, For instance, where a person carries on several businesses or both business and profession, he is entitled to set off losses in one business against profits in another, or losses in business against professional earnings and the tax is leviable only on the balance of profits after deducting such losses.

This general rule that a loss can be set off against income under the same head, is however, subject to the following two exceptions :

(1) A loss in a speculation business can be set off only against the profits of another speculation business ; and

(2) A loss in respect of a capital asset other than a short-term capital asset can be set off only against the income in respect of any other capital asset not being a short-term capital asset.

According to section 67(2), the share of a partner in the income or loss of the firm is to be apportioned under the various heads of income in the same manner in which the income or loss of the firm has been determined under each head of income.

Where a person who is resident in India carries on a business in India and is also a partner in a firm carrying on business outside India, he is entitled to have the loss incurred by him as a partner of that firm deducted from the income of his business in India in computing his income under the head "Profits or Gains of Business or Profession", even though the firm is a non-resident and the income of the firm is not liable to be assessed in India (*31 ITR 61*).

(2) Set-off under Another Head of Income. If after setting off losses against income under the same head the net result is still a loss, such loss may be set off, under section 71, against income of the same year under any other head of income. For instance, a loss in business may be set off against income from house property. The only exception to this rule is that a loss in speculation business cannot be set off against income falling under any other head.

A loss sustained by an assessee under any head of income (other than capital gains) can be set off against his short-term capital gains ; and a short-term capital loss sustained by him can be set off against his ordinary income. The effect of these provisions is that short-term capital gains are treated like ordinary income and will be added to the other income and tax will be levied on the aggregate income at the rate applicable to the latter.

A long-term capital loss can be set off in the same assessment year against long-term capital gain.

Any loss computed for a speculation business can be set off only against profits of another speculation business ; but a non-speculation business loss can be set off against profits of a speculation business in the same assessment year.

Where the assessee is a registered firm a loss incurred by it under one head of income is to be set off against its income under another head in the same assessment year. Any loss which cannot be so set off is to be apportioned among the partners, and each partner may set off his share of the loss against his income under any head in the same year.

Where an unregistered firm has been assessed under section 183(b) as a registered firm, its losses for that assessment year are to be dealt with as if it were a registered firm.

Where the assessee is an unregistered firm which has not been assessed under section 183(b), that firm and that firm alone can set off a loss incurred by it under one head of income against its income under another head in the same assessment year, but no individual partner has the right to set off his share of the firm's loss against his own income of the same year.

Mode of Set-off. Section 71 does not lay down any particular mode or order of setting-off loss under one head against income under another head and, in the absence of any statutory provision to the contrary, one must follow the rule of carrying out the set off in a manner most beneficial to the assessee (*30 ITR 828*).

Thus, loss under one head must be set off against income under another head which is directly liable to be taxed in the hands of the assessee instead of against income which, though included in the total income, is not directly chargeable in his hands, *e. g.*, share of income from an unregistered firm taxed at source. After so setting off, if there remains a loss under any head it is to be set off against income which is not chargeable to tax, for the purpose of computing the total income of the previous year.

It has been held by the Supreme Court (*41 ITR 630*) that, for the purpose of ascertaining the total income of an assessee, his share of loss in a registered firm has to be set off against his share of profit in an unregistered firm which has separately been taxed.

Note : The question of set-off of losses of firm is fully explained and illustrated in a subsequent chapter dealing with the assessment of firms.

Carry-forward of Business Losses

Under section 72, where for any assessment year the net result of the computation under the head "Profits and Gains of Business or Profession" is a loss to the assessee, not being a loss sustained in a speculation business, and such loss cannot be wholly set off in the manner laid down in section 71, such loss shall be carried forward to the following assessment year and set off against the income of *any* business or profession carried on by him and assessable for that assessment year, *provided that the business or profession for which the loss was originally computed continued to be carried on by him in the previous year relevant to that assessment year.* Thus, a non-speculation business loss carried forward can be set off against the income of *any* business (including speculation business) carried on by the assessee.

The right conferred by section 72 to carry forward unabsorbed losses of a business is available only when the business is continued without break from year to year and not otherwise (*58 ITR 1*).

Where a business carried on by a person as its sole proprietor is continued by that person in partnership with another, the provisions of section 72 would apply (*43 ITR 405*). This is because when a firm carries on business, it is a business carried on by the partners of that firm.

Business loss carried forward from earlier years can be set off against income derived from shares and securities which are held as stock-in-trade

because in that case a business is carried on in shares and securities (*60 ITR 303*).

No loss can be carried forward under this section for more than eight assessment years immediately succeeding the assessment year for which the loss was first computed.

The unabsorbed business loss of an industrial undertaking, which is discontinued in the circumstances mentioned in section 33B (Rehabilitation allowance) will be carried forward and allowed to be set off against the profits of the re-established, reconstructed or revived business up to a period of 8 years as reckoned from the previous year in which the business is re-established, reconstructed or revived by the assessee.

Speculation Loss. Under section 73, where for any assessment year any loss computed in respect of a speculation business, has not been set off against profits of another speculation business, such loss shall be carried forward to the following assessment year and set off against the profits of a speculation business carried on by the assessee and assessable for the assessment year.

It is not necessary that the speculation business for which the loss was originally computed should continue to be carried on in the previous year relevant to that assessment year. Section 73 does not require that the loss in speculation business in one commodity, which is carried forward, must be set off against profits of a speculation business in the same commodity.

No loss can be carried forward under this section for more than 8 assessment years immediately succeeding the assessment year for which the loss was first computed.

Note : If there is any unabsorbed depreciation or any deduction on account of capital expenditure on scientific research also carried forward, any business loss carried forward under section 72 and any speculation business loss carried forward under section 73 must be set off in priority to the setting-off of such unabsorbed depreciation or carried-forward deduction on account of capital expenditure on scientific research, because the latter can be carried forward indefinitely. Of course, if there is only a business loss carried forward from an earlier assessment year, the current allowance for depreciation and current deduction on account of capital expenditure on scientific research for the relevant previous year must first be deducted from the business profits, and it is only when there is a balance of profits left that the carried-forward business loss should be set off against it (*33 ITR 367*).

Loss under the Head "Capital Gains". Under section 74, the carry-forward of losses under the head "Capital Gains" is to be dealt with as follows :

Such portion of the short-term capital loss as cannot be wholly set off against income under any head can be carried forward for 8 assessment years to be set off against short-term capital gains for those years.

Such portion of the long-term capital loss as cannot be wholly set off against any long-term capital gain can be carried forward for 4 assessment years to be set off against long-term capital gains for those years. This right of carry-forward is however subject to one exception. In the case of a non-company assessee, a long-term capital loss cannot be carried forward if the amount of such loss does not exceed Rs. 5,000.

Loss from Lotteries Etc. Under section 74A, losses from lotteries crossword puzzles, races, card games, other games and from gambling or betting will be allowed to be set off only against the income from the same source. For this purpose each of the following sources will be regarded as a separate and distinct source :

(*a*) Lotteries,

(*b*) Crossword puzzles,

(*c*) Races including horse races,
(*d*) Card games,
(*e*) Other games of any sort,
(*f*) Gambling or betting of any form not falling under any of the above items.

Losses relating to these sources incurred in one year will not be allowed to be carried forward except in one case, namely : owners of race horses will be allowed to carry forward and set off the loss incurred by them on maintenance of race horses against their income from the source "race including horse race" in subsequent years. The benefit of carry-forward will be allowable for *four* assessment years next following the assessment year for which the loss was first computed.

Losses of Firms. Under section 75 to 77, with regard to the losses of firms, the same provisions operate for the carry-forward and set-off under sections 72-74A as they apply to set off of losses under section 70 and 71.

Where a registered firm which was working at a loss is dissolved and one of the partners continues the same business as sole proprietor, he is entitled to set off his share of the losses incurred by the firm against the profit accruing to him from the business as its sole proprietor after the dissolution of the firm, under section 72(1)(i), because the business remains the same for the purpose of section 72(1)(i) and the identity of the business does not change by reason of the change in persons who carry on that business (*47 ITR 619*).

Conversely and for the reason given in the above paragraph where an individual incurs a loss in a business carried on by him as sole proprietor and a registered firm of which he is a partner takes over his business as a running business together with its assets and liabilities, he has a right to have the loss carried forward and set off under section 72(1)(i), against his share of the registered firm (*43 ITR 405*).

Illustration

A registered firm has two partners M and S and closes its accounts on 31st March. The firm had incurred losses which were apportioned between the partners as under :

Assessment year	1972-73 :	M Rs. 2,000 and S Rs. 1,800.
,,	1973-74 :	M Rs. 4,750 and S Rs. 4,500.
,,	1974-75 :	M Rs. 3,250 and S Rs. 3,100.

Due to losses, partner S retired on 31st March 1974 and partner M took over the firm's business as his proprietary concern. For the year ended 31st March 1975 this business made a profit of Rs. 8,500.

M in his individual assessment claims set-off of the carried-forward losses of 1972-73 to 1974-75. Examine his claim and compute his total income for the assessment year 1975-76.

Yes, M is entitled to set off his share of the losses incurred by the firm against the profits of his proprietary business, because the business remains the same. His total income for the assessment year 1975-76 will be as follows :

	Rs.
Income from his proprietary business	8,500
Less Carried-forward losses	10,000
Loss	1,500

Losses in Case of Change in Constitution of a Firm or on Succession.

The broad principle underlying section 72 to 74 is that the right of carry-forward and set-off of losses is available only to the person who has

suffered the loss and to no one else. Therefore, section 78 provides as follows :

(*a*) Where a change has occurred in the constitution of a firm, the firm is not entitled to carry forward and set off against its own profits of a subsequent year so much of its loss as is proportionate to the share of a retired or deceased partner, nor is any partner entitled to carry forward and set off against his own share of profits any other partner's share of the loss.

(*b*) Where a person carrying on any business or profession is succeeded in such capacity by any other person, the successor has no right to carry forward and set off any loss incurred by his predecessor, the general principle being that the successor in business must be treated as if he had commenced or set up a new business. The only exception to this general rule is the case where the succession is by inheritance. The heir would be entitled to carry forward the business loss incurred by the previous owner.

Illustrations

(1) A, B and C are partners of an unregistered firm, sharing profits and losses equally. For the previous year ended 31st March 1974 the firm's loss was determined to be Rs. 30,000. On 31st March 1974 C retired and D came in as a partner.

For the year ended 31st March 1975, the firm made a profit of Rs. 24,000. The firm claims set-off of carried-forward loss of Rs. 30,000 against the profit of Rs. 24,000. Examine the claim and allocate the shares of A, B and D for the assessment year 1975-76.

Suppose C retired on 30th September 1974 and D came in on 1st October 1974. What will be the shares of A, B, C and D for the assessment year 1975-76 ?

As partner C retired on 31-3-1974 the last day of the previous year for 1974-75 assessment, his share of the loss is Rs. 10,000 (one-third of Rs. 30,000). This loss cannot be carried forward for set-off against the firm's income of assessment year 1975-76. Therefore, the income of the firm for the assessment year 1975-76 will be :

	Rs.
Income of the firm for the previous year 1974-75	24,000
Less Loss carried forward from 1974-75 assessment year (Rs. 30,000 – Rs. 10,000)	20,000
Total Income	4,000

This will be allocated among the partners as under :

Partner A's share (Rs. 8,000 – Rs. 10,000)	–2,000
Partner B's share (Rs. 8,000 – Rs. 10,000)	–2,000
Partner D's share	8,000

If partner C retired on 30-9-1974 the loss of Rs. 30,000 would be carried forward to be set off against the firm's income of the assessment year 1975-76. Therefore, the income of the firm for the assessment year 1975-76 will be :

	Rs.
Income of the firm for the previous year 1974-75	24,000
Less Loss carried-forward from 1974-75 assessment year	30,000
Loss	6,000

Only Rs. 4,000 of this loss will be carried forward and set off in the subsequent assessment years, because the retired partner's share of the loss will not be carried forward.

This will be allocated among the partners as under :

	A	B	C	D
	Rs.	Rs.	Rs.	Rs.
Income for 6 months to 30-9-1974	4,000	4,000	4,000	—
Income for 6 months to 31-3-1975	4,000	4,000	—	4,000
	8,000	8,000	4,000	4,000
Less Set-off of loss carried forward from assessment year 1974-75	–10,000	–10,000	–10,000	—
Shares of partners	–2,000	–2,000	–6,000	4,000

(2) H and his nephew J were partners with equal shares in a partnership which carried on business in cloth. On 14th August 1973, H died without leaving a will. He had no children and only his widow survived him. J took the wife of H as his equal partner under a deed of partnership dated 15th August 1973, and the business was continued.

In the assessment year 1975-76, the widow of H claimed to set off against her share of the profits for the previous year ended Diwali, 1974 her share of the loss for the previous year ended Diwali 1973 as well as the share of the loss incurred prior to 15th August 1973 when her husband H was alive.

Is she entitled to do so ? Give reasons.

The question in this case is whether the widow succeeded her husband H as a partner by inheritance. If it is assumed that there was no change in the quantum of the interest that H had, the extent of the capital he had brought into the partnership, the relation which subsisted between H and J and the conduct of J and the widow, the widow had succeeded by inheritance to her husband H in his capacity as a partner. Therefore, she was entitled to set off against her share of the profits the losses suffered by her as well as by her husband (*33 ITR 80*).

Losses of Certain Companies.

Under section 79, where a change in shareholding has taken place in a previous year in the case of a company (not being a company in which the public are substantially interested), no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless :

(*a*) on the last day of the previous year the shares of the company carrying not less than 15 per cent of the voting power were beneficially held by the same persons who held them on the last day of the previous year in which the loss was incurred ; or

(*b*) the Income-Tax Officer is satisfied that the change in the shareholding was not effected with a view to avoiding or reducing tax liability.

This section implements the recommendations of the Tyagi Committee, because there were instances where persons acquired companies which sustained losses in earlier years, carried on profitable business through them and were able to reduce their tax liabilities by setting off the earlier losses of the companies when the shares were held by different persons. This section is intended to get over this position.

Submission of Return of Losses.

Under section 80, no loss can be carried forward and set off under sections 72-74, unless it has been determined in pursuance of a return filed by the assessee.

Intimation of Loss. Under section 157, where in the course of assessment of the total income of any assessee it is established that a loss has taken place which the assessee is entitled to have carried forward and set off, the Income-Tax Officer shall notify to the assessee by an order in writing the amount of the loss so computed by him. This is to obviate any dispute in future regarding the quantum of the loss.

The order contemplated by section 157 can be passed only in the course of the assessment of the total income of any assessee, *i. e.*, in the course of assessment proceedings. If at the time of making the assessment the Income-Tax Officer fails to pass an order notifying the loss, that would not defeat the assessee's right to carry forward the loss and set it off against the profits of a subsequent year (*25 ITR 90*).

Summary.

In cases where an assessee is entitled to both depreciation and development rebate, the question arises as to which should be deducted first. In respect of assets installed after the 31st December 1957, the position emerging from a combined reading of sections 2(45), (32)(2), 33(2), 33A(2) and 72(2) is that the allowances and losses should be deducted in the order in which they are enumerated below, in a case where profits are insufficient to absorb all of them :

1. Current depreciation—32(1).
2. Carried-forward business loss of earlier years—section 72(1).
3. Unabsorbed depreciation of earlier years—section 32(2).
4. Unabsorbed development rebate of earlier years—explanation (i) to section 33(2).
5. Current development rebate—explanation (i) to section 33(2).
6. Unabsorbed development allowance of earlier years—section 33A(2) explanation (i).
7. Current development allowance—section 33A(2) explanation (i).

Therefore in a case where there is unabsorbed depreciation the development rebate cannot be deducted at all. The result of this may well be that, over a period of 8 years, the depreciation may continue to be carried forward and the development rebate may never get a chance of being actually allowed since the right to the rebate lapses after 8 years (*Kanga & Palkhivala*, 6th Edition, p. 369).

9. Rounding-off of Income (Section 288A).

Where the total income (after ignoring paise) is not a multiple of Rs. 10, it will be rounded off to the nearest multiple of Rs. 10 by ignoring the fraction which is less than Rs. 5 and increasing the fraction which amounts to Rs. 5 or more to Rs. 10, and the total income so rounded off will be deemed to be the total income.

Illustrations

The following illustrations are very important. They should be worked out very carefully after studying the next chapter.

(1) N Co. Ltd. furnished the following particulars of its assessment for the assessment years 1974-75 and 1975-76 :

Assessment year 1974-75 (previous year ended 31-3-1974) :

(*a*) A new industrial undertaking started production at the beginning of the year, the capital employed being Rs. 10,00,000 and the profits Rs. 40,000 before allowance of Rs. 15,000 development rebate.

(*b*) There is an old business showing a loss of Rs. 50,000 before allowance of depreciation of Rs. 30,000 and development rebate of Rs. 5,000.

(*c*) The only other source of income was shares in Indian companies from which the dividends for the year were Rs. 35,000.

Assessment year 1975-76 (previous year ended 31-3-1975) :

(*a*) New industrial undertaking : Capital employed was Rs. 12,50,000 and the profits Rs. 3,00,000 before allowance of Rs. 25,000 as current year's development rebate.

(*b*) Old business : Profits were Rs. 60,000 before allowance of current development rebate of Rs. 5,000.

(*c*) Dividends from Indian companies Rs. 40,000.

Compute the "Gross Total Income" and the "Total Income" for the assessment year 1975-76 stating your reasons wherever necessary. (*C. A. Final, May 1972*)

This is a difficult but very good illustration, which should be studied carefully.

According to the Income-Tax Act, 1961, where the profits in any year are insufficient to absorb all the admissible allowances and losses, such allowances and losses should be deducted or set off in the following order :

1. Current depreciation.
2. Carried-forward business losses of earlier years.
3. Unabsorbed depreciation of earlier years.
4. Unabsorbed development rebate of earlier years.
5. Current development rebate.

According to these rules, the computation of gross total income and total income for the assessment years 1974-75 and 1975-76 would be as follows :

Assessment Year 1974-75

		Rs.
1. Business Profits :		
Profits from new industrial undertaking	40,000	
Less Current year's loss from old business	– 50,000	
Net Loss	– 10,000	
2. Other Sources :		
Dividends from Indian companies	35,000	
Less Set-off of current year's business loss	10,000	
	25,000	
Less Current year's depreciation of old business Rs. 5,000 being unabsorbed	25,000	—
Gross Total Income and Total Income		Nil

Notes :

(1) In the absence of business profits, the depreciation allowance for any year may be set off against any other income for that year.

(2) As the gross total income is nil, the total income will also be nil as no deductions are admissible under sections 80J and 80M.

(3) The following items are carried forward :

(*a*) Unabsorbed depreciation of old business Rs. 5,000

(*b*) Unabsorbed development rebate of old business Rs. 5,000.
Unabsorbed development rebate of new industrial undertaking Rs. 15,000.

(*c*) Deficiency of tax-holiday benefit, being 6% p. a. of Rs. 10,00,000 capital employed—Rs. 60,000.

Assessment Year 1975-76

				Rs.
1.	Business Profits :			
	Profit from the new industrial undertaking		3,00,000	
	Less Unabsorbed development rebate	15,000		
	Current development rebate	25,000	40,000	2,60,000
	Profit from old business		60,000	
	Less Unabsorbed depreciation b/f		5,000	
			55,000	
	Less Unabsorbed development rebate	5,000		
	Current development rebate	5,000	10,000	45,000
				3,05,000
2.	Other Sources :			
	Dividends from Indian companies			40,000
	Gross Total Income			3,45,000
	Deductions :			
	Tax-holiday benefit under section 80J :			
	Deficiency b/f	60,000		
	Current year's benefit being 60% of Rs. 12,50,000	75,000	1,35,000	
	Deduction for inter-corporate dividends under section 80 M being 60% of Rs. 40,000		24,000	1,59,000
	Total Income			1,86,000

Notes :

1. The unabsorbed depreciation of past years can be deducted from income under *any* head.
2. The question requires the computation of gross total income and total income for the assessment year 1975-76 ; but in order to do that it is necessary to compute these incomes for the assessment year 1974-75 as well.

(2) The particulars for the purpose of assessing the income of L Co. Ltd. for assessment years 1974-75 and 1975-76 were as under :

	Assessment year 1974-75 Rs.	Assessment year 1975-76 Rs.
Interest on securities (Debentures of companies) gross	+12,000	+12,000
Income from house property	+15,000	+15,000
Profits of business or profession :		
(*a*) Textile Manufacturing :		
Trading Profit/Loss before depreciation or development rebate	−1,00,000	+2,00,000
Depreciation	60,000	75,000
Development rebate	25,000	20,000
(*b*) Hosiery Manufacturing :		
Trading Profit/Loss before depreciation	−50,000	+75,000
Depreciation	20,000	18,000
(*c*) Agency Business	−15,000	Not carried on
Income from Other Sources	−5,000	+25,000

Assuming that there is no loss nor depreciation nor development rebate brought forward from any assessment year earlier than the assessment year 1974-75, compute the net assessable results for each of the two assessment years 1974-75 and 1975-76 indicating your reasons for treatment of any particular item in particular year.

(*C. A. Final, Nov. 1968*)

Assessment for 1974-75

			Rs.
1.	Interest on securities		12,000
2.	Income from house property		15,000
			27,000
	Deduct Loss from agency business	15,000	
	Loss under the head "Other Sources"	5,000	
	Loss from textile manufacturing	7,000	27,000
	Total Income		Nil
	Business loss c/f for 8 years : Textiles	93,000	
	Hosiery	50,000	1,43,000
	Depreciation c/f indefinitely		80,000
	Development rebate c/f for 8 years		25,000

As the agency business has been discontinued, the loss incurred therein for the assessment year 1974-75 cannot be carried forward to 1975-76. So is the case with the loss relating to other sources. Therefore these should be set off first before setting off any loss in textile manufacturing.

Assessment for 1975-76

				Rs.
1.	Interest on securities			12,000
2.	Income from house property			15,000
3.	Income from business :			
	Textile manufacturing	2,00,000		
	Less Depreciation	75,000	1,25,000	
	Hosiery manufacturing	75,000		
	Less Depreciation	18,000	57,000	
			1,82,000	
	Less Business loss b/f from 1974-75		1,43,000	39,000
4.	Income from other sources			25,000
				91,000
	Less Unabsorbed depreciation b/f			80,000
				11,000

Less Unabsorbed development rebate b/f (leaving Rs. 14,000 development rebate c/f)		11,000
Total Income		Nil

Unabsorbed development rebate for 1974-75 carried forward for 8 years Rs. 14,000.
Unabsorbed development rebate for 1975-76 carried forward for 8 years Rs. 20,000.

(3) The business income of an assessee is worked out at Rs. 1,75,000 including short-term capital gain of Rs. 5,000 for the assessment year 1975-76 before making adjustments for depreciation or development rebate for the year. Determine the total income for the assessment year 1975-76 taking into consideration the following facts, indicating precisely the amounts which will be carried forward :

	Rs.
1. Depreciation for the assessment year 1975-76	30,000
2. Development rebate for the assessment year 1975-76	45,550
3. Speculation loss brought forward from the assessment year 1973-74	27,500
4. Capital loss incurred in the assessment year 1975-76	10,000
5. Unabsorbed depreciation brought forward from the assessment year 1966-67	30,000
6. Business loss brought forward from the same business for the assessment year 1966-67	50,000
7. Unabsorbed development rebate brought forward from the assessment year 1974-75	20,000

Computation of Total Income
for the assessment year 1975-76

			Rs.
Business income			1,75,000
Less Current year's depreciation—section 32(2)	30,000		
Business loss of Rs. 50,000 for the assessment year 1966-67 cannot be set off as it is more than 8 years old.	—		
Unabsorbed depreciation for the assessment year 1966-67 (no time limit)—section 32(2)	30,000		
Unabsorbed development rebate for assessment year 1974-75—explanation (i) to section 33(2)	20,000		
Development rebate for current year—explanation (i) to section 33(2)	45,550	1,25,550	
Total Income			49,450

Amounts to be carried forward :

	Rs.
1. Speculation loss for assessment year 1973-74 to be carried forward for 8 years—section 73	27,500
2. Capital loss (long-term) for assessment year 1975-76 to be carried forward for 4 years, as it cannot be set off	

against short-term capital gains—
section 70(2)(ii) and section 74(2)(b) 10,000

(4) The assessment of X for the year 1974-75 showed a loss of Rs. 20,000 under cloth business to be carried forward and also unabsorbed depreciation of Rs. 10,000.
For the assessment year 1975-76 his income was computed as under :

	Rs.	Rs.	Rs.
House Property			5,000
Cloth Business :			
Profit before allowing Depreciation		20,000	
Less Depreciation for 1975-76	15,000		
Unabsorbed depreciation b/f from 1974-75	10,000	25,000	
Net loss under business			5,000
Total Income			Nil

Business loss of 1974-75 to be carried forward=Rs. 20,000.
Discuss whether the above computation is correct.

In this case, both business loss and unabsorbed depreciation are carried forward from the assessment year 1974-75. According to section 72(2), it is the business loss carried forward which is to be given effect to first in preference to unabsorbed depreciation. The computation given is not correct. It should be as follows :

	Rs.	Rs.
Income from House Property		
Less Unabsorbed depreciation of 1974-75	5,000	
	5,000	—
Cloth Business :		
Profit before depreciation	20,000	
Less Depreciation for 1975-76	15,000	
	5,000	
Less Business loss b/f from 1974-75 set off	5,000	
		—
Total Income		Nil

Business loss of 1974-75 c/f=Rs. 15,000.
Unabsorbed depreciation of 1974-75 c/f=Rs. 5,000.

(5) A Ltd. gives you the following particulars in respect of its accounting year ended 31-3-1975 :

1. Its profit and loss account showed a net profit of Rs. 2,40,000 after providing Rs. 10,000 for provision for doubtful debts and Rs. 21,000 towards the development rebate reserve.

2. The profit and loss account included on the debit side the following :

(*a*) Rs. 20,000 being interest paid on moneys borrowed for extending the company's factory premises for financing its expansion in manufacturing facilities which expansion was however still in progress as on 31-3-1975.

(*b*) Depreciation of Rs. 60,000 is provided in the books but the amount computed under the Income-Tax Act in that respect is Rs. 1,40,000. In addition, the development rebate computed in respect of new additions to plant and machinery during the year was Rs. 30,000.

(*c*) Loss on sale of assets as per books Rs. 3,000, against which under section 41(2) of the Income-Tax Act there was a profit of Rs. 500.

(*d*) Rs. 2,500 being fees paid to the company's chartered accountants for arguing the company's appeals before the Tribunal against the levy of penalties for assessment years 1972-73 and 1973-74, which appeals had been dismissed by the Tribunal.

(*e*) Rs. 2,500 being penal interest paid for late payment of sales-tax.

(*f*) Rs. 500 being the fine imposed on the company by the Municipality for contravening their regulations.

(*g*) Rs. 32,000 being the aggregate of remuneration and expenditure on providing perquisites to the company's works manager comprising :

	Rs.
(*i*) Remuneration	18,000
(*ii*) Company's contribution to provident fund	1,800
(*iii*) Rent paid for free quarters	10,800
(*iv*) Medical benefits	1,400

3. Included on the credit side of the company's profit and loss account are :

(*a*) Dividend from :

	Rs.
(*i*) The company's foreign subsidiary in Malayasia	5,000
(*ii*) Other Indian companies	25,000

(*b*) Sale proceeds of fractional coupons received on "rights" issue by Y Ltd. in which the company held shares, the "cost" of such coupons assumed to nil — 200

Compute the company's gross total income and its total income for the assessment year 1975-76. (*C. A. Final, Nov. 1972*)

		Rs.
Net Profit as per Profit and Loss Account		2,40,000
Less Income considered separately :		
Dividend from a foreign subsidiary	5,000	
Dividends from Indian companies	25,000	
Sale proceeds of rights	200	30,200
		2,09,800
Add Inadmissible Items :		
Provision for Bad Debts	10,000	
Development Rebate Reserve	21,000	
Profit under section 41(2)	500	
Penal interest not being incurred for business purposes	2,500	
Fine not being incurred for business purposes	500	
Excess amount of perquisites as calculated below	7,200	41,700
		2,51,500
Less Undercharge for depreciation (Rs. 1,40,000 – Rs. 60,000)	80,000	
No development rebate to be allowed as the amount of development rebate reserve falls short of the required amount of Rs. 22,500	—	80,000
Business Income		1,71,500

Computation of Total Income

		Rs.
1. Business Profits		1,71,500
2. Capital Gain from sale of rights (short-term)		100
3. Income from Other Sources :		
Dividend from a foreign subsidiary	5,000	
Dividends from Indian companies	25,000	30,000
Gross Total Income		2,01,600
Deduction under section 80M :		
60% of Rs. 25,000 dividends from Indian companies		15,000
Total Income		1,86,600

Notes :

1. The interest paid on moneys borrowed for expanding a business is allowable although the assets brought into existence with the borrowed money may not be actually used for the purpose of the business in the relevant accounting year.
2. It is assumed that (*i*) the loss of Rs. 3,000 is terminal depreciation correctly calculated, (*ii*) it is not included in Rs. 60,000 depreciation debited to profit and loss account and (*iii*) the terminal depreciation and the profit of Rs. 500 under section 41(2) relate to different assets. Therefore the terminal depreciation is allowable and the profit of Rs. 500 is chargeable to tax.
3. Fees paid to chartered accountants for services in connection with assessment proceedings and with appeals are allowable in full.
4. Under section 40A(5) (*a*)(*ii*), the expenditure incurred by a tax-payer in providing any perquisites to an employee is not allowed as a deduction in excess of 20% of the employee's salary or Rs. 1,000 per month whichever is less. In computing the total amount of perquisites, the employer's contribution to the recognised provident fund is not to be taken into account. Here it is assumed that the company's provident fund is a recognised provident fund. Moreover, under executive instructions, Rs. 1,400 value of medical benefits is not to be treated as a perquisite if such benefit is given to all employees.
   The amount allowable for perquisites will be 20% of salary of Rs. 18,000, that is to say, Rs. 3,600, because it is less than Rs. 1,000 per month. The amount of perquisite (free quarters) is Rs. 10,800. Therefore Rs. 10,800 – Rs. 3,600 = Rs. 7,200 is excessive which is disallowed.
5. Where a shareholder, who is an investor, sells his rights for a price, the consideration received from the sale is chargeable to tax as a short-term capital gain after deducting therefrom the depreciation in the value of his old shares caused by a fall in their market price on account of the issue of rights shares. It is assumed that the company is an investor and that the depreciation caused in the value of the old shares is Rs. 100. Therefore Rs. 200 – Rs. 100 = Rs. 100 is a short-term capital gain liable to tax.
6. The deduction under section 80L is available only in the case of individuals and Hindu undivided families.

(6) A religious Hindu individual died, leaving behind a large estate consisting of house properties and agricultural land. According to his "will", the entire property was given to Shri Hanumanji, being the ancestral Deity installed in a private

temple, but out of the entire income a sum of Rs. 2,000 per month was to be divided equally in favour of his widow and only son.

For the year ended 31st March 1975 the net income from agriculture amounted to Rs. 20,000, while the income from house properties (as computed under section 24 without deducting the annual charge) came to Rs. 80,000.

During the year Rs. 10,000 was spent on bhog, puja and other expenses of the deity.

What income is liable to income-tax and in whose hands ?

In this case the entire property is held by the deity (Shri Hanumanji) under a legal obligation for private religious purposes. Therefore, the income of the property is not exempt from income-tax.

As the widow and the son of the deceased do not share in the ownership of the property, the assessment of its income will be made on the deity in the status of an individual. A deity is an artificial juridical person and the assessment will be made through the manager of the temple.

The agricultural income of Rs. 20,000 is exempt. The chargeable income is that derived from house properties, which comes to Rs. 80,000 before deduction of any annual charge. The annual charge created by the will on entire income of Rs. 1,00,000 (Rs. 20,000+80,000) is Rs. 24,000. Therefore the proportionate annual charge on the income from house properties will be Rs. 80,000/1,00,000 of Rs. 24,000=Rs. 19,200. After deducting Rs. 19,200 from Rs. 80,000, the net income from house properties is Rs. 60,800.

The bhog, puja and other expenses on the deity are personal expenses and are disallowed.

The widow and the son of the deceased receive in their individual capacity a sum of Rs. 12,000 each for which they will be assessed separately, the existence of agricultural income in the hands of the deity being irrelevant.

The assessments will therefore be made as follows :

(*a*) Deity as an individual under the head "Income from House Property" Rs. 60,800.

(*b*) Widow as an individual under the head "Income from Other Sources" Rs. 12,000.

(*c*) Son as an individual under the head "Income from Other Sources" Rs. 12,000.

(7) M is the general manager of a limited company at Calcutta. The business was formerly carried on by a firm which was converted into a public company in 1967. M had been employed with the firm and then with the company and he has been in service with them for 30 years. The following information is available regarding his income and outgoings etc. for the year ended 31-3-1975 :

		Rs.
1.	Salary	70,000
2.	M's contribution to recognised provident fund	9,000
3.	Company's contribution to his provident fund	9,000
4.	Interest credited to provident fund account at 7%	7,000
5.	House rent allowance at Rs. 600 per month. He actually paid a monthly rent of Rs. 900 for the house in which he lived.	
6.	Entertainment allowance at Rs. 500 p. m. This has been paid at the same rate right from 1954 first by the firm and then by the company.	
7.	On Independence Day 15th August 1974, the company gave him a cash gift of Rs. 5,000 in appreciation of his services.	
8.	Interest on fixed deposit with bank on money kept apart for the marriage of two daughters	1,500
9.	Dividend on shares in Indian companies purchased with the intention of giving them in dowry to the two daughters (before deduction of tax at source)	400
10.	Honorarium received from the Institute of Business Management, Calcutta, for setting a question paper on business management and for valuing the answer-books of candidates	1,000
11.	Life insurance premium on his policy for Rs. 3,00,000	15,000
12.	M is very popular with the workers. In order to maintain good relations he made a declaration in writing and told the company in 1972 to deduct a sum of Rs. 500 per month from his salary for a period of five years. The amount is to be spent for setting up a free dispensary for the families of the workers at their colony	6,000
13.	Interest credited by the company on the above fund	1,000

Work out the total income of M for the assessment year 1975-76.

Statement of Total Income of M
for the assessment year 1975-76

			Rs.
1.	Income from Salary :		
	Salary as such	70,000	
	Company's contribution to provident fund in excess of 10% of Rs. 70,000	2,000	
	Interest on provident fund account in excess of 6%	1,000	
	House rent allowance as calculated below	3,400	
	Entertainment allowance, nothing being exempt as he did not receive it from his present employer before 1-4-1955	6,000	
	Cash gift in appreciation of services rendered by him being profit in lieu of salary	5,000	
		87,400	
	Less Standard deduction	3,500	83,900
2.	Income from other sources :		
	Interest on Bank deposit	1,500	
	Dividend gross	400	
	Honorarium received as examiner, not being casual income	1,000	2,900
	Gross Total Income		86,800

Deductions :			
For contribution to provident fund limited to 1/5 of salary subject to maximum of Rs. 8,000		8,000	
Life insurance premium		15,000	
		23,000	
Further restricted to maximum exempt amount of		20,000	
First	2,000		
50% of next Rs. 3,000	1,500		
40% of balance of Rs. 15,000	6,000	9,500	
For bank interest and dividend being less than Rs. 3,000		1,900	11,400
Total Income			75,400

Notes :

1. The exempt amount of house rent allowance is as under :

	Rs.
Amount of allowance	7,200
20% of salary	14,000
Excess of rent paid over 10% of salary (*i. e.*, Rs. 10,800 – Rs. 7,000)	3,800
Statutory ceiling	4,800

Therefore, the lowest of the above amounts, namely : Rs. 3,800 is exempt, while the balance of Rs. 3,400 is taxable.

2. Deduction of Rs. 500 per month from salary for setting up a free dispensary is merely application of income and is not allowable as a deduction.
3. Interest of Rs. 1,000 credited to the fund by the company is not taxable as income because it does not arise to the assessee.

(8) An Indian national doing business in Nepal since 1954 spends four months in India every year except that in the years 1966 and 1969 he did not come to India at all. The business in Nepal is controlled in that country.

The assessee has got a bank account in India in which he deposits every year a fixed sum of Rs. 10,000 brought by him to this country out of his business profits in Nepal.

He has got another business in India which is looked after by his son.

He maintains the calendar year as his previous year for both the businesses. The particulars of his income for the year ended 31st December 1974 were as follows :

	Rs.
(*a*) Profit of the business in Nepal	50,000
(*b*) Profit of Indian business before depreciation	25,000
Depreciation allowance for Indian business	40,000
(*c*) Income from a house property in Nepal	6,000
(*d*) Income from a house property in India	18,000

He sold in India during the year certain shares purchased by him for investment purposes in 1971 at a cost of Rs. 40,000. The sale proceeds were Rs. 35,000.

On the basis of the data furnished, determine the residential status of the assessee and compute his total income. Reasons must be given wherever necessary.

(*C. A. Final, Nov. 1971*)

Assessee's residential status for previous year 1974. The assessee was not in India for 182 days nor did he maintain a dwelling-place in India for 182 days ; but in the four years preceding the year 1974 he was in India for 16 months (more than 365 days) and he was in India during 1974 for four months (more than 60 days). Therefore he is resident for the year 1974. However, he was not resident in India in 9 out of the 10 years (1964-1973) preceding the year 1974 because he was not in India at all for 1966 and 1969. Accordingly he is *resident not ordinarily resident* in India for the previous year 1974.

An individual, who is not ordinarily resident in India, is liable to tax on (*i*) income received in India, (*ii*) income earned in India, and (*iii*) income arising outside India from a business controlled in India.

The assessee's total income for the previous year 1974 will be as follows :

		Rs.
1. Income from house property in India	18,000	
Less Short-term capital loss	5,000	
	13,000	
Less Current year's depreciation out of the unabsorbed amount of Rs. 15,000	13,000	—
2. Income from business :		
Profits of Indian business before depreciation	25,000	
Less Current year's depreciation to the extent of profits, Rs. 15,000 being unabsorbed	25,000	—
3. Capital Gains :		
Cost of shares required in 1971	40,000	
Less Sale proceeds	35,000	—
Short-term capital loss deducted from income from house property above	5,000	
Total Income		Nil

Unabsorbed depreciation c/f = Rs. 2,000

Notes :

1. While unabsorbed depreciation can be carried forward for an indefinite period, short-term capital loss can be carried forward only for 8 years. Therefore the short-term capital loss has been deducted in full from income from house property.
2. As the assessee is resident but not ordinarily resident in India, his income from Nepal business not controlled in India is not liable to tax.
3. The assessee is liable to tax in respect of his income *received* in India and not in respect of income brought into India. There is a difference between receipt and bringing in. Receipt means the first receipt.
4. The interest earned on bank deposits in India is taxable, but its amount is not given. Therefore it has been ignored.
5. The income from house property in Nepal is not chargeable to tax in India because it does not arise in India.

(9) M has been the manager of a firm of publishers since 1-4-1953. From the following information compute his total income for the assessment year 1975-76 :

1. From 1-4-1974 he is drawing a salary of Rs. 800 per month.
2. The firm maintains an unrecognised staff provident fund to which he contributes 8% of his salary and the firm contributes an equal amount.
3. He retired from service on 31-12-1974 when he was paid :
   (*i*) His salary for the month of December 1974 ;
   (*ii*) Bonus of Rs. 1,500 for the period 1-4-1974 to 31-12-1974 ;
   (*iii*) A gratuity of Rs. 7,500 equal to 10 months' salary ; and
   (*iv*) Rs. 14,000 accumulated balance in his provident fund account, which included Rs. 6,000 his own contributions and Rs. 1,000 interest thereon.
4. He lives in his own house, the municipal valuation of which is Rs. 3,000. the annual municipal taxes paid being Rs. 300.
5. On 1-7-1974 he opened a 15-year C. T. D. account at the post-office, in which he is depositing Rs. 300 per month.
6. He is insured for Rs. 25,000 and pays Rs. 2,000 as annual premium.
7. In May 1974 he received a gift of Rs. 5,000 from his *nanaji*.

Statement of M's Total Income
for the assessment year 1975-76

	Rs.	Rs.
1. Salary : As such	7,200	
Bonus	1,500	
Gratuity is exempt	—	
Balance of provident fund account after deducting his own contributions and interest thereon	7,000	
	15,700	
Less Standard deduction	1,440	14,260
2. Income from house property :		
Annual value of residential house	3,000	
Less Municipal taxes	300	
	2,700	
Less-Self occupation allowance	1,350	
Annual value in the case	1,350	
Less One-sixth for repairs	225	1,125
3. Income from other sources :		
Interest on his own contributions to unrecognised provident fund		1,000
Gross Total Income		16,385

Deduction for life insurance premium (Rs. 2,000) and C. T. D. (Rs. 1,800) :		
First	2,000	
50% of balance of Rs. 1,800	900	2,900
Total Income		13,485
Rounded off		13,490

Note : The gift of Rs. 5,000 is not income liable to tax.

(10) G Co. Ltd. issued on 1-5-1974 10,000 equity shares by way of bonus by capitalising out of reserves a sum of Rs. 2,50,000. D, one of the shareholders, received 100 such bonus shares on his original holding of 500 equity shares of Rs. 25 each. The original shares had been acquired by him at a cost of Rs. 18 per share in the year 1970.

On 30-6-1974, D sold all the bonus shares and 200 of his original shares at Rs. 28 per share. D is not a dealer in shares.

During the year ended 31st March 1975 D received a dividend of Rs. 2,000 from G Co. Ltd. His other income for the said year consisted of bank interest of Rs. 1,500 and salary of Rs. 35,000. He contributed to a recognised provident fund a sum of Rs. 2,500 and his premium of Rs. 8,000 on an insurance policy for Rs. 1,00,000 on his own life was paid by his employer and is included in his salary income of Rs. 35,000. He also deposited during the year a sum of Rs. 4,000 under the Cumulative Time Deposit Rules.

Compute D's gross total income and the total income for the assessment year 1975-76 on the basis of the data supplied, indicating your reasons wherever necessary.

(*C. A. Final, Nov. 1971*)

It is assumed that his deposit in cumulative time deposit account is not for 5 years, and that the salary income is arrived at after making the standard deduction.

D's Total Income for the assessment year 1975-76

	Rs.	Rs.
1. Salary as such	35,000	
Employer's contribution to recognised provident fund assumed to be not exceeding 10% of D's salary	—	
Interest on provident fund assumed not to exceed 6% p. a.	—	35,000
2. Capital Gains (short-term) as calculated below		3,900
3. Other Sources : Bank Interest	1,500	
Dividends from G Co. Ltd.	2,000	3,500
Gross Total Income		42,400
Deductions :		
(*a*) In respect of		
Contributions to recognised P. F.	2,500	
Life insurance premium	8,000	
Cumulative time deposit	4,000	
	14,500	

But under section 80C it is restricted to 30% of gross total income of Rs. 42,400	12,720	
The deduction allowable will be :		
First	2,000	
50% of Rs. 3,000	1,500	
40% of balance Rs. 7,720	3,088	
	6,588	
(*b*) In respect of dividends (Rs. 2,000) and bank interest (Rs. 1,500), maximum allowable under section 80L	3,000	9,588
Total Income		32,812
Rounded off		32,810

Computation of Capital Gain

	Rs.
Cost of original 500 shares at Rs. 18 per share	9,000
Therefore the cost of original 500 shares and 100 bonus shares taken together will also be	9,000
The cost of each share (9,000/600)	15
Sales proceeds of 300 shares at Rs. 28 per share	8,400
Less Cost of 300 shares at Rs. 15 per share	4,500
Capital Gain	3,900

As the original shares as well as the bonus shares have been held for less than 60 months, this capital gain is a short-term capital gain.

(11) The Profit and Loss Account of Sahas Ltd., an Indian company engaged wholly in the manufacture of electronic equipment (priority industry) for the year ended 31st March 1975 showed a profit of Rs. 2,50,000 after providing Rs. 6,50,000 for depreciation and Rs. 1,50,000 for development rebate reserve.

During the scrutiny of the Profit and Loss Account the following points have emerged :

(*a*) Profit of Rs. 30,000 on sale of shares held for 35 months was credited to profit and loss account.

(*b*) Rs. 40,000 due from a customer was written off as irrecoverable, the party having been declared insolvent on 30th March 1975.

(*c*) The company had constructed in December 1974 quarters for its workers drawing salary of Rs. 7,500 or less at a cost of Rs. 4,00,000.

(*d*) The written-down value of plant and machinery on 1-4-1974 was Rs. 10,00,000 and that of buildings was Rs. 6,00,000. Depreciation admissible on plant and machinery is at 10% and on buildings at 5%. Four times of machinery purchased costing Rs. 600 each had been debited to profit and loss account An addition of Rs. 3,00,000 was made to plant and machinery on 25-3-1975.

(*e*) It had sold an item of machinery during the year for Rs. 90,000, the original cost of which was Rs. 75,000 and the written-down value on 1-4-1974 was Rs. 50,000. The surplus of Rs. 40,000 was taken to reserve.

(*f*) The profit and loss account included credit for a sum of Rs. 20,000 received from a Nigerian company as royalty for use of patent developed by the company under an agreement approved by Government.

(*g*) Rs. 10,000 realised as rent from workers occupying company's quarters was credited to profit and loss account. Repairs of Rs. 2,000, collection charges of Rs. 400 and municipal taxes of Rs. 2,000 incurred are debited to profit and loss account.

(*h*) Purchases aggregating Rs. 60,000 were made in cash, each purchase exceeding Rs. 5,000.

(*i*) One-fifth of an expenditure of Rs. 2,00,000 incurred in purchase of plant and machinery for scientific research in electronic equipments in the previous year was written off to profit and loss account, the company having decided to write off the balance in the next four years.

(*j*) A net dividend of Rs. 50,000 was credited to profit and loss account, the tax deducted at source being Rs. 10,000. Of this dividend, Rs. 20,000 is dividend exempted under section 80K.

(*k*) The company's assessment records show the following amounts as brought forward :

	Rs.
Unabsorbed depreciation	40,000
Unabsorbed development rebate	50,000
Unabsorbed loss	7,00,000

Compute the total income of the company for the assessment year 1975-76 indicating at the foot of the computation by way of notes the reasons for inclusion or exclusion of any of the above items. (*C. A. Final, May 1973*)

It is assumed that the quarters constructed in December 1974 are used for housing employees whose residence there is necessary for the efficient conduct of the company's business. Therefore the quarters are used for business purposes and expenses connected therewith and also depreciation in respect thereof are admissible deductions in computing business profits.

		Rs.
Profit as per Profit and Loss Account		2,50,000
Less Income considered separately :		
Profit on sale of shares being short-term capital gain	30,000	
Dividend	50,000	80,000
		1,70,000
Add Bad debts written off prematurely	40,000	
Depreciation, correct amount to be allowed	6,50,000	
Development rebate reserve	1,50,000	
Payments not made by crossed cheques, being disallowed	60,000	
Profit under section 41(2), being balancing charge (Note 1)	25,000	9,25,000
		10,95,000
Less Depreciation (Note 2)	2,55,000	
Development rebate (Note 3)	—	
Balance of capital expenditure on scientific research (Note 4)	1,60,000	4,15,000
Business Profits		6,80,000

Computation of Total Income

		Rs.
1. Business Profits	6,80,000	
Less Loss b/f	6,80,000	—
2. Capital Gains :		
Short-term capital gain on sale of shares	30,000	
Long-term capital gain on sale of machinery, assuming that the machinery sold was acquired more than 60 months before	15,000	45,000
3. Income from other sources :		
Dividend gross		60,000
		1,05,000
Less Unabsorbed depreciation b/f	40,000	
Unabsorbed development rebate b/f	50,000	90,000
		15,000
Less Part of current development rebate		15,000
Gross Total Income		Nil

Amounts carried forward :
Business loss Rs. 20,000
Current development rebate Rs. 1,10,600

Notes :

1. On sale of machinery the amount of capital gain and that of balancing charge are as under :

	Rs.
Sale proceeds	90,000
Less Cost of machinery sold	75,000
Capital gain assumed to be long-term	15,000
Cost of machinery sold	75,000
Less Written-down value thereof	50,000
Balancing charge	25,000

2. The amount of depreciation allowable for the assessment year 1975-76 is as follows :

Initial Depreciation :

	Rs.
20% of the cost of quarters for low-paid employees	80,000
Normal Depreciation :	
Plant and Machinery : 10% of Rs. 12,50,000 (Rs. 10,00,000 — Rs. 50,000 + Rs. 3,00,000)	1,25,000
Buildings : 5% of Rs. 10,00,000 (Rs. 6,00,000 + Rs. 4,00,000)	50,000
	2,55,000

3. The amount of development rebate due for the assessment year 1975-76 is as follows :

	Rs.
25% of Rs. 3,00,000 cost of new machinery	75,000
25% of Rs. 2,400 cost of four items of machinery written off	600
25% of Rs. 2,00,000 cost of plant and machinery purchased for scientific research written off	50,000
	1,25,600

4. Rs. 2,00,000 being the entire capital expenditure on scientific research is deductible, but only Rs. 40,000 has been debited to profit and loss account of the year. Therefore the balance of Rs. 1,60,000 is also to be deducted.
5. As the gross total income of the company is "Nil", the following deductions are not available as they are to be made from gross total income :

(*a*) Under section 80K, full amount of dividend attributable to the tax-holiday profits of a new industrial undertaking.

(*b*) Under section 80M, 60% of dividends received by an Indian company from other Indian companies.

(*c*) Under section 80-O, any royalty received by an Indian company from a foreign company for supply of technical know-how or technical services.

(12) The particulars of income of an Indian company as computed for the purpose of income-tax assessment for the assessment year 1975-76 are as follows :

	Rs.
Income from house property	250,000
Profits and gains of business or profession :	
Profits before depreciation	2,00,000
Depreciation allowable	75,000
Income from other sources :	
Dividend from an Indian company (gross)	40,000

The company's business is a new industrial undertaking established in the immediately preceding previous year. The capitals as at the beginning and at the end of the computation period were Rs. 45,00,000 and Rs. 50,00,000 respectively.

Compute the gross total income and the total income of the company for the assessment year 1975-76, using the above-noted data and indicating your reasons wherever necessary. (*C. A. Final, Nov. 1973*)

The capital employed in the industrial undertaking during the computation period is Rs. 45,00,000, because in computing the capital employed all additions to and deductions from assets and liabilities made during the computation period are to be ignored.

The tax-holiday concession will be Rs. 2,70,000 being 6% per annum of Rs. 45,00,000.

Section 80J(3) specifically provides that deduction in respect of tax-holiday benefit must be given first before allowing the deduction under section 80M in respect of inter-corporate dividends.

The gross total income and the total income of the company for the assessment year 1975-76 will be as follows :

		Rs.
1. Income from house property		25,000
2. Business profits :		
Profits	2,00,000	
Less Depreciation	75,000	1,25,000

3. Income from other sources :	
Dividend from Indian company (gross)	40,000
Gross Total Income	1,90,000
Deduction :	
Under section 80J (equal to the amount of gross total income)	1,90,000
Total Income	Nil

Rs. 80,000 being unabsorbed tax-holiday benefit is carried forward for deduction from the gross total income in future assessment years.

As the entire gross total income is wiped off by the tax-holiday benefit, no deduction is available in respect of inter-corporate dividend.

(13) The Profit and Loss Account of Rama Industries (a partnership firm) disclosed a profit of Rs. 2,78,000 for the year ended 30th June 1974.

The following salient points were noticed on verification of the Profit and Loss Account :

(*a*) The firm had occupied for the purposes of its business premises owned by partner A. Its fair rental value was Rs. 36,000 but the firm had paid the partner a rent of Rs. 38,000.

(*b*) A sum of Rs. 24,000 had been paid as salary to partner B for services rendered (found reasonable from a commercial point of view).

(*c*) A remuneration of Rs. 24,000 (reasonable from a commercial point of view) had been paid to an employee who was the wife of partner C.

(*d*) A fee of Rs. 5,000 paid to an advocate for appearing in an unsuccessful income-tax appeal was included in general expenses.

(*e*) A sum of Rs. 24,000 spent on foreign travelling in respect of export promotion was included in travelling expenses.

(*f*) A sum of Rs. 25,000 paid in an earlier year (but disallowed in income-tax assessment) as damages for breach of contract had been received back this year and included in miscellaneous receipts.

(*g*) General expenses include a donation of Rs. 10,000 to an approved charitable institution.

(*h*) Salaries account includes Rs. 35,000 being the salary of Rs. 25,000 and perquisites of Rs. 10,000 to the Manager.

(*i*) Interest of Rs. 20,000 had been paid in respect of a sum of Rs. 5 lakhs borrowed and invested by the firm in an agricultural farm. No income had been received from this farm.

(*j*) Miscellaneous expenses include entertainment expenses of Rs. 10,000.

An analysis of the Balance Sheet of the firm as on 30th June 1974 disclosed the following features :

(*k*) A compensation of Rs. 30,000 received from an insurance company for the loss of the firm's car had been credited to motor-car account. The motor-car was purchased in 1966 for Rs. 25,000 and its written-down value on 1-7-1973 was Rs. 10,000.

(*l*) The machinery account included this year's purchase of instruments for Rs. 1,00,000 for scientific research relating to the firm's business and a depreciation at 20% had been written off in respect of this item.

(*m*) The provision for bad and doubtful debts includes a recovery of Rs. 10,000 in respect of a debt written off and allowed as deduction in the prior year.

Compute the total income of the firm. Tax need not be calculated.

(C. A. Final, Nov. 1974)

Computation of Total Income of the Firm for assessment year 1975-76

		Rs.
Profit as per Profit and Loss Account		2,78,000
Add Items disallowed :		
(*a*) Rent paid by a firm to a partner is an allowable deduction; but if the rent so paid is in excess of the fair market rents, the ITO can disallow such excess under section 40A(2). The excess in this case is Rs. 38,000 – Rs. 36,000 = Rs. 2,000 which is disallowed.	2,000	
(*b*) Salary paid to a partner is not allowable as a deduction under section 40(b) even if the amount is reasonable.	24,000	
(*c*) A reasonable remuneration paid to the wife of a partner cannot be disallowed. No adjustment is therefore necessary.	—	
(*d*) The expenses incurred in connection with income-tax appeals are an admissible deduction. Therefore no adjustment is necessary.	—	
(*g*) Charitable donation being application of income is not an admissible deduction. A deduction in respect of it is to be allowed under section 80G.	10,000	
(*h*) The manager's salary being less than Rs. 5,000 per month is allowable ; but Rs. 5,000 being excess of perquisites over 20% of salary is disallowed under section 40A(5).	5,000	
(*i*) Interest on money borrowed and utilised for investment in assets yielding tax-free income is not an allowable deduction.	20,000	
(*j*) Entertainment expenditure incurred in India is disallowed under section 37(2B).	10,000	
(*k*) Compensation of Rs. 30,000 received from the insurance company implies that the car was a total loss caused by fire, theft or accident. Thus there was no transfer of it and Rs. 5,000 being excess over cost cannot be charged to tax as capital gain under section 45. But Rs. 15,000 being excess of cost over the written-down value represents depreciation allowed in the past and is liable to tax under section 41(2).	15,000	
(*m*) The bad debt of Rs. 10,000 recovered during the year is chargeable to tax under section 41(1).	10,000	96,000
		3,74,000
Less Items to be deducted :		
(*e*) Under section 35B, a weighted deduction of 1-1/3 times the export promotion expenditure is allowable. Therefore 1/3 of Rs. 24,000 is a further allowable deduction.	8,000	
(*f*) As Rs. 25,000 paid in an earlier year was disallowed, it is not taxable under section 41 when it is received back.	25,000	

(*l*) Under section 35(2)(ia), the full amount of scientific research expenditure (including capital expenditure) is allowed as a deduction. Therefore Rs. 80,000 (Rs. 1,00,000 – Rs. 20,000 allowed as depreciation) is further to be deducted	80,000	1,13,000
Business Income		2,61,000
Business income being gross total income		2,61,000
Less Deduction in respect of charitable donation being 55% of Rs. 10,000		5,500
Total Income		2,55,500

Note : Where the assessee is a widely-held domestic company, the weighted allowance under section 35B is $1\frac{1}{2}$ times the qualifying export promotion expenditure.

(14) Patel Industries Private Ltd. is engaged in the manufacture of plastic goods. Besides the old unit at Ahmedabad, it started a new unit for the manufacture of the same type of goods at Anand on 1st July 1973 at a cost of Rs. 50 lakhs. The following figures are supplied by the company for its accounting year ended 31st December 1974 :

	Ahmedabad Unit Rs.	Anand Unit Rs.
(*a*) Business income (as computed under Income-Tax Act) :		
Income before depreciation and development rebate	10,00,000	17,50,000
Depreciation	3,00,000	7,00,000
Development rebate	60,000	40,000
Section 80J relief	—	1,50,000
(*b*) Income from dividends from Indian companies (gross)	1,00,000	—
(*c*) Income from property and other sources	40,000	—
(*d*) Brought forward losses etc. of 1973 :		
Business loss	—	2,00,000
Unabsorbed depreciation	—	9,00,000
Unabsorbed development rebate	—	6,00,000
Deficiency under section 80J	—	75,000
(*e*) The company has paid donation of Rs. 1,50,000 to a public charitable trust (recognised under section 80G)		

You are required to compute the total income of the company for the assessment year 1975-76. Work out the deductions allowable under Chapter VIA and indicate the amount of deficiency, unabsorbed loss etc., if any to be carried forward.

(*C. A. Final, Nov. 1974*)

Like illustration (1), this is also a difficult but very good illustration which should be carefully worked out.

According to the Income-Tax Act, where the profits in any year are insufficient to absorb all the admissible allowances and losses, such allowances and losses should be deducted or set off in the following order :

1. Current depreciation.
2. Carried-forward business losses of earlier years.
3. Unabsorbed depreciation of earlier years.
4. Unabsorbed development rebate of earlier years.
5. Current development rebate.

Applying these rules the total income of the company for the assessment year 1975-76 will be as follows :

The Anand Unit is a new industrial undertaking which commenced production on 1-7-1973. It is entitled to the tax-holiday benefit under section 80J. It is immaterial that the old and the new units are engaged in the manufacture of the same kind of goods.

The business profits of the new unit have therefore to be computed separately.

Computation of Company's Total Income for assessment year 1975-76

		Rs.
Anand Unit :		
Business income before allowing depreciation and development rebate		17,50,000
Less Current depreciation		7,00,000
		10,50,000
Less Brought-forward business loss		2,00,000
		8,50,000
Less Unabsorbed depreciation of which Rs. 50,000 is still left		8,50,000
		Nil
Ahmedabad Unit :		
Business income before allowing depreciation and development rebate		10,00,000
Less Current depreciation	3,00,000	
Current development rebate	60,000	3,60,000
Business Income		6,40,000
		6,40,000
1. Business income		40,000
2. Income from property and other sources		1,00,000
3. Dividends from Indian companies		
		7,80,000
Less Balance of unabsorbed depreciation of Anand Unit	50,000	
Unabsorbed development rebate of Anand Unit	6,00,000	
Current development rebate of Anand Unit	40,000	6,90,000
Gross Total Income		90,000
Deductions :		
In respect of intercorporate dividends under section 80M, 60% of Rs. 1,00,000	60,000	
In respect of charitable donation under section 80G, 50% of Rs. 3,000 qualifying amount being 10% of Rs. 90,000 – Rs. 60,000	1,500	61,500
Total Income		28,500

As the Anand Unit has no business profits for 1974, no deduction under section 80J can be allowed for the year, but the amount of allowable deduction will be carried forward as 'deficiency'.

The company is entitled to carry forward the following amounts of deficiency to be deducted from the profits of Anand Unit in the assessment year 1976-77 and subsequent years :

	Rs.
Deficiency under section 80J for 1973	75,000
Deficiency under section 80J for 1974	1,50,000

Each year's deficiency can be carried forward for 8 assessment years including the initial assessment year.

CHAPTER 14

Deductions in Computing Total Income

In order to simplify the income-tax law, sections 80A to 80U have substituted with effect from 1-4-1968 the system of deductions in computing the total income of an assessee, instead of rebates of tax allowed before that date.

Section 80A lays down the general principles of deduction, section 80B contains some definitions, sections 80C to 80G deal with deductions in respect of certain kinds of payments made by the assessee for which a rebate of tax was being allowed before 1-4-1968 ; sections 80H to 80TT deal with deductions in respect of certain kinds of income of the assessee, and section 80U provides for other deductions.

General Principles.

Section 80A lays down the following two general principles governing the deductions to be made in computing the total income of the assessee :

(1) *Maximum limit of deductions.* The aggregate amount of deductions to be made is limited to the gross total income of the assessee. The expression "gross total income" is defined below.

(2) *Deductions from Income of firm, etc.* Where a deduction has been allowed under section 80G or 80H or 80HH or 80J or 80K or 80MM or 80N or 80O or 80QQ or 80S or 80T or 80TT in computing the total income of a firm, an association of persons or a body of individuals, no deduction under the same section shall be allowed in computing the total income of a partner of the firm or a member of the association or body, in relation to his share in the income of the firm, association or body.

Definitions.

Displaced Person. This means a person who, on account of the partition of India or on account of civil disturbance, left his place of residence in Pakistan and has been subsequently residing in India.

Domestic Company. It means an Indian company or any other company which distributes dividends in India out of its income liable to Indian income-tax.

Foreign Company. It is a company which is not a domestic company.

Gross Total Income. This means the total income computed in accordance with the provisions of the Income-Tax Act, before making any deductions under sections 80C to 80U.

In the case of an individual, the gross total income also includes any income arising to the spouse or minor child of the individual, in respect of which the individual is chargeable to tax under section 64.

This is an important definition for several purposes, *e.g.*, for calculating the qualifying amount of life insurance premium, etc.

However, for the purpose of calculating the qualifying amount of charitable donations the gross total income is to be reduced by any portion thereof which is entitled to rebate of income-tax and also by any amount in respect of which the assessee is entitled to a deduction under sections 80C—80F and 80H to 80U. *This is an important point to remember.*

Repatriate. This means a person of Indian origin who was ordinarily resident in a foreign country and who, on being forced to leave that country, has returned to India with the intention of permanently residing therein. A person is deemed to be of Indian origin if he or either of his parents or any of his grand-parents was born in undivided India.

(A) DEDUCTIONS IN RESPECT OF CERTAIN PAYMENTS

1. Deduction in Respect of Life Insurance Premia, etc. :

Section 80C, which deals with this deduction has already been explained in full in a previous chapter relating to salary income.

2. Deduction in Respect of Medical Treatment of Dependants :

Under section 80D, a *resident* individual or a Hindu undivided family is entitled to a deduction in respect of expenditure incurred on the medical treatment of a handicapped dependant in the computation of his or its total income.

The amount of the admissible deduction is Rs. 2,400 in a case where the handicapped dependant remains as an in-patient in a hospital or other medical institution for 182 days or more and Rs. 600 in any other case. In either case the amount of the allowable deduction is to be reduced by the dependant's income, if any. Where the assessee has incurred such expenditure on more than one dependant, the deduction is allowed for only one chosen by the assessee.

3. Deduction in Respect of Payment for Securing Retirement Annuities :

Under section 80E, where an individual, *who is a citizen of India and who is resident in India*, is a partner in a registered firm of chartered accountants, solicitors, lawyers and architects, he is entitled to a deduction, in the computation of his total income, of the amount of premiums paid or contributions made for securing retirement annuities under an approved annuity contract or from an approved fund.

This deduction is limited to 10% of the gross total income or Rs. 5,000 whichever is less. The amount of deduction shall not exceed the amount of income from profession, and no deduction is allowed in the case of an individual (*i*) whose gross total income includes income from interest on securities, house property, capital gains or any other income not derived from personal exertion and all such income is more than Rs. 10,000 or (*ii*) who is entitled to any pension.

The approval of annuity contracts and funds will be given by the Commissioner subject to certain conditions and the rules made by the Board.

This is the first attempt in the history of our tax legislation to encourage self-employed individuals to make provision for their maintenance and also the maintenance of their dependants after their retirement from active life.

4. Deduction in Respect of Educational Expenses :

Under section 80F, where an individual, who is not a citizen of India but who is resident in India, has incurred out of his income liable to tax any

expenditure on the full-time education of a dependent child of not more than 21 years of age in a university, college, school or other educational institution outside India, he is entitled to the deduction of a specified amount in the computation of his total income.

The specified amount is Rs. 1,500 for each such child subject to a maximum amount of Rs. 3,000 in respect of two or more children.

5. Deduction in Respect of Donations :

Under section 80G, in computing the total income of an assessee there shall be allowed a deduction of 50% of the qualifying amount of donations paid in cash by companies and of 55% of those paid in cash by other assessees.

The donations eligible for this deduction are as follows :

(*i*) Donations to National Defence Fund, Jawaharlal Nehru Memorial Fund and Prime Minister's Drought Relief Fund.

(*ii*) Donations to any other fund or institution to which this section applies.

(*iii*) Donations to Government or any local authority to be used for any charitable purpose.

(*iv*) Donations for the renovation or repair of any temple, mosque, gurdwara, church or other place notified by the Central Government to be a place of historic importance or a place of public worship of renown.

(*v*) Donations to any association or institution established in India for the control, supervision, regulation or encouragement of specified sports and games in India, provided the association or institution is exempt from income-tax under section 10(23).

Limit of qualifying amount. No deduction is allowed if the total amount of donations is less than Rs. 250.

The maximum amount of donations qualifying for deduction is as follows :

(*a*) There is no maximum limits for donations mentioned in (*i*) above.

(*b*) The maximum amount of other donations qualifying for deduction is 10% of the gross total income (as reduced by any portion thereof on which income-tax is not payable and by any amount in respect of which the assessee is entitled to any other deduction under sections 80C to 80U except section 80(G) or Rs. 2,00,000 whichever is less.

However, where the sums qualifying for deduction include any donations for the repair or renovation of temples, mosques, gurdwaras etc. notified by the Central Government, the monetary limit over donations, qualifying for deduction will be raised from the general limit of Rs. 2,00,000 to Rs. 5,00,000 (subject to the alternative percentage limit of 10 per cent of the gross total income of the donor) to cover only the donations to notified temples, mosques, gurdwaras etc.

Applicability of the section. This section applies to donations mentioned in (*ii*) above if the fund or institution is *established in India* for a charitable purpose (not including a purpose which is substantially of a religious nature) and if it fulfils the following conditions, namely :

(*a*) The institution or fund is one whose income is excluded from the total income under section 11 or 12, or it is a university or other educational institution existing solely for education purposes and not for purposes of profit, or it is a hospital or other medical institution which exists solely for philanthropic purposes and not for purposes of profit.

(*b*) Under its rules, no part of its income or assets is applicable to any non-charitable purpose.

(*c*) It is not meant for the benefit of any particular religious community or caste except scheduled castes, backward classes, scheduled tribes or women and children.

(*d*) It maintains regular accounts of its receipts and expenditure.

(*e*) It is (*i*) constituted as a public charitable trust or (*ii*) registered under the Societies Registration Act, 1860 or under section 25 of the Companies Act, 1956 or (*iii*) is a university established by law or (*iv*) any other educational institution recognised by Government or by a university or affiliated to any university or is an institution financed by Government or a local authority.

Charitable donations must be paid in cash, but under executive instructions, donations made out of stock-in-trade of a business concern are treated as having been made constructively in cash, if the value of the goods donated is included in the sales and a contra debit is made in the profit and loss account to represent the sum donated.

This deduction can be allowed only when a donation is made out of income included in the gross total income of an assessee. Where a donation is made out of the income of a previous year, and the assessee has taxable as well as non-taxable (*e. g.*, agricultural) income, and there is no evidence to show that the donation has been made out of not-taxable income, the full amount of the donation is to be allowed as a deduction.

Note : A deduction to which an assessee is entitled in respect of any donation made to any institution or fund will not be denied merely because, subsequent to the donation, any part of the income of the institution or fund becomes chargeable to tax.

Illustration

The taxable income of an individual for the previous year ended 31st March 1975 was as follows :

		Rs.
(*a*)	Income from house property	36,375
(*b*)	Share income from an unregistered firm	25,000
(*c*)	Dividend (gross) from an Indian company	3,625

During the year he contributed Rs. 10,000 to Public Provident Fund, paid Rs. 5,000 as premium on a policy on the life of his son, and gave a donation of Rs. 10,000 to Agra University.

Compute his total income for the assessment year 1975-76.

			Rs.
1.	Income from house property		36,375
2.	Business Profits : Share income from an unregistered firm		25,000
3.	Other Sources : Dividend gross		3,625
		Gross Total Income	65,000
Deductions :			
	For provident fund contributions (Rs. 10,000) and insurance premium (Rs. 5,000) :		
	First 50% of next Rs. 3,000	2,000	
	40% of balance Rs. 10,000	1,500	
		4,000	
		7,500	

For charitable donation 55% of Rs. 2,950 as calculated below	1,623	
For dividend (maximum)	3,000	12,123
Total Income		52,877
Rounded off		52,880

The deduction of Rs. 3,000 on account of dividend is given under section 80L which is explained later in this chapter.

The maximum amount of donation qualifying for deduction is as follows :

		Rs.
Gross total income		65,000
Less Share income from unregistered firm	25,000	
Deduction for P.F. and Premium	7,500	
Deduction for dividend	3,000	35,500
		29,500

Qualifying amount 10% of Rs. 29,500=Rs. 2,950

(B) DEDUCTIONS IN RESPECT OF CERTAIN INCOMES

1. Deduction in respect of Profits of New Industrial Undertaking Employing Displaced Persons :

Under section 80H, where the gross total income of an assessee includes any profits derived from any new industrial undertaking to which this section applies, a deduction is allowed of an amount equal to 50% of such profits in computing the total income of the assessee subject to a ceiling of Rs. 1 lakh.

This deduction will be allowed for the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles and *nine* assessment years immediately succeeding.

This section applies to any industrial undertaking which fulfils *all* the following conditions, namely :

(1) It is not formed by the splitting up or reconstruction of a business already in existence.

(2) It is not formed by the transfer to a new business of a building, machinery or plant previously used for any purpose.

(3) It begins to manufacture or produce articles in any part of India at any time within a period of *three* years after 1st April 1967.

(4) It employs on every working day throughout the previous year forty or more workers in a manufacturing process carried on with or without the aid of power.

(5) It employs displaced persons or repatriates or members of their families, and the daily average number of such employees is not less than 60% of the daily average number of all the persons employed throughout the previous year.

2. Deduction in Respect of Profits from Newly Established Industrial Undertakings or Hotel Business in Backward Areas :

Under section 80HH, a tax-payer deriving profits from a new industrial undertaking or the business of a hotel set up in any specified backward area will be entitled to a deduction, in the computation, of his total income, of 20% of such profits. The backward areas are specified in the Eighth Schedule.

This deduction is allowed with reference to the profits as reduced by the deduction under section 80H. Where the assessee is entitled to the deduction under section 80J, effect shall first be given to the deduction under section 80HH.

In the case of an assessee (other than a company or a co-operative society), the deduction will be admissible only if the accounts of the assessee have been audited by a chartered accountant and the report of such audit in the prescribed form is furnished along with the return of income.

Industrial Undertaking. This section is applicable to any industrial undertaking which fulfils all the following conditions :

(1) It has begun or begins to manufacture or produce articles after 31-12-1970 in any backward area.

(2) It is not formed by the splitting up or reconstruction of a business already in existence in any backward area.

(3) It is not formed by the transfer to a new business of machinery or plant previously used for any purpose in any backward area.

(4) It employs ten or more workers in a manufacturing process carried on with the aid of power or employs twenty or more workers in a manufacturing process carried on without the aid of power.

Hotel. This section applies to the business of any hotel where all the following conditions are fulfilled :

(1) The business of the hotel has started or starts functioning after 31-12-1970 in any backward area.

(2) The business of the hotel is not formed by the splitting up or reconstruction of a business already in existence.

(3) The hotel is for the time being approved by the Central Government.

Period of Deduction.

Where the industrial undertaking commences production or the hotel starts functioning after 31-3-1973, the deduction will be allowed for each of the ten assessment years beginning with the assessment year relevant to the previous year in which the industrial undertaking commences production or the hotel starts functioning.

However where the industrial undertaking has begun production or the hotel has started functioning before 1-4-1973 but after 31-12-1970, the number of assessment years for which the deduction is to be allowed will be reduced by the number of assessment years that have expired before 1-4-1974.

3. Deduction in Respect of Profits of New Industrial Undertakings, Ships or Hotel Business :

This deduction under section 80J has already been explained in chapter 8.

4. Deduction in Respect of Dividends of Tax-holiday Profits :

Section 80J grants a deduction in respect of the profits from newly established industrial undertakings or ships or hotel business up to 6% per annum on the capital employed.

Section 80K grants a deduction to the shareholder in respect of so much of the dividend paid or deemed to be paid by a company as is attributable to the profits in respect of which the company is entitled to a deduction under section 80J.

Rule 20 of the Income-Tax Rules prescribes the basis for determining the portion of the dividend deductible under section 80K.

This deduction is available to the beneficial owner of the shares whether the shares are registered in his own name or in the name of any other person.

Where the dividend on the shares in a company owned by a person is chargeable to tax as the income of any other person (*e. g.*, under section 64), such other person will be entitled to the deduction in the computation of his total income for the dividend attributable to the "tax-holiday" profits of the company paying the dividend.

5. Deduction in Respect of Investment Income :

Under section 80L, income derived by any tax-payer from any of the following sources will be allowed as a deduction up to Rs. 3,000 in the aggregate :

(*i*) Interest on any security of the Central Government or a State Government.

(*ii*) Interest on such debentures of co-operative societies (including co-operative land mortgage banks and co-operative land development banks) or other institutions or authorities as may be notified by the Central Government.

(*iii*) Interest on deposits made under any scheme framed by the Central Government and notified by it in this behalf.

(*iv*) Dividends from any Indian company.

(*v*) Income from units of the Unit Trust of India.

(*vi*) Interest on deposits with Indian banking companies (including interest on compulsory deposits) and co-operative societies carrying on banking business (including co-operative land mortgage banks and co-operative land development banks).

(*vii*) Interest on deposits with an approved financial corporation engaged in providing long-term finance for industrial development in India.

(*viii*) Interest on deposits with a co-operative society made by a member of the society.

(*ix*) Dividends from any co-operative society.

Besides the above deduction of Rs. 3,000, an additional deduction up to Rs. 2,000 is allowed in respect of income from units of the Unit Trust of India.

This deduction is available only in the case of individuals and Hindu undivided families.

In a case where the income of a tax-payer also includes any dividends which are allowed as a deduction under section 80K (*i. e.*, dividends attributable to the profits of new industrial undertaking enjoying tax-holiday concession), only that part of the dividends in respect of which deduction is not available under that section will be taken into account for the purpose of allowing the deduction under section 80L.

6. Deduction in Respect of Certain Inter-corporate Dividends :

Under section 80M, where the gross total income of a company includes and dividends from a domestic company, the following deduction is allowed in computing the total income of the recipient company :

(*a*) 60% of such income where the assessee is a domestic company.

(*b*) 65% of such income where the assessee is a foreign company.

This deduction is available to the recipient company even where the shares to which the dividend relates are registered in the name of a person other than the recipient company.

In a case where the company is entitled also to the deduction under section 80K in respect of dividends received by it, the deduction under section 80M will be allowed with reference to the amount of the dividends as reduced by the deductions under section 80K.

7. Deduction in Respect of Royalties, etc., Received from any Concern in India :

Under section 80MM, an Indian company which derives income by way of royalty, commission, fees or any other payment from an Indian concern in consideration of the provision to the Indian concern of technical know-how or technical services are entitled to a deduction of 40% of the amount of such income in the computation of their total income.

The deduction is admissible only where the technical know-how or technical services are provided to the Indian concern under an agreement approved by the Central Board of Direct Taxes for this purpose.

Note : Under section 80-O, the whole of such income received by an Indian company from a foreign government or a foreign enterprise is allowed as a deduction in the computation of the total income of the Indian Company.

8. Deduction in Respect of Dividends Received from Certain Foreign Companies :

Under section 80N, where the gross total income of an Indian company includes any dividends received by it from a foreign company on shares in the foreign company allotted in consideration of the supply of technical know-how or technical services, a deduction will be allowed only to the extent the dividends are received in or are brought into India in accordance with the law for regulating payments and dealings in foreign exchange.

This deduction is admissible only where the technical know-how or technical services are provided to the foreign company under an agreement approved by the Central Board of Direct Taxes for this purpose.

Illustrations

(1) For the previous year ended 31st December 1974, the gross total income of an assessee consisted of the following :

Interest on government securities Rs. 1,000 gross
Business profits Rs. 25,000
Dividend from units in the Unit Trust of India Rs. 500
Interest on bank deposits Rs. 500
Dividend Rs. 800 from an Indian company, 75% of which is attributable to tax-holiday profits
Dividend Rs. 1,000 from an Indian company, 60% of whose income is agricultural income subjected to agricultural income-tax in a State
Dividend Rs. 1,000 from a non-resident company out of profits earned in India
Dividend Rs. 2,000 from another Indian company
Dividend Rs. 1,000 from a foreign company on shares allotted for the supply of technical know-how
Fees Rs. 5,000 for rendering technical services to an Indian concern

Compute the total income for the assessment year 1975-76 if the assessee is (*i*) an individual and (*ii*) an Indian company, assuming the dividends to be gross.

When the assessee is an individual :

		Rs.
1. Interest on government securities	—	1,000
2. Business profit	—	25,000

3. Income from other sources :			
Dividend from Unit Trust of India	500		
Interest on bank deposits	500		
Fees from an Indian concern	5,000		
Dividends from companies	5,800		11,800
	Gross Total Income		37,800
Less Admissible deductions :			
Under Section 80K : full amount of dividend attributable to tax-holiday profits (75% of Rs. 800)		600	
Under section 80L : on account of investment income (interest from government securities, dividend from Unit Trust, interest on bank deposits, dividends from Indian companies)		3,000	
Under section 80MM : 40% of fees from Indian concern for supply of technical services		2,000	
Under section 80N : full amount of dividend from a foreign company for supply of technical know-how		1,000	6,600
	Total Income		31,200

When the assessee is an Indian company :

Gross Total income as calculated above			37,800
Less Admissible deductions :			
Under section 80K		600	
Under section 80M : 60% of dividends from Indian companies (Rs. 200+Rs. 1,000+ Rs. 2,000=Rs. 3,200)		1,920	
Under section 80MM		2,000	
Under section 80N		1,000	5,520
	Total Income		32,280

Notes :

1. Dividend paid by a company out of its agricultural income is not agricultural income in the hands of shareholders and no relief is admissible in respect of agricultural income-tax paid by the company.
2. The non-resident company from whom a dividend of Rs. 1,000 has been received is not a domestic company.
3. The deduction under section 80L is not available in the case of a company.

(2) B Co Ltd. (an Indian company) has a gross total income of Rs. 10,00,000 for the assessment year 1975-76. It is found that during the relevant previous year it had donated Rs. 1,50,000 to the National Defence Fund and Rs. 1,00,000 to the Delhi University.

Furthermore, the gross total income includes a sum of Rs.3,00,000 being the profits of a newly-established industrial undertaking whose capital employed in the undertaking (computed according to the rules) was Rs. 20,00,000 and which had started producing its goods two years earlier.

Lastly it is found that the company's gross total income included dividends of Rs. 50,000 derived from another Indian company.

Compute the total income of the company for the assessment year 1975-76 on the basis of the above-noted data.

		Rs.
Gross total income		10,00,000
Less Admissible deductions :		
Under section 80G : 50% of the qualifying amount of donation as calculated below *i. e.*, 50% of Rs. 2,35,000	1,17,500	
Under section 80J : 6% of Rs. 20,00,000 capital employed on account of profits of new industrial undertaking	1,20,000	
Under section 80M : 60% of Rs. 50,000 dividend from an Indian company	30,000	2,67,500
Total Income		7,32,500

Qualifying amount of donations :	Rs.
Donation to National Defence Fund	1,50,000
Donation to Delhi University being 10% of gross total income of Rs. 10,00,000 as reduced by other deductions of Rs. 1,20,000 and Rs. 30,000, *i. e.*, 10% of Rs. 8,50,000	85,000
	2,35,000

9. Deduction in Respect of Royalty etc. Received from Foreign Government or Enterprises :

Under section 80-O, where the gross total income of an Indian company includes any income by way of royalty, commission, fees or any similar payment received by it from a foreign Government or a foreign enterprise (whether organised as a company or not) in consideration of the supply of technical know-how or technical services to the foreign Government or enterprise, a deduction of the full amount of such income is allowed in computing the total income of the assessee.

This deduction is admissible only where the technical know-how or technical services are provided to the foreign Government or enterprise under an agreement approved by the Central Government in this behalf before the 1st day of October of the relevant assessment year, and such income is received in or brought into India by the assessee or on his behalf in accordance with the law for regulating payments and dealings in foreign exchange.

10. Deduction in Respect of Income of Co-operative Societies :

Under section 80P, where the gross total income of a co-operative includes any income which qualifies for deduction, the whole of such income will be allowed as a deduction in computing the total income of the society.

The classes of income qualifying for deduction and the conditions on which the deduction is allowable are explained in full in a subsequent chapter dealing with the assessment of co-operative societies.

11. Deduction in Respect of Profit from Publishing Business :

Under section 80QQ, any person carrying on a business in India of the printing and publication of books or of publication of books without the activity of printing, will be entitled to a deduction in the computation of his total income of an amount equal to 20 per cent of the profits from such business included in the gross total income. This deduction will be admissible for ten assessment years beginning with the assessment year 1971-72.

For the purpose of this deduction "books" will not include newspapers, journals, magazines, diaries, brochures, tracts, pamphlets and other publications of a similar nature by whatever name called.

Where the assessee is also entitled to the deduction under section 80H or section 80HH or section 80J or section 80P, the deduction under section 80QQ will be allowed with reference to such profits included in the gross total income as reduced by the deductions under sections 80H, 80HH, 80J and 80P.

12. Deduction in Respect of Foreign Remuneration of Professors etc. :

Under section 80R, where the gross total income of an individual, who is a citizen of India, includes any remuneration received by him outside India from any foreign university or other educational institution or such other foreign association or body as may be notified by the Central Government, for rendering service as a professor, teacher or research worker, a deduction of 50% of such remuneration for 36 months is allowed in computing his total income.

13. Deduction in Respect of Professional Income from Foreign Sources in Certain Cases :

Under section 80RR, an author, playwright, artist, musician or actor resident in India, deriving income in the exercise of his profession from any foreign source will be entitled to deduction in the computation of his total income, of an amount equal to 25% of the part of such income which is received in or brought into India by him or on his behalf in foreign exchange in accordance with the Foreign Exchange Regulation Act.

14. Deduction in Respect of Remuneration from Foreign Employers :

Under section 80RRA, a resident Indian citizen receiving remuneration from a foreign Government or a foreign enterprise or any foreign association or body for any service rendered by him outside India is entitled to a deduction of 50% of such remuneration.

This deduction is allowed only in the case of Government employees and technicians. In the case of a Government employee, this deduction will be allowed where his service outside India is sponsored by the Central Government. In the case of a technician, the deduction will be allowed only in cases where the contract of service with a foreign employer is approved by the Central Government or the prescribed authority.

A technician means a person having specialised knowledge and experience in the specified fields (such as agriculture, public administration, industrial or business management, accountancy etc.) who is employed by a foreign employer in a capacity in which such knowledge and experience are actually utilised.

This deduction is allowed in respect of the remuneration received for service for a period of only 36 months.

15. Deduction in Respect of Compensation for Termination of Managing Agency etc. :

Under section 80S, where the gross total income of a non-company assessee includes any income by way of compensation for termination of managing agency etc., which is chargeable to tax as income from business, a deduction of 25% of such income is allowed in computing the total income. The maximum amount of such deduction is limited to Rs. 1,00,000.

This deduction of 25% is not admissible in respect of management compensation which is taxable as income from business.

16. Deduction in Respect of Long-term Capital Gains :

Under section 80T, where the gross total income of an assessee (not being a company) includes any long-term capital gains, the following deductions will be allowed in computing his total income :

(1) In a case where the gross total income does not exceed Rs. 10,000 or where the long-term capital gains do not exceed Rs. 5,000, the whole of such long-term capital gains will be allowed as a deduction.

(2) In any other case, the assessee will be allowed the following deductions :

(*a*) In respect of long-term capital gains relating to lands or buildings or any rights therein, the first Rs. 5,000 of such gains *plus* 25% of the balance, if any.

(*b*) In respect of long-term capital gains relating to other capital assets, the first Rs. 5,000 thereof [in so far as such deduction has not been availed of under (*a*) above] *plus* 40% of the balance, if any.

Note : The tax on long-term capital gains of companies is not regulated by this section but by section 115 the provisions of which are explained in a subsequent chapter dealing with assessment of companies.

Illustrations

(1) In the following cases, compute the total income of an individual for the assessment year 1975-76 :

(*a*) Income from house property Rs. 2,000.
Short-term capital gains Rs. 2,000.
Long-term capital gains Rs. 6,000.

(*b*) Business income Rs. 10,000.
Long-term capital gains Rs. 4,000.

(*c*) Business income Rs. 20,000.
Long-term capital gains relating to land and buildings Rs. 8,000.
Long-term capital gains relating to other capital assets Rs. 5,000.

(*d*) Interest on government securities Rs. 2,000.
Income from house property Rs. 3,000.
Business income Rs. 15,000.
Long-term capital gains relating to land and buildings Rs. 3,000.
Long-term capital gains relating to other capital assets Rs. 7,000.

		Rs.
(*a*)	Income from house property	2,000
	Short-term capital gains	2,000
	Long-term capital gains	6,000
	Gross Total Income	10,000
	Deduction under section 80T as the gross total income does not exceed Rs. 10,000	6,000
	Total Income	4,000
(*b*)	Business income	10,000
	Long-term capital gains	4,000
	Gross Total Income	14,000

	Deduction under section 80T as the long-term capital gains do not exceed Rs. 5,000			4,000
	Total Income			10,000
(*c*)	Business income			20,000
	Long-term capital gains relating to land and buildings			8,000
	Other long-term capital gains			5,000
	Gross Total Income			33,000
	Deduction under section 80T :			
	In respect of long-term capital gains relating to land and buildings : First	5,000		
	25% of Rs 3,000	750		
	In respect of other long-term capital gains :			
	40% of Rs. 5,000	2,000		7,750
	Total Income			25,250
(*d*)	Interest on government securities			2,000
	Income from house property			3,000
	Business profits			15,000
	Long-term capital gains relating to land and buildings			3,000
	Long-term capital gains relating to other capital assets			7,000
	Gross Total Income			30,000
	Deductions :			
	Deduction under section 80L in respect of interest on government securities		2,000	
	Deduction under section 80T :			
	In respect of long-term capital gains relating to land and buildings		3,000	
	In respect of other long-term capital gains : Rs. 5,000 — Rs. 3,000	2,000		
	40% of balance of Rs. 5,000	2,000	4,000	7,000	9,000
	Total Income				21,000

(2) A had received by way of gift from his father on 1-12-1973 one hundred shares on which he had received on 1-4-1974 one hundred shares as bonus shares from the company. On 1-11-1974 he sold the entire lot for Rs. 20,000. A's father had acquired the shares in 1953 for a price of Rs. 5,000 and on 1-1-1954 the market value per share was Rs. 80 whereas on 1-1-1956 it was Rs. 90.

Compute A's capital gain for the assessment year 1975-76 for which his previous year was the year ending on 31-3-1975. Will he be entitled to any deduction in respect of such gain in computing his total income ? (*C. A. Final, Nov. 1972*)

The shares held by A's father as an investment are a capital asset, and their transfer by way of a gift to his son is not treated as a transfer and therefore A's father is not liable to any tax on capital gain.

Where a capital asset is received as a gift, the cost of the capital asset to the donee is taken to be the cost thereof to the transferor, which is Rs. 5,000. But their market value on 1-1-1954 was Rs. 8,000. A is entitled to take Rs. 8,000 as the cost of acquisition of these shares.

The cost of the bonus shares to A is not taken as nil, but their cost is ascertained by spreading the cost of the original shares (Rs. 8,000) over the original shares and the bonus shares. Thus dividing Rs. 8,000 by 200 the cost of each share is Rs. 40.

The original 100 shares are a long-term capital asset as they have been held both by the father and A for more than 60 months, while the 100 bonus shares are a short-term capital asset as they have been held for only 7 months.

The sale proceeds of Rs. 20,000 are half for original shares and half for bonus shares. Therefore the long-term capital gain is Rs. 10,000 – Rs. 4,000 = Rs. 6,000 and the short term capital gain is also the same. The capital gains to be included in the total income will be Rs. 6,000 + 6,000 = Rs. 12,000.

The deduction to be allowed on account of long-term capital gain from the gross total income will be Rs, 5,000 + 40% of Rs. 1,000 *i.e.*, Rs. 5,000 + Rs. 400 = Rs. 5,400.

17. Deduction in Respect of Lottery Winnings :

Under section 80TT, in computing the total income of non-corporate assessees, the whole of the income by way of lottery winnings will be allowed as a deduction if the gross total income of the assessee does not exceed Rs. 10,000 or if the winnings do not exceed Rs. 5,000. Otherwise, the deduction will be allowed of an amount equal to Rs. 5,000 plus 50% of the balance of income by way of lottery winnings.

Illustration

Z is employed in a Government office drawing a salary of Rs. 400 and a dearness allowance of Rs. 100 p. m.

In the previous year ended 31-3-1975 he received Rs. 2,000 gross as interest on government securities.

He is the owner of a big house consisting of three flats of the same size and construction. Flat No. 1 is occupied by him for his residence. Flat No. 2 (built in July 1969) is let out to a tenant for residential purposes. Flat No. 3 (built in January 1972) is let out to a tenant for running a book stall. The monthly rent of the flats let out is Rs. 250 each and the municipal taxes paid amount to 10% of the rental value.

In November 1974 (*i*) he lost Rs. 5,000 in gambling on the Diwali day, (*ii*) he won Rs. 1,500 in the card game of bridge, and (*iii*) he won Rs. 1,00,000 in a State lottery.

Compute his total income for the assessment year 1975-76.

			Rs.
1. Income from salary :			
Salary and dearness allowance		6,000	
Less Standard deduction		1,200	4,800
2. Interest on securities			2,000
3. Income from house property :			
Flat No. 1 (self-occupied) ;			
Annual value on the basis of rent received from flats let out	3,000		
Less Municipal taxes	300		
Less Self-occupation allowance	2,700		
	1,350		
Annual value in this case		1,350	
Flat No. 2 (let out for residence) :			
Annual value on basis of rent	3,000		
Less Municipal taxes	300		

Annual value in this case		2,700	
Flat No. 3 (let out for a shop) :			
Annual value on basis of rent	3,000		
Less Municipal taxes	300		
Annual value in this case		2,700	
		6,750	
Less One-sixth for repairs		1,125	5,625
4. Income from other sources :			
Bridge winnings (in excess of Rs. 1,000)		500	
Winnings from a state lottery		1,00,000	1,00,500
Gross Total Income			1,12,925
Deductions :			
Under section 80L, in respect of interest on government securities		2,000	
Under section 80TT, in respect of lottery winnings :			
First	5,000		
50% of balance of Rs. 95,000	47,500	52,500	54,500
Total Income			58,425
Rounded off			58,430

Notes :

1. In respect of flat No. 2 the three-year tax-holiday benefit of Rs. 600 was over with the assessment year 1972-73.
2. In respect of flat No. 3 the five-year tax-holiday benefit of Rs. 1,200 is not available as the flat is not let out for purposes of residence.
3. The loss from gambling can be set off only against income from gambling and it cannot be carried forward.

(C) OTHER DEDUCTIONS

Under section 80U, in computing the total income of a resident individual who, as at the end of the previous year, is either totally blind or suffers from any other permanent physical disability which substantially reduces his capacity to engage in a gainful employment or occupation, a deduction of Rs. 5,000 will be allowed in computing his total income.

In order to be eligible for this deduction, the assessee must furnish in respect of the first assessment year for which the deduction is claimed a certificate from a registered oculist in case of total blindness and a certificate from a registered medical practitioner in case of permanent physical disability.

SUMMARY

Sections 80C—80U allow the following deductions in computing the total income of an assessee. These deductions should be carefully remembered.

In Respect of Expenditure

1. **Section 80C.** Full amount of the first Rs. 2,000 plus 50% of the next Rs. 3,000 plus 40% of the balance of the qualifying amount of payments on accounts of life insurance premium, provident fund contributions and cumulative time deposits in post-office.

2. **Section 80D.** Rs. 2,400 spent by a resident individual or a Hindu undivided family on the medical treatment of a handicapped dependant who remains as an in-patient in a hospital for 182 days or more, and Rs. 600 in every other case such deduction to be reduced by the income of the dependant, if any.
3. **Section 80E.** 10% of the gross total income or Rs. 5,000, whichever is less, on account of payments made for securing retirement annuities in the case of an individual, who is a citizen of India and is resident in India and is a partner in a registered professional firm.
4. **Section 80F.** Rs. 1,500 for each child subject to a maximum of Rs. 3,000 for two or more children spent by a *resident* non-citizen individual on the education of his children abroad.
5. **Section 80G.** 50% of the qualifying amount of charitable donations made by companies and 55% of that made by other assessees.

In Respect of Income

6. **Section 80H.** For 10 years 50% of the profits of an industrial undertaking employing displaced persons and owned by any assessee, subject to a maximum of Rs. 1,00,000.
7. **Section 80HH.** For 10 years 20% of the profits of an industrial undertaking or a hotel set up in a backward area.
8. **Section 80J.** Tax-holiday profits for 5 years (being 6% per annum of capital employed) from new industrial undertaking or ships or hotel business.
9. **Section 80K.** Full amount of dividends attributable to the tax-holiday profits of new industrial undertakings, ships or hotel business owned by Indian companies.
10. **Section 80L.** Up to Rs. 3,000 in respect of certain investment income (such as dividend from Indian comhanies, interest on government securities, dividend from Unit Trust of India, interest on deposits in banks and co-operative societies, etc.). *This deduction is allowed only to individuals and Hindu undivided families.*
11. **Section 80M.** The following deduction in respect of inter-corporate dividends :
    (*a*) 65% of dividends received by a foreign company from Indian companies.
    (*b*) 60% of dividends received by an Indian company from other Indian companies.
12. **Section 80MM.** 40% of any royalty, commission, fees or any other payment received by an Indian company from an Indian concern for supply of technical know-how or technical services.
13. **Section 80N.** Dividend received by an Indian company from a foreign company on shares allotted for supply of technical know-how or technical services to the extent it is received in or brought into India in accordance with foreign exchange regulations.
14. **Section 80-O.** Any royalty, commission, fees or any similar payment received by an Indian company from a foreign Government or a foreign enterprise for supply of technical know-how or technical services.
15. **Section 80P.** Certain incomes of co-operative secieties as explained in a subsequent chapter dealing with the assessment of co-operative societies.

16. **Section 80QQ.** 20% of the profits from the business of printing and publishing of books for five assessment years beginning with the assessment year 1971-72.
17. **Section 80R.** 50% of the foreign remuneration of a professor or teacher who is a citizen of India for 36 months' service abroad.
18. **Section 80RR.** 25% of that part of the professional income of an author, playwright, artist, musician or actor from foreign sources which is brought into India in foreign exchange.
19. **Section 80RRA.** 50% of remuneration received by resident Indian citizens from foreign employers.
20. **Section 80S.** 25% of compensation received by a non-company assessee for termination of an agency, subject to a maximum of Rs. 1,00,000.
21. **Section 80T.** Deduction in respect of long-term capital gains in the case of non-company assessees as explained before.
22. **Section 80TT.** Deduction in respect of lottery winnings in the case of non-company assessees as explained before.

Other Deduction

23. **Section 80U.** Rs. 5,000 in the case of resident individuals who are totally blind or who suffer from a permanent physical disability.

CHAPTER 15

Income-Tax Authorities

Appointment and Control

According to section 116, there shall be the following classes of income-tax authorities namely :

(1) The Central Board of Direct Taxes.
(2) Directors of Inspection.
(3) Commissioners of Income-Tax.
(4) Additional Commissioners of Income-Tax.
(5) Assistant Commissioners of Income-Tax, who may be either Appellate Assistant Commissioners of Income-Tax or Inspecting Assistant Commissioners of Income-Tax.
(6) Income-Tax Officers ; and
(7) Inspectors of Income-Tax.

Director of Inspection includes an Additional Director of Inspection, a Deputy Director of Inspection or an Assistant Director of Inspection.

Appointment. Under section 117, the Central Government may appoint as many Directors of Inspection, Commissioners of Income-Tax, Appellate or Inspecting Assistant Commissioners of Income-Tax and Income-Tax Officers of Class I Service, as it thinks fit.

The Commissioner may, subject to the rules and orders of the Central Government, appoint as many Income-Tax Officers of Class II Service and as many Inspectors of Income-Tax as may be sanctioned by the Central Government.

Subject to the rules and orders of the Central Government, an income-tax authority may appoint such executive or ministerial staff as may be necessary to assist in the execution of its functions.

Control. Under section 118, Inspecting Assistant Commissioners are subordinate to the Commissioners within whose jurisdiction they perform their functions, and also to the Director of Inspection and Additonal Director of Inspection, but they are not subordinate to a Deputy or an Assistant Director of Inspection.

Income-Tax Officers are subordinate to the Commissioners and the Inspecting Assistant Commissioner within whose jurisdiction they perform their functions, and also to the Director of Inspection. Additional Director of Inspection and a Deputy Director of Inspection, but they are not subordinate to an Assistant Director of Inspection.

Inspectors of Income-Tax are subordinate to the Income-Tax Officer or other income-tax authority under whom they are appointed to work and to

any other income-tax authority to whom the said officer or other authority is subordinate.

Board's Powers to Issue Instructions

Section 119 empowers the Board to issue from time to time such orders, instructions or directions to other income-tax authorities as it may deem fit for the proper administration of the Income-Tax Act, subject to the condition that no such orders, instructions or directions shall be issued so as :

(*a*) to require any income-tax authority to make a particular assessment or to dispose of a particular case in a particular manner, or
(*b*) to interfere with the discretion of the Appellate Assistant Commissioner in the exercise of his appellate functions.

In the interest of proper and efficient management of the work of assessment and collection of revenue, the Board may issue general or special orders from time to time in respect of any class of incomes or class of cases setting forth guide lines, principles or procedures to be followed by other income-tax authorities in the work relating to assessment or collection of revenue or the initiation of proceedings for the imposition of penalties. It is specifically provided that such orders should not be prejudicial to assessees ; they may be in relaxation of any of the following provisions or otherwise :

Section 143 (procedure of assessment).
Section 144 (best judgment assessment).
Sections 147 and 148 (assessment of escaped income).
Sections 154 and 155 (rectification of assessments).
Section 210 (order demanding advance tax).
Sections 271 and 273 (penalties for defaults).

Such orders should be published in the prescribed manner for general information, if the Board is of the opinion that it is necessary so to do in the public interest.

The Board may issue general or special orders in relation to any case or class of cases, authorising the Commissioner of Income-Tax or the Income-Tax Officer to admit an application or claim for any exemption, deduction, refund or any other relief under the Income-Tax Act after the expiry of the period of limitation for the purpose. Such orders may be issued by the Board with a view to avoiding genuine hardship in any case or class of cases.

Every Income-Tax Officer shall observe and follow the instructions issued to him for his guidance by the Director of Inspection or by the Commissioner of Income-Tax or by the Inspecting Assistant Commissioner within whose jurisdiction he is functioning.

Jurisdiction

Director of Inspection. Under section 120, Directors of Inspection shall perform such functions of any other income-tax authority as may be assigned to them by the Board.

Commissioners. Under section 121, Commissioners shall perform their functions in respect of such areas or of such persons or of such income or of such cases as the Board may direct. The Board is empowered to distribute and allocate the work on functional basis among two or more Commisioners of Income-Tax having concurrent jurisdiction over the same area or the same persons or classes of persons or the same incomes or classes of income or the same cases or classes of cases.

Additional Commissioners. They perform such functions of Commissioners as may be assigned to them.

Appellate Assistant Commissioners. Under section 122, Appellate Assistant Commissioners shall perform the functions in respect of such areas or of such persons or of such incomes as the Board may direct. Where any such directions have assigned to two or more Appellate Commissioners the same persons or the same incomes, they shall perform their functions in accordance with any order which the Board may make for the distribution and allocation of the work to be performed.

Inspecting Assistant Commissioners. Under section 123, Inspecting Assistant Commissioners shall perform their functions in respect of such areas or of such persons or classes of persons or of such incomes or classes of income or of such cases or classes of cases as the Commissioner may direct.

It will be open to the Commissioner to distribute and allocate the work on functional basis among two or more Inspecting Assistant Commissioners having concurrent jurisdiction over the same area or the same persons or classes of persons or the same incomes or classes of income or the same cases or classes of cases.

Income-Tax Officers. Under section 124, Income-Tax Officers shall perform their functions in respect of such areas or of such persons or classes of persons or of such incomes or classes of income or of such cases or classes of cases as the Commissioner may direct.

It will be open to the Commissioner or the Inspecting Assistant Commissioner authorised by him in this behalf, to distribute and allocate the work on functional basis amongst two or more Income-Tax Officers having concurrent jurisdiction over the same areas or the same persons or classes of persons or the same incomes or classes of income or the same cases or classes of cases.

Within the limits of the area assigned to him, the Income-Tax Officer shall have jurisdiction :

(*a*) In respect of any person carrying on a business or profession, if the place at which he carries on his business or profession is situated within the area or where his business or profession is carried on in more places than one, if the principal place of his business or profession is situated within the area ; and

(*b*) In respect of any other person residing within the area.

Where a question arises as to whether an Income-Tax Officer has jurisdiction to assess any person, the question shall be determined by the Commissioner, or where the question is one relating to areas within the jurisdiction of different Commissioners, by the Commissioners concerned or if they are not in agreement, by the Board.

Under section 125, it will be open to the Commissioner to direct that the powers conferred on the Income-Tax Officer and the Appellate Assistant Commissioner shall, in respect of any specified case or class of cases or of any specified person or class of persons, be exercised by the Inspecting Assistant Commissioner and the Commissioner respectively.

It will also be open to the Commissioner of Income-Tax to direct that specific functions vested in the Income-Tax Officer under the Income-Tax Act shall be performed by an Inspector of Income-Tax or any member of the ministerial staff subordinate to the Commissioner or other lower income-tax authorities, in respect of any specified area, case or class of cases, person or class of persons, income or class of incomes, subject to such conditions, restrictions or limitations as may be specified by him. However, the Commissioner may not assign to the Inspector of Income-Tax or any member of the ministerial staff certain important functions of the Income-Tax Officer such as the function of summoning and examining witnesses, making searches and seizures, making of assessments, reopening of assessments in cases of

escapement of income, issue of recovery certificates, distress warrants or garnishee orders, levy of penalty, etc., unless the Board authorises him to do so.

Under section 127, the Commissioner may, after giving the assessee a reasonable opportunity of being heard in the matter, wherever it is possible to do so, and after recording his reasons for doing so, transfer any case from any Income-Tax Officer or Income-Tax Officers subordinate to him to any other Income-Tax Officer or Income-Tax Officers also subordinate to him, and the Board may similarly transfer any case from any Income-Tax Officer or Income-Tax Officers to any other Income-Tax Officer or Income-Tax Officers. But no such opportunity need be given to the assessee where the transfer is from one Income-Tax Officer to another whose offices are at the same place.

Where any case has been so transferred to two or more Income-Tax Officers, the Board or the Commissioner or any Inspecting Assistant Commissioner authorised by him in this behalf may distribute and allocate the work in such a case on functional basis among the Income-Tax Officers to whom the case has been transferred.

The transfer of a case may be made at any stage of the proceedings, and shall not render necessary the reissue of any notice already issued by the Income-Tax Officer or Income-Tax Officers from whom the case is transferred.

Inspectors of Income-Tax. Under section 128, Inspectors of Income-Tax shall perform such functions in the execution of the Income-Tax Act as are assigned to them by the Commissioner or by any other income-tax authority under whom they are appointed to work.

Change of Incumbent of an Office. Under section 129, whenever in respect of any income-tax proceeding, an income-tax authority ceases to exercise jurisdiction and is succeeded by another who has and exercises jurisdiction, the income-tax authority so succeeding may continue the proceeding from the stage at which the proceeding was left by his predecessor, but the assessee concerned may demand that, before the proceeding is so continued, the previous proceeding or any part thereof be reopened or that, before any order of assessment is passed against him, he be reheard.

Powers

Power regarding Discovery etc. Under section 131(1), the Income-Tax Officer, Appellate Assistant Commissioner, Inspecting Assistant Commissioner and Commissioner have the same powers as are vested in a court under the Code of Civil Procedure, 1908, when trying a suit in respect of the following matters, namely :

(*a*) discovery and inspection ;

(*b*) enforcing the attendance of any person, including any officer of a banking company, and examining him on oath ;

(*c*) compelling the production of books of account and other documents ; and

(*d*) issuing commissions.

According to section 131(2), where a person to whom a summon is issued either to give evidence or produce books of account or other documents at a certain place and time intentionally omits to attend or produce the books of account or documents at that place or time, the income-tax authority may impose upon him such fine not exceeding Rs. 500 as it thinks fit.

Under section 131(3), subject to any rules made in this behalf by the Board, the Income-Tax Officer, Appellate Assistant Commissioner or Commissioner may impound and retain in his custody for such period as he thinks fit any books of account or other documents produced before him, but the Income-Tax Officer shall not :

(*a*) impound any books of account or other documents without recording his reasons for doing so ; or

(*b*) retain in his custody any such books or documents for a period exceeding 15 days (exclusive of holidays) without obtaining the approval of the Commissioner therefor.

Power of Search and Seizure. Under section 132, where the Director of Inspection or the Commissioner has reason to believe that :

(*a*) any person required to produce any books of account or documents has failed to do so or will not do so, or

(*b*) any person is in possession of any money, bullion, jewellery or other valuable article representing undisclosed income or property, he may authorise any Deputy Director of Inspection, Inspecting Assistant Commissioner, Assistant Director of Inspection or Income-Tax Officer (referred to as the authorised officer) to make a search of an assessee's place. The authorised officer shall have the power to :

(*i*) enter and search any building or place where he has reason to suspect that such books of account, other documents, money, bullion, jewellery or other valuable article are kept ;

(*ii*) break open the lock of any door, box, locker, safe, almirah or other receptacle where the keys thereof are not available ;

(*iii*) seize any such books of account, other documents, money, bullion, jewellery or other valuable article found as a result of such search ; and

(*iv*) make a note or an inventory of any such things.

The authorised officer may requisition the services of any police officer or any officer of the Central Government or of both to assist him in making the search.

Where it is not practicable to seize any asset found during the search, the authorised officer may serve an order on the person concerned not to remove or part with or otherwise dealt with it except with his previous permission. In order to ensure that such an order is not contravened, section 275A provides for punishment of contravention of such order.

During the course of search and seizure the authorised officer may examine on oath any person who is found to be in possession of books of account, documents or assets like money, bullion, etc. The statement made during such examination may thereafter be used in evidence in any proceedings under the Act.

Where any asset is seized, then within 90 days of such seizure and with the previous approval of the Commissioner, the Income-Tax Officer shall pass an order estimating in a summary manner the undisclosed income, calculating the amount of tax thereon and specifying the amount that will be required to satisfy all existing taxation liabilities of the person concerned. Before making such an order, the Income-Tax Officer has to afford a reasonable opportunity to the person concerned for being heard and make such inquiry as may be prescribed.

Section 132A makes provision relating to the application of assets retained under section 132. These assets, may be applied to the discharge of the existing liabilities in respect of which the assessee is in default. If any assets or proceeds thereof remain after the tax liabilities have been discharged, they will be forthwith paid or made over to the person from whose custody they were seized.

Power to Call for Information. Under section 133, the Income-Tax Officer, the Appellate Assistant Commissioner or the Inspecting Assistant Commissioner may require :

(*a*) any firm to furnish him with a return of the names and addresses of the partners of the firm and their respective shares.

(*b*) any Hindu undivided family to furnish him with a return of the names and addresses of the manager and the members of the family.

(*c*) any person whom he has reason to believe to be a trustee, guardian or agent, to furnish him with a return of the names and addresses of the persons for whom he is a trustee, guardian or agent.

(*d*) any assessee to furnish a statement of the names and addresses of all persons to whom he has paid in any previous year rent, interest, commission, royalty or brokerage or any annuity (not chargeable under the head "Salaries") amounting to more than Rs. 400, together with particulars of all such payments made.

(*e*) any dealer, broker, or agent or any person concerned in the management of a stock or commodity exchange to furnish a statement of the names and addresses of all persons to whom he or the exchange has paid any sum in connection with the transfer of assets, or on whose behalf or from whom he or the exchange has received any such sum, together with particulars of all such payments and receipts.

(*f*) any person (including a banking company or any officer thereof) to furnish information in relation to such points or matters or to furnish statements of account or affairs giving information in relation to such points or matters as, in the opinion of the Income-Tax Officer, the Appellate Assistant Commissioner, or the Inspecting Assistant Commissioner, will be useful for or relevant to, any assessment proceeding.

Power of Survey. Under section 133A, the Income-Tax Officer (or any Inspector of Income-Tax authorised by him in this behalf) can enter any premises in his jurisdiction where any business or profession is carried on by an assessee and to inspect any books of account or documents, to take extracts therefrom and to place marks of identification thereon.

The Income-Tax Officer or the Inspector can do so only during usual business hours, and he cannot remove from the place which he has entered any books of account or other documents.

Power to Inspect Registers of Companies. Under section 134, the Income-Tax Officer, Appellate Assistant Commissioner, or the Inspecting Assistant Commissioner, or any person subordinate to him authorised in writing in this behalf by such authorities, may inspect, and if necessary, take copies of any register of the members, debenture-holders or mortgagees of any company.

Power to Make Inquiries. Under section 135, the Director of Inspection, the Commissioner and the Inspecting Assistant Commissioner shall be competent to make any inquiry under the Income-Tax Act, and for this purpose shall have all the powers that an Income-Tax Officer has in relation to the making of inquiries.

Proceedings to be Judicial Proceedings. Under section 136, any proceeding under the Income-Tax Act before an income-tax authority shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228 and for the purposes of section 196 of the Indian Penal Code.

Though the income-tax authorities do not strictly act as courts of law, it is clear that they act in a quasi-judicial capacity. They may draw inferences and consider evidence, which may not be admissible under the Evidence Act. Though they are not courts of law, they must proceed in a judicial manner and come to a judicial conclusion upon properly ascertained facts. They must

proceed without bias and must give sufficient opportunity to the assessee to place his case before the Department.

They must conduct themselves in accordance with the principles of justice, equity and good conscience.

Disclosure of Information

Before 1st April 1964, there was a ban on the disclosure of information supplied to the Income-Tax Department by assessees. This ban has now been lifted. Under section 138, such information may be disclosed in the following circumstances :

(1) It is open to the Board or any other income-tax authority specified by it to disclose information relating to income-tax assessees to authorities functioning under any tax, law or to authorities administering the Foreign Exchange Regulation Act or to any other authority functioning under any other law as may be notified by the Central Government, without any application for the purpose from such authorities. The information will be furnished if, in the opinion of the Board or other income-tax authority, the disclosure of information is necessary to enable the authorities mentioned above to perform their functions under the law.

(2) Where a person makes an application to the Commissioner in the prescribed form for any information ralating to any assessee in respect of any assessment made on or after 1st April 1960, the Commissioner may, if he is satisfied that it is in the public interest so to do, furnish or cause to be furnished the information asked for in respect of that assessment only, and his decision in this behalf shall be final and shall not be called in question in any court of law.

The Central Government is empowered to notify classes of assessees in respect of whom disclosure of information would not be made.

Section 280 provides for the punishment of any public servant who makes any unauthorised disclosure of information. This is a necessary safeguard.

Immunity from Prosecution

Section 291 empowers the Central Government to grant immunity from penal proceedings or prosecutions to those persons who have abetted offences but have come forward to give evidence against the assessee.

Under this section, the Central Government may, if it is of opinion (the reasons for such opinion being recorded in writing) that with a view to obtaining the evidence of any person, who appears to have abetted concealment of income, tender to such person immunity from prosecution for any offence under the Income-Tax Act or under the Indian Penal Code or under any other Central Act and also from imposition of any penalty under the Income-Tax Act on condition of his making a full and true disclosure of the whole circumstances relating to the concealment of income.

If it appears to the Central Government that any person to whom immunity has been tendered has not complied with the condition on which the tender was made or is wilfully concealing anything or is giving false evidence, the Central Government may record a finding to that effect, and thereupon the immunity shall be deemed to have been withdrawn.

Bar of Suits in Civil Courts

Under section 293, no suit can be brought in any civil court to set aside or modify any assessment order made under the Income-Tax Act, and no prosecution suit, or other proceeding shall lie against the Government or any Officer of the Government for anything in good faith done or intended to be done under the Act.

CHAPTER 16

Procedure for Assessment

The law to be applied in income-tax matters is the law in force in the assessment year unless it is otherwise stated or implied. Consequently, where a law is passed after expiry of the accounting period but during the assessment year, the law applicable to assessment of income earned during the accounting period is the law in force during the assessment year and not the law in force during the accounting period (*51 ITR 129*).

Return of Income

(1) **Voluntary Return.** Under section 139(1), every person, if his total income (or the total income of any other person in respect of which he is assessable) for the previous year exceeded the maximum not-taxable limit, must voluntarily furnish to the Income-Tax Officer a return of his income for the previous year in the prescribed form and verified in the prescribed manner. The time allowed for the submission of the return of income is as follows :

(*a*) In the case of every person whose total income includes any income from business or profession, the return of income must be filed before the expiry of four months from the end of the previous year (or the previous year which expired last) or the 30th June of the assessment year, *whichever is later*.

(*b*) In the case of every other person, the return of income must be filed before the 30th June of the assessment year.

However, on an application made in the prescribed manner, the Income-Tax Officer may in his discretion extend the date for furnishing the return ; but notwithstanding that the date is so extended interest shall be chargeable as explained below.

Exception. According to section 139(1A), it is not necessary for a person to furnish a voluntary return of his income or the income of any other person in respect of whose total income he is assessable, if his total income (or the total income of such other person) consists only of income chargeable under the head "Salaries" or of income chargeable under that head and also income of the nature referred to in section 80L(1).

The requirement of furnishing a voluntary return will be waived only if the following conditions are satisfied :

(*a*) If the person concerned was employed by a company at any time during the previous year, he was not a director of the company or a person having a substantial interest in the company.

(*b*) The salary of the person (exclusive of the value of all benefits or amenities not provided for by way of monetary payment) did not exceed Rs. 18,000.

(*c*) The income (if any) of the person of the nature referred to in section 80L (1) did not exceed Rs. 3,000 in the aggregate.

(*d*) The tax deductible at source from the income chargeable under the head "Salaries" had been deducted.

Consequences of Default. These are explained in a subsequent chapter dealing with penalties and prosecutions.

Illustration

(*a*) A firm of cloth merchants closed its accounts on 15th March 1975. It must file its return of income before 15th July 1975.

(*b*) The accounting year of a company engaged in the manufacture of shoes ended on 31st December 1974. It must file its return of income before 30th June 1975.

(*c*) The previous year of a bookseller ended on 30th June 1974. He must file his return of income before 30th June 1975.

(*d*) The previous year of a college professor ended on 31st March 1975. He must file his return of income before 30th June 1975.

(2) Notice by Income-Tax Officer. Under section 139(2), in the case of any person who, in the Income-Tax Officer's opinion, is assessable under the Income-Tax Act, whether on his own total income or on the total income of any other person during the previous year, the Income-Tax Officer may, before the end of the relevant assessment year, serve a notice upon him requiring him to furnish, within 30 days from the date of service of the notice, a return of his income or the income of such other person during the previous year, in the prescribed form and verified in the prescribed manner.

A return can be demanded by the Income-Tax Officer under section 139(2), even before the time allowed for filing a return under section 139(1) has expired (*69 ITR 842*).

However, on an application made in the prescribed manner, the Income-Tax Officer may in his discretion extend the date for furnishing the return ; but notwithstanding that the date for furnishing the return has been extended interest shall be chargeable as explained below.

Consequences of Default. If a person fails to furnish his return of income in response to a notice issued by the Income-Tax Officer under section 139(2), the consequences of his failure are as follows :

(*a*) He is liable to penalty and prosecution as explained in a subsequent chapter dealing with penalties and prosecutions.

(*b*) A best judgment assessment will be made on him under section 144.

(*c*) The registration of a firm may be refused under section 185(5).

(*d*) The registration of a firm may be cancelled under section 186(2).

An assessment may be made upon a return filed under section 139(1), because a notice under section 139(2) is not a condition precedent to assessment in every case. But no assessment can be made on a person who fails to make a voluntary return and on whom an individual notice under section 139(2) has not been served. It is only when a person fails to make a return in response to such a notice that a best judgment assessment may be made on the ground of default in filing a return. Even the penalty under section 271(1) for non-compliance with section 139(1) can be imposed only after a notice under section 139(2) is served, assessment is made and the tax payable determined, because the penalty is calculated by reference to the tax payable, and the tax payable cannot be determined till the assessment is made, and the assessment cannot be made till an individual notice is served. Thus, a notice under section 139(2) is a condition precedent to the making of any assessment in case of non-compliance with section 139(1).

3. Return of Loss. Section 139(3) provides that any assessee who has not been served with a notice under section 139(2) and who intends to carry forward and set off a business loss or a loss under the head "Capital Gains", must file a return within the time allowed under section 139(1) or within such further time which, on an application made in the prescribed manner, the Income-Tax Officer may in his discretion allow. If the return is not so filed the assessee would not be entitled to carry forward the loss.

Thus, three types of assessees have to file a return, namely : (*a*) those whose total income exceeds the maximum amount not chargeable to tax ; (*b*) those who are served with a notice under section 139(2) whether they have any assessable income or not ; and (*c*) those who desire to carry forward a loss.

Belated Return. According to section 139(4), any person who has not furnished a return within the time allowed to him under section 139(1) or 139(2), may, before the assessment is made, furnish the return for any previous year within the prescribed period.

The prescribed period is *four* years for any assessment year commencing on or before 1st April 1967, *three* years for the assessment year 1968-69 and *two* years for any subsequent assessment year.

Revised Return. Under section 139(5), if any person having furnished a return discovers any omission or wrong statement therein, he may furnish a revised return at any time before the assessment is made. The offence of filing a deliberately false return, which is punishable under section 277, is not condoned by the filing of a revised return, and a penalty may be imposed under section 271 in respect of the previous false return notwithstanding the filing of the revised return.

However, it is not correct to state that the filing of the second return is of no consequence at all while considering the liability of the assessee for penalty. All the facts and circumstances commencing with the filing of the original return and ending with the assessment may be taken as relevant for considering the assessee's liability for penalty (*77 ITR 276*).

Signing of Return. Under section 140, the return of income (or return of loss) must be signed and verified as follows :

(*a*) In the case of an individual, (*i*) by the individual himself, (*ii*) where the individual is absent from India, by the individual concerned or by some person authorised by him in this behalf, and (*iii*) where the individual is mentally incapacitated from attending to his affairs, by guardian or by any other person to act on his behalf.

(*b*) In the case of a Hindu undivided family, by the karta, and where the karta is absent from India or is mentally incapacitated from attending to his affairs, by any other adult member of such family. Where there is no major male member in a Hindu undivided family, a return may be filed on behalf of the family by the eldest adult minor male member who manages the family affairs (*45 ITR 577*). In income-tax law there is a distinction between the words "adult" and "major." An adult person is one who has attained discretion and who can control and manage the affairs of (say) a Hindu undivided family, even though he may not have attained the age of majority.

(*c*) In the case of a company or a local authority, by the principal officer thereof.

(*d*) In the case of a firm by any partner thereof, not being a minor.

(*e*) In the case of any other association, by any member of the association or the principal officer thereof.

(*f*) In the case of any other person, by that person or some person competent to act on his behalf.

Interest Chargeable.

Under section 139(8), where the return for an assessment year is furnished after the due date or is not furnished, then whether or not the Income-Tax Officer has extended the date for furnishing the return, the assessee is liable to pay simple interest at 12% per annum, reckoned from the day immediately following the due date to the date of furnishing the return or, where no return has been furnished to the date of completion of the assessment under section 144, on the amount of the tax payable on the total income as determined on regular assessment as reduced by any advance tax paid and any tax deducted at source.

In the case of a registered firm or an unregistered firm assessed in the manner of a registered firm under section 183(b), the tax payable will, for the purpose of this provision, be calculated as if the firm were an unregistered firm.

The Income-Tax Officer has the power to reduce or waive the interest payable by any person for delay in or failure to furnish the return of income in such cases and under such circumstances as may be prescribed.

Where as a result of an order of rectification or an order on appeal, reference or revision, the amount of tax on which interest was payable has been reduced, the interest shall be reduced accordingly, and the excess interest paid shall be refunded.

Illustration

In the following cases, calculate the amount of interest chargeable from the assessees :

(*a*) A firm of cloth merchants, whose accounting year ended on 15th March 1975, filed its return of income on 15th September 1975. Its assessment for 1975-76 was completed on 1st October 1975 and the amount of tax payable was found to be Rs. 20,000.

(*b*) The accounting year of a company engaged in the manufacture of shoes ended on 31st December 1974. It was granted an extension of one month for the filing of its return of income. The return was filed on 25th July 1975. Its assessment for 1975-76 completed on 1st September 1975 resulted in a demand of Rs. 40,000.

(*c*) The previous year of a practising chartered accountant ended on 30th June 1974. He did not file any return of income for the assessment year 1975-76. His ex-parte assessment was completed on 1st September 1975 and the amount of income-tax payable was assessed at Rs. 12,000.

(*d*) A college professor, whose previous year ended on 31st March 1975, filed his return of income on 1st August 1975. On completion of assessment for 1975-76 income-tax of Rs. 5,000 was found to be payable.

(*a*) The due date for the filing of return of income is 15th July 1975. There is a delay of two months. Interest at 12% p. a. on Rs. 20,000 for two months is Rs. 400.

(*b*) The due date for the filing of return of income is 30th June 1975 but the return was filed on 25th July 1975. Therefore interest is chargeable at 12% p. a. on Rs. 40,000 for 24 days and it comes to Rs. 320.

(*c*) The due date for the filing of return of income is 30th June 1975 ; but no return has been filed. Therefore interest is chargeable on Rs. 12,000 at 12% p. a. for two months (July and August 1975). The interest chargeable comes to Rs. 240.

(*d*) The due date for the filing of return of income is 30th June 1975 and there is a delay of one month. Therefore interest on Rs. 5,000 at 12% p. a. for one month will be charged and it comes to Rs. 50.

Commencement of Assessment Proceedings.

The assessment proceedings under the Income-Tax Act commence when a voluntary return is filed under section 139(1) or an individual notice under section 139(2) is served.

Self-assessment

Under section 140A, where a return has been furnished under section 139 and the tax payable on the basis of such return as reduced by any tax already paid exceeds Rs. 500, the assessee shall pay the tax so payable within 30 days of furnishing the return.

After a regular assessment under section 143 or 144 has been made any tax paid on self-assessment shall be deemed to have been paid towards such regular assessment.

Where a regular assessment has not been made before the expiry of 30 days above referred to, the assessee is liable to a penalty in case of failure to pay the tax on self-assessment within the time allowed. Before levying the penalty, the Income-Tax Officer is required to give the assessee a reasonable opportunity of being heard. In a case of continuing failure to pay the tax on self-assessment, such penalty may be levied from time to time, but the aggregate amount of penalty leviable is limited to 50 per cent of the tax which was due on self-assessment and has not been paid.

Provisional Assessment for Refund

Section 141 which provided for provisional assessment for demanding tax has been deleted. Section 141A deals with provisional assessment for purposes of refund.

Where an assessee claims that the advance tax paid by him and the tax deducted at source from any part of his income exceeds the tax payable by him, section 141A enables the Income-Tax Officer to make a provisional assessment after making the following adjustments to the income or loss declared in the return :

(*a*) rectifying any arithmetical error in the return and the accompanying accounts and documents ;

(*b*) allowing any deduction, allowance or relief which on the basis of the information available in the return, accounts and documents is *prima facie* admissible but has not been claimed in the return ; and

(*c*) disallowing any deduction, allowance or relief claimed in the return but which on the basis of the information available in the return, accounts and documents is *prima facie* inadmissible.

In making such provisional assessment, the Income-Tax Officer may also refer to the past assessment, records of the assessee *only* for giving effect to deductions on account of unabsorbed depreciation, unabsorbed development rebate etc. or to give effect to losses brought forward from the earlier years and not for any other purposes.

Where the regular assessment has been delayed for a period of six months from the date of receipt of the return of income, the Income-Tax Officer *shall* make a provisional assessment and grant the refund due to the tax-payer.

Regular Assessment

An assessment made under section 143 or 144 is known as a regular assessment which may be :

(*a*) an assessment on the basis of return ;

(*b*) an assessment on the basis of evidence produced ; or

(*c*) a best judgment assessment.

The circumstances in which each kind of regular assessment may be made are discussed below :

Inquiry before Assessment.

Under section 142(1) for the purpose of making an assessment, the Income-Tax Officer may serve on any person who has made a return under section 139(1) or upon whom a notice has been served under section 139(2) whether a return has been made or not—a notice requiring him, on a date specified therein :

(*a*) to produce, or cause to be produced, such accounts or documents as the Income-Tax Officer may require ; or

(*b*) 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 the Income-Tax Officer may require.

The Income-Tax Officer cannot require an assessee to produce any accounts relating to a period more than three years prior to the previous year, the income of which is being assessed. When, therefore, the Income-Tax Officer is assessing or reassessing the income of a past previous year, the period of three years is to be counted from that previous year. However, this limitation applies only to books of account ; it does not apply to documents. No limitation is placed upon the powers of the Income-Tax Officer to call for documents of any date.

Though under section 142(1) the Income-Tax Officer cannot call for accounts relating to a period earlier than three years prior to the relevant accounting year, it has been held that when inquiring into the truth or otherwise of the statements made by the assessee in his return the Income-Tax Officer may, in exercise of his power under sections 143(3) and 131, call for accounts of a period more than three years prior to the accounting year. In such a case if the accounts relating to a period prior to three years before the accounting year are not produced that would not be a ground for making a best judgment assessment under section 144 but would justify an adverse inference to be drawn against the assessee (*45 ITR 198*).

The Income-Tax Officer must obtain the previous approval of the Inspecting Assistant Commissioner before requiring the assessee to furnish a statement of all assets and liabilities not included in the accounts. This statement is usually called for once in three or four years from all big assessees and also in cases where large concealments are being investigated. The statement gives particulars of all investments and assets owned by the assessee whether shown in the accounts or not. By calculating the growth of net assets (*i. e.*, assets minus liabilities) between two points of time, the Income-Tax Officer can form an estimate of actual income (after allowing for capital receipts, personal and other expenditure etc.) There might also be certain assets the income from which has not been correctly returned.

Under section 142(2), for the purpose of obtaining full information in respect of the Income or loss of any person, the Income-Tax Officer may make such inquiry as he considers necessary ; and under section 142(3) the assessee shall, except where a best judgment assessment is made under section 144, be given an opportunity of being heard in respect of any material gathered and proposed to be utilised for the purpose of the assessment.

Assessment on the Basis of Return
or
Summary Assessment

Under section 143(1), where a return has been made under section 139 the Income-Tax Officer may, without requiring the presence of the assessee or the production by him of any evidence in support of the return, make an assessment of the total income or loss of the assessee after making the following adjustments to the income or loss declared in the return :

(*a*) rectification of any arithmetical errors in the return and the accompanying accounts and documents ;

(*b*) allowance of any deduction, allowance of relief which on the basis of the information available in the return, accounts and documents is *prima facie* admissible but has not been claimed in the return ; and

(*c*) disallowance of any deduction, allowance or relief claimed in the return but which on the basis of the information available in the return, accounts and documents is *prima facie* inadmissible.

In making such assessment the Income-Tax Officer may also refer to the past assessment records of the assessee *only* for the purpose of giving effect to deductions on account of unabsorbed depreciation, unabsorbed development rebate etc , or to give effect to losses brought forward from the earlier years but not for any other purpose.

The Income-Tax Officer will then determine the sum payable by the assessee or refundable to him on the basis of such assessment.

Assessment on the Basis of Evidence

Evidence is proof, either written or verbal, of facts in issue between parties. It means and includes :

(*a*) All statements which the court permits or requires to be made before it by a witness, in relation to matters of facts under inquiry. Such statements are called oral evidence.

(*b*) All documents produced for the inspection of the court. Such documents are called documentary evidence.

In income-tax proceedings both oral and documentary evidence is used. Since on many points in dispute direct or positive evidence is not available, circumstantial evidence plays an important part in income-tax matters.

Notice Under Section 143(2). In the following cases the Income-Tax Officer shall serve on the assessee a notice requiring him, on a date specified therein, either to attend at the Income-Tax Officer's office or to produce or to cause to be there produced any evidence on which the assessee may rely in support of the return :

(*a*) Where an assessment has been made under section 143(1) and the assessee makes within one month from the date of service of the notice of demand an application to the Income-Tax Officer objecting to the assessment ; or

(*b*) Where the Income-Tax Officer considers it necessary or expedient to verify the correctness or completeness of the return by requiring the presence of the assessee or the production of evidence in this behalf, whether or not an assessment has been made under section 143 (1).

In a case where an assessment has been made under section 143(1), the notice under section 143(2) (except where such notice is in pursuance of an

application by the assessee) shall not be issued by the Income-Tax Officer without the previous approval of the Inspecting Assistant Commissioner.

In a case where the assessment made under section 143(1) is objected to by the assessee, the assessee shall not be deemed to be in default in respect of the tax demanded which is disputed by the assessee and further no interest shall be chargeable under section 220 (2) in respect of such disputed amount.

Assessment under section 143(3). On the day specified in the notice the Income-Tax Officer, after hearing such evidence as the assessee may produce (either personally or through an authorised representative) and such other evidence as the Income-Tax Officer may require on specified points and after taking into account all relevant material which the Income-Tax Officer has gathered, shall proceed as follows :

(*a*) In a case where no assessment has been made under section 143(1) he shall by an order in writing make an assessment of the total income or loss of the assessee, and determine the sum payable by the assessee or refundable to him on the basis of such assessment. This is the '*first*' regular assessment under section 143(3).

(*b*) In a case where an assessment has been made under section 143(1), if such assessment has been objected to by the assessed or if the Income-Tax Officer is of opinion that such assessment is incorrect, inadequate or incomplete in any material respect, he shall by an order in writing make a fresh assessment of the total income or loss of the assessee and determine the sum payable by him or refundable to him on the basis of such assessment. This is a '*fresh*' regular assessment under section 143(3).

Where an Income-Tax Officer fixes the gross profit at a flat rate when making an assessment under section 143(3) relying, on the gross profits disclosed by cases which he considers to be comparable to that of the assessee, without furnishing to the assessee details of the cases which the Income-Tax Officer considers as comparable, it has been held that the Income-Tax Officer has acted in violation of the provisions of section 142(3) and the assessment made under section 143(3) is illegal (*68 ITR 796*).

Notice Under Section 142 (1) and 143(2). The difference between the provisions of these two sections is as follows :

(*a*) While section 142(1) empowers the Income-Tax Officer to issue a notice requiring the assessee to produce such accounts, documents or information as the Income-Tax Officer may require, section 143(2) empowers him to issue a notice requiring the assessee to attend at the Income-Tax Officer's office or to produce any evidence on which the assessee may rely in support of his return.

(*b*) The notice under section 142(1) may be issued even before the return is filed, but the notice under section 143(2) can be issued only after the return is filed.

(*c*) Under section 143(2), the assessees *may* produce such evidence as he pleases or *may* elect not to produce any evidence at all ; but under section 142 (1) the assessee *must* produce the accounts and documents required by the Income-Tax Officer and wilful failure to produce the same would be punishable under sections 271(1)(b) and 276(c) and would entail a best judgment assessment under section 144. When the assessee refuses or fails to comply with the notice under section 142(1), the Income-Tax Officer has a right to enter the assessee's business premises to examine the accounts under section 132(1)(i).

If the assessee has failed to produce evidence on which the Income-Tax Officer can make a proper assessment of the income, the Income-Tax Officer must himself take steps to procure material for the purposes from other sources. Under section 131, the Income-Tax Officer may examine witnesses on oath, compel the production of documents, and issue commissions for the examination of witnesses. He may interrogate tradesmen in the same line as the assessee, experts, past employees acquainted either with the business of the assessee or that class of business in the neighbourhood.

The Income-Tax Officer is not debarred from relying on private sources for information, which sources he may not disclose to the assessee at all. But in case he proposes to use against the assessee the result of any private inquiry made by him, he should communicate to the assessee the substance of such information in order to put the assessee in possession of full particulars of the case he is expected to meet and should further give him sufficient opportunity to meet it. This principle is now established by the judgment of the Supreme Court in *Dhakeswari Cotton Mills Ltd. v C. I. T.* (*26 ITR 775*) where an assessment based on the results of private inquiries conducted behind the back of the assessee was set aside.

Onus of Proof. When a person is bound to prove the existence of any fact, it is said that the burden or onus of proof lies on that person. The general rule of evidence, as enunciated in section 101 of the Indian Evidence Act, is that the burden of proof lies on the person who substantially asserts the affirmative and not upon the party who denies it. In Income-Tax proceedings the burden of proof goes on shifting from the assessee to the Department and *vice versa*, according to the issues involved and according to the progress of the case, and it can best be illustrated by examples.

The burden of proof in the following cases lies on the assessee :

(*a*) That a particular income is exempt from tax under one or the other section of the Income-Tax Act.
(*b*) That he is entitled to an allowance claimed.
(*c*) That a partnership agreement is genuine.
(*d*) That the control and management of a Hindu undivided family is wholly outside India.
(*e*) The nature and source of a cash credit found in the books of the assessee.
(*f*) The nature and source of any investments recorded in the books of assessee.

In the following cases, on the other hand, the burden of proof lies on the Department :

(*a*) That the penal provisions of the income-tax law are attracted.
(*b*) That a particular income is liable to tax.
(*c*) That there has been a change in the method of accounting employed by the assessee.
(*d*) That income has escaped assessment.
(*e*) That a transaction is a benami transaction.

Fresh Hearing. Under section 129, when an income-tax authority ceases to have jurisdiction and is succeeded by another before the completion of any proceeding, the successor may continue the proceeding from the stage at which the proceeding was left by his predecessor. But the assessee has a right to demand that, before the proceeding is so continued, the previous proceeding or any part thereof be reopened or that before any order for assessment is passed against him, he be re-heard.

Best Judgment Assessment

A best judgment assessment is an assessment made by the Income-Tax Officer to the best of his judgment against a person who is in default as regards supplying information.

The Income-Tax Officer should not be influenced by a desire to punish the assessee for the default he has committed however culpable such default might be. A best judgment assessment must be made upon inadequate material but it does not mean that the Income-Tax Officer can make the assessment capriciously or without regard to any available material at all. The assessment must be to the best of his judgment ; and the word 'judgment' itself implies consideration of something ; here it must be consideration of the facts relating to the income of the assessee and of the material which is available to him.

While making a best judgment assessment, the Income-Tax Officer is not entitled to make a pure guess without any evidence or any material at all. There must be something more than bare suspicion to support an assessment. In *Dhirajlal Girdharilal v. C. I. T.* (*26 ITR 136*), the Supreme Court set aside the assessment on the ground that it was based on bare suspicion, conjectures and surmises.

Compulsory Best Judgment Assessment.

Under section 144, the Income-Tax Officer is bound to make a best judgment assessment in any of the following three cases namely :

(*a*) Where the assessee has failed to make the return required by a notice under section 139(2) and has not made a return under section 139(4) or a revised return section 139(5).

(*b*) Where there has been a failure to comply with the terms of a notice issued under section 142(1) requiring the assessee to produce accounts or other documents or information specified therein.

(*c*) Where the return has been made, but the Income-Tax Officer considers it to be incorrect or incomplete and serves a notice under section 143(2), upon the assessee requiring his appearance or the production by him of evidence in support of his return, but the assessee does not comply with the terms of the notice.

Consequences of Best Judgment Assessment. Where such an assessment has been made, the consequences are :

(*a*) The assessee is liable to penalties under section 271.

(*b*) The assessee is liable to prosecution under section 276 if the default was failure to file his return required by a notice under section 139(2) or to comply with the notice under section 142(1).

(*c*) If the assessee is a firm, registration is liable to be refused or may be cancelled if the firm is already registered.

(*d*) If the assessee is a company in which the public are not substantially interested, it would lose the further opportunity that may in certain circumstances be available for distribution of further dividend in order to escape the additional income-tax.

(*e*) In an appeal against the quantum of assessment the assessee cannot bring on record any new facts before the appellate authorities.

Cancellation of Best Judgment Assessment. Section 146 enables the assessee to apply to the Income-Tax Officer to cancel the best judgment assessment and to make a fresh assessment ; but the cancellation can only be on any of the following grounds, namely :

(*a*) That the assessee was prevented by sufficient cause from making the return required under section 139(2) ; or

(*b*) That he did not receive the notice issued under section 142(1) or section 143(2) ; or

(*c*) That he had not a reasonable opportunity to comply, or was prevented by sufficient cause from complying with the terms of the notice issued under section 142(1) or 143(2).

The application under this section must be made within *one* month from the service of the notice of demand.

It is for the assessee to show cause and for the Income-Tax Officer to be satisfied that the cause shown is a sufficient one. If the Income-Tax Officer is so satisfied, he must cancel the assessment made under section 144 and proceed to make a fresh assessment in accordance with the provisions of section 143 or section 144.

A valid fresh assessment cannot be made under this section if the original assessment which is cancelled was itself time-barred and consequently incompetent (*39 ITR 137*).

Appeal. The assessee may appeal against the best judgment assessment to the Appellate Assistant Commissioner. He may further appeal to the Appellate Tribunal against the order of the Appellate Assistant Commissioner, and he may finally come to the High Court on a reference for determination of any question of law.

Discretionary Best Judgment Assessment.

In the following circumstances, section 145(2) confers on the Income-Tax Officer a discretionary power to make a best judgment assessment under section 144 or an ordinary Assessment under section 143(3) :

(*a*) where the assessee's accounts are incorrect or incomplete ; or

(*b*) where no method of accounting has been regularly employed by the assessee.

In these two cases, even if the Income-Tax Officer does make a best judgment assessment, he has no power on that account to refuse to register the firm or cancel its registration.

Where the best judgment assessment is made because the accounts are incorrect or incomplete or because no method of accounting has been regularly employed by the assessee, no application can be made under section 146 for the cancellation of the best judgment assessment but an objection to the correctness or validity of such an assessment can be raised in an appeal against the assessment.

Difference between an Assessment Under Section 143(3) and that Under Section 144. The difference between these two kinds of assessment is as follows :

(1) In making an assessment under section 143(3) the Income-Tax Officer has to assess to the best of his judgment on the evidence before him ; while under section 144 he has often to assess to the best of his judgment without any such evidence.

(2) The assessee on whom an assessment is made under section 143(3) has no right to apply to the Income-Tax Officer for the cancellation of the assessment ; he can only file an appeal to the Appellate Assistant Commissioner against such assessment. An assessee on whom a best judgment assessment has been made under section 144 can apply to the Income-Tax Officer to cancel the best judgment assessment and to make a fresh assessment, and he has also a right of appeal to the Appellate Assistant Commissioner against (*i*) the Income-Tax Officer's refusal to cancel the best judgment assessment, and (*ii*) the best judgment assessment itself.

Assessment of Escaped Income

The normal procedure for assessment is that an assessee submits a return of income of the Income-Tax Officer and places his accounts and other evidence before him, and the Income-Tax Officer, after examining the accounts and evidence, comes to a finding and makes the assessment. This must result in the correct amount of tax being found payable by the assessee. There is, however, the erring human element on both sides. There is the likelihood of concealment of income and faking of accounts and evidence by the assessee resulting in a smaller assessment and there is also the likelihood of an excessive assessment being imposed by the Income-Tax Officer.

The assessee has his remedies against the arbitrary or incorrect findings of the Income-Tax Officer, and it is only fair that the Revenue should have powers to impose additional assessments when there has been an escapement or an under-assessment of income.

Section 147 gives power to the Income-Tax Officer to assess income which escaped assessment or was under-assessed in a past assessment year (referred to as the relevant assessment year) and also to revise the loss or depreciation allowance computed by him in excess of the proper amount. This additional or supplementary assessment may be made in two circumstances, namely :

(1) Under section 147(a), where the Income-Tax Officer has *reason to believe* that, owing to the assessee's omission or failure to make a return for any assessment year or to disclose full particulars of his income, the income has wholly or partially escaped assessment for that year.

(2) Under section 147(b), notwithstanding that there has been no default on the part of the assessee, where the Income-Tax Officer has *reason to believe*, in the consequence of information in this possession, that income has escaped assessment for any assessment year.

For the above purpose, the following are also deemed to be cases where income has escaped assessment :

(*a*) where income chargeable to tax has been under-assessed ; or

(*b*) where such income has been assessed at too low a rate ; or

(*c*) where such income has been made the subject of excessive relief ; or

(*d*) where excessive loss or depreciation allowance has been computed.

It is provided that the production before the Income-Tax Officer of account books or other evidence from which material evidence could with due diligence have been discovered by the Income-Tax Officer will not necessarily amount to disclosure of all material facts necessary for the assessment. This means that if income escapes assessment as a result of the Income-Tax Officer's inadvertence or negligence or failure to examine properly the account books produced by the assessee, the Income-Tax Officer would be justified in making a reassessment in a subsequent year.

The fact that an assessment has become final in appeal would not preclude the Income-Tax Officer from exercising his powers under this section. Reassessment proceedings may be taken more than once under this section in respect of the same assessee for the same assessment year.

A person cannot be said to have omitted or failed to disclose something if he had no knowledge of such thing. The words "omission or failure to disclose fully and truly all material facts" therefore cover only the cases where the assessee, knowing all the material facts, does not mention them fully and truly.

All that section 147(a) requires is that Income-Tax Officer should have reason to believe that as a result of the assessee's failure to make a return or to disclose the full particulars of his income, the income, has escaped assessment, and section 147(b) also requires that the Income-Tax Officer should have reason to believe, in consequence of information in his possession, that income has escaped assessment. The words "if the Income-Tax Officer has reason to believe" suggest that the belief must be that of an honest and reasonable person based upon reasonable grounds, and that the Income-Tax Officer may act under this section on direct or circumstantial evidence but not on mere suspicion, gossip or rumour.

Two conditions must be satisfied before the Income-Tax Officer can take action under section 147(b). These conditions are (*i*) he should receive the information after the original assessment, and (*ii*) the information should lead him to the belief that income has escaped assessment. He cannot take any action under this section merely because he happens to change his opinion or to hold an opinion different from that of his predecessor on the same set of facts.

Information for the purposes of this section need not be wholly extraneous to the record of the original assessment. A mistake apparent on the face of the order of assessment would itself constitute 'information,' whether someone else gave that information to the Income-Tax Officer or whether he informed himself (*41 ITR 547*).

If a firm had escaped assessment in the relevant assessment year, proceedings may be taken against it under this section, even if the firm stands dissolved at the time of the issue of the notice as provided in section 189.

After a Hindu undivided family has disrupted and an order recording partition has been passed under section 171(3), if any portion of the family's income earned prior to partition is found to have escaped assessment, reassessment may be made on the family under this section. In such a case, it is not necessary to issue the notice to every member of the family ; it is sufficient if the notice is addressed to the Hindu undivided family and served on the quondam karta.

An assessment may be made on the representative of a deceased assessee under this section in respect of the income of the deceased which had escaped assessment.

Appeal. An appeal lies against an assessment, or a reassessment made under section 147.

Procedure for Reopening Assessments.

Section 148 provides that, before making the assessment, reassessment or recomputation under section 147, the Income-Tax Officer must serve on the assessee a notice containing all or any of the requirements which may be included in a notice under section 139(2). Where an assessment starts with a notice under section 148, all the relevant provisions of the Act apply as effectively as where the assessment starts with a notice under section 139(2) in the ordinary course.

The Income-Tax Officer is bound to record his reasons in every case before issuing a notice under section 148. It is on the basis of the reasons recorded by the Income-Tax Officer that the Commissioner's or the Board's prior sanction must be obtained in cases where action is taken after the lapse of four years or eight years respectively as required by section 151. Failure of the Income-Tax Officer to record his reasons and to obtain the previous sanction of the Commissioner or the Board, as the case may be, would vitiate the assessment.

The issue of a notice under section 148 is a condition precedent to the validity of any proceedings under section 147. Therefore, if no such notice is issued, the assessment would be bad.

Time-limit for Notice. Section 149 provides four periods of limitation from the end of the relevant assessment year within which a notice under section 148 should de issued. These are :

(*a*) 8 years in cases falling under section 147(a)—cases of failure to file a return or of concealment, where the escaped income is likely to amount to less than Rs. 50,000 for that year.

(*b*) 16 years in cases falling under section 147(a)—cases of failure to file a return or of concealment, where the escaped income is likely to amount to at least Rs. 50,000 for that year.

(*c*) 4 years in cases falling under section 147(b)—cases where there is no failure to file a return and no concealment.

(*d*) 2 years where the assessee is sought to be assessed as the agent of a non-resident in respect of the non-resident's income.

These time-limits do not apply to the reopening of an assessment for any year by reason of an order on appeal, revision or reference. But no appellate or revisional authority can give a direction to make an assessment or reassessment which would have been time-barred if it had been made at the time when the order impugned in appeal or revision was made.

Other Provisions. Section 152 provides that in an assessment, reassessment or recomputation made under section 147, the tax is chargeable at the rate or rates at which it would have been charged had the income not escaped assessment.

Where an assessment is reopened in circumstances falling under section 147(b), an assessee who has not gone in appeal or revision can claim that the proceedings under section 147 be dropped on his showing that he had been assessed 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.

Time-limit for Assessment and Reassessment

Section 153 prescribes the following time-limits for the completion of assessments and reassessments :

Assessment Under Section 143 or 144. In cases of concealment of income an assessment under section 143 or 144 must be completed within 8 years from the end of the relevant assessment year.

In cases where there is no concealment, the assessment may be completed within the prescribed period from the end of the relevant assessment year. The prescribed period is *four* years as regards the assessment year 1967-68 and earlier years, *three* years as regards the assessment year 1968-69 and *two* years for subsequent years.

In every case the section grants a maximum extension of one year from the date of the filing of a return or a revised return. This is because an assessee may file his return or revised return just before the expiry of the above time-limits, as he can do so before his assessment made.

Assessment or Reassessment Under Section 147. In a case of failure to file a return or concealment, an assessment or reassessment under section 147(a) must be made within four years from the end of the assessment year in which the notice under section 148 was served. In cases falling under section 147(b) the assessment or reassessment must be made within four years from the end of the assessment year in which the income was first assessable with a

maximum extension of one year from the date of service of the notice under section 148.

What is required is that the assessment must be completed within the period of limitation. It is not necessary that the order of assessment should be communicated to the assessee or the notice of demand should be served on him within that period.

Other Assessments. In relation to the assessment year 1971-72 and subsequent assessment years, the fresh assessment to be made in the following circumstances must be completed within the time noted against each :

(*a*) When an *ex-parte* assessment under section 144 has been cancelled by the Income-Tax Officer on the application of the assessee—within *two* years from the end of the financial year in which the order of cancellation was made.

(*b*) When an assessment is made as a result of an order passed in appeal by the Appellate Assistant Commissioner or the Appellate Tribunal—within *two* years from the end of the financial year in which such order was received by the Commissioner.

(*c*) When an assessment is made as a result of an order passed by the commissioner in exercise of his revisionary powers—within *two* years from the end of the financial year in which such order is passed.

Such fresh assessment may be completed within the time aforesaid even if the time-limits specified above for the completion of assessments and reassessments have expired.

Cases in which there is no Time-limit. Subject to the provisions stated above, there is no time-limit for the completion of an assessment or reassessment in the following cases :

(*a*) Where a best judgment assessment is cancelled and a fresh assessment is made under section 146.

(*b*) Where an assessment or a reassessment is made as a result of an order in appeal, revision or reference, or of an order of any court.

(*c*) Where an assessment is made on a partner in consequence of a reassessment made on the firm.

Rectification of Mistake

Under section 154, with a view of rectifying any mistake apparent from the record :

(*a*) the Income-Tax Officer may amend any order of assessment or of refund or any other order passed by him ;

(*b*) the Appellate Assistant Commissioner may amend any order passed by him in appeal or in imposing a penalty ;

(*c*) the Inspecting Assistant Commissioner may amend any order imposing a penalty passed by him ; and

(*d*) the Commissioner may amend any order passed by him in revision.

Further, the Income-Tax Officer, the Appellate Assistant Commissioner, the Inspecting Assistant Commissioner and the Commissioner may rectify any mistake in an order passed by them even where such order has been considered and decided in any proceeding by way of appeal or revision, except where the mistake relates to matters which have been so considered and decided.

The authority concerned *may* make an amendment *suo motu* for rectifying any such mistake and *shall* make such amendment when the mistake is brought to its notice by the assessee, and where the authority concerned is the Appellate Assistant Commissioner, by the Income-Tax Officer also. The Income-Tax Officer also can apply to the Appellate Assistant Commissioner for the rectification of a mistake in the Appellate Assistant Commissioner's order.

When an amendment is made under this section, an order shall be passed in writing by the income-tax authority concerned.

If the rectification of mistake reduces the assessment, a refund of any excess tax paid must be made to the assessee ; but when an assessment is enhanced or a refund reduced by the rectification. the assessee will be served with a notice of demand. Before making an order of rectification which enhances the assessment or reduces the refund, the assessee must be given an opportunity of being heard.

Save as otherwise provided in section 155, no amendment under section 154 shall be made after the expiry of *four* years from the date of the order sought to be amended.

This section does not confer on the income-tax authorities and the Tribunal a general power of review or revision or authorise any assessee to introduce any new facts in connection with the relevant assessment. An Income-Tax Officer can correct under this section mistakes made by a predecessor. The mistakes are not confined to arithmetical or clerical ones ; they include obvious mistakes of law.

According to the Supreme Court, a mistake apparent from the record must be an obvious and patent mistake and not something which can be established by a long-drawn process of reasoning on points on which there may be conceivably two opinions. A decision on a debatable point of law is not a mistake apparent from the record. It is not open to the Income-Tax Officer to go into the true scope of the provisions of law in a rectification proceeding under section 154 (*82 ITR 50*).

Rectification may be made under section 154 not only of mistake in the final order but also of a mistake in any part of the record or proceedings in the case. But it must be a mistake and the mistake must be apparent from the record. The record consists of the assessment order as well as all proceedings and materials on which the assessment is based. A clerical or arithmetical mistake would amount to a mistake apparent from the record.

The only authority which can rectify an order is the authority which passed the order and not any higher or lower authority. However, the incumbent of the office may change and the rectification may be made by the successor.

According to section 246, an order passed under section 154 or 155 by the Income-Tax Officer is appealable.

Deemed Cases of Rectification of Mistake.

Section 155 provides that in the following cases, where there is no mistake apparent from the record, the Income-Tax Officer is empowered to amend the order of assessment and his action is deemed to be a rectification of mistake.

(1) Where the share incomes of the partners of a firm have to be modified on the completion of any assessment or reassessment of the firm or on the result of an appeal, revision or reference in the firm's case. Such mistake can be rectified within four years from the date of the final order in the case of the firm.

(2) Where the share incomes of the members of an association of persons or a body of individuals have to be modified on the completion of any assessment or reassessment of the association or body or on the result of any appeal, revision or reference in the case of the association or body. Such mistake can be rectified within four years from the date of the final order in the case of the association or body.

(3) Where as a result of proceedings under section 147 the loss or depreciation allowance for an earlier assessment year is to be recomputed, the rectification of the later assessments of an assessee. Such a mistake can be rectified within four years from the date of the order passed under section 147.

(4) Where any of the conditions on which development rebate or development allowance has been granted to an assessee is infringed, the development rebate or allowance is deemed to have been wrongly allowed, and the total income of the assessee for the relevant year will be recomputed. Such a mistake can be rectified within four years from the end of the previous year in which the infringement took place.

(5) Where a bad debt is written off in the accounts of the previous year relevant to the current assessment year, but the Income-Tax Officer finds that the debt had become a bad debt in any of the *four* earlier previous years, the Income-Tax Officer can recompute the total income of the assessee for such earlier previous year after allowing the bad debt. Such a mistake can be rectified within four years from the end of the assessment year relevant to the previous year in which the debt is written off.

(6) Where in the case of a company an order under section 104 has been made for any assessment year, recomputation of the distributable income of the company in pursuance of such order. Such a mistake can be rectified within four years from the date of the order under section 104.

(7) Where in any assessment year a capital gain arising from transfer of a residential house is charged to tax and within a period of one year after the date of the transfer the assessee purchases, or within two years after that date constructs a house for his own residence, the amendment of the order of assessment so as to exclude the amount of the capital gain not chargeable to tax under section 54. Such a mistake can be rectified within four years from the date of the assessment.

(8) Where in any assessment year a capital gain arising from the transfer of agricultural land is charged to tax, and the new land is purchased by the tax-payer after the completion of the assessment but within the specified period of two years, the Income-Tax Officer will amend the order of assessment so as to exclude the amount of capital gain not chargeable to tax. Such a mistake can be rectified within four years from the date of the assessment.

(9) Where any capital gain arising from the transfer (by way of compulsory acquisition) of any land or building forming part of an industrial undertaking belonging to the assessee is charged to tax, and the assessee has, within a period of three years after the date of the transfer, purchased or construction any other land or building for the purposes of shifting the industrial undertaking or setting up another industrial undertaking, then the Income-Tax Officer shall amend the order of assessment so as to exclude the amount of capital gain not chargeable to tax under section 54D. The period of four years for the rectification of such a mistake will be reckoned from the date of the assessment.

Notice of Demand

Under section 156, where any tax, interest, penalty, fine or any other sum is payable in consequence of any order passed under the Act, the Income-Tax Officer shall serve on the assessee a notice of demand in the prescribed form specifying the sum so payable and the time within which it is to be paid.

According to section 288B, the amount of tax (including tax deductible at source or payable in advance), interest, penalty, fine or any other sum payable, and the amount of refund due shall be rounded off to the nearest rupee.

According to section 289, a receipt shall be given for any money paid or recovered under the Act.

Time for Payment of Tax. According to section 220(1), any amount (otherwise than by way of advance tax) specified as payable in a notice of demand shall be paid within 35 days of the service of the notice at the place and to the person mentioned in the notice.

But as a measure of safeguard, it is provided that the Income-Tax Officer, with the previous approval of the Inspecting Assistant Commissioner, may reduce this period in cases where it will be deterimental to revenue to allow so much time.

On an application made by the assessee before the expiry of the due date for payment ; the Income-Tax Officer is authorised to extend the time for payment or allow payment by instalments subject to payment of interest.

Consequences of Default. If the amount specified in the notice of demand is not paid within the period specified therein, the assessee will incur the following liabilities :

(1) Under section 220(2), he is liable to pay simple interest at 12% per annum from the day commencing after the end of the time specified in the notice of demand. The interest is to be calculated according to Rules 118 and 119 of the Income-Tax Rules, 1962, and is payable in addition to a penalty.

Where the tax payable by an assessee has been reduced as a result of an order of rectification or an order on appeal, reference or revision, the interest payable by the assessee shall be consequently reduced and the excess amount paid, if any, shall be refunded.

(2) Under section 221, he shall, in addition to the amount of arrears and the amount of interest payable, be liable to pay by way of penalty an amount which, in the case of continuing default, may be increased from time to time up to the amount of tax in arrears. But an assessee must be given a reasonable opportunity of being heard before a penalty can be imposed upon him.

Where the Income-Tax Officer is satisfied that the default was for good and sufficient reasons, no penalty shall be levied under this section.

When as a result of any final order on appeal, revision or reference the amount of tax, for non-payment of which the penalty was levied, has been wholly reduced, the penalty levied shall be cancelled and the amount of penalty paid shall be refunded.

(3) Recovery proceedings may be taken against him. The various modes of recovery of tax are explained in a subsequent chapter dealing with collection and recovery of tax.

Intimation of Loss

Under section 157, where, in the course of the assessment of the total income of any assessee, it is established that a loss has taken place which the assessee is entitled to have carried forward and set off against future profits, the Income-Tax Officer shall notify to the assessee by an order in writing the amount of the loss as computed by him.

Intimation of Assessment of Firm

Under section 158, whenever a registered firm is assessed or an unregistered firm is assessed under section 183(b), the Income-Tax Officer shall,

notify to the firm by an order in writing the amount of its total income and the apportionment thereof between the several partners.

Transfers to Defraud Revenue Void

Under section 281, where, during the pendency of any proceeding under the Income-Tax Act, an assessee creates a charge on or parts with the possession (by way of sale, mortgage, exchange or any other mode of transfer whatsoever) of any of his assets in favour of any other person with the intention to defraud the revenue, such charge or transfer shall be void as against any claim in respect of any tax or any other sum payable by the assessee as a result of completion of the said proceeding.

But such charges or transfer shall not be void if made for valuable consideration and without notice of the proceedings under the Act.

Property Held Benami

Under section 281A, no person will be entitled to institute any suit claiming ownership of any property held by him benami, unless (*i*) he discloses the income from the property or the property itself for purposes of income-tax and wealth-tax, or (*ii*) he gives notice of his claim to the property in the prescribed form to the Income-Tax Officer.

This section does not apply to any suit of a value not exceeding Rs. 2,000.

Acquisition of Undervalued Property

Sections 269A-269S empower the Central Government to acquire any undervalued immovable property, including agricultural land, that is transferred on or after 15th November 1972. The main provisions of these sections are :

1. A notification issued by the Central Government enables it to take over any undervalued immovable property if its fair market value exceeds the amount declared in the transfer deed by more than 15 per cent.

2. The power of acquisition will apply only in cases where the fair market value of the immovable property exceeds Rs. 25,000, and the competent authority (*i. e.*, an Assistant Commissioner of Income-Tax authorised by the Central Government for the purpose) has reason to believe that the consideration for the transfer has been understated to facilitate tax evasion by the seller or buyer of such property.

3. The competent authority can initiate proceedings in respect of any immovable property by notice to that effect published in the Official Gazette within a period of nine months from the end of the month in which the instrument of transfer is registered.

4. An appeal may be preferred to the Appellate Tribunal against the order for the acquisition of any immovable property by the transferor or the transferee within 45 days from the date of such order or 30 days from the date of service of a copy of the order, whichever period expires later.

5. Where any immovable property is acquired, the Central Government will pay compensation equal to the amount of the consideration declared in the instrument of transfer and 15% of the said amount.

6. No registering officer will register any instrument of transfer by way of sale or exchange in respect of any immovable property unless the instrument is accompanied by a prescribed statement in duplicate. However, this statement is not required if the consideration for the transfer does not exceed Rs. 10,000.

7. The registering officer shall, at the end of every fortnight, forward to the competent authority one set of the statements received by him and also

a return in the prescribed form giving particulars of documents which have been registered by him during the fortnight.

8. The above provisions shall not apply to any transfer of immovable property made by a person to his relative on account of natural love and affection for a consideration which is less than its fair market value if a recital to that effect is made in the instrument of transfer.

Service of Notice

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

Where a notice is served through a serving officer of the Income-Tax Department, the mere fact that such officer does not find the party to be served with the notice at his address is not sufficient to establish that he cannot be found. It must be shown not only that the serving officer went to the place at a reasonable time when he would be expected to be present, but also that if he was not found, proper and reasonable attempts were made to find him either at that address or elsewhere. If after such reasonable attempts the position still is that the party is not found, then and then only can it be said that he cannot be found. Where the officer who had to serve a notice on an assessee went to his address but found that he had gone out, offered the notice to a person who was pointed out as the assessee's son, and on the latter's refusal to accept it affixed the notice to the premises, the service was not a good service (*37 ITR 493*). Mere temporary absence of the party to be served with a notice does not justify the serving officer's affixing a copy of the notice on the door of the party's house.

Any such notice or requisition may be addressed :

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

(*b*) in the case of local authority or company, to the principal officer thereof ;

(*c*) in the case of any other association or body of individuals, to the principal officer or any member thereof ; and

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

Under section 283, after a finding of total partition has been recorded by the Income-Tax Officer under section 171 in respect of any Hindu family, notice in respect of the income of the Hindu family shall be served on the person who was the last manager of the family, and if such person is dead, then on all adults who were members of the Hindu family immediately before the partition.

Where a firm or other association of persons is dissolved, notice in respect of the income of the firm or association may be served on any person who was a partner (not being a minor) of the firm or member of the association immediately before its dissolution.

Information at Source

Under section 285, every person responsible for paying any interest (not being interest on securities) must furnish to the Income-Tax Officer before 15th June each year a return showing the names and addresses of those persons to whom interest exceeding the prescribed amount (not being less than Rs. 400) was paid during the previous financial year, together with the amount paid to each such person.

Under section 285A, persons securing contracts of a value exceeding Rs. 50,000 for the construction of a building or the supply of goods of services in connection therewith, are required to furnish relevant information relating to such contracts to the Income-Tax Officer concerned, within one month of making the contract, failing which they will be liable to imposition of a fine by the Commissioner not exceeding Rs. 50 for each day of default, subject to the ceiling of 25% of the value of the contract. The particulars to be furnished by such persons are prescribed by rules made by the Board.

Under section 286, the principal officer of every company, which is an Indian company or which had made prescribed arrangements for the declaration and payment of dividends within India, must file with the Income-Tax Officer before 15th June each year a return giving the names and addresses of those shareholders to whom a dividend exceeding the prescribed amount was distributed during the preceding year and the amount distributed to each shareholder.

Appearance by Authorised Representative

According to section 288, any assessee who is entitled or required to attend before any income-tax authority or the Appellate Tribunal in connection with any Income-Tax proceedings may attend by an authorised representative except when he is required under section 131 to attend personally for examination on oath or affirmation.

For this purpose, an "authorised representative" means a person authorised by the assessee in writing to appear on his behalf, being :

(*a*) a person related to the assessee in any manner or, a person regularly employed by the assessee ; or

(*b*) any officer of a Scheduled Bank with which the assessee maintains a current account and has other regular dealings ; or

(*c*) any legal practitioner who is entitled to practise in any civil court in India ; or

(*d*) any chartered accountant or certified auditor ; or

(*e*) any person who has passed any accountancy examination recognised in this behalf by the Board ; or

(*f*) any person who has acquired such educational qualification as the board may prescribe for this purpose ; or

(*g*) any other person who immediately before 1st April 1962, was an income-tax practitioner and was actually practising as such.

As regards (*e*), the accountancy examination recognised by the Board is the National Diploma in Commerce awarded by the All-India Council for Technical Education, provided the diploma-holder has taken Advanced Accountancy and Auditing as an elective subject.

As regards (*f*) the educational qualifications prescribed by the Board are a degree in Commerce or Law conferred by a university incorporated by law in India or in Pakistan or by certain foreign universities.

If the authorised representative is a person formerly employed as an income-tax authority, not below the rank of an Income-Tax Officer, and has retired or resigned from such employment, after having served for not less than three years in any capacity, he shall not be entitled to represent any assessee for a period of *two* years from the date of his retirement or resignation.

Disqualifications. Besides the ban on the retired officers of the Income-Tax Department, the following persons are not qualified to represent an assessee :

(1) A person dismissed or removed from Government service after 1st April 1938 is debarred for all times.

(2) A person, who has been convicted of an offence connected with any income-tax proceeding or on whom a penalty has been imposed under the Income-Tax Act, is debarred for such time as the Commissioner may order. However, penalties imposed under items (*i*) and (*ii*) of section 271(1) do not lead to disqualification as these penalties are for comparatively minor offences.

(3) A person, who becomes an insolvent, is debarred for the period during which the insolvency continues.

(4) A legal practitioner or chartered accountant or certified auditor, who is found guilty of professional misconduct by an order passed by his professional body is debarred for the period stated in that order.

(5) Any other person, who is found guilty of misconduct in connection with any income-tax proceedings by the prescribed authority is debarred for such period as that authority may direct.

An order referred to in (2) above and a direction referred to in (5) above are subject to the following conditions, namely :

(*a*) No such order or direction shall be made in respect of any person without giving him a reasonable opportunity of being heard ;

(*b*) A person against whom such order or direction is made may, within one month of the making thereof, appeal to the Board to have the order or direction cancelled ; and

(*c*) No such order or direction shall take effect until the expiry of one month from the making thereof, or where an appeal has been preferred, until the disposal of the appeal.

Duty of Authorised Representative. According to Rule 12A of the Income-Tax Rules 1962, every authorised representative (other than an employee or relative of the assessee or an officer of a scheduled bank), who has prepared the return of income furnished by the assessee, is required to furnish to the Income-Tax Officer :

(*a*) particulars of accounts, statements or other documents supplied to him by the assessee for the preparation of the return of income ; and

(*b*) where the authorised representative has, for the purpose of preparation of the return of income, carried out any examination of such accounts, statements or documents, a report on the scope and results of such examination.

This rule provides for information to be given and a report to be furnished according to particular cases where (*i*) a return of income has been prepared without subjecting the accounts, statements or other documents to any examination ; and (*ii*) where the authorised representative has subjected such material to any examination. In the former case, he is expected to state the particulars only of the accounts, statements or other documents supplied to him, and in the latter case, he has also to prepare a report on the scope and results of the examination carried out by him.

Where such examination has been carried out, chartered accountants acting as authorised representatives should always endeavour to have their examination so made that the examination is purposeful and useful in order that it may be of assistance to the assessing officers.

Chapter 17

Liability in Special Cases

The following topics have been dealt with in this chapter :

1. Legal representative of a deceased person (section 159).
2. Representative assessees (sections 160 to 167).
3. Executors (sections 168 and 169).
4. Succession to a business or profession (section 170).
5. Partition of a Hindu undivided family (section 171).
6. Profits of non-residents from occasional shipping business (section 172).
7. Recovery of tax in respect of non-residents (section 173).
8. Persons leaving India (section 174).
9. Persons trying to alienate their assets (section 175).
10. Discontinuance of business or dissolution (sections 176 and 177).
11. Company in liquidation (section 178).
12. Private company in liquidation (section 179).
13. Royalties or copyright fees (section 180).
14. Liability of State Governments (section 181).

1. Assessment of Deceased Persons

Under section 159, where a person dies, his legal representative is liable to pay any sum which the deceased would have been liable to pay if he had not died, *in the like manner and to the same extent* as the deceased. The legal representative of the deceased is deemed to be a assessee for the purposes of the Income-Tax Act.

As legal representative means a person who in law represents the estate of a deceased person, and includes an executor, administrator, heir and any person who intermeddles with the estate of the deceased.

For the purpose of making an assessment (including a reassessment or recomputation under section 147) of the income of the deceased and for the purpose of levying any sum on the legal representative :

(*a*) any proceeding taken against the deceased before his death shall be deemed to have been taken against the legal representative and may be continued against the legal representative from the stage at which it stood on the date of the death of the deceased ;

(*b*) any proceeding which could have been taken against the deceased if he had survived, may be taken against the legal representative; and

(*c*) all the provisions of the Act shall apply accordingly.

Thus, the following possible situations are all covered by the above provisions :

(1) where a person dies before any proceeding for assessment of his income have been commenced ;

(2) where proceedings for assessment have been commenced by the automatic submission of return of income or by the issue of a notice, but the assessment has not been completed ;

(3) where proceedings for assessment have been completed, but the notice of demand has not been served, so that no 'arrears' have come into being ; and

(4) where assessment has already been made and the notice of demand also served, but the actual realisation of the tax has not been completed, so that the amount of the tax is in 'arrears'.

Liability of Legal Representative. Under this section, the legal representative is liable to pay out of the estate of the deceased any sum payable by the deceased ; but this liability is subject to the following limitations :

(*a*) The liability is only in respect of the tax or any other sum which the deceased would have been liable to pay if he had not died.

(*b*) The liability of the legal representative is limited to 'the extent to which the estate is capable of meeting the liability. The word 'estate' includes not merely the *corpus* but also the *income* accruing after death from the corpus left by the deceased (*41 ITR 311*).

However, the legal representative becomes *personally* liable to the extent of the value of any asset of the estate which he disposes of while the liability for tax remains undischarged. This personal liability is imposed only in respect of tax and not in respect of penalty, fine or interest payable.

The provisions of sections 161(2), 162 and 167 (as explained later) are made applicable to legal representative. Income falling under section 159 can be assessed only under this section ; the legal representative has the right of reimbursement and retention ; and the Department has the right of recovering all dues from the property under the control and management of the legal representative.

Assessment. Under section 159, assessment is to be made on the legal representative in respect of the income of the deceased till the time of his death. The income of the estate for the period from the date of death up to the end of the accounting year in which the death occurs should be assessed under section 168 in the hands of the executor. Thus, in respect of the year of death two separate and distinct assessments would have to be made one on the legal representative (including the executor) under section 159 in respect of the income of the deceased up to the date of death, and the other on the executor under section 168 in respect of the income of the estate for the rest of the accounting year. Assessments for the year subsequent to the year of death would be made on the executor till the administration of the estate is completed.

In assessing the legal representative under section 159 in respect of the income of the deceased for the year of death, the income will be apportioned up to the date of death ; but certain incomes like dividend and interest on securities do not accrue from day to day. If a dividend becomes payable after the death, a part thereof apportioned to the period up to the date of death cannot be treated as the income of the deceased.

Penalty on Legal Representative. Penalty proceedings for a default committed by the deceased can be started or continued against the legal representative under this section which applies not only in respect of tax

but also any other sum—penalty, fine or interest. Further, the legal representative being an assessee for the purposes of the Act, is liable to a penalty for his own default.

2. Representative Assessees

According to section 160(1), a representative assessee means :

(*i*) in respect of the income of a non-resident, which is deemed to accrue or arise in India, the agent of the non-resident, including a person who is treated as an agent ;

(*ii*) in respect of the income of a minor, lunatic or idiot, the guardian or manager who is entitled to receive or is in receipt of such income on behalf of such minor, lunatic or idiot ;

(*iii*) in respect of income which the Court of Wards, the Administrator-General, the Official Trustee or any receiver or manager (including any person, whatever his designation, who in fact manages property on behalf of another), receives or is entitled to receive on behalf or for the benefit of any person, such Court of Wards, Administrator-General, Official Trustee, receiver or manager ; and

(*iv*) in respect of income which a trustee appointed under a trust (including any Waqf deed) receives or is entitled to receive on behalf or for the benefit of any person, such trustee.

Every representative assessee is deemed to be an assessee for the purposes of the Income-Tax Act.

The persons who can be treated as the agent of a non-resident are enumerated in a subsequent chapter dealing with the assessment of non-residents.

Liability of Representative Assessees. Under section 161(1) every representative assessee, as regards the income in respect of which he is a representative assessee, shall be subject to the same duties, responsibilities and liabilities as if the income were his own, and shall be liable to assessment in his own name in respect of that income ; but any such assessment shall be made upon him in his representative capacity only, and the tax shall be levied upon and recovered from him in like manner and to the same extent as it would have been leviable upon and recoverable from the person represented by him.

Under section 161(2), where any person is assessable in the capacity of a representative assessee in respect of any income, he shall not in respect of that income, be assessed under any other provision of the Act.

It must be noted that there may be two separate assessments on a representative assessee—one in his representative capacity and the other in his private capacity the latter being in respect of his individual income derived from his personal properties.

Right of Representative Assessees. Under section 162(1), every representative assessee who, as such, pays any sum under the Act shall be entitled to recover the sum so paid from the person on whose behalf it is paid, or to retain out of any moneys that may be in his possession or may come to him in his representative capacity, an amount equal to the sum so paid.

Under section 162(2), any representative assessee, or any person who apprehends that he may be assessed as a representative assessee; may retain out of any money payable by him to the person on whose behalf he is liable to pay tax (referred to as the principal), a sum equal to his estimated liability. If the representative assessee or the person and the principal do not agree as to the estimated amount to be retained, such representative assessee or person may

secure from the Income-Tax Officer a certificate stating the amount to be so retained pending final settlement of the liability, and the certificate so obtained shall be his warrant for retaining the amount.

Under section 162(3), the amount recoverable from such representative assessee or person at the time of final settlement shall not exceed the amount specified in such certificate, except to the extent to which such representative assessee or person may at such time have in his hands additional assets of the principal.

Charge of Tax. According to section 161(1), tax is to be levied upon a representative assessee in the like manner and to the same extent as it would be leviable upon the beneficiary.

However, under section 164 tax is leviable on and recoverable from the representative assessee at the flat rate of 65 per cent or at rates applicable to the total income as if it were the total income of an association of persons, whichever course is more advantageous to the revenue. But in the following cases the flat rate of 65 per cent will not apply and the income will be chargeable to tax as if it were the total income of an association of persons :

(1) Where none of the beneficiaries has any other income chargeable to income-tax.

(2) Where the income is receivable under a trust declared by will.

(3) Where the trust was created by a non-testamentary instrument before 1-3-1970 and the Income-Tax Officer is satisfied that the trust was created *bona fide* exclusively for the benefit of the relatives of the settler or where the settler is a Hindu undivided family for the benefit of the members of such family in circumstances where such relatives or members are mainly dependent on the settler for their support and maintenance.

Where a part of the income is specifically receivable on behalf of any one person or on behalf of beneficiaries whose individual shares are determinate and known, and the other part of the income is not so receivable, it is only the latter part of the income which is liable to tax on the basis laid down in section 164.

Under section 165, where part only of the trust income is chargeable to tax, the beneficiary's share of the income should be taken to be derived proportionately from the chargeable and non-chargeable portions of the trust income, and should be assessed accordingly in the hands of the trustee.

Direct Assessment or Recovery Not Barred. Under section 166, nothing contained in the above provisions shall prevent either the direct assessment of the person on whose behalf or for whose benefit income therein referred to is receivable or the recovery from such person of tax payable in respect of such income.

Under section 167, the Income-Tax Officer shall have the same remedies against all property of any kind vested in or under the control or management of any representative assessee as he would have against the property of any person liable to pay any tax, and in as full and ample a manner, whether the demand is raised against the representative assessee or against the beneficiary direct.

3. Executors

An executor is a person to whom the execution of the last will of a deceased person is, by the testator's appointment, confided. When a man makes a will and therein names the person who shall execute his will, the person so named is the executor. An executor includes an administrator or other person administering the estate of a deceased person. An administrator

is a person appointed by a court to administer the estate of a deceased person when there is no executor.

Under section 168, the income of the estate of a deceased person after his death is chargeable to tax in the hands of the executor :

(*a*) if there is only one executor, then, as if the executor were an individual ; or

(*b*) if there are more executors than one, then, as if the executors were an association of persons.

For this purpose, the executor is deemed to have the same residential status as the deceased person had during the previous year in which his death took place.

The income of the estate from the date of the death up to the end of the previous year in which the death takes place is assessable under this section. Assessment for the years subsequent to the year of death would also be made on the executor till the administration of the estate is completed.

In computing the total income of any previous year under this section, any income of the estate for that previous year distributed to, or applied for the benefit of, any specific legatee of the estate during that previous year shall be excluded. The income so excluded shall be included in the total income of such specific legatee.

Under section 169 read with section 162, the executor who is assessed under this section has the right of retention and reimbursement in respect of tax paid or payable by him.

Section 159 is meant to enable the revenue to make an assessment on the legal representative (including an executor) in respect of the income which accrued to or was received by the deceased up to the date of his death. Section 168 authorises an assessment on the legal representative in respect of the income which accrues to him after the death, the estate being vested in him. After the estate is fully administered and the executor acts as trustee for the beneficiaries, he may be assessed under section 161 but not till then.

Illustration

A dies on 30th September 1974. His previous year was the financial year. B is appointed as his executor. The particulars of income for the previous year ended 31st March 1975 are as under :

(*a*) Income from 1st April 1974 to 30th September 1974 Rs. 15,000.

(*b*) Income from 1st October 1974 to 31st March 1975 Rs. 10,000.

How many assessments will be made on B, on what incomes and under which sections of the Income-Tax Act, 1961 ? In what status will he be assessed ? If the deceased was a non-resident in the previous year ended 31st March 1975 would it affect the degree of residence of the executor ?

For the assessment year 1975-76 two assessments will be made on B—one under section 159 in his capacity as a legal representative of A on a total income of Rs. 15,000 and the other under section 168 in his capacity as an executor of the estate of A on a total income of Rs. 10,000.

In his capacity as legal representative, B's status will be that of an individual. In his capacity as executor of A's estate, his status will again be that of an individual, because he is the sole executor. If there are two or more executors, their status is that of an association of persons.

The residential status of the executor is the same as that of the deceased. As A was non-resident, the assessments on B for both the periods will be made on the same basis.

Note : In addition to the two assessments referred to above, a separate assessment will be made on B in respect of his own income.

4. Succession to Business or Profession

Under section 170, where a person carrying on any business or profession (referred to as the predecessor) has been succeeded therein, otherwise than on death, by any other person (referred to as the successor) who carries on that business or profession.

(*a*) the predecessor shall be assessed in respect of the income of the previous year in which the succession took place up to the date of succession ; and

(*b*) the successor shall be assessed in respect of the income of the previous year after the date of succession.

For the purposes of this section, "income" means income from the business or profession including any capital gains accruing to the predecessor from the transfer of the business or profession as a result of the succession.

When the predecessor cannot be found, the assessment of the income of the previous year in which the succession took place up to the date of succession and of the previous year preceding that year shall be made on the successor in like manner and to the same extent as it would have been made on the predecessor, and all the provisions of the Act apply accordingly. This means that the liability of the successor is not limited to assessment only but extends to any other liability incurred by the predecessor in respect of the income assessed.

When any sum payable under this section in respect of the income of such business or profession for the previous year in which the succession took place up to the date of succession or for the previous year preceding that year, assessed on the predecessor, cannot be recovered from him, the Income-Tax Officer shall record a finding to that effect and the sum payable by the predecessor shall thereafter be payable by and recoverable from the successor, and the successor shall be entitled to recover from the predecessor any sum so paid.

When any business or profession carried on by a Hindu undivided family is succeeded to, and simultaneously or after the succession there has been a partition of the joint family property, the tax due in respect of the income of the business or profession succeeded to, up to the date of succession, shall be assessed and recovered in the manner provided in section 171.

Illustrations

(1) D carried on business as general merchant, his accounting year being the calendar year. On 1-7-1974 the business was taken over by T. It was found by the Income-Tax Officer that D has not submitted returns of income for the assessment year 1971-72 and onwards. The profits of the business for each of the 5 "previous year" ended 31-12-1974 amounted to Rs. 20,000, Rs. 30,000, Rs. 40,000, Rs. 50,000 and Rs. 60,000 respectively. The income of the broken period 1-1-1974 to 30-6-1974 was Rs. 20,000.

The whereabouts of D are not known. The Income-Tax Officer indicates his intention to make assessments on T as the successor to the business for all the pending years. Advise T as to his liability to be so assessed. (*C. A. Final, May 1974*)

Under section 170, where a person carrying on any business (referred to as the predecessor) has been succeeded therein (otherwise than on death) by any other person (referred to as the successor) who carries on that business.

(*a*) the predecessor shall be assessed in respect of the income of the previous year up to the date of succession, and

(*b*) the successor shall be assessed in respect of the income of the previous year after the date of succession.

For this purpose, income includes any capital gains accruing as a result of the succession.

Where the predecessor cannot be found, the assessment of the income of the previous year up to the date of succession and of the previous year preceding that year shall be made on the successor. Therefore T is liable to be assessed on (*i*) Rs. 20,000 being the income of the broken period 1-1-1974 to 30-6-1974 and (*ii*) Rs. 5,000 being the income of the previous year 1973. As the income of 1973 is below the taxable limit of Rs. 6,000 no tax will be payable thereon.

T is not liable to be assessed on the income of any earlier previous year.

(2) S purchases the business of a cloth shop from N on 1st May 1974 and continues to maintain like N the calendar year as the previous year for the said business.

N thereafter leaves India for good and his whereabouts are not known. The Income-Tax Officer finds that N had left without paying his outstanding tax liability of Rs. 25,000 for the assessment year 1973-74 and also without getting any subsequent assessments completed. It is found that N's income relative to the assessment year 1974-75 consisted of Rs. 50,000 from the cloth shop and Rs. 10,000 from other sources, the tax on the aggregate of which two sums would be Rs. 24,000. It is also found that the profits of the cloth shop for the period from 1st January 1974 to 30th April 1974 were Rs. 20,000, during which period N's other income was Rs. 5,000, he having no other assessable income after 30th April 1974. The tax on the total income of Rs. 25,000, would be Rs. 4,500.

The Income-Tax Officer, being unable to recover N's outstanding tax from him and also to make assessments of his income for the assessment years 1974-75 and 1975-76 intends to make S liable for the same.

State clearly the nature of S's liability, if any, in this regard, and also determine the actual amount of tax, if any, that he may have to bear on N's account.

(*C A. Final, Nov. 1968*)

Under section 170, where a person carrying on any business or profession has been succeeded therein (otherwise than on death), the general rule is that the successor is not liable to tax in respect of the income of the period prior to the date of succession. But there are two exceptions to this rule, namely :

(*a*) If the predecessor cannot be found, assessment can be made on the successor in respect of the income of the previous year in which the succession took place up to the date of succession and of the previous year preceding that year. Income from business would include capital gains accruing to the predecessor from the transfer of the business.

(*b*) If the tax assessed on the predecessor, in respect of the income of the previous year in which the succession took place up to the date of succession and of the previous year preceding that year, cannot be recovered from him, the recovery of the tax can be made from the successor, who will be entitled to recover from the predecessor any sum so paid.

It is only in these two cases and only in respect of the income of the year of succession and the preceding previous year that the successor can be held liable for the tax due from the predecessor. Further the successor is assessable only in respect of the income of the predecessor from the business in which succession has taken place and any capital gains arising from the transfer of the business. Therefore assessments on S in respect of the income of N will be as follows :

Assessment for 1974-75 : S would be assessed on N's income of Rs. 50,000 from business, and the tax payable thereon would be Rs. 20,000.

Assessment for 1975-76 : S would be assessed on N's income of Rs. 20,000 from business, and the tax payable thereon would be Rs. 3,600.

Thus, S will have to bear a tax of Rs. 20,000 + Rs. 3,600 = Rs. 23,600 on N's account. S is not liable to pay the outstanding tax of N amounting to Rs. 25,000 for the assessment year 1973-74.

5. Partition of a Hindu Undivided Family

The assessment after the partition of a Hindu undivided family is governed by section 171, which is explained in full in a subsequent chapter dealing with the assessment of Hindu undivided families.

6. Tax on Occasional Shipping Business

The assessment of tax on occasional shipping business is made in accordance with the provisions of section 172, which are explained in full in a subsequent chapter dealing with the assessment of non-residents.

7. Recovery of Tax in Respect of Non-residents

The recovery of tax in respect of non-residents is governed by section 173 which is explained in a subsequent chapter dealing with the assessment of non-residents.

8. Assessment of Persons Leaving India

Under section 174, when it appears to the Income-Tax Officer that any individual may leave India during the current assessment year or shortly after its expiry and that he has no present intention of returning to India, the total income of such individual for the period from the expiry of the previous year for that assessment year up to the probable date of his departure from India shall be chargeable to tax in that assessment year. This provision is an exception to the general principle embodied in section 4 that it is the income of the previous year that is taxable in an assessment year.

The total income of each completed previous year or part of any previous year included in the period referred to above shall be chargeable to tax at the rates in force in that assessment year and separate assessment shall be made in respect of each such completed previous year or part of any previous year.

For example, an individual whose previous year ends on 31st December may leave India, say, in February 1975. The income of year commencing on 1st January 1974 has to be covered, because the assessment year for that income will be 1975-76 which has not yet started. In such cases, the income of the complete previous year 1974 as well as that for the period from 1st January 1975 to February 1975 will be governed by this section. Of course, separate assessments will be made for these two periods, in the assessment year 1974-75.

However, the income of any previous year ended before the commencement of the assessment year, in which the Income-Tax Officer takes action under section 174, will be assessed in the normal manner under section 4.

Procedure. For the purpose of making an assessment under section 174, the Income-Tax Officer may serve a notice upon such individual requiring him to furnish within such time (not being less than 7 days) as may be specified in the notice, a return in the same form and verified in the same manner as a return under section 139(2), setting forth his total income for each completed previous year comprised in the period referred to above and his estimated total income for any part of the previous year comprised in that period, and the provisions of the Act shall apply as if the notice were a notice issued under section 139(2).

The Income-Tax Officer may estimate the income of such individual for such period or any part thereof, where it cannot be readily determined in the manner provided in the Act.

The tax chargeable under section 174 shall be in addition to the tax, if any, chargeable under any other provisions of the Act.

Note : Where the above provisions are applicable, any notice issued by the Income-Tax Officer under section 139(2) or section 148(1) in respect of any tax chargeable under any provision of the Act, may require the furnishing of the return by such individual within such period (not being less than 7 days) as the Income-Tax Officer may think proper. This reduction of the normal period for the submission of the return of income to 7 days may be necessary to finish the assessment before the assessee leaves India, and it will ultimately be for the benefit of the assessee, since he cannot obtain a clearance certificate under section 230(1) until his assessments have been finalised.

Illustration

F, a non-Indian citizen, after having served as an employee in an Indian concern for 25 years since 1949 retires from service on 30th September 1974 and decides to leave India on that date with no further intention of returning. The Income-Tax Officer, while making the assessment for the year 1972-73 on 10th September 1974 obtains this information. He finds that on that date the returns for the assessment years 1973-74 and 1974-75 are yet to be filed and further that during the period from 1st April 1974 to the date of departure F is likely to have an assessable income of Rs. 15,000.

Describe the special powers of assessment granted to the Income-Tax Officer in the connection and the manner in which such power is to be exercised in this case.

(C. A. Final, Nov. 1970)

In the circumstances mentioned, section 174 empowers the Income-Tax Officer to make the following separate assessments in the current assessment year :

(1) An assessment under this section on the estimated income of the current previous year up to the probable date of the assessee's departure from India at the rates in force in the current assessment year.

(2) An assessment under section 143 in respect of the income of the preceding previous year at the rates in force in the current assessment year.

(3) An assessment under section 147 in respect of the income of any earlier previous year at the rates in force in the relevant assessment year.

In this case the Income-Tax Officer will give the following notices calling for a return of income to be filed within the specified time being not less than seven days :

(*a*) A notice under section 174(4) calling for a return in respect of the estimated total income for the period from 1st April 1974 to 30th September 1974.

(*b*) A notice under section 139(2) calling for a return of income for the previous year ended 31st March 1974.

(*c*) A notice under section 148(1) calling for a return of income for the previous year ended 31st March 1973.

These notices will be issued soon after 10th September 1974 and on receipt of the returns separate assessments will be made under sections 174, 143 and 147.

9. Persons Trying to Alienate their Assets

Under section 175, if it appears to the Income-Tax Officer during any current assessment year that any person is likely to charge, sell, transfer, dispose of, or otherwise part with any of his assets with a view to avoiding payment of any tax liability, the total income of such person for the period from the expiry of the previous year for that assessment year to the date when the Income-Tax Officer commences proceedings under this section shall be chargeable to tax in that assessment year.

The provisions of section 174 shall apply *mutatis mutandis* to any proceedings under section 175.

10. Discontinuance of Business or Dissolution

The discontinuance of a business or profession means its complete closing down and the cessation of all its operatoins. There is no discontinuance if customers are merely notified that the business would be closed on a certain date but the business continues to be transacted, though it may be simply to complete the outstanding contracts. In the liquidation of a company there may be continuance of business. A business may be dormant and there may be little doing ; still the business continues. A business or a profession cannot be said to be discontinued so long as the proprietor is holding out for work.

If a professional man ceased to exercise his profession, there would be a discontinuance. Discontinuance denotes the disappearance of the business or profession. A business may persist notwithstanding a change in the persons carrying it on, *e. g.*, on the sale of a business. In such a case, the identity and continuity of the business is preserved, but there is a change of ownership. There is no discontinuance but there is a succession. There can be no discontinuance of a business or profession when it is sold to another.

When a single business is broken into several units and is divided and carried on by its former owner severally, there would be a discontinuance.

Under section 176, where any business or profession is discontinued in any assessment year, the income of the period from the expiry of the previous year for that assessment year up to the date of such discontinuance may, at the discretion of the Income-Tax Officer, be charged to tax in that assessment year.

The total income of each completed year or part of any previous year included in the period referred to above shall be chargeable to tax at the rates in force in that assessment year and separate assessment shall be made in respect of each such completed previous year or part of any previous year.

Any person discontinuing a business or profession shall give to the Income-Tax Officer notice of such discontinuance within 15 days thereof.

The tax chargeable under section 176 shall be in addition to tax, if any, chargeable under any other provisions of the Act.

Where an assessment is to be made under the provisions of section 176, the Income-Tax Officer may serve on the person whose income is to be assessed or in the case of a firm, on any person who was a partner of such firm at the time of its discontinuance or, in the case of a company, on the principal officer thereof, a notice containing all or any of the requirements which may be included in a notice under section 139(2), and the provision of the Act shall apply accordingly.

Where the above provisions are applicable, any notice issued by the Income-Tax Officer under section 139(2) or section 148(1) in respect of any tax chargeable under any other provision of the Act, may require the furnishing of the return by the person to whom these notices are issued within such period (not being less than 7 days) as the Income-Tax Officer may think proper.

Discontinuance of Profession. Under section 176(4), where any profession is discontinued in any previous year on account of the cessation of the profession by, or the retirement or death of, the person carrying on the profession, any sums received after the discontinuance shall be deemed to be the income of the recipient and charged to tax accordingly in the year of receipt, if such sums would have been included in the total income of the aforesaid person had they been received before such discontinuance.

The provision does not apply to the discontinuance of a business ; it applies only to the discontinuance of a profession such as that of a doctor, lawyer, accountant, etc.

Notice of Discontinuance. Under section 272, where any person fails to give the notice of discontinuance of his business or profession, the Income-Tax Officer may direct that a sum shall be recovered from him by way of penalty which shall not be less than 10% of the tax nor more than the amount of tax subsequently assessed on him in respect of the income of business or profession up to the date of its discontinuance.

Illustration

An assessee, with income from legal profession, had the financial year as his previous year. He died on 30-9-1974. His assessment for 1974-75 had been completed before his death. He is assessed on receipt basis.

For the half-year ended 30-9-1974 the gross receipts were Rs. 20,000 and the admissible expenses amounted to Rs. 4,000.

Out of the outstanding bills, the gross receipts for the half-year ended 31-3-1975 and 30-9-1975 were Rs. 8,000 and Rs. 6,000 respectively, the admissible expenses being 10% of the gross receipts.

For which assessment years and on what income will his legal heir be assessed ?

His legal heir will be assessed on the following income in the assessment years stated :

Assessment Year 1975-76

	Rs.
Gross receipts for half-year ended 30-9-1974	20,000
Gross receipts for half-year ended 31-3-1975	8,000
	28,000
Less Expenses (Rs. 4,000 for the half-year ended 30-9-1974 and Rs. 800 for the half-year ended 31-3-1975)	4,800
Total Income	23,200

Assessment Year 1976-77

Gross receipts for previous year 1975-76	6,000
Less Expenses (10%)	600
Total Income	5,400

Dissolution of an Association of Persons. Under section 177, where any business or profession carried on by an association of persons has been discontinued or where an association of persons is dissolved, the Income-Tax Officer shall make an assessment of the total income of the association of persons as if no such discontinuance or dissolution had taken place, and all the provisions of the Act, including the provisions relating to the levy of a penalty or any other sum chargeable under the Act, shall apply to such assessment.

Every person who was at the time of such discontinuance or dissolution a member of the association of persons, and the legal representative of any such person who is deceased, shall be jointly and severally liable for the amount of tax, penalty or any other sum payable and all the provisions of the Act shall apply to any such assessment or imposition of penalty or other sum.

Where such discontinuance or dissolution takes place after the commencement of any assessment proceedings, the proceedings may be continued against the persons referred to in the preceding paragraph, so that time may not be wasted in the reissue of notices, etc.

The limitation on the liability of the legal representative, as laid down in section 159, is not to be affected by the provisions of section 177.

The provisions of section 177 are identical with those of section 189 which deals with the dissolution of a firm or discontinuance of its business or profession. The provisions of section 189 are explained in a subsequent chapter dealing with the assessment of firms.

11. Company in Liquidation

Under section 178, the liquidator of a company which is being wound up is bound, within 30 days of his appointment, to give notice of his appointment to the Income-Tax Officer, who in his turn is bound within three months to intimate to the liquidator the estimated amount of tax liability of the company.

Until the liquidator has set aside an amount to meet the tax liability, he should not part with any of the assets except for paying secured creditors entitled to priority over Government dues.

If the liquidator fails to set aside the amount notified by the Income-Tax Officer, he would be personally liable for the company's tax to the extent of that amount. Where there are more liquidators than one, their liabilities are joint and several.

12. Private Company in Liquidation

Under section 179, when any private company is wound up and any tax assessed on the company, whether before or in the course of or after its liquidation, in respect of any income of any previous year cannot be recovered, then every person who was a director of the private company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax, unless he proves that the non-payment of tax by the company was not due to any gross negligence, misfeasance or breach of duty on his part.

A company whose name is struck off the register of companies does not fall under section 179 and a past director of such a company is not liable for the arrears of tax due by the company (*94 ITR 370*).

13. Copyright Fees on Royalties

Normally, a lump sum consideration received by an author of a literary or artistic work either for assignment of copyright or by way of royalties would fall to be taxed in full in the year in which such amount is received. Where, however, the completion of the work has taken the author more than 12 months, section 180 provides a special relief. If the author claims this relief, the relief is as follows :

(*a*) For the assessment year relevant to the previous year in which the lump sum consideration is received, two-thirds of such amount will be excluded from the total income and tax calcutated on this reduced total income. In addition tax will also be collected on the excluded amount at the rate applicable to a total income of half that amount.

(*b*) In each of the next two assessment years one-third of the lump sum amount will be added to the income otherwise determined and the tax collected in the first assessment year on the excluded amount will be refunded by adjustment in equal halves.

Illustration

X is a chartered accountant in practice. His professional income for the previous year ended 31st March 1973 is Rs. 20,000.

He started the writing of a book on "Income-Tax Law and Practice" in January 1971 and completed it on 30th June 1972. He gave the right of its publication to a firm of publishers in Delhi on 1st July 1972 and received on that date a sum of Rs. 15,000 as advance royalty.

State (*i*) how the amount of income-tax payable by him for the assessment year 1973-74 will be calculated, if he makes a claim for relief under section 180, and (*ii*) how his assessments for 1974-75 and 1975-76 will be made if his professional income for these two years is Rs. 25,000 and Rs. 30,000 respectively.

Assessment year		Rs.
1973-74	Income-tax on Rs. 25,000 (Rs. 20,000 + Rs. 5,000 being one-third of Rs. 15,000) at the rate applicable to Rs. 25,000 (say)	A
	Income-tax on Rs. 10,000 (two-thirds of Rs. 15,000) at the rate applicable to a total income of Rs. 5,000	B
	Tax-payable	A + B
1974-75	Income-tax on Rs. 30,000 (Rs. 25,000 + Rs. 5,000) at the appropriate rates	C
	Less Refund of half the additional tax B	$\frac{1}{2}$B
	Tax payable	C − $\frac{1}{2}$B
1975-76	Income-tax on Rs. 35,000 (Rs. 30,000 + Rs. 5,000) at the appropriate rates	D
	Less Refund of half the additional tax B	$\frac{1}{2}$B
	Tax payable	D − $\frac{1}{2}$B

14. Liability of State Governments

Under section 181, income-tax shall be payable by a State Government on the interest on any securities issued by it tax-free at such rate not exceeding 25% as may be notified by the Central Government from time to time.

CHAPTER 18

Collection And Recovery of Tax

The subjects dealt with in this chapter are :

1. Deduction of tax at source.
2. Advance payment of tax.
3. Recovery of tax.
4. Tax-clearance certificates.
5. Refunds.
6. Double taxation relief.

Notwithstanding that the regular assessment in respect of any income is to be made in a later assessment year, the tax on such income shall be payable by deduction at source or by advance payment, as the case may be, in accordance with the provisions of the Act. Sections 192 to 206 relate to deduction of tax at source, while sections 207 to 219 provide for the advance payment of tax.

In the case of income in respect of which there is no provision for deduction of tax at the time of payment, and in any case where tax has not been deducted in accordance with the provisions of sections 192 to 206, tax shall be payable by the assessee direct.

The deduction of tax is to be made at the time of payment ; but in the case of interest (other than interest on securities), it is also to be made at the time when such interest is credited to the payee's account.

DEDUCTION OF TAX AT SOURCE

The following expressions are used in connection with deduction of tax at source :

Rates in Force. This expression means the rate or rates specified for the purpose of deduction by the Finance Act of the year in which such deduction is required to be made.

Person Responsible for Paying. This expression means :

(*a*) in the case of payments of income chargeable under the head "Salaries" (other than payments by the Central Government or the Government of a State) the employer himself or if the employer is a company, the company itself including the principal officer thereof ;

(*b*) in the case of payments of income chargeable under the head "Interest on Securities" (other than payments made by or on behalf of the Central Government or the Government of State) the local authority, corporation or company including the principal officer thereof ; and

(*c*) in the case of credit or payment of any other sum chargeable under the Act, the payer himself or, if the payer is a company, the company itself including the principal officer thereof.

The provisions relating to deduction of tax in the case of incomes of different kinds are as follows :

Salaries.

Under section 192, any person responsible for paying any income chargeable under the head "salaries" to an employee (resident or non-resident) shall, at the time of payment, deduct income-tax therefrom. The deduction is to be made at the rate applicable to the employee's estimated income from salary and not at the rate applicable to his total income.

The person responsible for making the payment referred to above may, at the time of making any deduction, reduce or increase the amount to be deducted for the purpose of adjusting any excess or deficiency arising out of any previous deduction or failure to deduct during the financial year.

The trustees of a recognised provident fund, or any person authorised by the regulations of the fund to make payment of accumulated balance due to the employees, shall deduct tax at the time of payment in cases where the accumulated balance is not exempt from tax. Similarly, where any contributions made by an employer, including interest on such contributions in an approved superannuation fund is paid to the employee, income-tax on the amount so paid shall be deducted by the trustees of the fund in cases where such payment is not exempt from tax.

For the purposes of deduction of tax on salary payable in foreign currency, the value in rupees of such salary shall be calculated at the prescribed rate of exchange.

The employee's liability to deduct tax is absolute and is not affected by any private arrangement whereby the employee has undertaken to discharge his own tax liability.

Where deduction of tax is made from salaries by non-Government employees a monthly return of deduction of tax (in Form No. 21 as given in the Income-Tax Rules, 1962) must be sent to the Income-Tax Officer.

Return of Salaries. Under section 206, the prescribed person in the case of every officer of the Government, the principal officer in the case of every company, the prescribed person in the case of every local authority or other public body or association, and every private employer shall prepare, and within 30 days from the 31st March in each year, deliver to the Income-Tax Officer in the prescribed form and verified in the prescribed manner, a return in writing showing :

(*a*) the name and address of every person who was receiving on the 31st March, or has received or to whom was due during the year ending on that date, from the Government, company, authority, body, association or private employer any income chargeable under the head "Salaries" of such amount as may be prescribed ;

(*b*) the amount of the income so received by or so due to each such person, and the time or times at which the same was paid or due ; and

(*c*) the amount deducted in respect of income-tax from the income of each such person.

This return is to be prepared in Form No. 24 as given in the Income-Tax Rules, 1962.

Retirement Annuities to Partners of Registered Firms of Professionals.

Under section 80E(9), where any payment by way of annuity or otherwise is made by a person to whom premiums or contributions are payable under sections 80E(1) and 80E(4) in respect of retirement annuities of partners in registered firms of professionals, such person shall deduct from the total amount so paid during any financial year tax at such rates as would be applicable to such amount if it were the total income. The amount so deducted will be paid to the credit of the Central Government. If such person does not deduct the tax or after deducting fails to pay such tax, the provisions of section 201 shall apply.

Interest on Securities.

Under section 193, the person responsible for paying any income chargeable under the head "Interest on Securities" shall, at the time of payment, deduct income-tax at the rates in force from the amount of interest payable. But no tax shall be deducted from any interest payable on the following government securities :

(*a*) National Defence Bonds, 1972, held by a resident individual.
(*b*) National Defence Loan, 1968 or 1972, held by an individual.
(*c*) National Savings Certificates (First Issue).
(*d*) 7-year National Savings Certificates (IV issue).
(*e*) Such debentures issued by any co-operative society or any other institution or authority as may be notified by the Central Government.
(*f*) Gold Bonds, 1977 or 1980, held by a resident individual.

In order to facilitate investment in government securities by resident individuals, whose income does not attract income-tax under the Income-Tax Act, it is provided that interest on such securities will be paid without deduction of tax at source, where the holder declares in writing that the amount of his investment in the securities did not exceed Rs. 2,500 during the relevant previous year, that he was not previously assessed to income-tax, and that his total income during the previous year was below the minimum taxable amount.

Dividends.

Under section 194, the principal officer of an Indian company or a company which has made the prescribed arrangements for the declaration and payment of dividends (including dividends on preference shares) within India, shall, before making any payment in cash or before issuing any cheque or warrant in respect of any dividend or before making any distribution or payment to a shareholder of any amount which is included in the definition of dividend, deduct from the amount of such dividend income-tax at the rates in force.

Where in the case of any shareholder (not being a company), the Income-Tax Officer gives a certificate in writing in the prescribed manner that to the best of his belief the total income of the shareholder will be less than the minimum liable to tax, the person responsible for paying any dividend to the shareholder shall, so long as the certificate is in force, pay the dividend without any deduction.

Interest (other than interest on securities).

Section 194A provides for deduction of tax from interest other than interest on securities. The provisions of this section are as follows :

(*a*) It does not apply to interest credited or paid before 1st October 1967.

(*b*) It does not apply to interest credited or paid by individuals or Hindu undivided families, that is to say, it applies to interest credited or

paid by companies, firms, associations of persons, local authorities and artificial juridical persons.

(*c*) It applies only to interest credited or paid to residents. As to payments to non-residents there is already a provision as explained later.

(*d*) Tax must be deducted at the time of crediting such interest to the payee or at the time of payment in cash or in any other mode, whichever is earlier.

(*e*) Individuals, Hindu undivided families, unregistered firms and associations of persons having no taxable income and making a statement in writing to this effect, are entitled to receive their interest income without deduction of tax at source,

Such statements are required to be attested by :

(*i*) a member of Parliament or of a State Legislature ; or
(*ii*) a member of a District Council or a Metropolitan Council, a Municipal Corporation or Municipal Committee ; or
(*iii*) a Gazetted Officer of the Central or a State Government ; or
(*iv*) an officer of a banking company (including a co-operative bank) of the rank of sub-agent, agent or manager.

(*f*) Income-tax is to be deducted only if the amount of interest credited or paid during the financial year exceeds Rs. 1,000.

(*g*) The rates at which tax is to be deducted are (*i*) in the case of credits or payments to companies, at 20%, and (*ii*) in the case of credits or payments to non-company persons, at 10%.

(*h*) Within 30 days after 31st March each year, a return in the prescribed form must be furnished to the Income-Tax Officer showing the name and address of every person who has given an attested statement that his assessable income will be less than the minimum liable to tax.

(*i*) Payments of interest of the following persons are exempted from the operation of these provisions : Banking companies (including co-operative and land mortgage banks) ; financial corporations ; Life Insurance Corporation ; insurance companies ; co-operative societies ; Unit Trust of India.

Tax is not required to be deducted at source from any interest credited or paid by a firm to a partner of the firm or by a co-operative society to any other co-operative society.

No income-tax will be deductible at source from interest on deposits made under any scheme framed by the Central Government or from interest credited or paid by the Central Government under the various tax laws.

Winnings from Lotteries etc.

Under section 194B, income-tax will be deducted at source from winnings from lotteries and crossword puzzles at the rates in force where the payment exceeds Rs. 1,000.

Payments to Contractors.

Under section 194C, any person responsible for paying any sum to any contractor (who is resident in India) in pursuance of a contract between such contractor and the Central or any State Government, any local authority, statutory corporation, company or a co-operative society will be required to deduct income-tax at the rate of 20% of such sum.

Likewise, every contractor (other than an individual or a Hindu undivided family), who is responsible for paying any sum to any sub-contractor (who is resident in India) in pursuance of a contract with such sub-contractor will be required to deduct income-tax at the rate of 10% of such sum.

No deduction under this section will be required to be made if the consideration for the contract in either case does not exceed Rs. 5,000.

Where the Income-Tax Officer is satisfied, on an application made by the contractor or the sub-contractor, that the total income of the contractor or the sub-contractor justifies the deduction of tax at any lower rate or, as the case may be, no deduction of tax, he will give an appropriate certificate in this behalf.

Insurance Commission.

Under section 194D, any person responsible for paying to a resident any income by way of insurance commission or other remuneration in consideration of his procuring insurance business (including business relating to the continuance, renewal or revival of policies of insurance) will be required to deduct income-tax from such income at the rates in force. The deduction will have to be made at the time of the credit of the income to the account of, or payment thereof to, the payee, whichever is earlier.

Other Sums.

Under section 195, any person responsible for paying to a non-resident (not being a company) or to a company which is neither an Indian company nor a company which has made the prescribed arrangements for the declaration of any payment of dividends within India, any interest (not being interest on securities) or any other sum (not being dividends) chargeable to tax, shall at the time of payment, unless he is himself liable to pay any tax thereon as an agent, deduct income-tax thereon at the rates in force.

However, the deduction of tax at source from long-term capital gains of foreign companies is to be made at the same rates at which such income is chargeable to tax on regular assessment instead of at the rate specified in the annual Finance Act.

Where the person responsible for paying any such sum (other than salary, interest on securities, dividend or any other interest) to a non-resident, considers that the whole of such sum would not be income chargeable in the case of the recipient, he may make an application to the Income-Tax Officer to determine the appropriate proportion of such sum so chargeable, and upon such determination, tax shall be deducted only on that proportion of the sum which is so chargeable.

A person who is responsible for making any payment to a non-resident and who on the instructions of the non-resident, makes payment to his agent in India, is nevertheless liable to deduct tax from such payments (*35 ITR 134*).

Where interest, though payable to a non-resident, is not taxable under the Act, there is no obligation to make any tax deduction. On the other hand, where interest payable abroad is chargeable to tax and the payer does not deduct the tax, he will not get an allowance for such interest in his own assessment.

Any non-resident (including a foreign company which does not pay its dividends in India) may make an application to the Income-Tax Officer for a certificate authorising him to receive payments by way of interest (other than interest on securities) or any other sum (not being dividends) which a chargeable to tax, without deduction of tax at source. Such application may be made in the cases and under the circumstances to be specified in the Income-Tax Rules. On receipt of such an application the Income-Tax Officer may, subject to such conditions as may be laid down in the Rules, give a certificate authorising the payment of the income without deduction of tax at source. Every person responsible for paying any such interest or other sum to the holder of the said certificate shall make such payment without deducting tax at source so long as the certificate is in force.

Exceptions.

Under section 196, no deduction of tax shall be made by any person from any sums (interest, dividend or other income) payable to :

(*a*) the Government, or
(*b*) the Reserve Bank of India, or
(*c*) any statutory corporation which is exempt from income-tax on its income.

Exemption Certificate.

Under section 197, where in the case of any income of any person (other than a company) income-tax is required to be deducted at the time of credit or payment, but the Income-Tax Officer is satisfied that the total income of the recipient justifies the deduction of tax at any lower rates or no deduction of tax, as the case may be, the Income-Tax Officer shall, on an application made by the assessee in his behalf, issue to him such certificate as may be appropriate.

Where any such certificate is given, the person responsible for paying the income shall, until such certificate is cancelled by the Income-Tax-Officer, deduct income-tax at the rates specified in such certificate or deduct no tax, as the case may be.

Where the principal officer of a company considers that, by reason of the provisions of section 80K, the whole or any portion of the dividend will be deductible in computing the total income of the recipient, he may, before paying the dividend, make an application to the Income-Tax-Officer to determine the appropriate proportion of the dividend to be deducted under section 80K ; and on such determination by the Income-Tax Officer no tax shall be deducted on such proportionate amount.

Other Provisions relating to Deduction of Tax.

The tax deducted at source under sections 192 to 195 shall, for the purpose of computing the income of an assessee, be deemed to be income received.

Any deduction made in accordance with the provisions of sections 192 to 195 and paid to the Central Government shall be treated as a payment of tax on behalf of the person from whose income the deduction was made, or of the owner of the security or of the shareholder as the case may be, and credit shall be given to him for the amount so deducted on the production of the certificate furnished under section 203 in the assessment, if any, made for the immediately following assessment year.

Where such person or owner or shareholder is a person whose income is included in the total income of another person, the payment shall be deemed to have been made on behalf of, and the credit shall be given to, such other person.

According to Rule 30A of the Income-Tax Rules, 1962, where the dividend on any share is assessable as the income of a person other than the shareholder, any income-tax deducted at source and paid to the Central Government shall be deemed to be a payment of tax on behalf of, and the credit in respect thereof shall be given to, such other person in the circumstances specified in that rule.

Where any security or share is owned jointly by two or more persons not constituting a partnership, credit in respect of the tax deducted may be given to each such person in the same proportion in which the interest on such security or the dividend on such share has been included in his total income.

Under section 205, where tax is deductible at source, the assessee shall not be called upon to pay the tax himself to the extent to which tax has been deducted from the income.

Under section 200, the person deducting any sum in accordance with the provisions of section 192-195 shall pay, within the prescribed time, the sum so deducted to the credit of the Central Government or as the Board directs.

Certificate for Tax Deducted. Under section 203, every person deducting tax in accordance with the provisions of sections 192 to 195 shall, at the time of credit or payment of the sum or, as the case may be, at the time of the issue of a cheque or warrant for payment of any dividend to a shareholder, furnish to the person to whom such credit is given or such payment is made or the cheque or warrant is issued, a certificate to the effect that tax has been deducted, and specifying the amount so deducted, the rate at which the tax has been deducted and such other particulars as may be prescribed.

Indemnity. Under section 290, every person deducting, retaining, or paying any tax in respect of income belonging to another person is indemnified for the deduction, retention or payment thereof.

Consequences of Failure to Deduct or Pay.

The following are the consequences if a person responsible for deduction of tax does not deduct or after deducting fails to pay the tax to Government :

(1) Under section 201(1), he would be deemed to be an assessee in default in respect of the tax, would be personally liable to pay the tax (*1949 ITR 499*), and would also be liable to a penalty under section 221 in case of failure to deduct and pay the tax without good and sufficient reasons. The penalty under section 221 will be an amount which, in the case of continuing default, may be increased from time to time up to the amount of tax in arrear.

(2) Under section 201(1A), he would be liable to pay simple interest at 12% per annum on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually paid.

(3) Under section 201(2), where the tax has not been paid after it is deducted, the amount of the tax together with the amount of interest thereon shall be a charge upon all the assets of the person, but it would not be an overriding charge *vis-a-vis* other charges.

(4) Moreover, under section 276B, a person who without reasonable cause or excuse fails to deduct or after deducting fails to pay the tax, shall be punishable, on conviction before a court, with rigorous imprisonment up to six months and shall also be liable to fine. The fine shall be not less than a sum calculated at the rate of 15% per annum of the tax in default for the period from the date on which such tax was deductible up to the payment of the tax to the credit of the Central Government.

RATES FOR DEDUCTION OF TAX IN 1975-76

From Salaries and Retirement Annuities.

The rates in force in the financial year 1975-76 for the purpose of deduction of income-tax at source from salaries and retirement annuities payable to partners of registered professional firms are given later on in this chapter after "Advance Payment of Tax."

From Other Income.

Given below are the rates in force in the financial year 1975-76 for deduction of income-tax at source from (*i*) interest on securities, (*ii*) dividends, (*iii*) interest other than interest on securities, (*iv*) winnings from lotteries and crossword puzzles, (*v*) insurance commission, and (*vi*) other sums.

1. In the case of a person other than a company :	
(*a*) Where the person is resident :	
(*i*) on income by way of interest other than interest on securities	10%
(*ii*) income by way of winnings from lotteries and crossword puzzles	33%

(*iii*) income by way of insurance commission	10%
(*iv*) on any other income excluding interest on tax-free government securities	23%
(*b*) Where the person is not resident in India :	
(*i*) on the whole income excluding interest on tax-free government securities	33% or average rate whichever is higher*
(*ii*) on interest on tax-free government securities	16·5%
2. In the case of a company :	
(*a*) Where the company is a domestic company :	
(*i*) on income by way of interest other than interest on securities	21%
(*ii*) on any other income excluding interest on tax-free government securities	23%
(*b*) Where the company is not a domestic company :	
(*i*) on dividends payable by any domestic company	25·725%
(*ii*) on royalties payable by an Indian concern under an agreement approved by the Central Government	52·5%
(*iii*) on fees for technical services payable by an Indian concern under an agreement approved by the Central Government	52·5%
(*iv*) on interest on tax-free government securities	46·2%
(*v*) on any other income	73·5%

*The average rate is calculated as if such income were the total income.

ADVANCE PAYMENT OF TAX

In the case of income from which tax is not deductible at source (*e. g.*, income from house property or from business), sections 207-219 enable the Income-Tax Department to collect the tax in advance by instalments in the financial year in which the income is being earned at the rates of tax prescribed for the purpose (as given later in this chapter).

Income subject to Advance Tax. Under section 207, tax is payable in advance in accordance with the provisions of sections 208-219 in the case of income other than :

(*a*) capital gains ; and

(*b*) income by way of winnings from lotteries, crossword puzzles, races, card games, other games or from gambling or betting.

Liability to pay Advance Tax. Under section 208, advance tax is payable by an assessee in the financial year when his total income (exclusive of capital gains and income from winnings from lotteries etc.) as determined in the latest regular assessment (or in a subsequent self-assessment, if it is higher) or the current income as estimated by a person not hitherto assessed to tax, exceeds the limit set forth as below :

	Rs.
(*a*) In the case of a company or a local authority	2,500
(*b*) In the case of a registered firm	30,000

(*c*) In the case of any other person :
  (*i*) where the person is non-resident 5,000
  (*ii*) in other cases 10,000

Computation of Advance Tax. Under section 209, the amount of advance tax payable by an assessee in the financial year is to be computed in the following manner :

(1) Take his total income as determined in the latest regular assessment (or in a subsequent self-assessment if it is higher) or take the total income from the financial year as estimated by a person not hitherto assessed to tax.

(2) Deduct from such total income (*i*) the amount of any capital gains and (*ii*) income from winnings from lotteries etc. and the balance will be the income subject to advance tax. Then calculate income-tax on such income at the rates prescribed for the purpose after taking into consideration (*i*) net agricultural income and (*ii*) rates applicable to Hindu undivided families having at least one member whose total income for the relevant previous year exceeds the maximum amount not chargeable to tax.

(3) Reduce the amount of tax so calculated by the amount of tax deductible at source on the *gross* amount of income which is subject to such deduction and which has been *taken into account* in computing the total income, and the balance will be the advance tax payable.

Order by Income-Tax Officer. Under section 210, where a person has been previously assessed by way of regular assessment, the Income-Tax Officer may, on or after the 1st April in the financial year, by order in writing require him to pay to the credit of the Central Government advance tax determined in the manner explained above. The notice of demand shall specify the instalments in which the advance tax is payable.

If after the making of the above-mentioned order and at any time before the date which is 15 days prior to the date on which the last instalment of advance tax is payable by the assessee, tax is paid by the assessee on self-assessment or a regular assessment of the assessee is made in respect of a later previous year, the Income-Tax Officer may make an amended order for the payment of advance tax computed on the basis of the total income on which tax has been paid on self-assessment or in respect of which the regular assessment has been made, as reduced by the amount, if any, paid in accordance with the original order.

Instalments of Advance Tax. Under section 211, advance tax is payable in all cases in three equal instalments during the financial year. The due dates of these instalments are as follows :

(*i*) In the case of a person deriving 75% or more of the income subject to advance tax from a source or sources for which the previous year ends on or before 31st December. — June 15, September 15 and December 15

(*ii*) In any other case. — September 15, December 15 and March 15

If the notice of demand issued in pursuance of the order under section 210 is served after any of the dates on which the instalments specified therein are payable, the advance tax shall be payable in equal instalments on the specified dates falling after the date of service of the notice of demand, or in one sum on the 15th March if the notice is served after the 15th December.

Estimate by Assessee.

In the following cases, an assessee may or shall file an estimate of advance tax payable by him :

(1) Under section 212(1), if an assessee, who is required by the Income-Tax Officer to pay advance tax, estimates at any time before the last instalment is due in his case that, by reason of his total income (exclusive of capital gains and winnings from lotteries etc.) of the period which would be the previous year for the immediately following assessment year (*such total income being referred to as current income*) being likely to be less than the income on which advance tax has been demanded from him, the advance tax payable by him would be less than the amount which he is so required to pay, he *may at his option* send to the Income-Tax Officer an estimate of the current income and the advance tax payable by him and shall pay such amount of advance tax as accords with his estimate in equal instalments on such of the dates as have not expired or in one sum if only the last of such dates has not expired.

This provision has been liberalised to permit the payment of a lower amount of advance tax than that demanded if, for any other reason, the tax-payer considers that the advance tax payable by him on his current income would be lower than the amount demanded.

Under section 212(2), the assessee may send a revised estimate of the advance tax payable by him before any one of the specified dates, and adjust any excess or deficiency in respect of any instalment already paid in a subsequent instalment.

(2) Under section 212(3), any person who has not previously been assessed by way of regular assessment *shall*, in each financial year before the date on which the last instalment of advance tax is due in his case, if his current income is likely to exceed the limit of income applicable to him, send to the Income-Tax Officer an estimate of the current income and the advance tax payable by him and shall pay such amount of advance tax as accords with his estimate on such of the dates as have not expired, by instalments which may be revised if necessary.

An assessee, on whom assessment proceedings are pending, is not deemed to be a person who has been assessed (*53 ITR 705*).

(3) Under section 212(3A), where the advance tax payable by a tax-payer on the basis of his current income (*i.e.*, income which would be assessable in the following assessment year) exceeds the tax demanded from him under section 210 by more than one-third of the latter amount, the tax-payer is required to furnish an estimate of advance tax payable by him on the basis of his current income before the date on which the last instalment of such tax is due from him.

The Commissioner of Income-Tax is however empowered to extend the time-limit for furnishing the estimate of advance tax in this type of cases up to a period of 30 days immediately following the accounting period in respect of the tax-payer's business provided the tax-payer has paid the advance tax demanded from him under section 210 before the date on which the last instalment is ordinarily due. Such extension will be permissible only in cases where the Commissioner is satisfied that, having regard to the nature of the tax-payer's business and the accounting year of the tax-payer, it will be difficult for him to furnish the estimate of advance tax before the last date fixed for the purposes.

Interest Payable by Government.

Under section 214, the Central Government shall pay simple interest at 12% per annum on the amount by which the total advance tax paid during any financial year in which it is payable, exceeds the amount of tax determined on regular assessment from 1st April next following the said financial year to

the date of regular assessment for the assessment year immediately following the said financial year.

The interest so paid by Government will be the income of the assessee from other sources.

Interest Payable by Assessee.

Interest is payable by an assessee in the following three circumstances, namely :

(1) Under section 215(1), where in any financial year an assessee has paid advance tax on the basis of his own estimate and the advance tax so paid is less than 75% of the assessed tax, simple interest at 12% per annum from the 1st April next following the said financial year up to the date of the regular assessment shall be payable by the assessee upon the amount by which the advance tax so paid falls short of the assessed tax. This penal interest is chargeable only in cases where the shortfall in payment of advance tax is more than 25% of the assessed tax.

The expression "assessed tax" means the tax determined on the basis of the regular assessment (reduced by the amount of tax deductible at source) so far as such tax relates to income subject to advance tax and so far as it is not due to variations in the rates of tax made by the Finance Act for the year for which the regular assessment is made.

Under section 215(2), where before the date of completion of regular assessment tax is paid by the assessee on self-assessment or otherwise :

(*a*) interest shall be calculated in accordance with the foregoing provision up to the date on which the tax is so paid, and

(*b*) thereafter interest shall be calculated on the amount by which the tax so paid (in so far as it relates to income subject to advance tax) falls short of the assessed tax.

If, as a result of a rectification of mistake, an appeal, a revision or a reference to the High Court, the amount on which interest is paid is reduced, the excess interest, if any, shall be refunded.

Penalty Imposable

Under section 273, if the Income-Tax Officer, in the course of any proceedings in connection with the regular assessment of a person, is satisfied that the person has committed the following defaults, he may impose a penalty on him :

(*a*) He has furnished under section 212 an estimate of the advance tax payable by him which he knew or had reason to believe to be untrue.

(*b*) He has without reasonable cause failed to furnish an estimate of the advance tax payable by him as required by section 212(3).

(*c*) He has without reasonable cause failed to furnish a higher estimate of the advance tax payable by him as required by section 212(3A).

The amount of penalty, in addition to the tax payable by a person, which can be imposed upon him in respect of the above defaults is as follows :

(*i*) In cases referred to in (*a*), a sum equal to not less than 10% and not more than 150% of the amount by which the advance tax actually paid falls short of

(*a*) 75% of the assessed tax, or

(*b*) where a notice under section 210 was issued to the assessee, the amount payable thereunder, whichever is less.

(*ii*) In cases referred to in (*b*), a sum equal to not less than 10% and not more than 150% of 75% of the assessed tax.

(*iii*) In cases referred to in (*c*), a sum equal to not less than 10% and not more than 150% of the amount by which the tax payable under the notice issued to the assessee under section 210 falls short of 75% of the assessed tax.

Illustration

An Indian company maintaining the calendar year as its previous year was served with a notice of demand for payment of advance tax of Rs. 3,00,000 under section 210 of the Income-Tax Act, 1961, in two equal instalments of Rs. 1,50,000 each, one payable by 15th September 1974 and the other by 15th December 1974.

The company in order to avoid the payment of tax in advance, deliberately submitted a 'nil' estimate in August 1974 knowing fully well that its assessable income arising during 1974 was likely to be very large. No advance tax was paid accordingly during the year to 31st March 1975.

The assessment for the year 1975-76 was completed on 31st October 1975 within a week of the submission of the relevant return of income and the tax payable worked out at Rs. 5,00,000.

Assuming that the rates of tax for the assessment years 1974-75 and 1975-76 remained identical, discuss the liabilities, if any, incurred by the company by submission of a false estimate of advance tax and consequent failure to pay any tax in advance. Compute the measure of such liabilities. (*C. A. Final, May 1969*)

The following liabilities have been incurred by the company on account of the submission of a false estimate of advance tax and consequent failure to pay any tax in advance :

(*1*) *Interest.* Under section 215(1), where in any financial year an assessee has paid advance tax on the basis of his own estimate and the advance tax so paid is less than 75% of the assessed tax, simple interest at 12% per annum from the 1st April next following the said financial year up to the date of the regular assessment shall be payable by the assessee upon the amount by which the advance tax paid falls short of the assessed tax.

Therefore in this case, 12% per annum interest is payable for 7 months on Rs. 5,00,000, as no advance tax has been paid at all. The amount of such interest will be Rs. 35,000.

(*2*) *Penalty.* As the company submitted a false estimate of advance tax, it is liable under section 273 to a penalty of not less than 10% and not more than 150% of the amount by which the advance tax actually paid falls short of :

(*a*) 75% of the assessed tax, or

(*b*) the amount of tax demanded under section 210 whichever is less.

Therefore, the minimum penalty will be 10% of Rs. 3,00,000 and the maximum penalty will be 150% of Rs. 3,00,000.

Note : As the company's previous year ended on 31st December 1974, it had to submit its return of income by 30th June 1975, but it actually filed its return on 24th October 1975. Therefore it has to pay interest at 12% on Rs. 5,00,000 for 3 months and 23 days *i. e.*, from 1-7-1975 to 24-10-1975.

(2) Under section 216, if on making the regular assessment the Income-Tax Officer finds that any assessee has under-estimated the advance tax payable by him and thereby reduced the amount payable in any of the first two instalments, the Income-Tax Officer may require him to pay interest at 12% per annum on the difference between the amount paid in each such instalment and the amount which should have been paid having regard to the aggregate

tax actually paid in advance during the financial year for the period during which the payment of tax was deficient.

For the purpose of this section, any instalment due before the expiry of six months from the commencement of the previous year in respect of which it is to be paid, shall be deemed to have become due 15 days after the expiry of the said six months.

Illustration

A limited company whose accounting year ends on 31st December is required by an order under section 210 to pay during the financial year 1974-75 an advance tax of Rs. 30,000 in three equal instalments. The company furnishes its own estimate under section 212(1) and pays the first two instalments of Rs. 5,000 each on 15th June and 15th September 1974. It revises its estimate under section 212(2) and pays the last instalment of Rs. 7,000 on 15th December 1974.

The regular assessment of the company for 1975-76 is completed on 1st September 1975 and the tax payable determined at Rs. 24,000.

Assuming that the rates of tax for 1974-75 and 1975-76 are the same, calculate the interest payable by the company.

In this case, the assessee company is liable to pay interest both under section 215 and section 216.

Interest under section 215 :

	Rs.
Tax determined on regular assessment	24,000
Advance tax actually paid	17,000
Deficit tax paid	7,000

The interest payable on Rs. 7,000 for 5 months (from 1st April 1975 to 1st September 1975) at 12% per annum is Rs. 350.

Interest under section 216 :

According to the company's own estimate, the total advance tax paid in the financial year 1974-75 is Rs. 17,000. It should have been paid in three instalments of Rs. 5,667, Rs. 5,667 and Rs. 5,666 respectively. The first and the second instalments paid have been short by Rs. 667 each.

The interest payable by the company under section 216 is therefore as follows :

The first instalment was paid on 15-6-1974, but it is deemed to be due on 15-7-74 (15 days after the expiry of six months from the commencement of the previous year in respect of which it is paid). Therefore interest at 12% per annum is due on Rs. 667 for 5 months (15-7-1974 to 15-12-1974). Such interest comes to Rs. 33·35.

The second instalment was paid on 15-9-1974. Therefore interest at 12% per annum is due on Rs. 667 for 3 months (15-9-1974 to 15-12-1974). Such interest comes to Rs. 20·01.

The total interest payable is Rs. 33·35 + Rs. 20·01 = Rs. 53·36.

(3) Under section 217(1), where a person who has not hitherto been assessed to tax fails to furnish an estimate of the advance tax payable by him under section 212(3), simple interest will be chargeable from him at 12% per annum from the 1st April next following the financial year in which the advance tax was payable up to the date of the regular assessment upon the whole amount of the assessed tax.

(4) Under section 217(1A), where a person from whom a demand of advance tax has been made fails to furnish an estimate of the advance tax payable by him under section 212(3A) where the advance tax payable on his

current income exceeds the advance tax demanded from him by more than 33⅓% of the latter, simple interest will be chargeable from him at 12% per annum from the 1st April next following the financial year in which the advance tax was payable up to the date of the regular assessment upon the amount by which the advance tax paid falls short of the assessed tax.

Note : The interest which an assessee has to pay under sections 215-217 and the interest payable to him by Government under section 214 do not arise out of the same transaction. The interest payable by the assessee cannot therefore be deducted from the amount of interest received by him in computing his total income. Nor can the interest payable by him be claimed as business expenditure under section 37 or on the general principle of commercial expediency, where there is nothing to show that the liability was incurred by reason of a mistake on the part of an employee of the assessee (*31 ITR 153*).

Where Assessee Deemed to be in Default.

Under section 218, if any assessee does not pay on the specified date any instalment of advance tax that he is required to pay under section 210 and does not send an estimate or a revised estimate of the advance tax payable by him, he shall be deemed to be an assessee in default in respect of such instalment or instalments.

If an assessee has sent an estimate or a revised estimate of the advance tax payable by him, but does not pay any instalment in accordance therewith on the specified date or dates, he shall be deemed to be an assessee in default in respect of such instalments.

Credit for Advance Tax.

Under section 219, any sum (other than a penalty or interest) paid by an assessee as advance tax shall be deemed as a payment of tax in respect of the income of the period which would be the previous year for an assessment year next following the financial year in which it was payable, and credit therefore shall be given to the assessee in his regular assessment.

Illustrations

(1) B, an individual whose previous year ended on 30th September, receives on 1-5-1974 a notice under section 210 demanding payment of Rs. 60,000 as advance tax during the financial year 1974-75. After due payment of the first two instalments, B estimates that the tax on his income earned during the year to 30th September 1974 would amount to Rs. 1,50,000.

What, if any, are his obligations in regard to advance tax in view of this position ? (*C. A. Final, May 1970*)

In this case the tax on the current income of B (*i. e.*, income which would be assessable in the assessment year 1975-76) is estimated at Rs. 1,50,000, but the tax demanded from him is Rs. 60,000 only. In other words, the tax on the current income is more than 33⅓% of the tax demanded. Therefore it was obligatory for B, under section 212(3A), to file an estimate of his current income and the tax payable thereon and also to pay the advance tax on the basis of his estimate before 15th December 1974 which was the date for the payment of the last instalment in his case because his previous year ended before 31st December 1974.

B was not entitled to apply to the Commissioner for extension of time to file the estimate as the last instalment fell due for payment more than 30 days after the end of his previous year.

B paid as advance tax of Rs. 40,000 on 15th June and 15th September 1974 and he should have paid Rs. 1,10,000 on 15th December 1974 ; but he did not do so. Therefore he is liable to pay the following interest and penalty :

Interest under section 217 (1A). On making the regular assessment interest will be charged at 12% per annum from 1-4-1975 up to the date of the regular assessment on the amount by which the advance tax paid falls short of the assessed tax.

Penalty under section 273(c)(iii) The penalty imposable will be a minimum of 10% and a maximum of 150% of the amount by which the advance tax demanded falls short of 75% of the assessed tax.

(2) While making the assessment of X for the assessment year 1975-76 the Income-Tax Officer finds that the first assessment ever made on the assessee was made on 30th June 1975, the year of assessment being 1973-74. The tax for the assessment year 1975-76 works out at Rs. 1,00,000 and the Income-Tax Officer finds that, although the assessee was fully aware of the largeness of the income when it was earned, he failed without any reasonable cause to pay any tax in advance.

State, in relation to the assessment year 1975-76 what default in law, if any, has been committed by the assessee and indicate the nature of liabilities, if any, he has incurred under the Income-Tax Act for such default. *(C. A. Final, May 1971)*

In this case the assessee is a person who has not so far been assessed by way of a regular assessment before the financial year 1974-75. Therefore in the financial year ending 31st March 1975 X should have filed an estimate of his income liable to advance tax and have paid the advance tax before 15-3-1975. But he did not do so. Hence he has incurred the following liabilities for this default :

Interest under section 217(1). X is liable to pay interest, which will be charged by the Income-Tax Officer on making the regular assessment for 1975-76. The interest will be calculated from 1-4-1975 up to the date of the regular assessment at 12% per annum on Rs. 1,00,000 being the whole amount of tax assessed.

Penalty under section 273(b). X is also liable to a penalty for this wilful default. The amount of the penalty would be a minimum of 10% and a maximum of 150% of 75% of the assessed tax, that is to say, Rs. 10,000 and Rs. 1,12,500 respectively.

RATES IN FORCE FOR FINANCIAL YEAR 1975-76

The rates in force in the financial year 1975-76 for the following purposes are given below :

(*a*) Deduction of tax at source from salaries and retirement annuities payable to partners of registered professional firms.

(*b*) Computation of advance tax payable in the financial year 1975-76.

(*c*) Calculation of tax on current income in special cases as specified below :

- (*i*) Under section 132(5), calculation of tax on undisclosed income where it is not possible to ascertain the previous year to which such income relates.
- (*ii*) Under section 172(4), calculation of tax on the profits of non-residents from occasional shipping business.
- (*iii*) Under section 174(2), calculation of tax on the income of persons leaving India for good.
- (*iv*) Under section 175, calculation of tax on the income of persons likely to transfer property to avoid tax.
- (*v*) Under section 176(2), calculation of tax on the income of discontinued business or profession.

Rates of Tax. With one exception the rates of tax for the above purposes are the same as those applicable to assessments for the assessment year 1975-76 as given in subsequent chapters.

The exception is in respect of closely held domestic companies which are industrial companies. For assessment purposes, in the case of such companies,

the first Rs. 2 lakhs of the income is charged to tax at the rate of 55% and the rate of 60% is applicable on the balance of the total income.

For the above purposes, the concessional rate of 55% will be applicable only to such companies having a total income not exceeding Rs. 2 lakhs. Where the total income exceeds Rs. 2 lakhs, the higher rate of 60% will apply to the entire income of the company, subject to the following marginal relief, namely : where the total income of such companies exceeds Rs. 2 lakhs by a small amount, the income-tax payable will not exceed the aggregate of tax payable on an income of Rs. 2 lakhs *plus* 80% of the balance of income.

The rates of surcharge on income-tax will be 5% in the case of all companies.

Note : The advance tax payable by charitable and religious trusts in the financial year 1973-74 is not to be calculated according to the above rates, but it is to be calculated according to the provisions of section 164 which are explained in a subsequent chapter dealing with the assessment of such trusts.

RECOVERY OF TAX

When Assessee Deemed to be in Default.

Under section 220, if the amount specified in the notice of demand is not paid within the time originally fixed or subsequently extended, at the place and to the person mentioned, the assessee shall be deemed to be in default ; and where payment by instalments is allowed, the assessee shall be treated as in default of the entire amount outstanding if he defaults in payment of any of the instalments.

Where an assessee has appealed, the Income-Tax Officer may, in his discretion and subject to such conditions as he may impose, treat the assessee as not being in default in respect of the amount in dispute in the appeal, even though the time for payment has expired, so long as the appeal remains undisposed of.

Where an assessee has been assessed in respect of income arising outside India in a country, the laws of which prohibit the remittance of money to India, the assessee cannot be treated as being in default in respect of that part of the tax which is due on income which, by reason of such prohibition, cannot be brought into India, and the assessee must continue to be treated as not being in default so long as the prohibition continues.

Modes of Recovery

According to section 229, any sum imposed by way of interest, fine, penalty, or any other sum payable under the provisions of the Income-Tax Act, shall be recoverable in the manner provided for the recovery of arrears of tax. The several modes of recovery of tax are as follows :

1. Certificate to Tax Recovery Officer.

According to section 2(44), the "Tax Recovery Officer" means :

- (*i*) a Collector or an Additional Collector ;
- (*ii*) any such officer empowered to effect recovery of arrears of land revenue as may be authorised by a State Government to exercise the powers of a Tax Recovery Officer ; or
- (*iii*) any Gazetted Officer of the Central or a State Government who may be authorised by the Central Government to exercise the powers of a Tax Recovery Officer.

Under section 222, when an assessee is in default or is deemed to be in default in making payment of tax, the Income-Tax Officer may forward to the

Tax Recovery Officer a certificate under his signature specifying the amount of arrears due from the assessee, and the Tax Recovery Officer on receipt of such certificate shall proceed to recover from such assessee the amount specified therein by one or more of the following modes in accordance with the rules laid down in the Second Schedule to the Income-Tax Act 1961 :

(*a*) attachment and sale of the assessee's movable property ;

(*b*) attachment and sale of the assessee's immovable property ;

(*c*) arrest of the assessee and his detention in prison ; and

(*d*) appointing a receiver for the management of the assessee's movable and immovable properties.

The Income-Tax Officer may issue such a certificate, notwithstanding that proceedings for recovery of the arrears by any other mode have been taken.

Section 223 empowers the Income-Tax Officer to send the certificate both to the Recovery Officer in whose jurisdiction the assessee carries on business and to the Tax Recovery Officer in whose jurisdiction the assessee resides or has any property.

Under section 224(1), the correctness of the assessment shall not be questioned before the Tax Recovery Officer, and no objection to the certificate on any ground shall be entertained by him.

Section 224(2) empowers the Income-Tax Officer, either to withdraw or amend the certificate issued ; and the Income-Tax Officer must intimate to the Tax Recovery Officer any orders withdrawing or amending the certificate.

Notwithstanding that a certificate has been issued to the Tax Recovery Officer for the recovery of any tax, the Income-Tax Officer may grant time for the payment of the tax and thereupon the Tax Recovery Officer shall stay the proceedings until the expiry of the time so granted. Where a certificate for the recovery of tax has been issued, the Income-Tax Officer shall keep the Tax Recovery Officer informed of any tax paid or time granted for payment subsequent to the issue of such certificate.

2. Other Modes of Recovery.

Under section 226, notwithstanding the issue of a certificate to the Tax Recovery Officer, the Income-Tax Officer may recover the tax by any one or more of the modes specified as follows :

(1) Where the assessee is a salaried person, the Income-Tax Officer may require the person paying the salary to deduct from such payment any arrears of tax due from the assessee. However, if any part of the salary is exempt from attachment or execution of a decree of a civil court it cannot be attached by the Income-Tax Officer.

(2) The Income-Tax Officer may, at any time and from time to time, by a written notice, require any person from whom money is due or may become due to the assessee or any person who holds or may subsequently hold money for the assessee, to pay to the Income-Tax Officer so much of the money as is sufficient to pay the amount due by the assessee in respect of arrears or the whole of the money when it is equal to or less than that amount.

Such a notice may be issued to any person who holds or may subsequently hold any money for or on account of the assessee jointly with any other person, the shares of the joint-holders being presumed, until the contrary is proved, to be equal. A copy of the notice is to be forwarded to the assessee and also to the joint-holder.

Every person to whom a notice of attachment is issued is bound to comply with such notice , and in the case of a post-office, banking company or an insurer, the production of pass-book or deposit receipt or a policy is not necessary before payment is made to the Income-Tax Officer.

Where a person objects, by a statement on oath, to the notice of attachment on the ground that the sum demanded is not due to the assessee or that he does not hold any money for the assessee, he cannot be forced to make payment to the Income-Tax Officer ; but if it is subsequently found that the statement was false, he is liable to the extent of his own liability or to the extent of the liability of the assessee whichever is less.

Any person making a payment in compliance with a notice of attachment is deemed to have made the payment under the authority of the assessee, and the receipt of the Income-Tax Officer is a good discharge of the liability of such person to the assessee.

If a person, in disregard of the notice of attachment, makes a payment to the assessee, he would be personally liable to the extent of the payment made to the assessee or to the extent of the assessee's liability whichever is less. If the person, to whom a notice of attachment is sent, fails to make payment in pursuance thereof to the Income-Tax Officer he shall be deemed to be an assessee in default in respect of the amount specified in the notice.

(3) The Income-Tax Officer may apply to the court in whose custody there is money belonging to the assessee for payment to him of the entire amount of such money or, if it is more than the tax due, an amount sufficient to discharge the tax.

(4) The Income-Tax Officer may, if so authorised by the Commissioner by general or special order, recover any arrears of tax due from an assessee by distraint and sale of his movable property.

3. Recovery through State Government.

Under section 227, if the recovery of tax in any area has been entrusted to a State Government, the State Government may direct that tax shall be recovered with any municipal tax or local rate by the same person and in the same manner as the municipal tax or local rate is recovered.

Tax Recovery Commissioner.

According to section 2(43B), Tax Recovery Commissioner means a Commissioner or an Assistant Commissioner of Income-Tax authorised by the Central Government to exercise the powers of a Tax Recovery Commissioner.

In the course of effecting recoveries of taxes, the Tax Recovery Officer is required to pass various orders relating to attachment and sale of properties or appointment of receivers, etc. As the tax recovery work has been practically taken over by officers of the income-tax department, it is provided that an appeal from an original order passed by a Tax Recovery Officer would lie to the Tax Recovery Commissioner.

Apart from attending to the appellate work, the Tax Recovery Commissioners are placed in overall administrative charge of the tax recovery work in their respective jurisdictions.

Recovery of Tax in Pakistan.

Section 228 provides for reciprocal arrangements between India and Pakistan for recovery of tax due to them from the assets of an assessee living in the other country. The Income-Tax Officer may forward a certificate of recovery to a Collector in Pakistan through the Central Board of Revenue of Pakistan, if the assessee has property in the district of that Collector.

Where a Collector in India receives through the Board a certificate under the signature of an Income-Tax Officer in Pakistan, the Collector shall proceed to recover the amount specified therein and shall remit any sum so recovered by him to the Income-Tax Officer in Pakistan, after deducting his expenses in connection with recovery proceedings.

These provisions are to remain in force only so long as there are in force similar provisions in the law of Pakistan for the recovery of tax by a Collector in Pakistan on receipt of a certificate from an Income-Tax Officer in India.

Note: The above-mentioned modes of recovery are not exhaustive. Under section 232, the Government has the right to enforce payment of tax by any other method open to it, *e. g.*, by filing a suit against the defaulting assessee.

The Government has priority over unsecured creditors in the payment of debts in insolvency and liquidation. Therefore, arrears of tax, penalty, fine, interest, etc., which are due to Government, must be paid before the unsecured creditors are satisfied. The fact that a creditor has attached the assessee's property does not give him any preferential right over the Government.

Period for Commencing Recovery Proceedings.

Under section 231, proceedings for the recovery of tax must be commenced within *one* year from the last day of the financial year in which the demand is made, or, in the case of a person who is deemed to be an assessee in default, within *one* year from the last day of the financial year in which the assessee is deemed to be in default.

Write-off of Demand.

Where a defaulting assessee has no assets whatever, and the amount of tax due from him has become totally irrecoverable, on an application made by the Income-Tax Officer and recommended by the Inspecting Assistant Commissioner, the Commissioner has the power to sanction the write-off of the amount as irrecoverable.

The mere fact that a demand of income-tax is written off by the Department in their own accounts does not preclude the Department from recovering any arrears of tax outstanding when they find that it has become possible to recover it (*34 ITR 113*).

TAX-CLEARANCE CERTIFICATES

In order to secure that payment of tax is not evaded by any person, not domiciled in India but liable to tax, leaving the territory of India without setting his tax dues, section 230 provides for tax-clearance certificates.

Under this section, subject to such exceptions as the Central Government may specify in this behalf, a person who is not domiciled in India (or who, even if domiciled in India at the time of his departure, has no intention of returning to India) cannot leave the territory of India, by land, sea or air, unless he first obtains from such authority as may be appointed by the Central Government in this behalf (referred to as the "competent authority") a certificate stating that he has no liabilities under the Income-Tax Act and other Direct Taxes Acts, or that satisfactory arrangements have been made for the payment of all such taxes which are or may become payable by that person.

However, in the case of a person not domiciled in India the competent authority may, if it is satisfied that such person intends to return to India, issue an exemption certificate either in respect of a single journey or in respect of all journeys to be undertaken by that person within such period as may be specified in the certificate.

If the owner or charterer of any ship or aircraft allows any person to travel by such ship or aircraft without first satisfying him if that such person is in possession of a tax-clearance certificate or an exemption certificate, he shall be personally liable to pay the whole or any part of the amount of tax, if any, payable by such person as the Income-Tax Officer may determine. In respect of

any sum payable by the owner or charterer of any ship or aircraft, the owner or charterer shall be deemed to be an assessee in default for such sum.

Exemption. The following categories of persons have been exempted by the Central Government from producing tax-clearance certificates :

(1) All persons below the age of 18 years.

(2) Persons who are not domiciled in India provided their stay in India does not exceed 90 days.

(3) All employees of Government or a local authority and their wives.

(4) British service officers and other ranks proceeding ex-India on termination of their contract of service with the Government of India and their wives.

(5) All diplomatic envoys of foreign and commonwealth countries accredited to India and their wives.

(6) Foreign consular officers *de carriere* posted in India and their wives.

(7) Trade Commissioners and trade Agents *de carriere* of foreign and Commonwealth countries posted in India and their wives.

(8) Members of the staff on the establishment of any of the officers mentioned in (5) ; (6) and (7) above, provided they are nationals of the country represented by the officer.

(9) All persons proceeding on pilgrimage by sea to Hejaz provided they travel in deck class on the pilgrim ships with return tickets, hold pilgrim passes and are not in possession of international passports.

(10) All persons proceeding on pilgrimage by sea to Iran and Iraq provided they travel in deck class with return tickets, hold pilgrim passes and are not in possession of international passports.

Restriction on Registration of Transfers of Property.

Section 230A prohibits a registering authority appointed under the Indian Registration Act, 1908, from registering any document purporting to transfer, assign, limit or extinguish the right, title or interest of any person to or in any immovable property (*including agricultural land*) valued at more than Rs. 50,000, unless the person concerned produces before such authority a certificate from the Income-Tax Officer stating that :

(*a*) such person has paid or made satisfactory arrangements for the payment of all his existing tax liabilities under the Income-Tax Act and other Direct Taxes Acts and also under the Companies (Profits) Surtax Act as also the Super Profits Tax Act, or

(*b*) the registration of the document will not prejudicially affect the recovery of any existing liability under the said Acts.

The Central Board of Direct Taxes is empowered to exempt, by notification in the Official Gazette, any institution, association or body from the above requirement of obtaining a tax clearance certificate. This power is conferred on the Board so as to obviate practical difficulties in the case of institutions such as banks, Life Insurance Corporation, etc., which advance moneys in a large number of cases on the mortgage of immovable property and have to release the property from the mortgage when the debt has been discharged by the borrower.

This section now covers transfers of agricultural land. This is because agricultural land is liable to wealth-tax and transfers of agricultural land are

liable to gift-tax. Capital gains arising from transfers of agricultural land situated in urban areas are liable to income-tax. Apart from these considerations, agricultural land is liable to be attached and sold for recovery of income-tax arrears.

The provisions of section 230A have no application whatever to involuntary acts resulting in transfer, assignment, limitation or extinguishment of rights in property by the force of law or under an order of the court or under a decree (*83 ITR 430*).

REFUND OF TAX

Sections 237-245 deal with refund. The provisions of these sections are as follows :

When Claim for the Refund Arises. A person is entitled to refund of tax if the amount of tax paid by him or on his behalf is greater than the amount with which he is properly chargeable. A claim for refund of tax may arise in any of the following circumstances :

(*a*) Where tax has been deducted at source at a rate higher than the rate applicable to the total income of an assessee.

(*b*) Where the tax paid in advance exceeds the tax payable as determined on regular assessment.

(*c*) Where the total income is reduced in appeal or revision.

(*d*) Where the tax originally determined is reduced on account of rectification of a mistake.

(*e*) Where relief for double taxation is due.

So far as cases (*b*), (*c*) and (*d*) are concerned, no application for refund is necessary, because the Income-Tax Officer will grant the refund of his own accord.

Procedure for Claiming Refund. The assessee has to apply for refund in the prescribed form. An application for refund has to be made within the period specified below.

The application for refund must be accompanied by the return of income and also by certificates of deduction of tax at source. If the applicant is resident, the application should be made to the Income-Tax Officer who has jurisdiction to assess him. In the case of a non-resident, whose entire income has been taxed at source, the application should be made to the Income-Tax Officer, Non-resident Refund Circle, Bombay. In other cases, the Income-Tax Officer who has jurisdiction over the non-resident or his agent, is the officer to whom the application should be sent.

In a claim for refund, it is not open to the assessee to question the correctness of any assessment or other matter decided which has become final and conclusive or ask for review of the same.

Who is Entitled to Refund ? It is the owner of the income who applies for refund ; but where one person's income is included in the total income of another person and taxed in the latter's hands, it is the latter person who is entitled to apply for refund. The executor, administrator or other legal representative of a deceased assessee or the trustee or receiver in insolvency or the liquidator of a company or a guardian on behalf of an *incapax* is entitled to apply.

Limitation. A claim for refund must be made within the period specified below :

(*a*) Where the claim is in respect of income assessable for any assessment year commencing on or before 1st April 1967, *four* years from the last day of such assessment year.

(*b*) Where the claim is in respect of income assessable for the assessment year 1968-69, *three* years from the last day of the assessment year.

(*c*) Where the claim is in respect of income assessable for any other assessment year, *two* years from the last day of such assessment year.

This period of limitation does not apply to claims for refund of tax on account of reversal or modification of a judgment by the Supreme Court. In such cases the question of limitation does not arise at all as it is the duty of the authorities to make a refund under section 262(3) (*46 ITR 523*).

Issue of Refund. When the Income-Tax Officer is satisfied that refund is due to the assessee, he will issue a refund voucher payable at the Reserve Bank or the State Bank of India or any treasury or sub-treasury. If the applicant is a resident and the amount of refund is small, the amount may be sent by money order at Government cost. In the case of a non-resident, the amount of refund is remitted to him by bank draft at his cost, unless he appoints a duly authorised agent to receive the payment in India.

Appeal. An appeal lies against an order of the Income-Tax Officer refusing refund claimed or allowing short refund, to the Appellate Assistant Commissioner in the first instance and to the Appellate Tribunal thereafter. An alternative course is also open, namely, a petition to the Commissioner for revision.

Submission of a false application for refund is punishable on conviction before a magistrate with rigorous imprisonment up to two years subject to a minimum of six months.

Interest on Delayed Refunds. If the Income-Tax Officer does not grant the refund within the time stated below, the Central Government shall pay the assessee simple interest at 12% per annum on the amount directed to be refunded from the date immediately following the expiry of the period of three months to the date of the order granting the refund :

(*a*) In a case where the total income of the assessee consists only of interest on securities or dividends or both, interest will be payable for the period of delay beyond three months from the end of the month in which the claim for refund is made.

(*b*) In all other cases of delay in the grant of refund, interest will be payable for the period of delay beyond three months from the end of the month in which the total income is determined.

In computing the period for which interest is payable by Government, the period for which the delay is attributable to the assessee will be excluded.

Where a refund is due to an assessee in pursuance of an order passed in an appeal or other proceedings and the Income-Tax Officer does not grant the refund within a period of three months from the end of the month in which such order is passed, the Central Government will pay to the assessee simple interest at 9 per cent per annum on the amount of refund due from the date immediately following the expiry of the period of three months aforesaid to the date on which the refund is granted. In such a case it is not necessary for the assessee to make any claim for refund.

Exemption or Abatement Certificate. The necessity for making a claim for the refund of tax on account of deduction of tax at source can be avoided by obtaining a certificate from the Income-Tax Officer to the effect that the total income of the recipient is not liable to tax or is liable only at a lower rate. The certificate remains in force for a limited period or until it is cancelled by the Income-Tax Officer.

Set-off of Refund. Where a refund is found due to any person, the Income-Tax Officer, the Appellate Assistant Commissioner or the Commissioner

may, in lieu of payment of refund, set-off the refund against any sum remaining payable, after giving a written intimation thereof to the person.

DOUBLE TAXATION RELIEF

Double taxation arises where a person is subjected to tax on the same income in different countries on account of the differing operation of the taxation laws of each country.

The basic distinction between double taxation relief agreements and double taxation avoidance agreements is that in the former case the assessee is called upon to pay the tax first and then to claim relief; while the purpose of the latter is to avoid the necessity of taxing the same income in both the countries. The idea underlying the double taxation avoidance agreements is that as far as possible the same income does not become chargeable in the two countries simultaneously.

Some tax-payers having transactions with outside countries resort to dubious methods for evasing their liability under the tax laws. Tax evasion is thus closely linked with transactions involving over-invoicing and under-invoicing in import and export business, operations through secret foreign bank accounts and smuggling of valuable articles into and out of India. Cases of tax-payers, who thwart the attempts of the tax administration to collect tax dues by either retaining their assets abroad or transferring them secretly outside India, are also not unknown.

With a view to enabling the tax administration to tackle the problem of tax evasion having international ramifications, section 90 empowers the Central Government to enter into an agreement with the Government of a foreign country not only for the avoidance or relief of double taxation of income under the Income-Tax Act and under any corresponding law in force in that foreign country, but also for enabling the exchange of information for the prevention of evasion or avoidance of income-tax or for recovery of income-tax in either treaty country.

Corresponding amendments have also been made in section 44A of the Wealth-Tax Act, section 44 of the Gift-Tax Act and in section 24A of the Companies (Profits) Surtax Act respectively.

Double Taxation Relief Arrangements.

There are reciprocal arrangements for relief from double taxation between India and certain Commonwealth countries such as Aden, Kenya, Tanganyika, Uganda, Zanzibar, Ghana, Nigeria, Seirra Leone, Gambia and Mauritius. The arrangements operate in such a way that the combined relief obtained by a tax-payer on his doubly taxed income in the two countries is at the lower of the two taxes charged by India and the Commonwealth country.

Agreements for Avoidance of Double Taxation.

At present India has agreements for avoidance of double taxation with Pakistan, Ceylon, Sweden, Norway, Denmark, the Federal Republic of Germany, Japan, Finland, Austria, Greece and Lebanon. Comprehensive agreements for avoidance of double taxation of income with France and U.A.R. have been signed but are awaiting ratification. There are also agreements with Switzerland covering income of enterprises operating aircraft and with Rumania covering income of enterprises operating aircraft and shipping. Negotiations for comprehensive agreements for avoidance of double taxation of income with the United States of America, Belgium, Rumania and Italy are in progress.

The agreements for avoidance of double taxation with Sweden, Denmark, Norway, West Germany, Japan, Finland, Austria and the proposed agreement with U.S.A. can be broadly divided into two groups as follows :

(1) The agreements with Sweden, Denmark, Norway, Finland, Austria and to some extent the agreement with West Germany are based on the method of exclusion, *i. e.*, the income from sources allocated to one country is not taxed in the other country, though it can be taken into account for purposes of determining the rate of tax, if the laws of that country so require.

(2) The agreement with Japan, the proposed agreement with the U.S.A, and to some extent the agreement with West Germany are based on the method of tax credit, *i. e.*, the tax in the two countries is levied according to their respective laws but credit for the tax payable in one country is provided for by the other in respect of income from sources allocated to the first country. These agreements provide for giving credit for tax that would have been paid in India but for certain tax incentives.

Effect of Tax Treaties. The agreements for avoidance of double taxation not only demarcate the zones of taxation between India and the foreign countries concerned according to the nature and source of Income, but also ensure that the benefit of tax incentives is retained by the foreign investor as far as possible.

Unilateral Relief in India.

In the case of countries with which India has no agreement for relief or avoidance of double taxation, the Income-Tax Act grants the following unilateral relief of an assessee :

(1) Under section 91(1), a unilateral relief in respect of doubly taxed income is granted to a resident in India. The relief is limited to the lower of the two taxes. It is admissible on the income accruing or arising outside India but not on the income which is deemed to accrue or arise in India.

(2) A resident assessee is liable to income-tax in respect of his agricultural income in Pakistan. The agricultural income also suffers agricultural income-tax in Pakistan. Therefore section 91(2) allows relief in such cases. This relief is equal to either the Indian income-tax on the agricultural income in Pakistan or the Pakistan agricultural income-tax thereon, whichever is less.

(3) Section 91(3) provides for relief to a non-resident partner of a resident registered firm in respect of the share of income from the firm assessed in India as well as in a foreign country. The amount of relief on such doubly taxed income is to be calculated at the Indian rate of tax or the foreign rate of tax, whichever is lower, or at the Indian rate if both the rates are equal.

CHAPTER 19

Tax Credit Certificates

The law relating to the grant of tax credit certificates is contained in sections 280Y-280ZE.

A tax credit certificate is a form of monetary assistance given by Government to an assessee. Tax credit certificates are granted for the following purposes, namely :

(*a*) To provide an incentive to individuals and Hindu undivided families investing in newly issued equity shares of certain companies.

(*b*) To facilitate the shifting of industrial undertakings of public companies from urban areas to new areas.

(*c*) To encourage companies engaged in important industries and earning profits higher than in a base year.

(*d*) To stimulate exports.

(*e*) To encourage the production of certain goods liable to Central excise duty.

The amount due on the tax credit certificate is adjusted against any tax liability of the certificate-holder existing on the date on which the certificate is produced before the Income-Tax Officer, and the balance amount, if any, is to be refundable to him forthwith.

The amount of a tax credit certificate, whether adjusted against the tax liability of the certificate-holder or refunded to him, is wholly exempt from tax in all cases and is not included in the total income of any person.

The main provisions in regard to tax credit certificates are as follows :

1. Tax Credit Certificates to Certain Equity Shareholders.

Under section 280Z, in order to encourage investment in equity shares issued by public limited companies engaged in important industries, a monetary assistance is given to individuals and Hindu undivided families (whether resident or non-resident) subscribing to and paying for the issue of equity capital by such companies, or purchasing them from underwriters.

This assistance is in the form of a tax-free tax credit certificate for an amount calculated at 5% of the paid-up amount up to Rs. 15,000, at 3% of the next Rs. 10,000, and at 2% of the next Rs. 10,000 making in all Rs. 1,250 for a total investment of Rs. 35,000, by an individual or a Hindu undivided family. On an investment of Rs. 35,000 the relief work out at a tax-free return of 3·57%.

Tax credit certificates in respect of investment in the equity capital during a financial year will be granted for that financial year and for each of

the three successive years if the shares continue to be held until the end of the relevant year. If during any one of the three financial years subsequent to the year in which the investment was made, any such shares are sold or transferred, the individual or the Hindu undivided family concerned will be entitled to receive tax credit certificates for an amount proportionate to the investment retained after the sale or transfer.

The scope of 'eligible issue' of equity shares and the procedure for the grant of tax credit certificates has been laid down in a scheme notified by the Central Government in this behalf.

2. Tax Credit Certificates to Public Companies Shifting their Industrial Undertaking from an Urban Area to any Other Area.

Under section 280ZA, a relief is provided for companies owning an industrial undertaking from tax on the capital gains arising to them from the transfer of lands and buildings situated in an urban area, *where such transfer has been made with a view to shifting to any other area.* 'Urban area' means any area which the Central Government may declare to be an urban area having regard to the population, concentration of industries and other relevant factors.

The relief will be admissible where the company incurs expenditure in such other area on the acquisition of land, construction of buildings (including residential houses, hospitals, schools, etc., for its employees) and transportation of its machinery and other effects.

The amount of relief will be such proportion of the tax on the capital gains as the above-mentioned expenditure bears to the total amount of the capital gains, but not exceeding the amount of tax on the capital gains.

The tax relief will be given in the form of tax credit certificates, and the conditions for the grant of this relief are that the prior approval of the Central Board of Direct Taxes should be obtained by the company before shifting to the new area and the tax relief will be allowed for expenditure incurred in the new area during a period of three years from the date of such approval.

If the land or building in the new area is transferred by the company within a period of five years to any person other than the Government, a local authority, a statutory corporation or a Government company, half of the amount for which the tax relief was granted will be withdrawn and will become payable immediately by way of tax.

Detailed procedure for the grant of such certificates has been laid down in a scheme notified by the Central Government in this behalf.

3. Tax Credit Certificates to Industrial Companies liable to Income-Tax and for Surtax in Excess of Such Tax Payable in the 'base year'.

With a view to stimulating the growth and expansion of industry in the corporate sector, section 280ZB provides for the grant of tax-free credit certificates to companies engaged in the manufacture or production of any of the articles specified in the First Schedule to the Industries (Development and Regulation) Act, 1951, for a five-year period from the assessment year 1966-67 to 1970-71.

The amount of the tax credit certificate will be calculated at 20% of the amount by which the aggregate liability of the company to income-tax and surtax (if any) for any one or more of the years comprised in the aforesaid five-year period exceeds the aggregate liability of the company to the said taxes during the 'base year'. The amount of the tax credit certificate will however, be subject to maximum of 10% of the aggregate amount of such income-tax and surtax payable by the company for the relevant year.

In the case of companies which are liable to income-tax and surtax (if any) for the assessment year 1965-66, the base year will be the assessment year

1965-66. In the case of a company which is not liable to pay any tax for the assessment year 1965-66 but becomes so liable for any but the last of the following five years (1966-67—1970-71), such year will be treated as the 'base year', and the tax credit certificate will be granted in respect of the excess of the aggregate tax which it becomes liable to pay for any subsequent assessment year (within the five-year period mentioned above) over the aggregate tax for such base year.

The period during which a company should utilise its moneys for the purposes mentioned above and the procedure for the issue of tax credit certificates have been specified in a scheme framed by the Central Government for the purpose.

4. The Credit Certificates in Relation to Exports.

Under section 280ZC, any person who exports outside India, after the 28th February 1965, any goods or merchandise specified in a scheme by the Central Government, is entitled to a tax credit certificate of an amount calculated at the rates specified in the scheme, not exceeding 15% of the sale proceeds of the goods or merchandise.

The tax credit certificate is to be granted if the exporter receives the sale proceeds in India in accordance with the Foreign Exchange Regulation Act, 1947.

The Central Government has notified a scheme named "Tax Credit Certificate (Exports) Scheme, 1965" relating to the above-mentioned tax credit certificates. This scheme *inter alia* specifies the commodities for the export of which such tax credit certificates will be granted, the rates at which the amount of the certificate is to be calculated in each case, and the procedure to be followed in issuing the certificates.

5. Tax Credit Certificates in Relation to Increased Production of Goods.

Under section 280ZD, any person who manufactures or produces any goods during any one or more of the five financial years from 1965-66 to 1969-70 and clears such goods for the purpose of Central excise duty in a quantity exceeding the quantity of the goods so cleared by him during the 'base year', is entitled to a tax credit certificate for an amount being not more than 25% of the Central excise duty payable by him on the excess quantity of goods cleared during each of the relevant financial years.

The 'base year' in relation to an undertaking existing in the financial year 1964-65 is that very financial year, and in relation to any other undertaking it is the financial year in which such undertaking begins to manufacture or produce goods.

The goods in respect of which the tax credit certificate is to be granted and the rate at which the amount of the certificate is to be calculated are specified in a scheme notified by the Central Government for the purpose.

CHAPTER 20

Appeals And Revision

1. Appeal to the Appellate Assistant Commissioner

Appealable Orders.

Under-section 246, any person aggrieved by any of the following orders of an Income-Tax Officer may appeal to the Appellate Assistant Commissioner against such order :

(*a*) an order against a company, in which the public are not substantially interested, imposing additional income-tax under section 104.

(*b*) an order imposing a fine under section 131(2) on a person to whom a summons is issued either to attend to give evidence or to produce books of account or other documents and who intentionally omits to attend or produce the books of account or documents.

(*c*) an order against the assessee where the assessee denies his liability to be assessed, or any order of assessment under section 143(1) or 143(3) or section 144 where the assessee objects to the amount of income assessed or to the amount of tax determined or to the amount of loss computed, or to the status under which he is assessed.

(*d*) an order under section 146 refusing to reopen an assessment made under section 144.

(*e*) an order of assessment, reassessment, or recomputation under section 147 or section 150.

(*f*) an order of rectification of mistake under section 154 or section 155 wherever such orders are prejudicial to the assessee, or an order refusing to allow the claim made by the assessee under either of these sections.

(*g*) an order under section 163 treating the assessee as the agent of a non-resident.

(*h*) an order under sections 170(2) or (3) imposing an assessment on the successor in respect of the income of the predecessor or requiring the former to pay the tax due from the latter.

(*i*) an order under section 171 relating to the assessment after partition of a Hindu undivided family.

(*j*) an order under section 185(1)(b) or section 185(2), (3) and (5) relating to registration of firms.

(*k*) an order cancelling the registration of a firm under section 186(1) or (2).

(*l*) an order under section 201 treating a person as an assessee in default on account of his failure to deduct tax or pay it to Government.

(*m*) an order under section 216 regarding interest payable by an assessee in case of under-estimate of advance tax.

(*n*) an order under section 237 regarding refund of tax.

(*o*) an order imposing a penalty :
under section 140A (failure to pay the tax on self-assessment),
under section 221 (failure to pay the tax),
under section 270 (failure to furnish information regarding securities, etc.),
under section 271 (failure to furnish returns, comply with notices, concealment of income, etc.),
under section 272 (failure to give notice of discontinuance of business or profession),
under section 273 (false estimate of or failure to pay advance tax).

Under section 247, where the partners of a firm are individually assessable on their shares in the total income of the firm, any such partner may appeal to the Appellate Assistant Commissioner against any order of an Income-Tax Officer determining the amount of the total income or the loss of the firm or the apportionment thereof between the several partners, but he cannot agitate such matters in any appeal preferred against an order of assessment determining his own total income or loss.

Under section 248, any person having deducted and paid tax in respect of any sum, other than interest, who denies his liability to make such deduction, may appeal to the Appellate Assistant Commissioner to be declared not liable to make such deduction.

Form of Appeal and Limitation.

According to section 249, every appeal shall be in the prescribed form and shall be verified in the prescribed manner.

The appeal shall be presented within 30 days of the following dates, that is to say :

(*a*) where the appeal relates to any tax deducted from payments to non-residents under section 195, the date of payment of the tax, or

(*b*) where the appeal relates to any assessment or penalty, the date of service of the notice of demand ; or

(*c*) in any other case, the date on which intimation of the order sought to be appealed against is served.

The Appellate Assistant Commissioner may admit an appeal after the expiry of the above period if he is satisfied that the appellant had sufficient cause for not presenting it within that period.

Procedure in Appeal.

Under section 250, the Appellate Assistant Commissioner shall fix a day and place for the hearing of the appeal, and shall give notice of the same to the appellant and to the Income-Tax Officer against whose order the appeal is preferred.

The following shall have the right to be heard at the hearing of the appeal :

(*a*) The appellant either in person or by an authorised representative ; and

(*b*) The Income-Tax Officer either in person or by a representative.

The Appellate Assistant Commissioner shall have the power to adjourn the hearing of the appeal from time to time. He may, before hearing any appeal, make such further inquiry as he thinks fit or may direct the Income-Tax Officer to make further inquiry and report the result of the same to him. He may, at the hearing of an appeal, allow the appellant to go into any ground of appeal not specified in the grounds of appeal, if he is satisfied that the omission of that ground from the form of appeal was not wilful or unreasonable.

The order of the Appellate Assistant Commissioner disposing of the appeal shall be in writing and shall state the points for determination, the decision thereon and the reason for the decision. On the disposal of the appeal, the order passed by the Appellate Assistant Commissioner shall be communicated to the assessee and to the Commissioner.

Power of Appellate Assistant Commissioner.

Under section 251, in disposing of an appeal, the Appellate Assistant Commissioner shall have the following powers, namely :

(*a*) In an appeal against an order of assessment, he may confirm, reduce, enhance or annul the assessment, or he may set aside the assessment and refer the case back to the Income-Tax Officer for making a fresh assessment in accordance with the directions given by him and after making such further inquiry as may be necessary, and the Income-Tax Officer shall thereupon proceed to make such fresh assessment and determine, where necessary, the amount of tax payable.

(*b*) In appeal against an order imposing a penalty, he may confirm or cancel such order or vary it by enhancing or reducing the penalty ;

(*c*) In any other case, he may pass such orders as he thinks fit.

The Appellate Assistant Commissioner, shall not enhance an assessment or a penalty or reduce the amount of refund without giving the appellant a reasonable opportunity of showing cause against such enhancement or reduction.

In disposing of an appeal, the Appellate Assistant Commissioner may consider and decide any matter arising out of the proceedings in which the order appealed against was passed, notwithstanding that such matter was not raised before him by the appellant. Thus, the Appellate Assistant Commissioner is not confined to the points raised by the appellant in the appeal.

Under section 295, the Central Board of Direct Taxes is empowered to make rules regarding the circumstances in which, the conditions subject to which and the manner in which the Appellate Assistant Commissioner may permit an appellant to produce evidence which he did not produce or which he was not allowed to produce before the Income-Tax Officer.

2. Appeal to the Appellate Tribunal

Appellate Tribunal.

Under section 252, the Central Government shall constitute an Appellate Tribunal consisting of as many judicial and accountant members as it thinks fit to exercise the powers and discharge the functions of the Appellate Tribunal under the Act.

A judicial member shall be a person who has for at least ten years held a civil judicial post or who has been a member of the Central Legal Service (not below Grade III) for at least three years or who has been in practice as an advocate for at least ten years.

An accountant member shall be a person who has for at least ten years been in the practice of accountancy as a chartered accountant, or who has served as an Assistant Commissioner of Income-Tax for at least three years.

The Central Government shall ordinarily appoint a judicial member of the Appellate Tribunal to be the President thereof.

Appeal to Appellate Tribunal.

Under section 253(1), any assessee aggrieved by any of the following orders may appeal to the Appellate Tribunal against such order :

(*a*) an order passed by an Appellate Assistant Commissioner under section 131(2), imposing a fine for non-attendance or non-production of books of account, under section 154 ordering a rectification of mistake, under section 250 disposing of an appeal or under section 271 imposing a penalty ; or

(*b*) an order passed by an Inspecting Assistant Commissioner under section 154 rectifying a mistake or under section 274(2) sanctioning the imposition of a penalty of more than Rs. 1,000 ; or

(*c*) an order passed by a Commissioner under section 263 in revision, under section 285A imposing a fine, or under section 154 rectifying a mistake.

Under section 253(2), if the Commissioner objects to any order passed by an Appellate Assistant Commissioner under section 154 or section 250, he may direct the Income-Tax Officer to appeal to the Appellate Tribunal against the order.

Procedure for Appeal.

An appeal to the Appellate Tribunal shall be filed within 60 days of the date on which the order sought to be appealed against is communicated to the assessee or to the Commissioner.

The Income-Tax Officer or the assessee, on receipt of notice that an appeal against the order of the Appellate Assistant Commissioner has been preferred by the other party, may, within 30 days of the receipt of the notice file a memorandum of cross objections verified in the prescribed manner against any part of the orders of the Appellate Assistant Commissioner, and such memorandum shall be disposed of by the Appellate Tribunal as if it were an appeal presented within the prescribed time of 60 days.

The Appellate Tribunal may admit an appeal or permit the filing of a memorandum of cross-objections after the expiry of the time specified above if it is satisfied that there was sufficient cause for not presenting it within that time.

An appeal to the Appellate Tribunal shall be in the prescribed form and shall be verified in the prescribed manner and shall, except in the case of an appeal filed by the Department or memorandum of cross-objections, be accompanied by a fee of Rs. 125.

Order of Appellate Tribunal.

Under section 254, the Appellate Tribunal may, after giving both the parties to the appeal an opportunity of being heard, pass such orders as it thinks fit.

The Appellate Tribunal has no power to enhance the tax or penalty because it is the final court of appeal on facts. If the power of enhancement were given, there would be no opportunity for the appellant to have that matter considered by a higher court.

The Appellate Tribunal may, at any time within four years from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it, and shall make such amendment if the

mistake is brought to its notice by the assessee or the Income-Tax Officer. But no such order, which is prejudicial to the assessee, shall be made unless the Tribunal has given notice to the assessee of its intention to do so and has allowed him a reasonable opportunity of being heard.

The Appellate Tribunal shall send a copy of orders passed by it to the assessee and to the Commissioner.

On questions of fact the orders passed by the Appellate Tribunal shall be final.

Procedure of Appellate Tribunal.

The powers and functions of the Appellate Tribunal may be exercised and discharged by Benches constituted by the President of the Tribunal from amongst the members thereof.

Subject to the following exceptions, a Bench shall consist of one judicial member and one accountant member.

(*a*) The President or any other member of the Tribunal authorised in this behalf by the Central Government may singly dispose of any case which pertains to an assessee whose total income as computed by the Income-Tax Officer does not exceed Rs. 40,000.

(*b*) The President may, for the disposal of any particular case, constitute a special Bench consisting of three or more members, one of whom shall necessarily be a judicial member and one an accountant member.

(*c*) If the members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority if there is a majority, but if the members are equally divided, they shall state the point on which they differ, and the case shall be referred by the President for hearing on such point by one or more of the other members of the Tribunal, and any such point shall be decided according to the opinion of the majority of the members who have heard the case including those who first heard it.

The Appellate Tribunal shall have power to regulate its own procedure and the procedure of Benches thereof in all matters arising out of the exercise of its powers or of the discharge of its functions including the places at which the Benches shall hold their sittings.

The Appellate Tribunal shall, for the purpose of discharging its functions, have all the powers which are vested in the Income-Tax authorities, and any proceeding before the Tribunal shall be deemed to be a judicial proceeding, and the Tribunal shall be deemed to be a court for all the purposes of section 195 and Chapter XXXV of the Code of Criminal Procedure, 1898.

3. Reference to High Court

Under section 256, the assessee or the Commissioner may, within 60 days of the date upon which he is served with notice of an order of the Appellate Tribunal, by application in the prescribed form accompanied, where the application is made by the assessee, by a fee of Rs. 125, require the Appellate Tribunal to refer to the High Court of the State concerned *any question of law* arising out of such order, and the Tribunal shall, within 20 days of the receipt of such application, draw up a statement of the case and refer it to the High Court.

The only question of law which the assessee or the Commissioner can require the Appellate Tribunal to refer to the High Court under section 256 is any question of law arising out of the order of the Tribunal ; the Tribunal is

not bound to refer a question of law which does not arise out of its order. It is the fact admitted or found by the Appellate Tribunal that would form the basis on which the statement of case would be drawn and reference on the question of law made by the Tribunal to the High Court. Facts, which are not found in the order of the Tribunal or in the record before it cannot be the foundation for the raising of a question of law (*37 ITR 11*).

The Tribunal may, if it is satisfied that the applicant was prevented by sufficient cause from presenting the application in time, allow it to be presented within a further period not exceeding 30 days.

If the Tribunal refuses to state the case on the ground that no question of law arises, the assessee or the Commissioner may within six months from the date on which he is served with notice of such refusal, apply to the High Court and the High Court may require the Tribunal to state the case and refer it, and on receipt of any such requisition, the Tribunal shall state the case and refer it accordingly.

Where the Appellate Tribunal refuses to state a case, which it has been required by the assessee to state, the assessee may within 30 days from the date on which he receives notice of such refusal, withdraw his application and, if he does so, the fee of Rs. 125 paid by him shall be refunded.

Under section 257 if, on an application for reference, the Appellate Tribunal is of the opinion that, on account of a conflict in the decisions of High Courts in respect of any particular question of law, it is expedient that a reference should be made direct to the Supreme Court, the Tribunal may draw up a statement of the case and refer through its President direct to the Supreme Court.

Under section 258, if the High Court or the Supreme Court is not satisfied that the statement in a case referred to it are sufficient to enable it to determine the questions raised thereby, the Court may refer the case back to the Appellate Tribunal for the purpose of making such additions thereto or alterations therein as it may direct in that behalf.

Procedure for Hearing. According to section 259, a case referred to the High Court is to be heard by a Bench of not less than two judges of the High Court and is to be decided in accordance with the opinion of such judges or of the majority (if any) of such judges. Where there is no such majority, the judges shall state the point of law upon which they differ, and the case shall then be heard upon that point only by one or more of the other judges of the High Court, and such point shall be decided according to the opinion of the judges who have heard the case including those who first heard it.

Decision. Under section 260, the High Court or the Supreme Court upon hearing any such case shall decide the question of law raised therein, and shall deliver its judgment thereon containing the grounds on which such decision is founded, and a copy of the judgment shall be sent to the Appellate Tribunal which shall pass such orders as are necessary to dispose of the case conformably to such judgment.

The cost of any reference to the High Court or the Supreme Court, which shall not include the fee for making the reference, shall be in the discretion of the Court.

Questions of Law and Fact.

A question which involves an interpretation of any portion of the Income-Tax Act (or for that matter any other Act) or the application of any general principal of law is a clear question of law. A clear question of fact is one which can be answered or disposed of on the basis of the admitted or proved facts. But quite often there is little margin between them. For example, to hold that a document is not genuine is a finding of fact ; whether there was evidence

on which this finding is based is a question of law. Again, the question whether a finding of fact is consistent or inconsistent with the evidence on record is a question of law.

A finding on a question of fact is open to attack as erroneous in law only if it is not supported by any evidence or it is unreasonable and perverse. But where there is evidence to consider, the decision of the Tribunal is final, even though the High Court might not, on the materials, have come to the same conclusion if it had the power to substitute its own judgment (*31 ITR 36*).

The position which emerges from the decided cases is as follows :

(1) Where the point for determination is a pure question of law such as construction for a statute or document, the decision of the Tribunal is open to reference to the High Court.

(2) Where the point of determination is a mixed question of law and fact, while the finding of the Tribunal on the facts found is final, its decision as to the legal effect of those finding is a question of law which can be reviewed by the High Court.

(3) A finding on a question of fact is open to attack under section 256 as erroneous in law where there is no evidence to support it or if it is perverse.

(4) Where the finding is one of fact, the fact that it is itself an interference from other basic facts will not alter its character as one of fact.

4. Appeal to the Supreme Court

Under section 261, an appeal shall lie to the Supreme Court from any judgment of the High Court delivered on a reference made under section 256 in any case which the High Court certifies to be a fit case for appeal to the Supreme Court. The cost of the appeal shall be in the discretion of the Supreme Court.

Where the judgment of the High Court is varied or reversed in the appeal, effect shall be given to the order of the Supreme Court in the manner provided in the case of a judgment of the High Court.

Under section 265, notwithstanding that a reference has been made to the High Court or the Supreme Court or an appeal has been preferred to the Supreme Court, tax shall be payable in accordance with the assessment made in the case.

5. Writ Petitions

Apart from the jurisdiction which the High Court exercises under section 256 and the Supreme Court under section 261, there is nothing in the Income-Tax Act which fetters the free exercise of the powers vested in the High Court and the Supreme Court under the provisions of the Constitution to admit writ petitions.

In a writ petition to the High Court the petitioner has to make out a case, not only of an error of law having been committed by the subordinate authority or officer, however grave the error might be, or of want of jurisdiction, even though there may be total absence of jurisdiction, but he has in addition to show that manifest injustice has been done to him and injustice will be perpetuated if relief is not granted. The High Court will not ordinarily exercise its jurisdiction under article 226 of the Constitution, if an alternative remedy (*e. g.*, by way of an application for revision to the Commissioner) is available to the petitioner. The remedy under article 226 of the Constitution cannot be allowed to by-pass the remedies under the Income-Tax Act (*47 ITR 453* and *472*).

Where a citizen is being sought to be taxed in a manner, which is *prima facie* against the law, he has a right to invoke the writ jurisdiction of the High Court to have the position clarified at the earliest possible opportunity (*47 ITR 927*).

6. Revision by the Commissioner

Revision of Orders Prejudicial to Revenue.

Under section 263, the Commissioner may call for and examine the record of any proceeding under the Act, and if he considers that any order passed therein by the Income-Tax Officer is erroneous in so far as it is prejudicial to the interest of the revenue, he may after giving the assessee an opportunity of being heard and after making such inquiry as he deems necessary, pass such order thereon as the circumstances of the case justify, including an order enhancing or modifying the assessment, or cancelling the assessment and directing a fresh assessment.

The power of revision conferred upon the Commissioner is not administrative but it is quasi-judicial. In the exercise of that power the Commissioner must bring to bear an unbiased mind, consider impartially the objections raised by the aggrieved party and decide the dispute according to procedure consistent with principles of natural justice ; he cannot permit his judgment to be influenced by matters not disclosed to the assessee nor by dictation of another authority (*77 ITR 6*).

No such order shall be made (*a*) to revise an order of reassessment made under section 147 or (*b*) after the expiry of two years from the date of the order sought to be revised. But an order in revision may be passed at any time to give effect to any finding or direction contained in an order of the Appellate Tribunal, the High Court or the Supreme Court.

In computing the period of limitation, the time taken in giving an opportunity to the assessee to be reheard under the proviso to section 129 (change of incumbent of an office) and any period during which any proceeding under this section is stayed by any court shall be excluded.

An assessee adversely affected by the Commissioner's revisional order under section 263 may appeal to the Appellate Tribunal.

The Commissioner's power of revision under section 263 arises whenever any order of the Income-Tax Officer is considered erroneous, whether erroneous in law or in fact, whether the facts were known or unknown at the time of the first assessment or partly known and partly unknown. The power would exist even if the facts were wrongly interpreted and wrong conclusions drawn. The scope of section 263 covers the entire area of deficient assessment from whatever cause and from whatever circumstances the deficiency might have arisen. Section 263 overlaps the field covered by section 147 and extends to such outside field as is left uncovered by section 147. The combined powers, under section 263 and section 147 ensure to the Department the levy of full tax in all circumstances, subject of course to the time limits mentioned therein.

When an appeal is preferred from a decision of a court, and the appeal court after hearing the appeal passes an order, the order of the original court ceases to exist and is merged in the order of the appeal court, and although the appeal court may merely confirm the order of the trial court, the order that stands and is operative is not the order of the trial court but the order of the appeal court. *Therefore, the Commissioner is not competent to pass an order under section 363 enhancing an assessment in a matter in which an appeal was preferred against the order of the Income-Tax Officer and the said order was confirmed by the Appellate Assistant Commissioner* (*23 ITR 421*).

However, it would be open to the Commissioners to revise an assessment order under section 263, while an appeal against it is still pending before the

Appellate Assistant Commissioner, because the Income-Tax Officer's order must be regarded as subsisting and effective in law despite the pendency of the appeal (*34 ITR 130*).

Revision of Other Orders.

Under section 264, in the case of any order other than that to which section 263 applies passed by an authority subordinate to him, the Commissioner may, either of his own motion or on an application by the assessee for revision, call for the record of any proceeding under the Act in which any such order has been passed, and make such inquiry and may pass such order thereon (not being an order prejudicial to the assessee) as he thinks fit.

For this purpose, the Appellate Assistant Commissioner shall be deemed to be an authority subordinate to the Commissioner.

The Commissioner shall not of his own motion revise any order under the section if the order has been passed more than one year previously. In the case of an application for revision under this section by the assessee, the application must be made within one year from the date on which the order in question was communicated to him or the date on which he otherwise came to know of it, whichever is earlier. The Commissioner is empowered to condone delay in making an application for revision if he is satisfied that the assessee was prevented by sufficient cause from making the application in time.

Every application by an assessee for revision under this section shall be accompanied by a fee of Rs. 25.

The Commissioner shall not revise any order under this section in the following cases :

(*a*) Where an appeal against the order lies to the Appellate Assistant Commissioner or to the Appellate Tribunal but it has not been made and the time for its making has not expired, or in the case of an appeal to the Tribunal, the assessee has not waived his right of appeal ; or

(*b*) Where the order is pending on an appeal before the Appellate Assistant Commissioner ; or

(*c*) Where an appeal has been made to the Appellate Tribunal against the order.

The assessee may apply to the Commissioner for revision of the order of the Income-Tax Officer or that of the Appellate Assistant Commissioner. In either case the Commissioner's order will be final. The assessee himself has to choose whether he should appeal against an order of the Income-Tax Officer or of the Appellate Assistant Commissioner or he should apply to the Commissioner for its revision. The second course is cheaper, but in practice it may not be so effective as an appeal.

Whereas the power of revision conferred upon the Commissioner under section 264 is against any order passed by any authority subordinate to him (*i. e.*, the Income-Tax Officer or the Appellate Assistant Commissioner) the power of revision conferred upon the Commissioner under section 263 is restricted to any arder passed by the Income-Tax Officer. Section 263 does not confer upon the Commissioner the power to revise the orders of the Appellate Assistant Commissioner.

CHAPTER 21

Penalties and Prosecutions

The Income-Tax Act contains a number of provisions for the levy of penalty in case of defaults on the part of the assessee. These provisions are explained below.

Whether penalty should be imposed for failure to perform a statutory obligation is a matter of discretion of the authority to be exercised judicially and on a consideration of all the relevant circumstances. Even if a minimum penalty is prescribed, the authority competent to impose the penalty will be justified in refusing to impose the penalty when there is a technical or venial breach of the provisions of the Income-Tax Act or where the breach flows from a *bona fide* belief that the offender is not liable to act in the manner prescribed by the statute. This is according to a decision of the Supreme Court (*83 ITR 26*).

1. Failure to pay tax on self-assessment—Section 140A.

Where a regular assessment has not been made before the expiry of 30 days of furnishing the return, the assessee is liable to a penalty in case of failure to pay the tax on self-assessment within the time allowed. Before levying the penalty, the Income-Tax Officer is required to give the assessee a reasonable opportunity of being heard. In a case of continuing failure to pay the tax on self-assessment, such penalty may be levied from time to time but the total amount of penalty leviable is limited to 50% of the tax due on self assessment.

2. Failure to pay tax—Section 221.

If the amount specified in the notice of demand is not paid within the period specified therein, the assessee shall, in addition to the amount of arrears and the amount of interest payable, be liable to pay a penalty which in the case of continuing default may be increased from time to time up to the amount of tax in arrears. But the assessee must be given a reasonable opportunity of being heard.

3. Failure to furnish information regarding securities—Section 270.

Any person who has without reasonable cause failed to comply with a notice issued under section 94(6) relating to avoidance of tax by certain transactions in securities shall be liable to a penalty of an amount not exceeding Rs. 500 and a further penalty of like amount for every day after the levy of the first penalty during which the failure continues.

4. Non-filing or late filing of return—Section 271(1)(a).

Where a person has without reasonable cause failed to furnish the return of income, or has without reasonable cause failed to furnish it within the time allowed, he shall be liable to a penalty equal to 2% of the tax for each

completed month of default but not exceeding 50% of the tax. For the purpose of penalty, the tax in the case of a registered firm will be calculated as if it were an unregistered firm. The amount of the tax means the assessed tax (*i. e.*, tax as reduced by the amount deducted at source and paid in advance).

Exceptions. No penalty can be imposed for failure to furnish the return of income voluntarily under section 139(1) on an assessee whose total income does not exceed the taxable minimum in his case by Rs. 1,500, or on any person assessable as the agent of a non-resident.

Where a person has failed to comply with a notice under section 139(2) or section 148 but proves that he has no income liable to tax, the penalty imposable shall not exceed Rs. 25.

However, under executive instructions, no penalty is to be imposed on a person whose total income does not exceed Rs. 10,000.

5. Non-Compliance with notice under sections 142(1) or 143(2)-Section 271(1)(b)

Where a person has without reasonable cause failed to comply with any notice issued under section 142(1) or 143(2), he is liable to a penalty for such default. The amount of the penalty is equal to not less than 10% and not more than 50% of the tax which would have been avoided if the income returned by him had been accepted as the correct income. For the purpose of penalty, the tax in the case of a registered firm will be calculated as if it were an unregistered firm.

6. Concealment of Income—Section 271(1)(c).

Where any person has concealed the particulars of his income or furnished inaccurate particulars of his income, he is liable to a penalty for such default. The minimum penalty is equal to concealed income and the maximum penalty is twice the amount of concealed income.

Where the income returned by an assessee is less than 80% of the assessed income (reduced by expenditure incurred *bona fide* for earning the income but disallowed as a deduction), the assessee will be deemed to have concealed his income and be liable to a penalty.

The Income-Tax Officer is required to refer to the Inspecting Assistant Commissioner for imposition of penalty for concealment of income in all cases in which the concealed income, as determined by the Income-Tax Officer on assessment, exceeds Rs. 25,000. The Inspecting Assistant Commissioner has for this purpose all the powers for the imposition of penalty. It means that the Inspecting Assistant Commissioner himself will pass orders imposing a penalty and on making such an order he will send a copy thereof to the Income-Tax Officer.

Penalty on the ground of concealment can be imposed only if there is *conscious and deliberate* concealment on the part of the assessee. When upon the death of a karta a succeeding karta makes a return of income based on the accounts kept by the deceased, without knowledge of the falsity of the accounts, no penalty can be imposed on the joint family (*31 ITR 704*). If, however, a karta deliberately files a false return before his death, penalty can be imposed on the joint family represented by the succeeding karta (*50 ITR 487*).

In *C.I.T.v. Anwar Ali* (*76 ITR 696*), the Supreme Court has held that, in the absence of cogent material evidence, apart from the falsity of the assessee's explanation, from which it could be inferred that the assessee had concealed the particulars of his income or had deliberately furnished inaccurate particulars in respect of the source and that the disputed amount was a revenue receipt, the penalty cannot be imposed.

Neither section 64 nor section 139 imposes an obligation on the assessee to disclose in his return the income of his minor sons from their admission to the benefits of a partnership in the firm in which he is a partner. Therefore no penalty can be levied on the assessee under section 271(1)(c) for not disclosing

his sons' income in his return, Further, section 271(1)(c) speaks of concealment of his (assessee's) income and not the income of the minors which is to be included under section 64 (*84 ITR 770*).

7. Wrong distribution of profit by registered firm—Section 271(4).

If the profits of a registered firm are improperly distributed amongst the partners so as to return the income of any partner below the real amount and if any partner of such a firm returns his income below the real amount, a penalty of 150% of the amount of tax which would have been avoided if his return had been accepted as correct, may be imposed on him, and no refund or other adjustment can be claimed by any other partner by reason of this procedure.

8. Failure to give notice of discontinuance—Section 272.

Any person who fails to give notice of discontinuance of his business or profession, as required by section 176(3), shall be liable to a penalty for such default. The amount of penalty shall be not less than 10% of the tax but not exceeding the amount of tax subsequently assessed on him in respect of any income of the business or profession up to the time of its discontinuance.

9. Furnishing of untrue estimate under section 212—Section 273(a).

Any person who has furnished under section 212 an estimate of the advance tax payable by him which he knew to be untrue, shall be liable to a penalty which shall not be less than 10% nor more than 150% of the amount by which the advance tax actually paid falls short of :

(*a*) 75% of the assessed tax or

(*b*) where a notice under section 210 was issued to the assessee, the amount payable thereunder, *whichever is less.*

The expression "assessed tax" means the tax determined on regular assessment (reduced by the amount of tax deducted at source) so far as such tax relates to income subject to advance tax and so far as it is not due to changes in the rates of tax.

10. Failure to furnish an estimate of advance tax—Section 273(b).

Any person (not previously assessed) who has without reasonable cause failed to furnish an estimate of the advance tax payable by him, shall be liable to a penalty which shall not be less than 10% nor more than 150% of 75% of the assessed tax.

11. Failure to furnish higher estimate of advance tax—Section 273(c).

Any person who has without reasonable cause failed to furnish an estimate in the case where the tax liability on his current income exceeds by more than 1/3rd of the amount of advance tax demanded from him by the Income-Tax Officer, shall be liable to a penalty which shall not be less than 10% nor more than 150% of the amount by which the tax demanded by the Income-Tax Officer falls short of 75% of the assessed tax.

Procedure.

Under section 274(1), no order imposing a penalty shall be made unless the assessee has been heard or has been given a reasonable opportunity of being heard. If such opportunity to show cause is not given to the assessee, the imposition of a penalty would be invalid.

Bar of Limitation.

Under section 275, the time-limit for making an order imposing a penalty will be ordinarily *two* years from the end of the financial year in which

the proceedings in the course of which action for imposition of penalty has been initiated are completed.

However, where the relevant assessment or other order is the subject-matter of an appeal to the Appellate Assistant Commissioner or an appeal by the Income-Tax Officer to the Appellate Tribunal, the time-limit for completing the penalty proceedings will be either the two-year period as stated above or six months from the end of the month in which the order of the Appellate Assistant Commissioner or the Appellate Tribunal is received by the Commissioner, whichever is later.

The time taken in rehearing the assessee (due to change of the Income-Tax Officer or the Appellate Assistant Commissioner having jurisdiction) and any period during which the penalty proceedings have been stayed by an order of a court is to be excluded in computing the period of limitation.

Reduction of Penalty for Voluntary Disclosure.

With a view to encourage voluntary disclosure of undisclosed incom section 271(4A) empowers the Commissioner, in his discretion, to reduce o waive the amount of minimum penalty imposable under section 271(1)(i) o 271(1)(iii) in the case of a person who has voluntarily and in good faith made a full and true disclosure of his concealed income before detection of the same by the Income-Tax Officer and, in addition, has co-operated in any inquiry relating to the assessment of the concealed income and has either paid or made satisfactory arrangements for payment of any tax or interest which may become payable in respect of the income concealed.

In cases of voluntary disclosure of income, the Commissioner is required to obtain the previous approval of the Board for the waiver or reduction of the minimum statutory penalty imposable for concealment of income only where the income in respect of which penalty is leviable exceeds Rs. 5,00,000 in the aggregate for all the years covered by the disclosure. In regard to the waiver or reduction, in cases of voluntary disclosure, of the minimum statutory penalty leviable for default in furnishing the return of income, the Board's approval will be required only where the amount of such penalty exceeds in the aggregate a sum of Rs. 50,000.

Any order passed under the above provision shall be final and shall not be called in question before any court of law or any other authority.

Appeal.

An appeal lies to the Appellate Assistant Commissioner against an order of the Income-Tax Officer imposing a penalty. The Appellate Assistant Commissioner may in appeal confirm, cancel, enhance or reduce the penalty. An appeal lies to the Appellate Tribunal against an order passed by the Appellate Assistant Commissioner in appeal against a penalty imposed by the Income-Tax Officer or by the Inspecting Assistant Commissioner.

INTEREST PAYABLE BY ASSESSEE

An assessee is liable to pay interest at 12% per annum on account of the following defaults :

1. Non-filing or late filing of return—Section 139(8).

Where the return of income for any assessment year is furnished after the due date or is not furnished, whether or not the Income-Tax Officer has extended the date for furnishing the return, the assessee is liable to pay simple interest at 12% per annum, reckoned from the day immediately following the due date to the date of furnishing the return or, where no return has been furnished, to the date of completion of the assessment under section 144, on the

amount of the tax payable as determined on regular assessment as reduced by any tax deducted at source or paid in advance.

In the case of a registered firm, the tax payable for this purpose is to be calculated as if the firm were unregistered.

2. Failure to deduct tax or pay it—Section 201(1A)

If a person responsible for deduction of tax at source does not deduct or after deducting fails to pay the tax to Government, he is liable to pay simple interest at 12% per annum on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually paid.

3. Defaults in payment of advance tax—Sections 215, 216 and 217.

The interest chargeable for these defaults has been explained and illustrated in a previous chapter dealing with collection and recovery of tax.

4. Failure to pay tax demand—Section 220(2).

If the amount specified in the notice of demand is not paid within the time specified therein, the assessee is liable to pay simple interest at 12% per annum from the day commencing after the end of the time specified in the notice of demand. The interest is to be calculated in the prescribed manner and is payable in addition to the penalty.

Fine Imposable

A magistrate has jurisdiction to impose a fine under sections 275A, 276, 277 and 278. In addition a fine may be imposed by Income-Tax authorities in the following cases :

(1) Under section 131(2), where a person to whom a summons is issued either to attend to give evidence or to produce books of account or other documents, intentionally omits to do so, the Income-Tax authority may impose upon him such fine not exceeding Rs. 500 as it thinks fit, and the fine so levied may be recovered in the manner in which tax can be recovered.

The Income-Tax authority referred to above may be Income-Tax Officer, Appellate Assistant Commissioner, Inspecting Assistant Commissioner or Commissioner.

(2) Under section 285A, persons securing contracts of a value exceeding Rs. 50,000 for the construction of a building or the supply of goods or services in connection therewith, are required to furnish relevant information relating to such contracts to the Income-Tax Officer concerned within one month of making the contract.

A fine not exceeding Rs. 50 for each day of default (subject to the maximum limit of 25% of the value of the contract) may be imposed by the Commissioner for the default. The Commissioner shall, on making an order imposing a fine, forthwith send a copy of the same to the Income-Tax Officer.

OFFENCES AND PROSECUTIONS

Under section 132(3), where it is not practicable to seize any asset found during the search, the authorised officer conducting the search is empowered to serve an order on the person concerned not to remove or part with it without his previous permission. Section 275A provides that whoever contravenes such order shall be punishable with rigorous imprisonment up to two years and also with fine.

Under section 276, if a person fails to discharge the following duties, he shall be punishable with fine up to Rs. 10 for every day of default :

(1) To grant inspection or allow copies to be taken of the register of members, debenture-holders of mortgages of a company in accordance with the provisions of section 134.

(2) To furnish in due time any of the returns or statements mentioned in section 133, section 206, section 285 or section 286.

(3) To deduct and pay tax as required by section 226(2).

(4) To furnish a certificate of tax deducted at source as required by section 203.

Before 1st April 1962, the Indian Income-Tax Act, 1922, expressly provided that no prosecution for an offence could be instituted under that Act in respect of the same facts on which a penalty had been imposed. But there is no corresponding provision in the Income-Tax Act, 1961, and consequently a penalty may be imposed on an assessee and prosecution launched against him in respect of the same default.

Default on the Part of Liquidator. Under section 276A, a person who is appointed liquidator of a company and who (*i*) fails to give notice of his appointment to the Income-Tax Officer ; or (*ii*) fails to set aside the amount which is intimated to him by the Income-Tax Officer as being sufficient to cover the tax liabilities of the company ; or (*iii*) parts with any of the assets of the company or the properties in his hands, shall be punishable with rigorous imprisonment. The term of such imprisonment is subject to a maximum of two years and a minimum of six months, as in sections 277 and 278.

Default in Deducting Tax at Source. Section 276B provides that a person who fails to deduct or after deducting fails to pay the tax as required by law, shall be punishable, on conviction before a court, with rigorous imprisonment up to six months and shall also be liable to fine. The fine shall be not less than a sum calculated at the rate of 15% per annum of the tax in default for the period from the date when the tax was deductible up to the date of the payment of the tax to the credit of the Central Government.

Failure to file Return of Income. Under section 276C, if a person *wilfully* fails to furnish in due time the return of income under section 139(1) or 139(2) or 148, he shall be punishable with rigorous imprisonment up to one year or with fine of not less than Rs. 4 nor more than Rs. 10 for every day of default or with both, according to the discretion of the court.

However, the default in furnishing the return of income voluntarily under section 139(1) will not attract these punishments in the following cases namely :

(1) Where the return is for any assessment year commencing prior to 1st April 1971 ; or

(2) Where the return is for any assessment year commencing on or after 1st April 1971 if (*a*) the return is furnished before the expiry of the assessment year, or (*b*) the net tax payable on the total income as determined in the regular assessment does not exceed Rs. 3,000. The net tax means the gross tax less tax deducted at source and paid in advance.

Failure to Produce Accounts and Documents. Under section 276D, if a person wifully fails to produce account books and other documents called for by notice under section 142(1), he shall be punishable with rigorous imprisonment up to one year or with fine of not less than Rs. 4 nor more than Rs. 10 for every day of default or with both.

False Statement in Declaration. Under section 277, if a person makes a false statement in any verification or delivers a false account or statement, he shall be punishable with rigorous imprisonment for a minimum term of six

months (if special and adequate reasons to the contrary have been recorded in the judgment delivered by the court) and a maximum term of two years.

Abetment of False Return, etc. Under section 278, if a person abets or induces in any manner another person to make and deliver a false account, statement or declaration relating to any income chargeable under the Act, he shall be punishable with rigorous imprisonment for a minimum term of six months (unless special and adequate reasons to the contrary have been recorded in the judgment delivered by the court) and a maximum term of two years.

Section 279 provides that a person cannot be proceeded against for any of the above offences except at the instance of the Commissioner. The Commissioner may either before or after the institution of proceedings compound any such offence.

A person, in whose case the penalty imposable has been reduced or waived by the Commissioner, shall not be liable to be prosecuted in relation to the assessment for the assessment year in respect of which the penalty has been so reduced or waived.

Except where an income-tax authority itself is empowered to impose a fine, a person committing an offence under the Income-Tax Act is to be prosecuted in the court of a first class magistrate or a Presidency magistrate.

Publication of Information

Under section 287, the Central Government may publish the names of any assessee and any particulars relating to assessment proceedings in respect of such assessee, if it is of the opinion that it is necessary or expedient in the public interest to publish such information. However, such publication as to the imposition of any penalty or any conviction for an offence connected with any proceeding under the Income-Tax Act can be made only after the expiry of the time-limit for filing the first appeal or the disposal of the first appeal in the matter, as the case may be.

CHAPTER 22

Assessment of Individuals

As stated earlier, the various units of assessment as mentioned in section 4 read with section 2(31) are as follows :

(*i*) an individual,
(*ii*) a Hindu undivided family,
(*iii*) a company,
(*iv*) a firm,
(*v*) an association of persons or a body of individuals,
(*vi*) a local authority, and
(*vii*) an artificial juridical person.

An individual means a human being and includes an artificial juridical person. He or she is assessed to income-tax at a graded scale of rates according to the amount of his or her total income. An individual is taxed separately, though he may happen to be in any of the other units subject to tax. An individual's tax liability in such circumstances is as follows :

(1) *As a member of a Hindu undivided family.* Any sum received by an individual in his or her capacity as a member of a Hindu undivided family out of the income of the family is not liable to tax even though the family may not have paid any tax on its income.

Where the income of a member of a Hindu undivided family consists of his own personal earnings, such income is taxed in his hands as an individual.

The son of a Hindu does not acquire by birth any interest in his father's self-acquired property. In respect of the income of such property, the father is to be assessed as an individual.

According to Dayabhaga law, the son does not acquire by birth any interest in ancestral property. His rights arise for the first time on his father's death. In the father's life-time, therefore, the income from ancestral property is to be assessed as the income of an individual, unless the father himself is a member of a coparcenary *i. e.*, the father himself inherited the ancestral property along with a brother.

The holder of an impartible estate is also assessed as an individual in respect of the income of the estate.

(2) *As a member of an unregistered firm.* A partner in an unregistered firm is not liable to tax in respect of his share of income of the firm, if tax is payable by the firm itself, but such share is included in his total income for rate purposes. If the firm is not assessable by reason of its total income being below the taxable limit, each partner's share of the firm's income will be taxed in his hands.

(3) *As a member of a registered firm.* A registered firm or an unregistered firm assessed as a registered firm itself has to pay income-tax on its total income when that total income exceeds Rs. 10,000. Still, a partner of such a firm will be assessed on his share of the firm's income along with his other income, but his share of income from the firm is computed after deduction of his share of income-tax payable by the firm.

(4) *As a member of an association of persons.* The position of a member of an association of persons is the same as that of a partner of an unregistered firm.

(5) *As a shareholder in a company.* A company is chargeable to tax on its income as a distinct taxable unit, and it pays the tax in discharge of its own liability and not on behalf of its shareholders. A shareholder is liable to pay income-tax on the dividend he receives, and the whole of the dividend is taxable in his hands, even though a part of it may have been derived from non-taxable income of the company, *e. g.*, agricultural income.

Before paying the dividend to its shareholders, the company has to deduct income-tax at source from the gross amount of dividend declared by it, and credit is given to each shareholder for the amount of income-tax deducted from his dividend.

Other's Income Included in Total Income.

According to sections 60 to 64, in the following cases, the income actually belongs to persons other than the assessee, but in order to prevent avoidance of tax such income is included in the total income of the assessee :

(1) Where there is a transfer of income only without a transfer of the corpus such income is included in the total income of the transferor.

(2) Where there is a revocable transfer of the corpus, the income from the corpus is included in the total income of the transferor. A transfer of assets is not deemed to be revocable if it is not revocable during the life-time of the beneficiary or transferee.

(3) All such income is included in the total income of an individual as arises to his or her spouse from the membership of the spouse in a firm carrying on a business (but not a profession), in which the individual is a partner. The income is clubbed in the hands of that spouse who has the greater income (exclusive of the share income of the firm).

(4) All such income is included in the total income of an individual as arises to his or her legitimate minor child from the admission of the minor to the benefits of partnership in a firm in which such individual is a partner. Where both the parents are members of the firm in which the minor child is a partner, the income of the minor child should be clubbed with that of the parent who has the larger income of the two (exclusive of the share income of the firm).

(5) All such income is included in the total income of an individual as arises to his or her spouse from assets transferred to the spouse by such individual otherwise than for adequate consideration or in connection with an agreement to live apart.

(6) All such income is included in the total income of an individual as arises to his or her minor child (not being a married daughter) from assets transferred to the minor child by such individual otherwise than for adequate consideration.

(7) All such income is included in the total income of an individual as arises to any person or association of persons from assets transferred (otherwise than for adequate consideration) to the person or association by such individual, to the extent to which the income from such assets is for the immediate or deferred benefit of his or her spouse or minor child (not being a married daughter) or both.

(8) Where an individual converts at any time after 31st December 1969 his separate property into property belonging to the Hindu undivided family of which he is a member, the income from the converted property, in so far as it is attributable to the interest of the individual in the property of the family, will be deemed to arise to the individual and not to the family.

Further the income from the converted property, in so far as it is attributable to the interest of the spouse or any minor son of the individual in the property of the family, will be deemed to arise to the spouse or the minor son from assets transferred by the individual indirectly to the spouse or the minor son and such income will be includible in the total income of the individual.

Assessment in Case of Death.

A deceased individual is assessed through his legal representative or his executor. In making the assessment of an individual who has died, only his income accruing up to the date of death should be taken into account, because in respect of the income accruing after death the assessment is to be made on the heirs. This has already been explained fully in a preceding chapter dealing with liability in special cases.

Rates of Tax.

The rates of income-tax applicable to individuals for the assessment year 1975-76 are given in a subsequent chapter dealing with computation of tax.

Illustrations

(1) A's total income for the previous year ended 30th June 1974 has been computed at Rs. 2,50,000 and the assessment for the year 1975-76 has been completed. Subsequently, however, the following facts come to the notice of the Income-Tax Officer :

A owned 3% government securities of the face value of Rs. 10,00,000 interest on which was recivable half-yearly on 1st May and 1st November. These securities were sold by A to B (who was an assessee with an income below Rs. 5,000) on 20th October 1973 at a profit of Rs. 25,000, which amount had been directly credited to A's capital account as capital gain. These very securities were purchased by A from B on 11th May 1974 at the original cost price of A.

Would you consider it necessary to revise the total income of A, and if so under what particular provisions of the Income-Tax Act ? If further action is necessary, what formalities would have to be gone through and under what section of the Act ?

This is a case of bond-washing adopted for the purpose of tax avoidance. It will be necessary to revise the total income of A under section 147 of the Income-Tax Act. The Income-Tax Officer will give a written notice under section 94(6) demanding information relating to securities and also a notice under section 148 relating to the revision of assessment.

As a result of the above proceedings, Rs. 30,000 being one year's interest on securities, will be added to the total income of A, and at the same time Rs. 25,000 capital gain originally included in A's total income, will be deleted from it. Thus, the total income of A will be increased by Rs. 5,000.

(2) A German (having knowledge and experience in manufacturing operations) came out to Bombay for the first time on 1st November 1974 to take up the post of a technician in a large chemical works on a monthly salary of Rs. 5,000, under a contract approved by the Central Government. His other income for the year ended 31st March 1975 was as under :

(*a*) Six months' interest on Rs. 25,000, 3% Indian Government securities due on 1-1-1975. These securities were purchased by him on 1-12-1974 with money brought from Germany.

(*b*) Dividends from Indian companies Rs. 6,500 gross.
(*c*) Rs. 500 director's fees from a Bombay company.
(*d*) Rs. 10,000 income from dairy-farming in Germany, half of which was received by him in Bombay in March 1975.

He is insured for 10,000 marks with a German insurance company and he paid in Germany 500 marks as premium out of his dairy-farming income retained in Germany.

Compute his total income for the assessment year 1975-76.

He is a non-resident for the previous year ended 31st March 1975. As he is a foreign technician employed in India under a contract approved by the Central Government, his salary (to the extent of Rs. 4,000 per month) for the 24 months from 1-11-1974 is to the excluded from his total income. Therefore his total income for the assessment year 1975-76 is as follows :

			Rs.
1.	Salary (in excess of Rs. 4,000 per month) for 5 months	5,000	
	Less Standard deduction	1,000	4,000
2.	Interest on government securities		375
3.	Other Sources :		
	Dividends from Indian companies	6,500	
	Director's fees	500	
	Germany income received in India	5,000	12,000
	Gross Total Income		16,375
	Deduction in respect of interest on government securities and dividends		3,000
	Total Income		13,375

As the life insurance premium has been paid out of his non-taxable German income, he is not entitled to any deduction in respect thereof.

(3) K. S. Guha, Bar-at-law, was practising in the Calcutta High Court. On 1st June 1974 he closed his office and took up employment as law officer on a monthly salary of Rs. 3,000 in a firm of importers who did not permit him to practise.

From the following information compute his total income for the assessment year 1975-76 :

(*a*) Professional income (net) for April and May 1974 Rs. 3,000.
(*b*) Gratuitous payment received from an old client on 18th May 1974 for having ably conducted a case which involved an important question of labour law Rs. 5,000.
(*c*) Fees received after 31st May 1974 for professional advice given before Rs. 1,000.
(*d*) Receipts for contributing articles to law journals Rs. 3,000.
(*e*) He was on leave in UK in February 1975, drew his salary there and spent it entirely there.

He claims deduction of the following expenses :

(*a*) Purchase of law books in July 1974 Rs. 1,000.
(*b*) One-fourth of monthly rent of Rs. 500 paid for his residential flat which is partly used for doing the firm's work.
(*c*) Entertainment of firm's customers Rs. 500.

			Rs.
1.	Income from salary :		
	Salary for 10 months	30,000	
	Less Standard deduction	3,500	26,500
2.	Income from profession :		
	Income from April and May 1973	3,000	
	Amount received on 18-5-1973	5,000	
	Receipts after 31-5-1973	1,000	9,000
3.	Other Sources :		
	Receipts from contributions to law journals		3,000
	Total Income		38,500

There is no provision in section 16 for the deduction of rent paid for the flat used for doing employer's work and for the expenses of entertaining the employer's customers.

The leave salary drawn in the UK is taxable as it was earned in India.

The assessee's previous year ends on 31st March. He discontinued his profession on 31st May 1974. Any incomes received from profession before 31st March 1975 therefore fall in the previous year in which the profession is discontinued and are taxable.

Under section 176(4), any income received from a discontinued profession even after the end of the previous year in which the profession is discontinued, is made taxable in the year of receipt. This is an exception to the general rule that the business or profession should have been carried on at any time during the previous year before its income can be charged to tax.

(4) K, an Indian citizen and an individual resident in India, is the manager of Z Co. Ltd. carrying on the business of manufacture and sale of electrical goods at Delhi. He took up his present assignment on 15th October 1973. He was previously employed with P.Electrical Manufacturers Ltd., but his service there was terminated before the expiry of the agreed term of service.

He has furnished you with the following particulars of his income and expenditure for the year ended 31st March 1975 :

(*a*) He was entitled to a salary of Rs. 2,000 per month. Out of this salary, he drew Rs. 1,500 per month and the balance of Rs. 500 was paid by the company, under his standing instructions, direct to H. Tuberculosis Association, Hyderabad, which satisfies the conditions laid down in section 80G of the Income-Tax Act, 1961. His salary fell due each month on the closing date of the month.

(*b*) He received from the company a fixed entertainment allowance of Rs. 6,000 for entertaining customers and fixed conveyance allowance of Rs. 4,800 for meeting conveyance charges wholly and necessarily incurred for the performance of the duties of his office. He actually incurred an expenditure of Rs. 4,500 in entertaining company's customers and Rs. 4,000 as conveyance charges for which the conveyance allowance was granted to him. He regularly received an entertainment allowance of Rs. 6,000 from P. Electrical Manufacturers Ltd., his former employer, with whom he was employed since 1st April 1954.

(*c*) He received Rs. 1,500 on 1st October 1974 from his employer company as travelling assistance for himself, his wife and three children in connection with his proceeding on leave to his home town in Hyderabad.

(*d*) He received on 15th March 1975 Rs. 6,000 as compensation for loss of employment from his former employer, P. Electrical Manufacturers Ltd., his services being terminated before the expiry of his term of service due to misunderstanding with the management.

(*e*) He owned a house at Hyderabad which was kept reserved for his own occupation, but owing to his employment at Delhi he had to reside there in a house taken on rent. His house at Hyderabad therefore remained vacant during the accounting year except for two months of July and August 1974 when he went to Hyderabad on leave and occupied the same. The annual value of the house was Rs. 2,400, and the municipal taxes paid by him during the year amounted to Rs. 240.

(*f*) He held certain investments in the UK from which an income of Rs. 3,000 was derived by him during the year ended 31st March 1974, the whole of which was kept in deposit in a bank in London and was not brought into India. The total interest credited to him on his deposit in this bank account for the year ended 31st March 1975 amounted to Rs. 500 only.

You are required to compute for the information of K his total income for the assessment year 1975-76 giving reasons for the inclusion and exclusion of any of the above items, and to indicate on what income he will be liable to pay tax. Calculation of tax is not required.

	Rs.	Rs.
1. Salary :		
Salary *less* standard deduction of Rs. 1,000	23,000	
Entertainment allowance, no deduction being allowed on this account as the allowance was not received from his present employer before 1-4-1955	6,000	
Conveyance allowance being excess over the amount actually spent (Rs. 4,800 — Rs. 4,000)	800	
Compensation for loss of employment received from P. Electrical Manufacturers Ltd. being profit in lieu of salary.	6,000	
Travelling assistance of Rs. 1,500 for going on leave to his home town is to be excluded from total income under section 10(5)	Nil	35,800
2. Income from house property :		
Annual value of residential house	2,400	
Less Municipal taxes	240	
	2,160	
Less Self-occupation allowance	1,080	
Annual value in this case	1,080	
Proportionate annual value for two months	180	
Less One-sixth for repairs	30	150
3. Income from other sources :		
Income from U.K. investments	3,000	
Interest from a London bank	500	3,500
Gross Total Income		39,450

Deduction for charitable donation of Rs. 6,000 :		
55% of Rs. 3945 being 10% of gross total income		2,169
Total Income		37,281
Rounded off		37,280

As he is resident in India his foreign income is to be included in his total income though it is not brought into India.

(5) X is an individual resident at Dacca in Bangladesh. As he had to come to Calcutta very often since 1st April 1963 he had taken on rent one room for himself in a hotel at Calcutta which remained in his possession throughout the period from 1st April 1963 to 31st March 1975. He used to stay there whenever he came to Calcutta. His period of stay at Calcutta during each of the years from 1st April 1963 to 31st March 1975 was never less than 60 days in the aggregate, except during the years ended 31st March 1970 and 31st March 1971 when he was in Calcutta throughout these years for the medical treatment of his only son.

He owns lands in Bangladesh which are used solely for agricultural purposes. His lands are assessed to land revenue there. He also owns shares in certain Indian companies from which he derives dividends. He has furnished you with the following particulars of his income for the year ended 31st March 1975 :

	Rs.
(*a*) Agricultural income (net) in Bangladesh derived from the sale of products raised by him by cultivation on his lands there. This income had been assessed to agricultural income-tax there. No part of this income was remitted to or received in India by him or on his behalf	40,000
(*b*) Dividends from Indian companies, declared in India during the year ended 31st March 1975 but received by him in Bangladesh in that year	15,000
(*c*) Remittances received in India from Bangladesh out of his agricultural income there, which accrued or arose to him there before the year ended 31st March 1975 to meet his expenses in India	5,000

X wants to know from you whether he will be liable to pay Indian income-tax on his above-mentioned incomes and, if so, whether he will be entitled to any relief from the income-tax payable by him in India on his agricultural income in Bangladesh, including the remittance received by him in India therefrom, in respect of agricultural income-tax paid by him thereon in Bangladesh.

Draft a letter to X explaining what you consider to be the correct legal position.

Western Kutchery Road,
Meerut.
25th May, 1975.

Shri X,
Dacca.

Dear Sir,

With reference to your letter 20th May 1975, on the facts mentioned therein, the legal position regarding your liability to income-tax in India is as follows :

Your residential status. For the previous year ended 31st March 1975 you are resident in India for the following reasons :

(*a*) You have maintained a dwelling-place for yourself at Calcutta for more than 182 days in the previous year ended 31st March 1975 and you were in India for more than 30 days in that year ; and

(*b*) You have been resident in India in nine out of the ten previous years preceding the previous year ended 31st March 1975, and you have been in India for 730 days or more during the seven previous years preceding the previous year in question.

Your income liable to tax in India. As a resident in India you are liable to pay income-tax on (*i*) all income received or deemed to be received in India, wherever it may be earned ; and (*ii*) all income accruing or arising or deemed to accrue or arise in India, wherever it may be received. Remittances received in India out of foreign income, which accrued or arose before the previous year, do not attract tax in India. Therefore, your total income for the previous year ended 31st March 1975 will be as under :

	Rs.	Rs.
Income from other sources :		
Dividends from Indian companies declared in India being deemed to arise in India	15,000	
Agricultural income in Bangladesh not being agricultural income in India as the land is not in India	40,000	
Gross Total Income	55,000	
Deduction in respect of dividends (maximum)	3,000	
Total Income	52,000	

Relief on your agricultural income. As stated above, you are liable to pay Indian income-tax on your Bangladesh agricultural income, on which you also pay agricultural income-tax there. On proof being shown of the payment of the agricultural income-tax in Bangladesh, you will be granted, under section 91(2) of the Income-Tax Act, 1961, double taxation relief in India, calculated on your agricultural income at the Indian rate of income-tax or the Bangladesh rate of agricultural income-tax, whichever is lower.

Should you desire any further information, we shall be glad to furnish it on hearing from you.

Yours faithfully,

.....

Chartered Accountants

(6) The books of X, who is a money-lender, showed a profit of Rs. 30,000 in respect of the accounting year ended 31st March 1975 and a loss of Rs. 40,000 debited in his personal account arising from the sale of a house during the accounting year.

The house was purchased in court auction in discharge of a money-lending debt of the assessee's business ten years ago and was debited to the personal account of the assessee for own residence.

X made a return of income for loss of Rs. 10,000 for the assessment year 1975-76. Discuss the issues arising for assessment.

In this case, the issues arising for assessment for the assessment year 1975-76 are as follows :

(*a*) Though the house was purchased in discharge of a money-lending debt, it has not been kept as an asset or stock-in-trade of the money-lending business, since it was transferred to the personal account of the assessee for residential purposes and removed from the books of the money-lending business. Therefore, according to the

Supreme Court (*20 ITR 597*) the loss from the sale of the house will not be treated as the loss of the money-lending business.

(*b*) The loss from the sale of the residential house will fall under the head "Capital Gains" and will be a loss from a long-term capital asset, as the house was purchased ten years ago. In computing the total income of X, such loss cannot be set off against the assessee's income under any other head. The assessee will therefore be liable to tax on the total income of Rs. 30,000 from money-lending business.

(*c*) The loss of Rs. 40,000 under the head "Capital Gains" will however be carried forward for *four* succeeding assessment years and will be set off only against income from long-term capital assets in a subsequent year.

(7) As the manager of Bharat Textiles Ltd., X has filed a return for the previous year ended 31st March 1975 showing the following income :

		Rs.
Salary at Rs. 2,000 p. m.		24,000
Other Sources : Dividends gross from an Indian company		5,000
Interest on bank deposits		1,000

Besides, he has furnished the following information :

(*a*) The employer company paid an advance of Rs. 20,000 on 27-5-1974 for the purchase of a motor-car which X used both for private and employment purposes.

(*b*) He has to pay to Y Ltd. (in which he holds 150 shares out of the total 1,000 equity shares as on 31st March 1975) a sum of Rs. 10,000 which was advanced to him as a loan.

(*c*) He sold his only residential house in September 1974 for Rs. 75,000 which was purchased on 1st January 1954 for Rs. 40,000. The assessment for 1975-76 comes up for hearing in December 1975 and it is gathered that the assessee was constructing a new house at a cost of about Rs. 60,000 which would be completed by March 1976.

(*d*) He received from his employer company medical expenses Rs. 2,000 during the previous year ended 31st March 1975.

(*e*) He resides in furnished quarters provided by the employer.

(*f*) The employer has paid on X's behalf professional-tax of Rs. 400 during the year.

(*g*) By the conditions of service he is required to incur expenditure for the efficient administration of his office. During the year he paid Rs. 10,000 to a labour leader to avert a threatend strike on account of the dismissal of a delinquent labourer by the administration.

In the course of investigation, it came to light that assessee had made investments in the name of his wife, in the form of bank deposits of Rs. 1,00,000 on 1-12-1974. It is explained by the assessee that this represents the savings from out of the amounts received by her as presents from time to time from her father and also from out of the amounts paid to her by the assessee for domestic expenses. There is no corroboratory evidence for the explanation.

Compute the total income of X for the assessment year 1975-76 giving brief reasons for inclusion or exclusion of different items. Also indicate the reliefs due, if any, to the assessee.

			Rs.
1.	Salary income :		
	Salary as such (after standard deduction of Rs. 3,400)	21,600	
	Medical expenses being a benefit, as the salary exceeds Rs. 18,000	2,000	
	Value of rent-free house being $12\frac{1}{2}\%$ of Rs. 24,000	3,000	
	Professional-tax paid by employer	400	27,000

2. Other Sources :	Dividends (gross)	5,000	
	Bank interest	1,000	6,000
	Gross Total Income		33,000
Less Deduction for dividends and bank interest			3,000
	Total Income		30,000

The above working is subject to the following remarks :

1. An advance of salary is part of salary, but any other advance made by the employer to the employee is not taxable as salary.

2. Under section 2(22)(e), dividend includes any payment by a company by way of loan or advance to a shareholder, who holds shares carrying not less than 20% of the voting power. As X holds only 150 shares out of 1,000 or less than 20%, the amount of Rs. 10,000 advanced to him by Y Ltd. cannot be treated as dividend.

3. As the residential house was purchased on 1st January 1954 for Rs. 40,000, its fair market value on 1-1-1954 may be taken to be the same amount for the purpose of calculating capital gains. But as the assessee was constructing a new house within a period of two years from the date of sale of the first house, the capital gains chargeable to tax will be nil because the amount of capital gains (Rs. 35,000) is less than the cost of the new house (Rs. 60,000). It is assumed that the new house is for the residence of the assessee.

4. Under section 16(v), any amount actually spent by an employee out of his salary wholly, necessarily and exclusively in the performance of his duties is allowed as part of standard deduction. Averting a strike is not part of the manager's duties. Therefore, no deduction can be allowed on account of Rs. 10,000 paid by him to a labour leader.

5. The investment of Rs. 1,00,000 may be assessed in the hands of the assessee's wife by starting separate proceedings against her under section 69 on account of unexplained investment. If, however, in the course of investigation, it is discovered that the investment was linked with X's undisclosed sources, it will be assessed in the hands of X under section 68, and his total income in that case will be Rs. 1,30,000.

CHAPTER 23

Assessment of Hindu Undivided Families

A joint Hindu family consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters, while a Hindu coparcenary is a much narrower body including only those persons who acquire by birth an interest in the joint or coparcenary property. A joint Hindu family may be composed of smaller or branch joint families which may hold properties in their own right and may themselves be assessable units as distinct from the apex joint family.

However, for income-tax purposes a Hindu undivided family must satisfy the following two conditions, namely :

(1) That the family possesses common property. The common property consists of the following :

(*a*) Ancestral property. All property which a man inherits from a direct male ancestor is ancestral property and is at once held by him in coparcenary with his own male issues. But where he has inherited property from a collateral relation, as for instance, from a brother, nephew, cousin or uncle, it is not ancestral property in his hands in relation to his male issues.

(*b*) Property acquired with the aid of ancestral property.

(*c*) Property acquired by the individual members of the family without the aid of ancestral property, but treated by them as the property of the family.

Under the Hindu law, there is no necessity for joint family property to exist in order that there may be a joint family ; and it is a well-established principle of Hindu law that it is open to any member of a joint Hindu family to throw his separate or self-acquired property into the family hotchpot and thus treat it as joint family property. He can do so even if the hotchpot is empty. In the language used in *R. Subramania Iyer v. C. I. T.* (*28 ITR 352*), it is open to a member of a joint Hindu family to "impress upon his separate or self-acquired property the character of joint family property".

No formalities are necessary for the conversion of a coparcener's self-acquired property into coparcenary property. No registered instrument is necessary for blending the separate immovable properties of a coparcener with the coparcenary properties. The execution of a deed of declaration in which the coparcener declares that certain property detailed in the deed forms part of the joint family property is sufficient.

(2) That there is a Hindu coparcenary. The meaning of coparcenary is explained later on. The members of a Hindu undivided family consist of the following :

(*a*) Coparceners, *i. e.*, male members who are entitled to claim partition and to have a share on partition.

(*b*) Other members, *i. e.*, females who cannot claim partition but who are entitled to a share on partition.

However, in Dayabhaga law both male and female members are coparceners.

A Hindu undivided family remains as such even if there is only one male member along with females.

Stridhan. Property given to a Hindu female, whether during maidenhood, coverture or widowhood, by her parents and their relations or by her husband and his relations, is Stridhan according to all schools of Hindu law except that Dayabhaga law does not recognise immovable property given by a husband to his wife as stridhan.

School of Hindu Law.

Hindu undivided families are governed by two schools of Hindu law namely : Dayabhaga (दायभाग) and Mitakshara (मिताक्षरा), the former prevailing in Bengal, Assam and some parts of Orissa and the latter in the rest of India. The principal features of the two schools of Hindu law are as follows :

Dayabhaga Law. According to the Dayabhaga law, the sons do not acquire any interest by birth in ancestral property. Their rights arise for the first time on the father's death. On the death of the father they take such of the property as is left by him, whether separate or ancestral, as heirs and not by survivorship.

It is for this reason that in the father's life-time the income from ancestral property is to be assessed as the income of an individual, unless the father himself is a member of a coparcenary, *i. e.*, the father himself inherited the ancestral property along with a brother.

A coparcenary is formed only when the inheritance opens on the death of the father and there must be two or more heirs before a coparcenary can be formed. But if any of the male coparceners dies leaving surviving him a widow or a daughter, that widow or daughter would be admitted into the corparcenary in the place of the deceased coparcener. If, for example, a Hindu governed by the Dayabhaga law dies leaving three sons A, B and C, the three sons inherit the property jointly and form a coparcenary, although each inherits a defined share. If before partitioning their shares B dies leaving a widow BW, and C dies leaving a daughter CD, then A, BW and CD will be members of the coparcenary originally formed by A, B and C.

If the father dies leaving only one son, that son cannot form a coparcenary and he will be assessed as an individual.

Mitakshara Law. The son acquires by birth an interest in his father's ancestral property, and therefore after the birth of a son the income from ancestral property is to be assessed as the income of a Hindu undivided family. On the death of the father there is no change in the position except that the eldest son becomes the manager of the family in place of the father.

The right to managership of the Hindu undivided family is conferred on the father as the head of the family. The right to become the manager vests in the senior member of the family. The right to become the manager depends upon the fundamental fact that the person on whom the right devolves is a coparcener of the joint family. If a person is not a member of the coparcenary and is outside it, he has no right to claim the managership of the family and to claim a representative capacity on behalf of the other coparceners with reference to the dealings relating to the property of the family. The right is confined to the male members of the family, as the female members are not treated as coparceners though they are members of the joint family.

Section 14(1) of the Hindu Succession Act, 1956, is of wide import. Under this section a Hindu widow gets an absolute interest in the property of her husband who dies without a son. Moreover, every type of property "possessed by a female Hindu on 17th June 1956 (when the Hindu Succession Act came into force) became her absolute property in whatever manner she might have acquired it, the only necessary requisite being that she must have acquired it and possessed it on that date. Possession need not be actual physical possession or personal occupation of the property by the Hindu female but may be possession in law. The word "possessed" in section 14 is used in a broad sense and it means the state of owning or having in one's hand or power.

Under Mitakshara law, in a joint Hindu family consisting of a father and his minor sons, the father has the power to effect a partition between himself and his sons, whether they are majors or minors, with their consent. He may divide the properties physically or may only bring about a division in status. The division may be between himself and his sons or between the sons *inter se*. The partition, however, must be fair and the allotments substantially equal. If the partition is unequal and unfair, it is open to the sons, if they are majors to repudiate it, but if they are minors, it is open to them to set it aside after they attain majority. The partition so made is not void and will be good until it is set aside. The Income-Tax authorities, however, have no right to avoid the partition on the ground of an inequality in the division and the resultant prejudice to the interests of the minors (*18 ITR 586*).

The karta of a Hindu undivided family has only a limited power of making gifts out of joint family property, but when in the making of these gifts he is obviously joined by the other adult members of the family, the validity of the gifts can hardly be brought into question (*43 ITR 319*).

Coparcenary.

Coparcenary is a creature of Hindu law. The concept involves 'community of interest, unity of possession and common enjoyment'. Each coparcener's right extends to the whole joint family property. Though each one of them has interest in the whole family property, he has no definite share therein. Partitioning is the ascertainment of individual shares and it can be brought about by an unambiguous declaration of their intention to divide *i. e.*, by a conscious alteration of their status. At that stage the members of an erstwhile joint family become tenants-in-common. The next step is the division by metes and bounds, by which separate properties are allotted towards the said definite shares of the individuals. Although the said process does not involve transfer within the meaning of the Transfer of Property Act (*55 ITR 637*), it confers on a divided member an absolute title to a specified property, whereas before the partition he had only some interest in the entire joint family property.

A Hindu coparcenary includes only those persons who acquire by birth an interest in the joint family property. The persons who acquire such interest are sons, grandsons and great grandsons of the holder of the joint family property.

Sub-coparcenary. Where a coparcenary consists of brothers, uncles and nephews, each coparcener may form a sub-coparcenary (within the coparcenary) with his own issue. This can be done by a partition of some of the properties of the Joint Hindu family.

Conversion of Separate Property.

A coparcener who is interested in the coparcenary property and who owns separate property of his own may by deliberate and intentional conduct treat his separate property as forming part of the coparcenary property. In other words, the separate property of a coparcener loses its separate character

by reason of the owner's conduct and gets thrown into the common stock of which it becomes a part.

The basis of this doctrine of blending is the existence of coparcenary and coparcenary property as well the existence of the separate property of the coparcener.

Thus only a coparcener in a joint Hindu family has the right to throw his separate property into the family hotchpot. A female member of a Hindu undivided family cannot do so (*82 ITR 7*).

Partition.

A partition of the properties (both movable and immovable) can be effected by an oral agreement irrespective of the value of the property. Therefore a memorandum recording the fact of a partition which has already taken place is admissible in law, even if it is not registered under the Indian Registration Act (*77 ITR 1013*).

Persons Entitled to a Share on Partition. The following persons are entitled to a share on the partition of a joint Hindu family :

(*a*) All coparceners.

(*b*) A son in the womb of his mother at the time of partition though born after partition.

(*c*) Wife. On partition between the father and his sons, the wife takes a share equal to that of a son, even if the son is her step-son. If there are more wives than one, each will count as equal to a son.

(*d*) Mother. On a partition between sons, after the father's death, the mother also receives an equal share.

It is only the coparceners who are entitled to claim partition of Hindu undivided family. The wife or mother cannot claim partition, though on a partition she has a share in the property of the family.

According to a decision of the Supreme Court the doctrine that under Hindu law a son in his mother's womb is equal to a son actually in existence is not one of universal application and it applies mainly for the purpose of determining rights to property. This doctrine does not fit in with the scheme of the Income-Tax Act, and it was not the intention of the legislature to incorporate this special doctrine into the Act (*60 ITR 36*).

Allotment of Shares on Partition. After making provision, out of the assets available for partition, for marriage expenses, maintenance, father's debts and funeral expenses, the residue is to be divided in the manner explained in the following example :

A joint Hindu family consists of A, his wife B, his son C and two grandsons E and F (sons of a pre-deceased son D). On the partition of the family property, A, B, and C will each take one-fourth share and E and F will take their father's one-fourth share equally between them. That is to say, E and F will each get one-eighth share in the family property.

Alienation of Hindu Coparcenary Property.

Under Mitakshara law, the following persons alone have power to alienate Hindu coparcenary property :

(*a*) The whole body of coparceners if they are adults.

(*b*) The karta to the extent the alienation is for a legal necessity or for the benefit of the estate.

(*c*) The father to the extent noted below :

(i) He may make a gift of ancestral property within reasonable limits.

(*ii*) He may sell or mortgage ancestral property, including the interest of his sons, grandsons and great grandsons, for the payment of his debts provided it was an antecedent debt and was not incurred for immoral or illegal purposes.

(*d*) A sole surviving coparcener.

(*e*) Any other coparcener especially authorised by all other coparceners to do so.

Under Dayabhaga law, the foundation of a coparcenary is first laid on the death of the father. Since each coparcener takes a definite share of the coparcenary property, he can alienate his share by sale, mortgage, gift or will.

Gifts by Karta.

Under the Hindu law, the karta of a Hindu undivided family may gift a portion of the ancestral movable property to a member of the family within reasonable limits. If the gift is not within reasonable limits it may be challenged, but only by members of the family whose interests are affected thereby as the gift is voidable and not void.

Assessment of Hindu Undivided Families.

A Hindu undivided family is taxed (through its karta) as a separate entity like an individual according to its total income, and no account is taken of how that income is distributed amongst the individual members when such individual members are assessed in respect of their separate income. This applies even in cases where the income of the family is below the taxable minimum and is therefore not liable to tax in the hands of the family.

In a Hindu undivided family consisting of the mother and her minor sons, the mother can act as manager representing the family, and assessment and recovery proceedings may be taken against her in that capacity, or the eldest adult son (though minor) who manages the family affairs may file the return and be served with notices.

Once a family is assessed as undivided, it would continue, even after partition, to be assessed as an undivided family till an order is passed by the Income-Tax Officer under section 171 recognising the partition. Jain and Sikh undivided families are treated as Hindu undivided families.

A Hindu who declared for the purpose of the Special Marriage Act, 1872, that he did not profess the Hindu religion, did not thereby cease to be a Hindu ; the Hindu law still applied to him with the result that on a son being born he would be entitled to file a return as karta of a Hindu undivided family in respect of the income from the ancestral properties (*36 ITR 262*).

Salary Paid to Members of Family. Where a Hindu undivided family is able to show that the payment of salaries to its members was made as a matter of commercial expediency and for the purpose of earning profits, the family would be entitled to claim the payment as a deduction under section 37. Where, however, the members to whom salary was paid, have not rendered any service nor contributed to the earnings of the family, the family is not entitled to claim the salary as a deduction.

The remuneration paid to the karta of a Hindu undivided family is also deductible under section 37, if there is an agreement to pay such remuneration made by or on behalf of all the members of the family and the payment is in the interest of the family (*63 ITR 238*).

Income Taxed as a Family Income.

In the following cases, the income is to be taxed as the income of a Hindu undivided family :

(1) The Supreme Court held in *Gowli Buddanna v. C. I. T.* (*60 ITR 293*) that there need not be more than one male member to form a Hindu undivided family along with female members, and that even if the family is reduced to a sole surviving coparcener with other female members, the property and income belong to the joint family and in respect of such income the tax is leviable on the joint family and not on the male member as an individual.

(2) Where joint family property is partitioned and property is allotted to a coparcener who has a wife but no male issue, the income from the property is assessable as the income of the Hindu undivided family composed of the member and his wife (and daughters, if any) and cannot be included in the assessment of the member as an individual (*63 ITR 505*).

When Hindu undivided family property is partitioned between the members of the family, the share obtained by a coparcener in ancestral property as regards his male issues who take an interest in it by birth, whether they are in existence at the time of partition or are born subsequently. The property all along continues to be coparcenary property though the sole coparcener may be entitled to alienate the property.

(3) Where the funds of a Hindu undivided family are invested in a company or partnership, the dividends or share of profits are of course the income of the joint family. But in such cases even the fees, salary or other remuneration received by a member of the family as a director or partner, though it may be partially traceable to the personal exertions of the member, has been held taxable as the income of the family if :

(*i*) it is earned by detriment to the family funds, or
(*ii*) it is earned with the aid or assistance of those funds, or
(*iii*) there is a real connection between the income and the investment of the family funds.

This is according to a decision of the Supreme Court (*68 ITR 365*).

Income not taxed as Family Income.

In the following circumstances, the income is not treated and assessed as the income of the Hindu undivided family :

(1) Where the income of a member of a Hindu undivided family consists of his own personal earnings, such income is taxed in his hands as an individual.

(2) The son of a Hindu does not acquire by birth any interest in his father's self-acquired property. In respect of the income of such property, the father is to be assessed as an individual.

If a father gives his self-acquired property to his son, the son takes it as ancestral property, and therefore a business carried on by the son with the aid of such property would be joint family business and the joint family would be assessable in respect of the profits of that business.

But if the father intended the gift to be merely personal to the son, the profits of the business would be the individual income of the son and not the income of the family.

(3) According to Dayabhaga law, the son does not acquire by birth any interest in ancestral property. His rights arise for the first time on his father's death. In the father's lifetime, therefore, the income from ancestral property is to be assessed as the income of an individual, unless the father himself is member of a coparcenary, *i. e.*, the father himself inherited the ancestral property along with a brother.

(4) Where a female is the sole owner of the property which has devolved on her upon her husband's death, the income from the property is assessable in her hands as her own individual income and not as the income of a Hindu

undivided family, notwithstanding that the property may be subject to the right of maintenance of the assessee's mother-in-law and the assessee and her mother-in-law may constitute a Hindu undivided family, since there can be no undivided family consisting of female members only.

(5) The holder of an impartible estate is also assessed as an individual in respect of the income of the estate. This is explained later in this chapter.

(6) Where a member of a joint family carries on business on his personal account, the profit would be his individual income and not the income of the family though he may have borrowed the requisite capital from the family funds, and such profits would be taxed in his hands as an individual.

(7) Where members of a joint family carry on business on personal account in partnership, the profit would be the income of the partnership and not the income of the family. The firm would be assessed as an unregistered firm in respect of such profits.

(8) A Hindu father governed by the Mitakshara law has full powers within reasonable limits to make gifts of movable property to his wife or daughter etc., even without the consent of the other adult coparceners. Therefore, income from a portion of the joint family property which has been validly gifted by the karta to his wife, would not be taxable in the hands of the joint family even if the motive for making the gift was to reduce the tax liability of the family (*34 ITR 719*).

(9) In view of the provisions of the Hindu Succession Act, 1956, the income from assets inherited by a son from his father from whom he has separated by partition cannot be assessed as the income of the Hindu undivided family of the son (*67 ITR 164*).

(10) All property which a man inherits from a direct male ancestor is ancestral property and is at once held by him in coparcenary with his own male issues. But where he has inherited property from a collateral relative such as brother, nephew, uncle, cousin or *mama*, it is not ancestral property in his hands in relation to his male issues, it being his individual property the income from which is taxable in his individual assessment.

Assessment after Partition of a H. U. F.

Section 171 governs the assessment of a Hindu undivided family after its partition. For this purpose the term "partition" and "partial partition" are defined as follows :

Partition. This term means either of the following :

(*a*) Where the property, admits of a physical division, partition means the physical division of the property, but a physical division of the income without a physical division of the property producing the income shall not be a partition.

(*b*) Where the property does not admit of a physical division, then partition means such division as the property admits of, but a mere severance of status shall not be deemed to be a partition.

Partial Partition. This means a partition, which is partial as regards the persons constituting the Hindu undivided family, or the properties belonging to the Hindu undivided family, or both.

The provisions of section 171 are as follows :

(1) A Hindu family hitherto assessed as undivided shall be deemed to continue as a Hindu undivided family, except where a finding of a partition has been given by the Income-Tax Officer.

(2) Where at the time of making an assessment, it is claimed by or on behalf of any member of a Hindu family assessed as undivided that a partition

(whether total or partial) has taken place among the members of such family, the Income-Tax Officer shall make an inquiry thereinto after giving notice to all the members of the family. On the completion of the inquiry, the Income-Tax Officer shall record a finding as to whether there has been a total or partial partition of the joint family property, and, if there has been such a partition, the date on which it has taken effect. The finding as to the date of partition will facilitate assessments for the period before and after partition.

(3) Where a finding of total or partial partition has been recorded by the Income-Tax Officer and the partition took place during the previous year :

(*a*) the total income of the joint family in respect of the period up to the date of partition shall be assessed as if no partition had taken place ; and

(*b*) each member or group of members shall, in addition to any tax for which he or it may be separately liable, be jointly and severally liable for the tax on the income so assessed.

However, where the partition took place after the expiry of the previous year the total income of the previous year of the joint family shall be assessed as if no partition had taken place.

If the Income-Tax Officer finds, after completion of the assessment of a Hindu undivided family, that the family had already effected a partition (whether total or partial), the Income-Tax Officer shall proceed to recover the tax from every person who was a member of the family before the partition and every such person shall be jointly and severally liable for the tax on the income so assessed.

For this purpose, the several liability of any member or group of members shall be computed according to the portion of the joint family property allotted to him or it at the partition, whether total or partial.

(4) The provisions of this section apply in relation to the levy and collection of any penalty, interest, fine or other sum in respect of any period up to the date of partition of a Hindu undivided family as they apply in relation to the levy and collection of tax in respect of any such period.

Note : For purposes of section 171, severance in status alone is not sufficient. What is required is severance of status accompanied by ascertainment of shares and the division of the property. It is only then that the order contemplated in section 171 can be applied for and made, and till such an order is made the joint family continues to exist as a unit : although the status may have come to an end.

In other words section 171 contemplates a division of property, but the method of dividing the joint family property among the members depends upon the nature of the property. A business, for example, cannot be divided into parts in the same manner as a piece of land. The division of joint family business is possible only in the books. On the date of partition of the business, the capital of the business is to be divided among the various members and each member's account (newly opened) is to be credited with the amount falling to his share and all future transactions relating to him (such as withdrawals, share of profit or loss, etc.) are to be recorded therein. There must also be something to show that each member has full power of disposal over the amount standing to his credit after partition.

Under certain circumstances, there may be a partial partition of Hindu undivided family. The expression "partial partition" refers to two types of cases—(*i*) cases where one or some only of the members go out of the family, and (*ii*) cases where only a portion of the family property is divided. In the first case the outgoing members will be separately dealt with for purposes of assessment, and the remaining members will be treated as an undivided family,

Where some of the items of joint family property comparatively small in proportion to the entire assets and producing only a small income, have not been divided

for substantial reasons (such as practicability, convenience or reasonable sentiment) not affecting the general *bona fide* intention to become completely separated for all purposes, it would not by itself affect the case for total partition.

Rates of Tax.

The rates of income-tax applicable to Hindu undivided families for the assessment year 1975-76 are given in a subsequent chapter dealing with computation of tax.

Receipts from Family Income.

Under section 10(2), there shall be excluded from the total income of an assessee any sum which he receives as a member of a Hindu undivided family, where such sum has been paid out of the income of the family or, in the case of an impartible estate, where such sum has been paid out of the income of the holder of the estate belonging to the family.

Before this exemption can be claimed, the following conditions must be satisfied :

(*a*) that there is a Hindu undivided family ;

(*b*) that the assessee is a member of the family ;

(*c*) that the sum is received by such assessee as a member of the family ; and

(*d*) that the sum has been paid out of the income of the family.

If any of these conditions is not fulfilled, the amount received will not be excluded from the total income of the recipient.

An individual who is a member of a Hindu undivided family may be entitled to a share of the income of the family, because of his or her right to a partition and allotment of his or her share on separation or because of his or her right to maintenance out of the joint family property. Where a sum is so allotted to such an individual, it is received by such individual as a member of the Hindu undivided family.

However, if a maintenance is paid to a member not as a member of the joint family but in pursuance of some legal obligation, like the decree of a court, such an allowance will be liable to tax as the income of the recipient.

As an exception to the above-mentioned provision, section 64(2) provides that, where an individual converts his separate property into property belonging to the Hindu undivided family of which he is a member, the income from the converted property, in so far as it is attributable to his interest in the family property, is deemed to arise to him and is taxable in his hands.

Impartible Estate. It is an estate which is not divisible among the several members of a Hindu undivided family, but which goes only to a single heir. The succession to an impartible estate is governed by the general law of Mitakshara as superseded by custom, and the birthright of the senior member to take by survivorship still remains. Such right of survivorship is lost only by a separation of the claimant from the undivided family.

An impartible estate may consist of landed property, house property, securities and other sources of income. The income of an impartible estate is the absolute property of the holder of the impartible estate and it is not received by him as the income of a Hindu undivided family. It is therefore the subject of individual assessment.

Where any house property forms part of an impartible estate the income from such property is also assessed in the hands of the holder of the impartible estate, even though he is not the owner of such property and this provision is an exception to the rule that the income from house property is to be assessed in the hands of its owner.

Compute the total income of the family giving short reasons for allowing or disallowing items of losses or expenses.

		Rs.
Net Profit as returned		1,05,000
Less Dividends (treated separately)		50,000
		55,000
Add Loss in silver speculation	50,000	
Expenses incurred in a criminal case	10,000	
Cash stolen from iron safe being capital loss	10,000	
Cost of motor-bicycle	2,000	
Irrecoverable loan not given in the ordinary course of money-lending business	20,000	92,000
		1,47,000
Less Depreciation of motor-bicycle at 20%		400
Income from business		1,46,600
Dividends (assumed to be from Indian companies)		50,000
Gross Total Income		1,96,600
Deduction on account of dividends		3,000
Total Income		1,93,600

The above computation is subject to the following remarks :

(*i*) Hedging transactions are treated as ordinary business transactions and the loss of Rs. 1,00,000 in hedging contracts is an admissible deduction. But the loss of Rs. 50,000 in silver speculation will not be allowed as a deduction because a speculation loss can be deducted only from speculation profit.

(*ii*) Law charges of Rs. 10,000 incurred in a criminal case connected with alleged purchase of smuggled gold is not an allowable deduction (*28 ITR 427*).

(*iii*) Loss of cash by theft even from the business premises cannot be said to be incidental to the trade and is not an allowable deduction. If it could be proved that the cash formed part of the stock-in-trade and the loss occurred due to embezzlement by an employee, the case would have been different. But normally loss of this kind must be said to arise on account of the negligence of the assessee and there is no provision in the Act to allow such loss.

(*iv*) The loan of Rs. 20,000 to karta's brother-in-law without any interest is *prima facie* not a business loan. The bad debt claim is therefore disallowed.

(*v*) The salary of Rs. 3,000 paid to the son of the karta is allowed, it being presumed that he actually worked in the business.

(*vi*) The cost of motor-bicycle (Rs. 2,000) is capital expenditure, on which depreciation is allowed, as the son of the karta is an employee of the Hindu undivided family.

(4) A Hindu undivided family has filed a return for the assessment year 1975-76 showing the following income for the previous year ended 31st March 1975.

		Rs.	Rs.
House property (after deducting one-sixth for repairs)			20,000
Cloth business in Madras and Nagpur			60,000
Money-lending business	Cr.	50,000	
	Dr.	10,000	40,000

Speculation	Cr.	60,000	
	Dr.	40,000	20,000
			1,40,000

At the time of assessment, the two branches of the family X and Y claim partition under section 171 and registration under section 185 of the Income-Tax Act, the application for registration having been made before 31st March 1975. On inquiry you find that :

(*a*) In 1972 a Balance Sheet was drawn up and a separate capital account of each branch started in the books of the cloth and money-lending business. The profits for each business have been actually divided. A partnership deed was also drawn up, but neither registration nor partition was claimed to get the benefit of a set-off of the loss carried forward.

(*b*) Shares of the two branches were also fixed in property, but there was no partition in definite portions.

(*c*) Property fetching an annual rent of Rs. 24,000 was constructed in March 1974 at a cost of Rs. 1,00,000 from the joint funds.

(*d*) The net income from speculation was not divided on the ground that in unsettled contracts there was loss. Separate books of account are kept for speculation business.

(*e*) The debit side of speculation amount represents profits paid to various persons residing in Ceylon. As they were non-residents of India, the assessee says that he took the precaution of retaining income-tax at the appropriate rate and asks for a chalan being given to credit to Government account the income-tax so retained. The assessee is unable to furnish the particulars of the payees.

Pass such orders as are necessary to dispose of the claims and prepare the assessment of the parties (Hindu undivided family and the firm) concerned.

The following orders would be passed on the claims for partition of the Hindu undivided family and registration of the firm :

Section 171. The assessee's claim for complete partition cannot be accepted, as the house property has not been partitioned by metes and bounds and this is a necessary requisite. The fact that speculation profits have not been divided indicates that this business is also joint. Therefore, this is a case of partial partition of assets whereby the business of cloth and money-lending has ceased to be the business of the Hindu undivided family. Hence income from property and speculation would be assessed as the income of the Hindu undivided family and the income of cloth and money-lending business as that of the firm.

Section 185. The partnership deed and the account books evidence a genuine partnership. The profits of the cloth and money-lending business have been duly divided between X and Y. Registration is therefore granted under section 185 for the assessment year 1975-76.

Assessment of Hindu Undivided Family

	Rs.
Income from House Property	20,000
Speculation Income	60,000
Total Income	80,000

No deduction can be allowed for the speculation profits paid to non-residents, since the assessee has not proved payments by disclosing the indentity of the payees.

As a matter of custom, the junior members of an impartible estate have a right to receive maintenance allowances. Therefore, any sum received by way of maintenance by a junior member is not to be included in his total income.

Illustrations

(1) Atma Ram & Sons is a Hindu undivided family of which P is the Karta. The family consists of the karta and his three brothers (Q, R and S) as coparceners. The family and the coparceners had the following income for the year ended 31st March 1975 :

1. Salary of Q as manager of a company Rs. 18,000.
2. Interest on securities :
   (*a*) In the name of Q (investment made out of his salary) Rs. 4,200.
   (*b*) In the name of all the coparceners (investment made out of family funds) Rs. 2,900.
3. Property Income :
   (*a*) Ancestral house Rs. 12,000.
   (*b*) In the name of P (bought in 1954 out of family funds) Rs. 7,200.
4. Business :
   (*a*) Family business income Rs. 35,000.
   (*b*) Half share of income in a firm in which P is a partner in a representative capacity Rs. 3,600.
   (*c*) Income from profession as a lawyer of R Rs. 9,600.
5. Dividend from shares :
   (*a*) In the name of P bought out of family funds (gross) Rs. 3,000.
   (*b*) In the name of P's wife bought out of her stridhan Rs. 1,200.

Compute the total income of the family for the assessment year 1975-76.

(*C. A. Final, Nov. 1964*)

		Rs.
1. Interest on securities assumed to be gross		2,900
2. Income from house property		19,200
3. Business Profits :		
Family business	35,000	
Share income from a firm	3,600	38,600
4. Dividends (assumed to be from Indian companies)		3,000
Family's gross total income		63,700
Deduction on account of dividends		3,000
Total Income		60,700

The remaining income given in this case is not the income of the family.

(2) Ram Lal and his three major sons are members of a Hindu undivided family. Compute the family's total income for the accounting year ended 31st March 1975 from the following particulars, giving briefly your reasons.

The family had a cloth business at Kanpur which yielded a net profit of Rs. 50,000 after deduction of (*i*) salary of Rs. 12,000 to Ram Lal who managed the business, (*ii*) salary of Rs. 3,600 to one of his sons, who worked as a salesman, and (*iii*) commission of Rs. 5,000 to a stranger who secured a lucrative new agency.

The family owned shares with controlling voting power in a limited company at Kanpur, by virtue of which one of its members became the company's managing director and earned a total remuneration of Rs. 18,000.

On 19th April 1975, the family received a dividend of Rs. 20,000 (gross) declared by the company on 15th March 1975

		Rs.	Rs.
1.	Income from Business :		
	Net Profit from cloth Business	50,000	
	Add Commission paid for securing a new agency, being capital expenditure	5,000	55,000
2.	Income from other sources :		
	Dividend		20,000
	Gross Total Income		75,000
	Deduction on account of dividend		3,000
	Total Income		72,000

Salary paid to one of the karta's sons who served as a salesman is an admissible deduction, assuming that it is reasonable remuneration for the services rendered. Salary paid to Ram Lal (karta) is also deductible under section 37, assuming that there is an agreement to pay such salary made by or on behalf of all the members of the family and that the payment is in the interest of the family (*63 ITR 238*).

The dividend, though received after the previous year ended 31st March 1975 was declared within that year. As soon as a company declares a dividend, it becomes the income of the shareholders. Therefore the dividend is to be treated as the income of the family for the previous year 1974-75.

The remuneration of Rs. 18,000 received by a member of the Hindu undivided family as managing director of the limited company is his individual income, since it is for the personal service rendered by him without detriment to the assets of the family. The fact that he secured this post by virtue of the shares held by the family cannot change the character of his income (*18 ITR 194*).

(3) A Hindu undivided family carrying on business in gold, silver, money-lending, brokerage, and share dealings showed the following particulars in the return of income filed for the previous year ended 31st March 1975 :

	Rs.		Rs.
Loss in silver	1,00,000	Profit in gold	1,50,000
Loss on sale of securities	20,000	Profit in sovereigns	25,000
Loss in share dealings	50,000	Profit from brokerage	
Law charges	30,000	interest and commission	1,50,000
Bad Debts	50,000	Dividends gross	50,000
Establishment and contingencies	20,000		
Net Profit	1,05,000		
	3,75,000		3,75,000

The examination of the books of account disclosed the following facts :

(*a*) Silver account was found debited with loss in hedging contracts of Rs. 1,00,000 and loss of Rs. 50,000 in silver speculation.

(*b*) Law charges included expenses of Rs. 10,000 incurred in a criminal case connected with alleged purchase of smuggled gold.

(*c*) Bad debts included loss of cash of Rs. 10,000 by theft from *tijori* (iron safe) in the business premises and Rs. 20,000 as an irrecoverable loan given without interest to the karta's brother-in-law whose business failed.

(*d*) Establishment expenses included salary of Rs. 3,000 paid to the son of the karta and Rs. 2,000 for the purchase of a motor-bicycle in November 1974 claimed to enable him to attend office.

Compute the total income of the family giving short reasons for allowing or disallowing items of losses or expenses.

		Rs.
Net Profit as returned		1,05,000
Less Dividends (treated separately)		50,000
		55,000
Add Loss in silver speculation	50,000	
Expenses incurred in a criminal case	10,000	
Cash stolen from iron safe being capital loss	10,000	
Cost of motor-bicycle	2,000	
Irrecoverable loan not given in the ordinary course of money-lending business	20,000	92,000
		1,47,000
Less Depreciation of motor-bicycle at 20%		400
Income from business		1,46,600
Dividends (assumed to be from Indian companies)		50,000
Gross Total Income		1,96,600
Deduction on account of dividends		3,000
Total Income		1,93,600

The above computation is subject to the following remarks :

(*i*) Hedging transactions are treated as ordinary business transactions and the loss of Rs. 1,00,000 in hedging contracts is an admissible deduction. But the loss of Rs. 50,000 in silver speculation will not be allowed as a deduction because a speculation loss can be deducted only from speculation profit.

(*ii*) Law charges of Rs. 10,000 incurred in a criminal case connected with alleged purchase of smuggled gold is not an allowable deduction (*28 ITR 427*).

(*iii*) Loss of cash by theft even from the business premises cannot be said to be incidental to the trade and is not an allowable deduction. If it could be proved that the cash formed part of the stock-in-trade and the loss occurred due to embezzlement by an employee, the case would have been different. But normally loss of this kind must be said to arise on account of the negligence of the assessee and there is no provision in the Act to allow such loss.

(*iv*) The loan of Rs. 20,000 to karta's brother-in-law without any interest is *prima facie* not a business loan. The bad debt claim is therefore disallowed.

(*v*) The salary of Rs. 3,000 paid to the son of the karta is allowed, it being presumed that he actually worked in the business.

(*vi*) The cost of motor-bicycle (Rs. 2,000) is capital expenditure, on which depreciation is allowed, as the son of the karta is an employee of the Hindu undivided family.

(4) A Hindu undivided family has filed a return for the assessment year 1975-76 showing the following income for the previous year ended 31st March 1975.

		Rs.	Rs.
House property (after deducting one-sixth for repairs)			20,000
Cloth business in Madras and Nagpur			60,000
Money-lending business	Cr.	50,000	
	Dr.	10,000	40,000

Speculation	Cr.	60,000	
	Dr.	40,000	20,000
			1,40,000

At the time of assessment, the two branches of the family X and Y claim partition under section 171 and registration under section 185 of the Income-Tax Act, the application for registration having been made before 31st March 1975. On inquiry you find that :

(*a*) In 1972 a Balance Sheet was drawn up and a separate capital account of each branch started in the books of the cloth and money-lending business. The profits for each business have been actually divided. A partnership deed was also drawn up, but neither registration nor partition was claimed to get the benefit of a set-off of the loss carried forward.

(*b*) Shares of the two branches were also fixed in property, but there was no partition in definite portions.

(*c*) Property fetching an annual rent of Rs. 24,000 was constructed in March 1974 at a cost of Rs. 1,00,000 from the joint funds.

(*d*) The net income from speculation was not divided on the ground that in unsettled contracts there was loss. Separate books of account are kept for speculation business.

(*e*) The debit side of speculation amount represents profits paid to various persons residing in Ceylon. As they were non-residents of India, the assessee says that he took the precaution of retaining income-tax at the appropriate rate and asks for a chalan being given to credit to Government account the income-tax so retained. The assessee is unable to furnish the particulars of the payees.

Pass such orders as are necessary to dispose of the claims and prepare the assessment of the parties (Hindu undivided family and the firm) concerned.

The following orders would be passed on the claims for partition of the Hindu undivided family and registration of the firm :

Section 171. The assessee's claim for complete partition cannot be accepted, as the house property has not been partitioned by metes and bounds and this is a necessary requisite. The fact that speculation profits have not been divided indicates that this business is also joint. Therefore, this is a case of partial partition of assets whereby the business of cloth and money-lending has ceased to be the business of the Hindu undivided family. Hence income from property and speculation would be assessed as the income of the Hindu undivided family and the income of cloth and money-lending business as that of the firm.

Section 185. The partnership deed and the account books evidence a genuine partnership. The profits of the cloth and money-lending business have been duly divided between X and Y. Registration is therefore granted under section 185 for the assessment year 1975-76.

Assessment of Hindu Undivided Family

	Rs.
Income from House Property	20,000
Speculation Income	60,000
Total Income	80,000

No deduction can be allowed for the speculation profits paid to non-residents, since the assessee has not proved payments by disclosing the indentity of the payees.

Assessment of Firm

	Rs.
Cloth business	60,000
Money-lending business	40,000
Total Income	1,00,000

It is presumed that the necessary details have been furnished by the assessee in respect of the debits of Rs. 10,000 in money-lending account.

(5) A Hindu undivided family carrying on a trade in provisions declared an income of Rs. 23,000 in its return of income made for the assessment year 1975-76, the previous year being the year ended 31st December 1974. The following particulars are available :

(*a*) Salaries of Rs. 4,800 and Rs. 1,200 respectively paid to the karta and his wife for services rendered are claimed as expenses.

(*b*) A gift of Rs. 10,000 had been made by the karta in an earlier year to his minor unmarried daughter out of the family funds. The amount was deposited with a bank in her name and it earned interest of Rs. 750 in the year.

(*c*) The declared income included Rs. 3,200 being share of profits in a firm, HJK. In arriving at this amount the HUF had deducted a sum of Rs. 1,200 for charges incurred by the karta in maintaining an establishment to look after his interest in the firm and another sum of Rs. 600 ; being interest paid by the karta on moneys borrowed by him and advanced to the firm as a loan.

(*d*) The karta's wife is also a partner in the firm HJK. Her share of income for the assessment year 1975-76 was Rs. 6,000 and it was not included in the declared income of Rs. 23,000.

(*e*) A sum of Rs. 20,000 appeared in the accounts in favour of X. On inquiry the Income-Tax Officer found that X was employed on a petty salary and had little means. All the same, X affirmed on oath that he had advanced the loan.

(*f*) A sum of Rs. 15,000 appeared in the accounts as a credit in favour of the karta's wife and the narration in the entry was that the amount was the sale price of her old ornaments. A reputed jeweller's bill was produced to prove the sale, but the purchase of the ornaments was not proved.

(*g*) The Balance Sheet showed a difference of Rs. 365, being the excess of the total of the capital and liabilities side over the total of the assets side.

(*h*) The family had advanced a loan of Rs. 10,000 on a pronote at 9% per annum interest on 31-12-1971. The debtor did not make any payment. The family obtained from the debtor on 31-12-1974 a fresh pronote for Rs. 12,700 which included interest for the three years. It was contended that the amount of Rs. 2,700 representing interest was not assessable for the year 1975-76.

Compute the total income of the family for the assessment year 1975-76.

Income as returned by the family	Rs.
(*a*) Salaries paid to the karta and his wife for services rendered are an admissible deduction (*63 ITR 238*).	23,000
(b) There is nothing to show that the gift of Rs. 10,000 made by the karta to his minor unmarried daughter was unreasonable. Therefore the gifted funds belonged to the daughter and the income derived therefrom cannot be included in the family's income.	—
(*c*) The income returned includes Rs. 3,200 being share of profits from a firm. Interest payment of Rs. 600 is an admissible deduction, but there is no provision to allow deduction on account of establishment charges. Therefore Rs. 1,200 is added.	1,200
(*d*) The share income of the karta's wife from the firm of HJK cannot be included in the family's total income as there is no provision so to include it. Section 64(1)(i) is applicable in cases of assessments of individuals.	—
(*e*) As X was employed on a petty salary and had little means, he could not have advanced Rs. 20,000. His affirmation on oath is of no use. Rs. 20,000 is therefore added under section 68.	20,000
(*f*) As the purchase of the ornaments could not be proved, Rs. 15,000 is added as the family's undisclosed income under section 68.	15,000
(*g*) The difference of Rs. 365 in the Balance Sheet did not represent any income and is to be ignored.	
(*h*) Assuming that the assessee kept its accounts on the mercantile basis, the interest due only for the previous year is liable to income-tax.	900
Total Income	60,100

CHAPTER 24

Assessment of Firms And Associations

Under section 2(23), the terms, 'partner' and 'partnership' have the same meaning respectively as in the Indian Partnership Act of 1932, but the term partner also includes any person who being a minor has been admitted to the benefits of partnership. When there is no firm name given to a partnership the partnership business can be done in the name of a partner (*36 ITR 266*).

Section 4 of the Indian Partnership Act, 1932, defines partnership as the relation between persons who have agreed to share the profits of a business carried on by all or by any of them acting for all. It further provides that the persons who have entered into partnership with one another are called individually partners and collectively a firm. The name under which the business is carried on is called the firm name.

The definition of partnership has three distinct elements, namely : (*i*) there must be an agreement entered into by all the persons concerned ; (*ii*) the agreement must be to share the profits of a business, not necessarily its losses as well ; and (*iii*) the business must be carried on by all or by any of the partners acting for all. All these elements must exist before a group of persons can be said to be a partnership.

Legally it is not necessary that the loss incurred by a partnership should be shared by all the partners, nor is it necessary for every partner to contribute capital, for a person who becomes a partner may contribute his capital or his skill or both.

As stated above, the expression 'partner' includes any person who being a minor has been admitted to the benefits of partnership. A minor who has been admitted to the benefits of partnership has a right to such share in the property and profits of the firm as may be agreed upon—not between him and the partners (for he cannot be a party to a contract) but between the other partners. If there are at least two persons competent to contract among the members of the firm, there is partnership even if a minor has also been admitted to the benefits of partnership.

There may be a partnership of husband and wife. Thus, it has been held that a partnership between a husband and his wife in which the husband was almost everything in the concern (having the sole control of the management, the power of determining the partnership and of admitting new partners) was a valid partnership. The fact that the control is kept with the husband and that he has certain extra rights as a senior partner does not in any sense negative a partnership according to law.

The relation of partnership arises from contract and not from status. Therefore, the members of a Hindu undivided family carrying on a family

business as such are not partners in the business. It is however, open to the members of a Hindu undivided family to divide the family business and thereafter to carry on the business as partners without dividing the other assets of the family. Moreover, a Hindu undivided family may carry on a family business exclusively for its own benefit or it may carry on the business with one or more outsiders as partners with the family.

For the purpose of assessment, a firm may be registered or unregistered. A registered firm means a firm registered under the provisions of section 184 and 185, and an unregistered firm means a firm which is not a registered firm.

Registration of Firms

The law governing the registration of firms for income-tax purposes is contained in sections 184 to 186 and rules 22-25 of the Income-Tax Rules, 1962. The registration is different from the registration under the Indian Partnership Act or the Indian Registration Act.

The privilege of registration is given to a firm in order to enable it to get the benefit of a lower assessment than that which would be levied if the firm remained unregistered. If a firm desires to have this privilege it must comply with the requirements of law relating to registration.

The requirements of section 184 relating to registration of a firm are as follows :

(1) An application for registration of a firm may be made to the Income-Tax Officer on behalf of the firm, if the partnership is evidenced by an instrument.

(2) Such application may be made either during the existence of the firm or after its dissolution.

(3) Such application shall be signed :

(*a*) by all the partners (not being minors) personally ; or

(*b*) in the case of a dissolved firm, by all persons (not being minors) who were partners before its dissolution and by the legal representative of any such partner who is dead.

Where a partner happens to be absent from India, the application may be signed by some other person authorised to do so on his behalf, and in the case of a mentally incapacitated person, it may be signed by a person entitled under law to represent him.

(4) The application should be made before the end of the previous year for the assessment year in respect of which registration is sought. But the Income-Tax Officer may entertain an application made after the end of the previous year, if he is satisfied that the firm was prevented by sufficient cause from making the application in time.

(5) The application should be accompanied by the original instrument of partnership together with a copy thereof. However, if the Income-Tax Officer is satisfied that for sufficient reason the original instrument cannot be conveniently produced, he may accept a duly certified copy of it.

For the purpose of getting the registration of a firm, it is not necessary that there should be in existence an instrument of partnership from the very start of the partnership business. A firm can be brought into existence by an oral agreement but if the agreement of partnership is reduced to writing at any time before the end of the accounting period, the benefit of registration can be allowed to the firm in respect of that accounting year. All that is necessary is that the instrument of partnership must be in existence during the relevant accounting year (*36 ITR 194*).

(6) The application must be made in the prescribed form and must contain the prescribed particulars.

Effect of Registration. Where registration is granted to a firm for any assessment year, it shall have effect for every subsequent year if :

(*a*) there is no change in the constitution of the firm or the shares of the partners ; and

(*b*) the firm furnishes, before the expiry of the time allowed (whether fixed originally or on extension) for furnishing the return of income for such subsequent assessment year a declaration to that effect in the prescribed form and verified in the prescribed manner. Where the Income-Tax Officer is satisfied that the firm was prevented by sufficient cause from furnishing the declaration within the said period, he may allow the declaration to be furnished at any time before the assessment is made.

If there is any technical defect in such declaration, the Income-Tax Officer shall intimate the defect to the firm and give it an opportunity to rectify it within a period of one month. If the defect is not rectified within that period, then the Income-Tax Officer will declare by an order in writing that the registration granted to the firm for the earlier year shall not have effect for the subsequent assessment year.

Though it may be convenience for a partnership to have a firm name for many purposes, it does not follow that the firm name is an essential ingredient of the constitution of the firm and it is possible for a firm to carry on business without assuming a firm name. It cannot therefore be held that there has been a change in the constitution of a firm by the mere fact that the name of the firm has been changed and the Income-Tax Officer cannot refuse to renew the registration of a firm on the ground that the name of the firm has been changed (*79 ITR 749*).

Where any such change has taken place in the previous year, the firm shall apply for fresh registration for the assessment year concerned. Where a minor has been admitted to the benefits of a partnership and he attained majority and becomes a partner of the firm, there is a change in the constitution of the firm and the firm is not entitled to the continued benefit of the registration previously granted to the firm. The firm must apply for fresh registration (*83 ITR 233*).

Procedure for Grant of Registration. According to section 185, on receipt of an application for the registration of a firm, the Income-Tax Officer shall inquire into genuineness of the firm and its constitution as specified in the instrument of partnership ; and

(*a*) if he is satisfied that there is or was in existence during the previous year a genuine firm with the constitution so specified, he shall pass an order in writing registering the firm for the assessment year ; or

(*b*) if he is not satisfied, he shall pass an order in writing refusing to register the firm.

A firm shall not be regarded as a genuine firm if any partner of the firm was, in relation to the whole or any part of his shares in the income or property of the firm, at any time during the previous year, a benamidar of any other partner to whom he is not related as a spouse or a minor child.

Though the power to grant or refuse registration is vested in the Income-Tax Officer, its exercise is not discretionary ; but where the requisites for registration prescribed by the statute and the rules made thereunder are satisfied registration has to be given as a matter of right (*74 ITR 478*).

The Income-Tax Officer cannot reject an application for registration merely on the ground that the application is not in order but he must intimate the defect to the firm and give it an opportunity to rectify the defect in the application within a period of one month from the date of such intimation. If

the defect is not rectified within such time, the Income-Tax Officer may reject application.

An instrument of partnership is not a magical talisman. When an application for the registration of a firm is made, the Income-Tax Officer is entitled to examine whether the partnership is genuine, whether each of the partners mentioned therein is a real partner, whether the shares are specified properly, whether the shares specified are real ones and whether the profits which are to be distributed under the deed will truly be the profits of those particular individuals. If he finds that there is no genuineness with regard to any of these things it is open to him to reject the application on the ground that there is no genuine partnership brought into existence by the deed.

The mere fact that a former employee or a relative is taken up as a partner, or that he does not bring in any capital or that a partner occupies a dominant position and is in control of the business, or that no notice of partnership is given to the constituents of business, or that no separate capital account is opened, may not by itself be regarded as evidence for a finding that the partnership is not genuine.

Once the firm has been found to be genuine, it is not proper for the Income-Tax Officer to refuse registration on the technical plea that a small part of the profits has not been distributed. However, the partners will be assessed on their full share of income from the firm without making an allowance for the sum that has been carried forward to the next year.

The Income-Tax Officer would be justified in refusing registration if he finds as a matter of law that the partnership purported to be constituted under the instrument is not valid or has no existence in law. Thus, where under the terms of a partnership deed the management and the control of the business vested entirely in the hands of the senior partner and the other partners could not accept any business except with the consent of the senior partner and could not raise any loan or pledge the firm's property directly or indirectly except under the written authority of the senior partner, the partnership lacked the element of agency and as such could not be registered (*54 ITR 72*).

The fact that exclusive power and control, by agreement of the parties, was vested in one partner and the further circumstance that only one partner could operate the bank accounts or borrow on behalf of the firm was not destructive of the theory of partnership. Therefore such a firm is entitled to registration (*82 ITR 680*).

It is settled law that, where the kartas of Hindu undivided families enter into a partnership in their capacity as kartas representing their respective families, the adult members of their families do not become partners of the firm, but for the purpose of determining whether the total number of persons constituting the partnership exceeds twenty the adult members of the families must also be taken into account and if the total number of persons including the adult members of the families exceeds twenty the partnership cannot be registered.

Where a deed of partnership between 10 partners provided that 20% of the profits shall be paid as agency commission to partners nos. 1 to 3 and that net profits shall be divided between the 10 partners in certain specified shares, and the application for registration of the firm was rejected by the Income-Tax Officer on the ground that the deed did not specify the individual shares of the partners nos. 1 to 3 in the 20% commission :

It was held that as the 20% allowed as agency commission to partners nos. 1 to 3 was an expenditure of the firm and the shares of the 10 partners in the net profits of the firm were specified, the firm was entitled to registration (*60 ITR 487*).

The fact that one of the partners was a benamidar of another partner would not disentitle the firm to registration (*55 ITR 651*).

Where a firm is registered for any assessment year, the Income-Tax Officer shall record a certificate on the instrument of partnership to the effect that the firm has been registered for that assessment year, and where a declaration under section 184 is furnished by the firm for the relevant subsequent assessment year.

Where in respect of any assessment year there is any such default on the part of the firm as may lead to best judgment assessment, the Income-Tax Officer may refuse to register the firm for the assessment year.

Cancellation of Registration. Where a firm has been registered or its registration has effect for any assessment year, section 186 empowers the Income-Tax Officer to cancel the registration of the firm for that assessment year in the following circumstances :

(*a*) If the Income-Tax Officer is of opinion that there was during the previous year no genuine firm in existence as registered, he may, after giving the firm a reasonable opportunity of being heard and with the previous approval of the Inspecting Assistant Commissioner, cancel the registration of the firm. Such cancellation can be made only within 8 years from the end of the assessment year in respect of which registration has been granted or has effect.

(*b*) If there is, on the part of the firm, any such default as warrants a best judgment assessment under section 144, the Income-Tax Officer may cancel the registration of the firm for the assessment year, after giving the firm not less than 14 days' notice intimating his intention to cancel its registration and after giving it a reasonable opportunity of being heard.

Where the registration of a firm is cancelled for any assessment year, the Income-Tax Officer shall amend the assessments of the firm and its partners for that assessment year on the footing that the firm is an unregistered firm. Such amendment will be made as a rectification of mistake under section 154.

Illustration

Discuss the question of registration of the firm in the following cases :

(*a*) While considering an application for registration submitted by the partners of a firm, the Income-Tax Officer finds that one of the partners is a minor sharing profit or loss of the firm along with others.

(*b*) Where an application for registration has been filed, it is found that out of the four partners of the firm two are benamidars for X and Y who are not partners of the firm. (*C. A. Final, May 1967*)

(*a*) According to the Indian Partnership Act, 1932, this partnership is invalid because a minor partner shares in losses of the firm along with other partners. Therefore, this firm cannot be registered by the Income-Tax Officer.

However, if the partnership deed specifically states that the minor is admitted to the benefits of partnership, the clause in the partnership deed relating to sharing of losses can only mean that only the share of the minor in the partnership was intended to be made liable for losses but the minor was not to be made personally liable for the losses. Therefore, the firm is validly constituted and is entitled to registration. This is according to a decision of the Calcutta High Court in *Jeewanram Gangaram v. C. I. T.*

(*b*) An instrument of partnership is not a magical talisman. When an application is made for the registration of a firm, the Income-Tax Officer is entitled to examine whether the partnership is genuine, whether each of the partners mentioned therein is a real partner, whether the shares are specified properly, whether the shares specified are real ones and whether the profits which are to be distributed under the deed will truly be the profits of those particular individuals.

As there is no genuineness with regard to some of these things, Income-Tax Officer will refuse registration of the firm on the ground that there is no genuine partnership brought into existence by the deed.

Computation of Partner's Shares

For ascertaining the total income of a firm, the firm is treated as a separate entity apart from the members composing it ; but nothing paid to any partner by way of interest, salary, commission or other remuneration is allowed as a deduction.

Section 67(1) lays down the method of computing a partner's share in the profit or loss of the firm. This is done as follows :

Take any interest, salary, commission or other remuneration payable to the partners by the firm and add to or deduct from it respectively the partner's share in the balance of profit or loss of the firm *after* the *deduction* of any interest, salary, commission or other remuneration payable to any partner and also after the *deduction* of the tax payable by the registered firm or by an unregistered firm assessed as a registered firm. *This means that a partner of a registered firm or an unregistered firm assessed as a registered firm is entitled to the deduction of his share of income-tax payable by the firm on its total income from his share income from the firm.*

Though the interest, salary, commission or other remuneration payable by any partner is to be deducted from the firm's profit before computing a partner's share therein, such deduction is not permissible in computing the taxable business income of the firm.

Under section 67(2), the share of a partner in the income of the firm, as computed in the above manner, shall, for the purposes of assessment, be apportioned under the various heads of income in the same manner in which the income or loss of the firm has been determined under each head of income.

If the share of a partner in the income of a registered firm or a firm treated as registered under section 183(b), as computed under section 67, is a loss, such loss may be set off, or carried forward and set off, in accordance with the provisions of law already explained in an earlier chapter.

Deductions Allowable to a Partner from his Share Income from the Firm. Business carried on by a firm is business carried on by the partners. Profits of the firm are profits earned by all the partners in carrying on the business. The share of a partner is business income in his hands, and, being business income, expenditure necessary for the purpose of earning that income and appropriate allowances are deductible therefrom in determining the taxable income of the partner.

Thus, an assessee, who is a partner in several firms but who did not carry on any independent business, is entitled to deduct from his share of the profits from the firms the amounts paid as salary and bonus to staff, expenses for maintenance and depreciation of motor-cars and travelling expenses incurred by him in earning the income from the firms. This is the decision of the Supreme Court (*74 ITR 57*).

Section 67(3) expressly provides for a deduction, in computing a partner's share of the firm's profits, in respect of interest paid by him on capital borrowed for the purpose of investment in the firm.

Illustrations

(1) A, B and C are partners in a firm sharing profits and losses in the proportions of two-fifths, two-fifths and one-fifth respectively. The Profit & Loss Account of the firm for the year ended 31st December 1974 is as follows :

	Rs.		Rs.
Sundry Trade Expenses	50,000	Gross Profit	1,45,000
Interest on Capital :		Interest on Securities (not	
A	3,000	being government securities)	

B			
C	2,000	Gross	5,000
Salary to B	1,000		
Commission to C	6,000		
Net Profit	3,000		
	85,000		
	1,50,000		1,50,000

Compute the total income of the firm and allocate it amongst the three partners.

Computation of Firm's Total Income :

		Rs.	Rs.
1. Business Porfits :			
Net Profit as per Profit & Loss Account		85,000	
Add Expenditure disallowed :			
Interest on Capital	6,000		
Partner's salary	6,000		
Partner's Commission	3,000	15,000	
		1,00,000	
Less Interest on Securities not being business profit		5,000	95,000
2. Interest on Securities gross			5,000
Firm's Total Income			1,00,000

Its allocation amongst partners :

	A	B	C
	Rs.	Rs.	Rs.
Interest on capital	3,000	2,000	1,000
Salary	—	6,000	—
Commission	—	—	3,000
Balance of total income (2, 2, and 1)	34,000	34,000	17,000
	37,000	42,000	21,000
Income from Business	35,000	40,000	20,000
Interest on Securities gross	2,000	2,000	1,000

(2) XYZ, a partnership firm with X, Y and Z as partners sharing profits and losses equally, Z being the wife of X, carries on the business of commission agents. For the first previous year ended 31st March 1975 the Profit and Loss Account of the firm discloses a net profit of Rs. 2,00,000. The following particulars and information are available on examination of the books and records :

(*i*) Z became a partner by investing capital from her own resources, her husband having contributed no part of it directly or indirectly. She is actively engaged in the business.

(*ii*) Salary of Rs. 6,000 was paid to Y.

(*iii*) Interest of Rs. 2,400 and Rs. 2,000 was paid to X and Z on their respective capitals.

(*iv*) Z's godown was rented by the firm for which rent of Rs. 3,000 was paid to her.

(*v*) Tax of Rs. 10,000 paid during the year by the firm on a non-resident principal's account (for whom it was treated as agent) was written off as it became irrecoverable. The firm claims it either as an item of expenditure or as a bad debt.

The amounts noted in items (*ii*), (*iii*), (*iv*) and (*v*) above were debited to the Profit and Loss Account.

X has no other source of income. Y has further income of Rs. 2,000 from dividends. Z's only other source of income is the godown let out to the firm, the assessable income wherefrom for the year is Rs. 2,000.

Ignoring the question of registration, determine for the assessment year 1975-76 :

(*a*) The total income of the firm ;
(*b*) The allocation of the firm's profit amongst the partners ; and
(*c*) The gross total income of each partner.

Give reasons for your treatment of each item of information given above.

(*C. A. Final, Nov. 1969*)

(*a*) *Computation of firm's total income :*

		Rs.
Business Profits :		
Net Profit as per Profit and Loss Account		2,00,000
Add Irrecoverable tax paid on account of a none-resident principal, being disallowed per Supreme Court decision (*41 ITR 545*)	10,000	
Salary paid to a partner, disallowed under section 40(b)	6,000	
Interest paid to partners, disallowed under section 40(b)	4,400	20,400
Total Income		2,20,400

Section 40(b) does not prohibit the deduction of godown rent of Rs. 3,000 paid by the firm to a partner.

(*b*) *Its allocation amongst partners* :

	X	Y	Z
	Rs.	Rs.	Rs.
Interest on capital	2,400	—	2,000
Salary	—	6,000	—
Balance of total income equally	70,000	70,000	70,000
Share income from business	72,400	76,000	72,000

(*c*) *Gross total Income of each partner* :

Under section 64(1)(i), in computing the total income of any individual there shall be included all such income as arises directly or indirectly to the spouse of such individual from the membership of the spouse in a firm carrying on a business (and not a profession) in which such individual is a partner.

This section applies irrespective of whether the individual's spouse brings his or her own capital.

The income should be clubbed in the hands of that spouse who has the greater income (exclusive of the share income of the firm).

In this case, Z's income (exclusive of the share income of the firm) is greater than that of X. Therefore, X's share of income from the firm will be included in the total income of Z. The gross total income of the three partners will be as follows :

X.

He has no gross total income as his share is included in the gross total income of his wife Z

Y.

	Rs.
1. Business Profits : Share income from firm	76,000
2. Other Sources : Dividends	2,000
Gross total income	78,000

Z.

1. Income from house property	2,000
2. Business Profits : Share income from firm	72,000
3. Other Sources : Share income of X included under section 64(1)(i)	72,400
Gross total income	1,46,400

Assessment of Registered Firm

Rates of Income-Tax.

Income-tax is payable by a registered firm only when its total income exceeds Rs. 10,000. The rates at which income-tax is payable for the assessment year 1975-76 are as follows :

1. In the case of registered firms having professional income of not less than 51% of total income, the rates of income-tax are given below. The professions are those of solicitors, chartered accountants, lawyers, engineers, etc.

First Rs. 10,000 of total income	Nil
Next Rs. 15,000 of total income	4%
Next Rs. 25,000 of total income	7%
Next Rs. 50,000 of total income	13%
Balance of total income	22%

The income-tax at the above rates is to be increased by a surcharge of 10% thereof.

2. In the case of non-professional firms the rates are :

First Rs. 10,000 of total income	Nil
Next Rs. 15,000 of total income	5%
Next Rs. 25,000 of total income	7%
Next Rs. 50,000 of total income	15%
Balance of total income	24%

The income-tax at the above rates is to be increased by a surcharge of 10%.

Assessment.

Under section 182, after assessing the total income of a registered firm, the income-tax payable by the firm itself is determined and the share of each partner in the income of the firm is included in his total income and assessed to tax accordingly.

If such share of the partner is a loss, it shall be set off against his other income or carried forward and set off in accordance with the provisions of sections 70 or 75.

Where any partner of a registered firm is a non-resident, the tax on his share in the income of the firm shall be assessed on the firm at the rates which would be applicable if it were assessed on him personally, and the tax so assessed shall be paid by the firm.

Under section 91(3), a non-resident partner of a resident registered firm is entitled to double taxation relief in respect of his share income from the firm where such income is assessed to tax in India as well as in a foreign country. The relief on such doubly taxed income is calculated at the Indian rate of tax or the foreign rate of tax, whichever is lower.

A registered firm is authorised to retain 30 per cent of the share income of each partner as security for the due payment of the tax by the partner. If a partner fails to pay his tax, the amount withheld to the extent of the tax will be payable to Government. This provision will avoid hardship and secure at the same time prompt payment of tax by the partners.

As already stated before, a partner of a registered firm is entitled to the deduction of his share of income-tax payable by the firm from his share income from the firm.

Wrong Distribution of Profits.

Under section 271(4), if the profits of a registered firm are improperly distributed amongst the partners so as to return the income of any partner below the real amount and if any partner of such a firm returns his income below the real amount, a penalty of $1\frac{1}{2}$ times the amount of tax which would have been avoided if his return had been accepted as correct, may be imposed on him by the Income-Tax Officer or the Appellate Assistant Commissioner and no refund or other adjustment can be claimed by any other partner by reason of this procedure.

Illustrations

(1) A registered firm of solicitors has two partners A and B sharing profits and losses in the proportion of 1 : 2. The total income of the firm for assessment year 1975-76 has been computed as below :

			Rs.
House property			50,000
Profession		1,00,000	
Add A's salary	12,000		
B's interest	18,000	30,000	1,30,000
			1,80,000

Work out the amount of income-tax payable by the firm and the shares of partners in the income of the firm.

		Rs.
(*a*)	*Income-tax payable by the firm* :	
	On first Rs. 10,000	—
	On next Rs. 15,000 at 4%	600
	On next Rs. 25,000 at 7%	1,750
	On next Rs. 50,000 at 13%	6,500
	On balance of Rs. 80,000 at 22%	17,600
		26,450
	10% surcharge	2,645
	Tax payable by the firm	29,095

(*b*) *Share income of partners* :

	A Rs.	B Rs.
Salary	12,000	—
Interest	—	18,000
Balance of business income before tax (1 : 2)	33,333	66,667
	45,333	84,667
Less Share of firm's tax	9,698	19,397
Income from business	35,635	65,270

Income from house property	16,667	33,333
Share income from firm	52,302	98,603

(2) The registered firm of Atma Ram Balak Ram carried on wholesale cloth business. Partners and their shares were as under :

Name of Partner	*Shares*
1. Shri Atma Ram	50
2. Shrimati Savitri, wife of Atma Ram (partner)	15
3. Shrimati Radha, widow of Balak Ram	25
4. Charan Das, minor son of Atma Ram (partner)	5
5. Kumari Shakuntla, minor daughter of Shrimati Radha (partner)	5

the last two having been admitted to benefits of partnership.

The net profit as per the firm's Profit and Loss Account for the year ended 31st December 1974 was Rs. 1,62,000 which included a short-term capital gain of Rs. 15,000 which was correctly computed. The following points were noticed on scrutiny of the account books :

(*a*) Salary of Rs. 6,000 was paid to partner Atma Ram and Rs. 1,200 to Charan Das, aged 17 years, who was actually working in the shop.

(*b*) Rent of Rs. 6,000 was paid to partner Shrimati Radha who had herself paid municipal taxes of Rs. 150 in respect of the building let to the firm. She claimed collection charges at 6 per cent.

(*c*) Interest of Rs. 3,000 and Rs. 1,000 respectively was credited to the capital accounts of Shrimati Savitri and Kumari Shakuntla.

(*d*) Interest of Rs. 2,000 was debited to the capital account of Shrimati Radha.

(*e*) Expenses included (*i*) Rs. 50 for charity ; (*ii*) Rs. 500 paid to a chartered accountant for representation before the Income-Tax Officer ; and (*iii*) Rs. 150 for partnership deed expenses.

(*f*) It was claimed that Rs. 2,500 credited to Profit and Loss Account should be deducted as being receipt of a capital nature. It was found that this amount had been received from a textile mill as damages for failure to deliver the goods as per contract.

Determine the total income of the firm and compute the tax due. Also allocate the shares of the partners.

Work out the total income of Atma Ram and Shrimati Radha, assuming that they had no income other than that indicated above.

Total Income of Registered Firm :

		Rs.
Profit as per Profit and Loss Account		1,62,000
Less Capital gain considered separately		15,000
		1,47,000
Add Charity	50	
Partnership deed expenses	150	200
Interest to partner	4,000	
Salary to partners	7,200	11,200
Business Profits		1,58,400
Capital Gain short-term		15,000
Total Income		1,73,400

The interest of Rs. 2,000 received by the firm from partner Shrimati Radha is to be included in the total income of the firm (*24 ITR 176*). Compensation of Rs. 2,500 received for non-performance of a contract entered in the course of business is a revenue receipt (*26 ITR 910*).

Income-tax payable by the firm :

	Rs.
On first Rs. 10,000	—
On next Rs. 15,000 at 5%	750
On next Rs. 25,000 at 7%	1,750
On next Rs. 50,000 at 15%	7,500
On balance of Rs. 73,400 at 24%	17,616
	27,616
10% surcharge	2,762
Tax payable by the firm	30,378

Share income of partners :

Partners	1 50% Rs.	2 15% Rs.	3 25% Rs.	4 5% Rs.	5 5% Rs.
Salary	6,000	—	—	1,200	—
Interest	—	3,000	—	—	1,000
Balance of profits before tax	73,600	22,080	36,800	7,360	7,360
	79,600	25,080	36,800	8,560	8,360
– Share of firm's tax	15,189	4,557	7,594	1,519	1,519
Business income	64,411	20,523	29,206	7,041	6,841
Capital gain short-term	7,500	2,250	3,750	750	750
Share income from firm	71,911	22,773	32,956	7,791	7,591

Total Income of Atma Ram :

			Rs.
1.	Business income		64,411
2.	Capital gain short-term		7,500
3.	Other Sources :		
	Share income of wife	22,773	
	Share income of minor son	7,791	30,564
	Total Income		1,02,475
	Rounded off		1,02,480

Total income of Shrimati Radha :

1.	Income from house property as calculated below	4,875
2.	Business income	29,206
3.	Capital gain short-term	3,750
4.	Other Sources :	
	Share income of minor daughter assumed to be unmarried	7,591
	Total Income	45,422
	Rounded off	45,420

The income from house property is computed as follows :	Rs.
Rent received being annual value	6,000
Less Municipal taxes	150
Annual value in this case	5,850
Less One-sixth for repairs	975
	4,875

Notes : Collection charges are not allowable as the building is wholly let to the firm.

1. Interest on capital paid to a minor admitted to the benefits of partnership is income arising from his or her admission to the benefits of partnership (*41 ITR 570*).
2. Since a partner cannot be an employee of the firm, any salary paid by the firm to the spouse or minor child for services rendered, would be income arising from membership in the firm (*33 ITR 538*).
3. Shrimati Radha paid Rs. 2,000 interest to the firm, but it is not stated how the money withdrawn from the firm, on which such interest was paid, was utilised by her. Therefore the interest paid by her cannot be allowed as a deduction.

Assessment of Unregistered Firms

Under section 183, in the case of an unregistered firm, the Income-Tax Officer may :

(*a*) determine the tax payable by the firm itself on the basis of its total income ; or

(*b*) assess the partners of the unregistered firm in respect of their shares of the firm's income instead of assessing the unregistered firm as a unit, if such a course would be more advantageous to revenue.

An unregistered firm is assessed to income-tax like an individual according to the amount of its total income. If the total income is below the taxable limit, no tax is payable by the firm.

Under section 86(iii), income-tax is not payable by a partner of an unregistered firm on his share of the firm's income on which income-tax is payable by the firm, though it is included in his total income for rate purposes.

If the firm's total income is below the taxable limit, a partner's share in the firm's income will be taxed in his hands.

Rates of Tax.

The rates of income-tax applicable to unregistered firms for the assessment year 1975-76 are given in a subsequent chapter dealing with computation of tax.

Section 183 (b). Where the Income-Tax Officer finds that the tax payable by the firm, if it is assessed as a registered firm taken together with the tax payable by the partners individually if the firm were so assessed, would be greater than the aggregate amount of the tax payable by the firm as an unregistered firm and the tax payable by the partners individually, he may then proceed to assess the firm as a registered firm.

Where this procedure is adopted the firm will be liable to tax on its total income in the same manner as a registered firm and the partners will be chargeable to tax on their respective shares in the income of the firm on the footing that they were partners in a registered firm.

Where the Income-Tax Officer applies the procedure of section 183(b) to any unregistered firm, the following provisions shall apply thereto as they apply in the case of a registered firm :

(*a*) Set-off and carry-forward of losses ;

(*b*) Assessment in respect of a non-resident partner ; and

(*c*) Right to retain 30% of the share income of each partner as a security for the due payment of tax.

Under section 158, whenever a registered firm is assessed or an unregistered firm is assessed under section 183(b), the Income-Tax Officer shall notify to the firm by an order in writing the amount of its total income assessed and the apportionment thereof between the several partners.

Where the total income of the individual partners of an unregistered firm is very much higher than that of the firm itself, it is advantageous for the firm to remain unregistered. Therefore section 183(b) is designed to prevent such evasion of tax.

Set-off and Carry-forward of Losses. An unregistered firm itself can set off a loss incurred by it under one head of income against its income under another head in the same assessment year, but no individual partner has the right to set off his share of the firm's loss against his own income of the same year. The carry-forward of business losses is also to be dealt with in the same way.

Under section 76, in the case of an unregistered firm assessed under section 183(b) for any assessment year, its losses for that assessment year will be dealt with as if it were a registered firm.

Where the income-tax authorities do not proceed to determine the loss incurred by an unregistered firm, a partner of that firm is entitled to claim a set-off of his share of the loss incurred by the firm against the profits of his other business (*36 ITR 266*).

It has been held by the Supreme Court (*41 ITR 630*) that for the purpose of ascertaining the total income of an assessee, his share of loss in a registered firm has to be set off against his share of profit in an unregistered firm which has been separately taxed, and that the assessee is also entitled to carry forward his share of the loss in the registered firm.

Illustrations

(1) X has furnished you with the following particulars of his income and losses for the previous year ended 31st March 1975 :

(*a*) Income from interest on debentures (gross) Rs. 2,400, the Income-Tax deducted at source being Rs. 552.

(*b*) Five-eighth share of income from B & Co. assessed as an unregistered firm for the year 1975-76, the profits of which were taxed in the hands of the firm : Rs. 22,000.

(*c*) One-half share of loss in A & Co. assessed as a registered firm for the year 1975-76 Rs. 10,000.

(*d*) One-third share of loss in C & Co. also assessed as a registered firm for the year 1975-76 : Rs. 8,000.

You are required to work out for the information of X his total income for the assessment year 1975-76 and to indicate whether he will be entitled to the benefit of carry-forward of his share of losses in the two registered firms.

The answer to this question is based on the decision of the Supreme Court in Seth Jamnadas Daga and Others *v.* C. I. T. (*41 ITR 630*).

The total income of X for the assessment year 1975-76 is as follows :

			Rs.
1.	Interest on securities (gross)		2,400
2.	Income from business :		
	Share of profits from an unregistered firm	22,000	
	Less Share of losses in registered firm	18,000	4,000
	Total Income		6,400

Although no tax is payable on X's share of income from the unregistered firm, it has to be included in his total income for determining the rate applicable to his other income. All that section 86(iii) does is to save the share income from an unregistered firm from liability to tax in the hands of X. It does not affect the computation of the total income of X to determine the rate applicable under section 4(1) in the light of section 66. X's share of losses in the two registered firms has to be set off against his share of income from the unregistered firm to ascertain his total income.

X is also entitled to carry forward Rs. 18,000, being his share of losses in the registered firms to the succeeding assessment year under section 75 read with section 72. Section 72 has little to do with the manner in which the total income of an assessee has to be determined for the purpose of finding out the rate applicable to his income taxable in the year of assessment. It provides for a different situation altogether ; it provides for the carry-forward of a loss in business to the subsequent assessment year or years till the loss is absorbed in profits or till it cannot be carried forward any further.

(2) A, B and C are partners in a firm sharing profits and losses in the proportions of 2, 2 and 1. The firm's profit and loss account for the year ended 31st December 1974 showed a net loss of Rs. 40,000 after charging the following items :

	A	B	C
	Rs.	Rs.	Rs.
Interest on Capital	1,000	2,000	3,000
Salary	3,000	—	—
Bonus	2,000	2,000	2,000

A's taxable income from other sources was Rs. 16,000, while B and C had no other sources of income.

State how the assessment of the firm and of the partners will be made if the firm is (*a*) registered, and (*b*) unregistered.

			Rs.
Net loss as per Profit & Loss Account			40,000
Deduct Payments to partners :			
Interest on capital		6,000	
Salary		3,000	
Bonus		6,000	15,000
Loss of the firm			25,000

Share income of partners :

	Share of firm's loss	Interest on Capital	Salary	Bonus	Net result	
	Rs.	Rs.	Rs.	Rs.	Rs.	
A (2/5)	16,000	1,000	3,000	2,000	10,000	Loss
B (2/5)	16,000	2,000	—	2,000	12,000	,,
C (1/5)	8,000	3,000	—	2,000	3,000	,,
	40,000	6,000	3,000	6,000	25,000	

If the firm is registered, the firm's loss will be passed on to the partners. A will be assessed on a total income of Rs. 6,000 (Rs. 16,000 his separate income minus Rs. 10,000 share of firm's loss) ; while B and C will not be liable to tax, and their shares of the loss in the firm will be carried forward.

If the firm is unregistered, no tax will be due from it, the result being a loss of Rs. 25,000. This loss cannot be passed on to the partners, but will be carried forward in the hands of the unregistered firm itself. Only partner A will be assessed on his separate income of Rs. 16,000.

(3) X is the proprietor of two separate businesses called A and B. He made a net profit of Rs. 50,000 in business A and suffered a loss of Rs. 80,000 in business B. He also received Rs. 60,000 as his share of profits from an unregistered firm. What is the taxation liability of X ?

Statement of Total Income

	Rs.
Loss from proprietary business (Rs. 50,000 minus Rs. 80,000)	−30,000
Share of profits from an unregistered firm which has been taxed	60,000
Total Income	30,000

As the unregistered firm has been assessed to income-tax, X is not liable to pay any tax at all. He is liable to pay income-tax on the loss of Rs. 30,000 at the rates applicable to Rs. 30,000. As the figure is a loss, it does not matter what the rate of tax is. The tax is nil. The rate is a positive rate, but the figure to which it is applied is negative. Therefore, the tax payable is nil.

(4) (*a*) X & Co. is a registered firm of two equal partners X and Y doing wholesale business in foodgrains in Bombay. Its profit and loss account for the financial year 1974-75 shows a net profit of Rs. 40,000 which has been found acceptable. The following accounts in the books however showed certain entries regarding the partners :

(*i*) Purchases Account : Rs. 10,000 paid to partner X for paddy bought from him. The paddy was grown on his own land.

(*ii*) Salary and Commission Account : Rs. 3,000 salary and Rs. 1,200 commission paid to partner X for managing the business.

(*iii*) Rent Account : Rs. 3,000 paid to partner Y for the use of his godowns.

(*iv*) Interest Account : Rs. 3,000 paid to partner X for the capital invested by him and Rs. 2,000 received from partner Y for loans taken by him.

Compute the firm's total income and the tax payable by it for the assessment year 1975-76. Also apportion the total income between the partners.

(*b*) The capital invested by X in the above-mentioned firm has been borrowed from outsiders to whom he paid interest of Rs. 1,500 per annum.

He was previously staying in East Africa, came to India in 1971 and has now settled down here permanently. He and his brother Z are equal partners in a business run in East Africa, and his share of profits of Rs. 7,000 for the year ended 31-3-1975 has been credited to his account with the firm there. Since 1971 that business is wholly controlled and managed by Z in East Africa.

Compute X's total income for the assessment year 1975-76.

(*c*) The godowns let out by partner Y are on the ground floor of a building owned by him since 1961. In 1972 he added a first floor comprising two residential flats. The flats were ready for occupation on 1-10-1972 from which date they are fetching rents of Rs. 300 and Rs. 100 per month respectively. Y has undertaken to bear the repairs and to pay the municipal taxes which work out to 30% of the rents charged. Besides he pays ground rent of Rs. 200 and insurance premium of Rs. 250 for the entire building.

Compute Y's total income for the assessment year 1975-76.

(*a*) *Firm's Total Income* :

	Rs.
Net Profit as per accounts	40,000
Add Salary, commission and interest paid to partner X (Rs. 3,000 + Rs. 1,200 + Rs. 3,000)	7,200
Total Income	47,200

Only interest, salary, bonus, commission or other remuneration paid to a partner can be added. The amount paid to partner X for paddy purchased from him and the rent paid to partner Y for the use of his godowns cannot be added. While interest paid to a partner is to be added, there is no provision to deduct interest received from a partner. The latter is as much the firm's income as interest received from an outsider.

Tax payable by the firm :

	Rs.
On first Rs. 10,000	—
On next Rs. 15,000 at 5%	750
On balance of Rs. 22,200 at 7%	1,554
Surcharge at 10% on Rs. 2,304	2,304·00
	230·40
Tax payable	2,534·40
Rounded off	2,534·00

Apportionment between Partners :

	X	Y
	Rs.	Rs.
Total Income		47,200
Less Salary, commission and interest paid to partner X		7,200
Less Income-tax payable by the firm		2,534
Divisible income		37,466
Salary	3,000	—
Commission	1,200	—
Interest	3,000	—
Divisible income (equally)	18,733	18,733
Share income from business	25,933	18,733

(*b*) *Total Income of X* :

1. Business income :

	Rs.
Share income from the firm	25,933
Less Interest on borrowed capital invested in the firm	1,500
Total Income	24,433

X is a resident not ordinarily resident in India in the previous year ended 31-3-1975. Therefore his share of profits from the East Africa business is not liable to tax because it is neither received or deemed to be received in India nor does it arise from a business controlled in India.

Rs. 10,000 received from the firm for sale of paddy grown on his own land is agricultural income.

(*c*) *Total Income of Y* :

			Rs.
1.	Income from house property :		
	Godowns :		
	Rent received from the firm	3,000	
	Less Municipal Taxes (30%)	900	
	Annual value in this case		2,100
	Flat No. 1 :		
	Rent received	3,600	
	Less Municipal Taxes (30%)	1,080	
		2,520	
	Less Statutory allowance for property let out for residential purposes (available for five assessment years beginning with the assessment year 1973-74)	1,200	
	Annual value in this case		1,320
	Flat No. 2 :		
	Rent received	1,200	
	Less Municipal Taxes (30%)	360	
		840	
	Less Statutory allowance for property let out for residential purposes being less than Rs. 1,200	840	
	Annual value in this case		—
	Annual value of whole house		3,420
	Less One-sixth for repairs	570	
	Ground rent	200	
	Insurance Premium	250	1,020
			2,400
2.	Business Income :		
	Share income from the firm		18,733
	Total Income		21,133
	Rounded off		21,130

(5) A firm having two equal partners A and B suffered a loss of Rs. 30,000 during its accounting year ended 31st March 1975 as under :

	Rs.
Business profits after paying Rs. 10,000 as interest on capital to partner A	50,000
Loss from house property	80,000
Net Loss	30,000

Partner A had during that year an income of Rs. 25,000 from house property and partner B who had no income that year claimed a loss of Rs. 10,000 brought forward

from the preceding year from his individual cloth business which had been closed on 31st March 1974.

Compute the total income of each partner for the assessment year 1975-76 assuming the firm to be (*a*) registered, and (*b*) neither registered nor assessable under section 183(b).

	Rs.
Firm's profit as per Profit & Loss Account	50,000
Add Interest to partner A	10,000
	60,000
Less Loss from house property	−80,000
Net Loss	−20,000

Allocation of firms loss between A and B :

	A Rs.	B Rs.
Interest on capital	10,000	—
Balance of Business income	25,000	25,000
	35,000	25,000
Less Loss from house property	−40,000	−40,000
Share of Loss	−5,000	−15,000

(*a*) When the firm is registered, A can set off his share of the firm's loss (Rs. 5,000) against his property income of Rs. 25,000, and his total income will be only Rs. 20,000. B can carry forward for 8 years his share of the firm's loss (Rs. 15,000) for future set-off against his share of the profits from the same firm or against any other business profits. On the discontinuance of B's individual cloth business his right to carry forward the loss from that business died with the business. He cannot be allowed to carry forward that loss.

(*b*) When the firm is unregistered, the firm's loss of Rs. 20,000 will be carried forward for 8 years for set-off against its own future profits and no partner is allowed to set off his share of the firm's loss against his other income, if any. A's total income will therefore be Rs. 25,000, and B's total income will be nil.

(6) The total income for the assessment year 1975-76 of a partnership firm ABC, in which A, B and C are equal partners, is a loss of Rs. 10,000 arrived at after disallowance of the following items :

Salary to A Rs. 15,000 ; Salary to C Rs. 5,000 ; Interest to A Rs. 12,000 ; Interest to B Rs. 3,000.

The firm is not granted registration.

A has a separate business from which the income for the assessment year 1975-76 is Rs. 18,000. He has also a house property used by him for his own residence, the annual value whereof is Rs. 5,000. The only expenses in respect of this house during the previous year were interest of Rs. 1,200 on a loan taken for its construction.

Compute A's total income for the assessment year 1975-76 indicating whether the share of income or loss allocated to him from the unregistered firm shall be included in his total income and charged to tax.

(*C. A. Final, May 1972*)

The partners' shares of the income or loss from the unregistered firm will be as under :

	Total Rs.	A Rs.	B Rs.	C Rs.
Salary	20,000	15,000	—	5,000
Interest	15,000	12,000	3,000	—
	35,000	27,000	3,000	5,000
Less Firm's loss before the disallowance	−45,000	−15,000	−15,000	−15,000
Shares of each partner	−10,000	12,000	−12,000	−10,000

The firm has incurred a loss of Rs. 10,000 and is not liable to pay any tax for the assessment year 1975-76. It can carry forward this loss to be set off against its future business income. As the firm is unregistered, B and C are not entitled to carry forward their share of loss.

A's Total Income for assessment year 1975-76

			Rs.
1. Income from House Property :			
Annual value (ignoring municipal taxes)		5,000	
Less Self-occupation allowance		1,800	
Annual value in this case		3,200	
But the annual value is limited to 10% of his other income of Rs. 30,000		3,000	
Less One-sixth for repairs	500		
Interest on loan taken for construction of the house	1,200	1,700	1,300
2. Income from Business :			
Share income from unregistered firm		12,000	
Income from separate business		18,000	30,000
Total Income			31,300

A is not entitled to any rebate of tax in respect of his share income from the unregistered firm, as the firm is not liable to tax because it has suffered a loss.

Under section 183 (b), the Income-Tax Officer may assess an unregistered firm as if it were a registered firm if such a course is more advantageous to revenue. As the firm itself has incurred a loss and the partners have separate incomes, the Income-Tax Officer would certainly assess the firm under section 183(b). In that case the firm itself will not pay any tax and it will not carry forward its loss of Rs. 10,000. Each partner's share of income or loss would be assessed in his own personal assessment, and B and C would each be entitled to carry forward his share of loss for future set-off.

(7) Patel & Co. is a firm engaged in the manufacture of pharmaceutical products. It consists of three partners A, B and C sharing profits and losses in the proportions of 3, 2 and 1 respectively.

The firm's accounts for the year ended 31st December 1974 disclosed a net profit of Rs. 1,80,000 after debiting *inter alia* the following items :

(*a*) Salary of Rs. 15,000 paid to partner C, who is a chemist and was in charge of the firm's laboratory.

(*b*) Rent of Rs. 9,000 paid to partner B for the portion of his building in which the firm's office was situated.

(*c*) Rs. 12,000 paid as interest to partner A on a loan advanced by him to the firm.

(*d*) Rs. 60,000 as the first instalment of the total consideration of Rs. 3,00,000 payable to British Laboratories Ltd., London, in five equal annual instalments, for securing from them the exclusive right to manufacture in India one of their special products known as "Tubercolin" a preventive of tuberculosis, and Rs. 10,000 paid to them as royalty for the use of their formulae for the manufacture of the same.

No income-tax was deducted at source from the above payments.

(*e*) Rs. 15,000 being the cost of new appliances purchased and installed in January 1974 in the firm's laboratory, set up for carrying out research for improving the firm's products and for discovering a preventive for cancer.

Depreciation debited to the Profit & Loss Account was the same as is admissible under the Income-Tax Act.

The net profit of Rs. 1,80,000 included Rs. 6,000 being interest received on a long-term deposit with the State Bank of India.

Compute the total income of the firm giving briefly the reasons for inclusion or exclusion of each item.

Total Income of the firm :

		Rs.
Profit as per Profit & Loss Account		1,80,000
Less Bank interest assessable under the head "Other Sources"		6,000
		1,74,000
Add Salary paid to partner C	15,000	
Interest paid to partner A	12,000	
First instalment of consideration payable to the London concern, being capital expenditure	60,000	87,000
Business Profits		2,61,000
1. Business Profits		2,61,000
2. Other Sources : Bank interest		6,000
Total Income		2,67,000

The full amount of capital expenditure on scientific research related to the class of business carried on by the assessee is allowable as a deduction.

The royalty of Rs. 10,000 paid by the firm to the London concern for the use of the latter's formulae is a revenue charge. Section 40 expressly disallows interest and salary paid to a non-resident without deduction of tax, but there is no provision regarding disallowance of royalty paid without deduction of tax. Hence royalty is admissible as a deduction.

Change in Constitution of Firms

Section 187 deals with cases where at the time of making the assessment it is found that a change has occurred in the constitution of a firm. In the following circumstances there is a change in the constitution of a firm :

(*a*) Where one or more of the partners cease to be partners or one or more new partners are admitted but one or more of the old partners continues as partners ; or

(*b*) Where all the partners continue with a change in their respective shares or in the shares of some of them.

Under this section, where at the time of making an assessment it is found that a change has occurred in the constitution of a firm, the assessment shall be made on the firm as constituted at the time of making the assessment but :

(*i*) the income of the previous year, shall be apportioned between the partners who, in such previous year, were entitled to receive the same ; and

(*ii*) where the tax assessed upon a partner cannot be recovered from him, it shall be recovered from the firm as constituted at the time of making the assessment.

Thus, each partner is taxed only in respect of the profits to which he was actually entitled in the previous year. The principle adopted is that the tax should be borne by each partner (whether present or past) according to his actual share in the firm's income of the previous year.

According to section 188, where a firm carrying on a business or profession is succeeded to by another firm and the case is not one covered by section 187, *separate* assessments shall be made on the predecessor firm and the successor firm in accordance with the provisions of section 170, the provisions of which have already been explained in a preceding chapter dealing with liability in special cases.

Section 187 applies to both registered and unregistered firms and the procedure of assessment in each case would be as follows :

Registered Firms. The total income of the firm as constituted at the time of making the assessment is computed, but the tax payable by the registered firm on such total income is not determined (except income-tax at specially low rates where the total income exceeds Rs. 10,000). Instead, the firm's income is apportioned amongst the old and new partners who in the previous year were entitled to receive the same, and each partner's share is included in his total income.

Unregistered Firms. The total income of the firm as constituted at the time of making the assessment is computed and the tax payable by it determined as if there had been no change in the constitution of the firm. The firm as constituted at the time of making the assessment would be liable to pay the tax. In other words, the new partners would be liable to pay the tax even in respect of that portion of the previous year's income which was received by the partners prior to the change. But only that portion of the firm's income of the previous year, to which each partner was entitled, would be included in his total income.

Illustrations

(1) On 1st May 1975, while making the assessment for the year 1974-75, the Income-Tax Officer finds that "Traders' Concern", a partnership firm with P, Q and R as partners sharing profits and losses in the ratio of 3 : 2 : 1 and adopting the calendar year as its previous year, was reconstituted on 1st July 1973 by retirement of P and admission of S and T as new partners.

After the reconstitution Q, R, S and T became sharers in the profits and losses in the ratio of 4 : 2 : 1 : 1 and that position still continues.

An account was made for the full year 1973 and the Profit and Loss Account shows a credit balance of Rs. 50,000 debited *inter alia* with the following items :

Salary to P Rs. 60,000; Commission to Q Rs. 2,000; Commission to R Rs. 800; Interest to S Rs. 1,200.

Does the change in the constitution lead to the making of two separate assessments of the firm—one for the period up to 30th June 1973 and the other for the rest of the year 1973 ? Discuss fully.

Assuming that the book profits, as adjusted by the above-noted four items of salary, commission and interest, constitute the assessable profits, and further that the profits of Rs. 50,000 accrued evenly throughout the year, compute, for the purposes of inclusion in their individual assessments, the share of each partner in the income of the firm for the year 1973. (*C. A. Final, November 1968*)

On the retirement of P and the admission of S and T as partners there is a change in the constitution of the firm of P, Q and R There is no succession to this firm. Therefore under section 187 only one assessment will be made on the firm of Q, R, S and T as constituted at the time of making the assessment, but the income of 1973 will be apportioned between the partners who were entitled to receive the same, that is to say, it will be apportioned among P, Q, R, S and T.

However, according to section 188, where a firm is succeeded to by another firm, separate assessments are made on the predecessor firm and the successor firm in accordance with the provisions of section 170.

As the profit of Rs. 50,000 has accrued evenly throughout 1973 Rs. 25,000 is the profit for the first six months and Rs. 25,000 for the next six months.

Profit apportioned among partners :

		Rs.	Rs.
P : $\frac{1}{2}$ of Rs. 25,000		12,500	
Q : $\frac{1}{3}$ of Rs. 25,000	8,333		
$\frac{1}{2}$ of Rs. 25,000	12,500	20,833	
R : $\frac{1}{6}$ of Rs. 25,000	4,167		
$\frac{1}{4}$ of Rs, 25,000	6,250	10,417	
S : $\frac{1}{8}$ of Rs. 25,000		3,125	
T : $\frac{1}{8}$ of Rs 25,000		3,125	50,000

Total Income of firm of Q, R, S, and T :

	Rs.
Profit as per P. & L. Account	50,000
Add Salary paid to P	6,000
Commission paid to Q	2,000
Commission paid to R	800
Interest paid to S	1,200
Total Income of firm	60,000

Partner's shares in firm's income :

	P	Q	R	S	T	Total
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Share of Profits	12,500	20,833	10,417	3,125	3,125	50,000
Salary	6,000	—	—	—	—	6,000
Commission	—	2,000	800	—	—	2,800
Interest	—	—	—	1,200	—	1,200
	18,500	22,833	11,217	4,325	3,125	60,000

(2) A firm, whose accounting year is the calendar year, had three partners A, B and C at the beginning of 1974 sharing profits in the proportions of 8, 5 and 3 respectively. C went out of the partnership on 1st September 1974 and was replaced by D who had formerly been an employee, and the subsequent profits were divided in the proportions of 8, 6 and 2 respectively.

The firm's accounts for the whole of 1974 show a net income of Rs. 24,000 after deducting the following items :

Rs. 3,000 paid as interest to A.
Rs. 1,800 paid as interest and Rs. 3,600 as rent for business premises to B.
Rs, 1,600 paid as salary to C at the rate of Rs. 200 per month.
Rs. 1,800 paid as salary to D at the rate of Rs. 150 per month.

Calculate the total income of the firm the share income of each partner.

	Rs.
Net Income shown	24,000
Add Interest to partner A	3,000
Interest to partner B	1,800
Salary to partner C	1,600
Salary to partner D for 4 months when he was a partner	600
Total Income of the firm	31,000

The share income of each partner is as follows :

Assuming that the profits of the firm accrued evenly throughout the whole year 1974, the profits for the period up to 31-8-1974 and from 1-9-1974 are Rs. 16,000 and Rs. 8,000 respectively.

	A	B	C	D
	Rs.	Rs.	Rs.	Rs.
Interest	3,000	1,800	—	—
Salary	—	—	1,600	600
Balance of income for the first period (8 : 5 : 3)	8,000	5,000	3,000	—
Balance of income of the second period (8 : 6 : 2)	4,000	3,000	—	1,000
	15,000	9,800	4,600	1,600

Note : Rent (Rs. 3,600) paid to B and salary (Rs. 1,200) paid to D for the first 8 months of the year when he was not a partner are not to be added to the firm's total income. These items will be considered separately in the assessment to B and D.

Dissolution of Firms

Under section 189, where a firm is dissolved or the business or profession carried on by it is discontinued, the assessment shall be made on the firm as such as if no dissolution or discontinuance had taken place, and all the provisions of law (including the provisions relating to the imposition of a penalty or fine) shall apply to such assessment.

Every person who was at the time of such dissolution or discontinuance a partner of the firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable for the amount of tax, penalty or any other sum payable. The liability of such legal representative is however limited to the extent to which the estate of the deceased is capable of meeting the liability.

Where such dissolution or discontinuance takes place after any proceedings in respect of an assessment year have commenced, the proceedings may be continued against the persons referred to above from the stage at which they stood at the time of such dissolution or discontinuance.

Note : On the death of an individual, the income earned by the deceased is assessable under section 159 in the hands of his legal representative. Under section 178, in the winding-up of a company, the liquidator represents the company till the winding-up is finished. A local authority is a statutory body, and there is no question of its disappearance. Therefore, the only cases in which a practical difficulty may arise on account of the disappearance of the assessee before the time of assessment are those of a Hindu undivided family being found to be divided and a firm or an association of perons being dissolved. To meet the case of a disrupted Hindu family, section 171 empowers the Income-Tax Officer to compute the income as if the Hindu undivided family continued to exist at the time of the assessment and the tax payable by the joint

family is made recoverable from the members of the family either jointly or severally. Section 177 applies the same principle to an association of persons and section 189 to a firm which is dissolved or whose business is discontinued. The principle underlying these provisions is that, when a unit of assessment breaks up, the liability to tax should devolve on the component members.

Other Associations of Persons

The word 'association' has no technical meaning. It simply means a 'group'. An association of persons (not being a company, firm, Hindu undivided family or local authority) may be an association of individuals, firms, Hindu undivided families, or companies. An association may include minors as well.

The word 'associate' means 'to join in common purpose or to join in an action'. Therefore an "association of persons", as used for income-tax purposes, means an association in which two or more persons join in a common purpose or common action, and the association must be one, the object of which is to produce income, profits or gains.

An association of persons is no doubt a unit of assessment under the Act. A combine for a joint venture or grouping for a common enterprise is a distinctive feature of an association of persons which has been personified by the Act. It is the income earned as a result of the common endeavour that is chargeable to tax as the income of the associated personnel. A mere joint receipt is not sufficient to club the persons receiving it as such an association (*51 ITR 741*).

An association of two or more persons for acquisition of property which is to be managed for the purpose of producing income falls within the words "otherassociations of persons". Co-heirs and co-legatees joining together in a common purpose would be chargeable as an association of persons. Thus, if the sons of a deceased Musalman retain joint management of the deceased's property, receive rent jointly and credit them jointly in the books, it is an association of persons.

Before any group of persons can be called an "association of persons" it must be established on facts that they are in the nature of partners, *i. e.*, the established facts of the case must at least lead to an inference that the members of the group, of their volition or free will, have joined in a venture with a view to earning profits (*30 ITR 61*).

In order to assess certain persons in the status of association of persons, there must be some evidence of joint venture or there must be something to show that income was the result of some joint effort or a joint business (*30 ITR 36*).

Section 26 enacts that where two or more persons own jointly some house property in definite and ascertained shares, they cannot be charged as an association of persons in respect of the income of such property. But this section applies only to house property and not to any other source of income. Moreover, if persons jointly owning some house property do not possess any definite shares in its income, section 26 would not apply to them. Therefore, in respect of investments or the sources of income owned in common by two or more persons and also in respect of house property owned jointly in undefined shares, the co-owners are to be assessed as an association of persons.

An association of persons is assessed to income-tax exactly in the same manner as an individual. Each member's share of income from the association is dealt with in his own assessment as if it were a share of profits from an unregistered firm.

Chapter 25

Assessment of Companies

Kinds of Companies.

In connection with the assessment of companies, it is very important to understand the meaning of the following terms :

Company. The definition of the term "company" under the Income-Tax Act is wider than that in the Companies Act, 1956. According to section 2(17) of the Income-Tax Act, a company means :

(*i*) any Indian company as defined below, or

(*ii*) any company incorporated in any country outside India, or

(*iii*) any institution, association or body which was assessed as a company for any assessment year up to and including the assessment year 1970-71, or

(*iv*) any institution, association or body (whether incorporated or not and whether Indian or non-Indian) which is declared by the Central Board of Direct Taxes to be a company for purposes of the Income-Tax Act.

According to the Government Trading Taxation Act, 1956, where the Government of any British Dominion carries on any trade or business in India, it is assessable in the same manner and to the same extent as a 'company', and all the provisions of the Income-Tax Act relating to the levy and collection of tax applicable to companies which apply to such business.

Indian Company. According to section 2(26), an Indian company means :

(*i*) a company registered in India under any law relating to companies, or

(*ii*) a corporation established under a Central, State or Provincial Act, or

(*iii*) any institution, association or body which is declared by the Central Board of Direct Taxes to be an Indian company.

However, the registered or principal office of the company, corporation, institution, association or body must be in India.

Industrial Company. It is a company which is mainly engaged in the following industries :

(*a*) Generation or distribution of electricity or any other form of power ;
(*b*) Manufacture or processing of goods ;
(*c*) Construction of ships ; and
(*d*) Mining.

A company is deemed to be mainly engaged in the above industrial activities if the income attributable to any of the aforesaid activities is not less than 51% of its gross total income.

Company in which the Public are Substantially Interested. The following types of companies are deemed to be companies in which the public are substantially interested :

(1) A company owned by the Government or the Reserve Bank of India or in which not less than 40% of the shares are held by Government or the Reserve Bank or a corporation owned by that Bank.

(2) A public company as defined in the Companies Act, 1956, whose equity shares are listed in a recognised stock exchange in India.

(3) A public company whose equity shares are not listed in a recognised stock exchange in India, but which satisfies the following conditions :

(*i*) Its equity capital carrying not less than 50% (40% in the case of an Indian industrial company) of the voting power has been held throughout the relevant previous year by Government, a statutory corporation, a company in which the public are substantially interested or a wholly-owned subsidiary of such company, or by the public. The public does not include a director or a company in which the public are not substantially interested.

(*ii*) The said shares where, during the relevant previous year freely transferable by the holder to the other members of the public.

(*iii*) The affairs of the company or the shares carrying more than 50% (60% in the case of an Indian industrial company) of the voting power were at no time during the relevant previous year controlled or held by five or fewer persons. In computing the number of five or less persons the Government, a statutory corporation or a company in which the public are substantially interested and its subsidiary shall not be taken into account ; while a shareholder and his relatives and nominees shall count as a single member. Thus, if more than 50% of the equity shares of a non-industrial public company are held even by two public companies, it will be a company in which the public are substantially interested.

It is also provided that a company which is registered under section 25 of the Companies Act (*i. e.*, a company having for its object the promotion of commerce, art, science, religion, charity or any other useful object and which prohibits payment of dividends to its members) will be regarded as a company in which the public are substantially interested without the application of the above tests as to the composition of the ownership and control of the company.

Further in order to extend the benefit to entities which are not registered as companies but are declared to be companies for tax purposes and to companies limited by guarantee which are not registered under section 25, the Central Board of Direct Taxes is empowered to direct that such entities or companies shall be treated as companies in which the public are substantially interested.

Widely-held Company. It is a company in which the public are substantially interested as defined above.

Closely-held Company. It is a company in which the public are not substantially interested.

Domestic Company. A domestic company means an Indian company, or any other company which, in respect of its income liable to income-tax, has made the prescribed arrangements for the declaration and payment within India of the dividends payable out of such income.

According to Rule 27 of the Income-Tax Rules, 1962, the arrangements to be made by a company for the declaration and payment of dividends within India shall be as follows :

(1) The share register of the company for all shareholders must be regularly maintained at its principal place of business within India.

(2) The general meeting for passing the accounts of the previous year relevant to the assessment year and for declaring any dividends in respect thereof, shall be held only at a place within India.

(3) The dividends declared, if any, shall be payable only within India to all shareholders.

Non-domestic or Foreign Company. It is a company which is not a domestic company. In other words, it is a company which is not an Indian company or which has not made the prescribed arrangements for the declaration and payment of dividends in India.

Foreign companies are taxed at somewhat higher rates as compared to domestic companies, in order to compensate for the loss of revenue from the non-resident shareholders who would not be subject to Indian tax on dividends declared by such companies outside India out of the profits earned in India.

Note : The Income-Tax Act makes a distinction in tax treatment as between a domestic company in which the public are substantially interested and a closely-held domestic company (*i.e.*, a domestic company in which the public are not substantially interested). Closely-held companies are required (subject to certain exceptions) to distribute dividends up to the statutory percentage of their distributable income, failing which they are liable to pay additional income-tax with reference to their undistributed profits. Closely-held companies are (subject to certain exceptions) also liable to income-tax on their income at rates which are higher than the rates applicable in the case of widely-held domestic companies.

Investment Company. It is a company whose gross total income consists mainly of income which is chargeable under the heads "Interest on Securities", "Income from House Property", "Capital Gains" and "Income from Other Sources".

Trading Company. It is a company whose business consists *mainly* in dealing in goods or merchandise produced by others. That is to say, a company is a trading company if its income from trading is not less than 51% of its gross total income.

Residence of Company.

According to section 6, a company is resident in India in any year (*a*) if it is an Indian company ; and (*b*) if the control and management of its affairs is situated wholly in India that year.

Profit or Loss Prior to Incorporation.

Under sections 22 and 28, it is not only the legal ownership that has to be looked to, but the Department can also go into the question of beneficial ownership and decides who would be held liable for the tax after taking into account the question as to who is as a matter of fact in receipt of the income which is going to be taxed. For this reason, the profit earned by a company before its incorporation is assessable as its income from business although it is a capital profit.

Directors' Remuneration and Perquisites.

As already explained in detail in a previous chapter dealing with the computation of profits of a business or profession, the following provisions of

law relate to allowance in respect of remuneration and prequisites of the directors of a company in computing its business income :

(1) Under section 37(3), expenditure incurred by a company on the maintenance of residential accommodation of and travelling by a director is allowed as a deduction only to the extent and subject to such conditions as may be prescribed.

(2) Under section 40(c), expenditure incurred by a company in providing any remuneration or benefit or amenity to a director or a relative of the director and also the expenditure or allowance in respect of any assets of the company which are used by such persons for their own benefit, are not allowable as a deduction to the extent such expenditure or allowance is, in the opinion of the Income-Tax Officer, excessive or unreasonable. The deduction in respect of such expenditure and allowance is subject to the ceiling limit of Rs. 72,000 in a year for any one director or relative.

Assessment of Companies.

The assessment proceedings in the case of a company, as in the case of other assessees, commence with the filing by the principal officer of the company of a return of total income of the company. It is the duty of the principal officer of a company to file such a return of income, even though it may be a company in liquidation.

A one-man company is a distinct legal entity assessable as any other company. But if a person, who holds the beneficial interest in all or almost all the shares in a company, makes such arrangement between himself and the company that the company acts merely as an agent for the purpose of carrying on his own business, then for income-tax purposes the business will be regarded as his business and not that of the company, and he himself would be assessable on the profits of the business. Whether the company is a sham or a mere cloak for the person whose business the company carries on as his agent or nominee is a question of fact depending upon the special circumstances of each case. The burden of proving that the company is sham or a mere agent or benamidar for another lies on the Income-Tax Department.

A company is chargeable to tax, at the rates of income-tax applicable to it on its profits (whatever their amount may be) as a separate entity, and it pays the tax in discharge of its own liability and not on behalf of its shareholders.

A shareholder is himself liable to tax on the dividend received by him, even though a part of it may have been derived from non-taxable income of the company, *e. g.*, agricultural income, capital profits, etc.

Additional Income-Tax on Undistributed Profits

Not only in India but also in many other countries, companies which are controlled by a few persons are required to distribute a minimum amount of their profits as dividend. This is because in many cases these companies are run by rich persons, and if they actually received dividends in their hands they would have to pay larger amounts of tax on those dividends. Therefore, they generally try to keep the bulk of profits with the company undistributed so that their personal tax liability may not increase.

It is the object of sections 104-109 to prevent this unjustifiable advantage to persons who have a controlling interest in companies. The provisions of these sections are as follows :

Levy of Additional Income-Tax.

Under section 104(1), where the Income-Tax Officer is satisfied that in respect of any previous year the profits distributed as dividend by any company

within the twelve months immediately following the expiry of that previous year are less than the statutory percentage of the distributable income of the company for that previous year, he shall make an order in writing that the company shall, in addition to usual income-tax payable by it, be liable to pay additional income-tax at the following rates on the distributable income as reduced by the amount of dividends actually distributed if any, within the said period of 12 months :

(*a*) at 50% in the case of an investment company ;
(*b*) at 37% in the case of a trading company ; and
(*c*) at 25% in the case of any other company.

Where a loan advanced to a major shareholder during the accounting year has been deemed to be a dividend within the meaning of section 2(22)(e) and assessed in his hands, such deemed dividend counts as distribution of dividend (*59 ITR 466*).

Once it is found that there is a shortfall in the dividends distributed, the additional income-tax payable at the above rates is charged on the distributable income less the amount of dividends actually distributed.

Exceptions. This additional levy does not affect the following categories of companies :

(1) Companies in which the public are substantially interested and wholly-owned subsidiaries of such companies.
(2) Indian industrial companies, and in the case of closely-held companies partly engaged in industrial activities, insofar as, their profis from industrial activities are concerned.
(3) Indian companies engaged in capital-intensive industries, that is to say, companies the value of whose machinery or plant (exclusive of office appliances and road transport vehicles) used for the purposes of business is Rs. 50 lakhs or more on the last day of the relevant previous year.
(4) Foreign companies which have not made prescribed arrangements for declaration and payment of dividends in India.
(5) Indian companies whose sale proceeds from exports or gross receipts from constructional operations or services carried out or rendered outside India are 50% or more of their total sales or gross receipts of the relevant previous year.

It may be noted that companies formed with foreign collaboration are not liable to pay any additional income-tax, because they are either public companies whose shares are listed in a recognised stock-exchange or else they are mainly engaged in industrial activities.

Statutory Percentage.

The statutory percentage of distributable income which should be distributed in order to escape the additional income-tax, is as under :

(1) In the case of an investment company which is not engaged in any industrial activity.	90%
(2) In the case of an Indian company (including an investment company) which is partly engaged in industrial activities and partly in other activities :	
(*a*) in relation to profits attributable to industrial activities	Nil
(b) in relation to the balance of its gross total income	60%
But this percentage of 60% is raised to 90%	
(*i*) if it is an investment company ; or	
(*ii*) if the accumulated profits and	

reserves exceed, in the case of a trading company 100%, and in any other case, 200% if either its paid-up capital and loans from shareholders, or the book-value of its fixed assets, whichever is higher.

(3) In the case of any other company. 60%

In order to provide a measure of incentive to Indian investment companies to take to industrial activities, the exemption from penal tax has been extended to such companies for non-distribution of their profits from industrial activities.

Under section 107A, a company (not being an investment company) may apply to the Central Board of Direct Taxes for a reduction of the minimum amount required to be distributed by it on the ground that having regard to the current requirements for the development of its business, the distribution of dividends larger than what it has already declared would not be possible or advisable. The Board may reduce the amount required to be distributed by an amount not exceeding 20% of the statutory percentage.

Distributable Income.

The quantum of distributable income of a company is to be computed by deducting from the gross total income the following amounts :

(*a*) The amount of income-tax and surtax payable by the company in respect of its total income but not any additional income-tax payable under section 104(1).

(*b*) The amount of any tax levied by government or a local authority in excess of the amount allowed in computing the total income.

(*c*) Any sum with reference to which a deduction is allowable to the company under section 80G (donations).

(*d*) Losses under the head "Capital Gains" relating to long-term capital assets.

(*e*) Income arising outside India in a country the laws of which prohibit the remittance of money to India, provided that when subsequently the restriction on remittance is removed the amount so deducted must be added in computing the distributable income of the previous year in which the restriction is removed.

(*f*) The amount actually transferred by a banking company to the statutory reserve fund.

(*g*) Any expenditure actually incurred for the purpose of the business but not deducted in computing the taxable income from business and being (*i*) a bonus or gratuity paid to an employee ; (*ii*) legal charges ; (*iii*) excessive remuneration to directors, etc., of a company ; and (*iv*) any expenditure claimed as a revenue expenditure but not allowed as such and not resulting in the creation of an asset or enhancement in the value of an asset.

(*h*) Any expenditure actually incurred for earning an income (other than business income) but not deducted in computing such income, provided such expenditure has not resulted in the creation of a capital asset or in the enhancement in the value of an existing capital asset.

Other Provisions.

Circumstances in which the Income-Tax Officer cannot make an Order Under Section 104(1). Section 104(2) provides that the Income-Tax Officer cannot make an order under section 104(1) in the following circumstances :

(*a*) Where, owing to the losses incurred by a company in earlier years or to the smallness of the profits made in the previous year the payment of a dividend or a larger dividend within the 12 months after the end of the previous year would be unreasonable ; or

(*b*) Where the payment of dividend or a larger dividend than that declared within the 12 months after the end of the previous year would not have resulted in a benefit to the revenue ; or

(*c*) Where at least 75% of the share capital of the company has throughout the previous year, been held by an institution or fund established in India for a charitable purpose, the income of which from dividend is exempt under section 11.

According to a decision of the Supreme Court (*57 ITR 176*), before an Income-Tax Officer can take action under section 104(1), a duty is cast on him to satisfy himself that, having regard to the losses incurred by the company in earlier years or the smallness of the profit made, the payment of a dividend or a larger dividend than that declared would be reasonable. He (the Income-Tax Officer) only does what the directors should have done. He puts himself in the place of the directors. Though the object of the section is to prevent evasion of tax, the provision must be worked not from the standpoint of the tax-collector but from that of a businessman. The yardstick is that of a prudent businessman. The reasonableness or the unreasonableness of the amount distributed as dividends is judged by business considerations such as the previous losses, the present profits, the availability of surplus money and the reasonable requirements of the future and similar others. He must take an overall picture of the financial position of the business. It is neither possible nor advisable to lay down any decisive tests for the guidance of the Income-Tax Officer. It depends upon the facts of each case. The only guidance is his capacity to put himself in the position of a prudent businessman or the directors of a company and his sympathetic and objective approach to the difficult problem that arises in each case.

Approval of Inspecting Assistant Commissioner. Under section 107, no order can be made by the Income-Tax Officer under section 104(1), unless he has obtained the prior approval of the Inspecting Assistant Commissioner, and the latter shall not give his approval until he has given the company a hearing.

Time-Limit. Section 106 imposes a time limit for passing an order under section 104(1). No such order can be passed after the expiry of four years from the end of assessment year relevant to the previous year referred to in section 104 (1), or after the expiry of one year from the end of the financial year in which the assessment or reassessment of the profits of the aforesaid previous year was made, whichever is later.

With respect to the assessment year 1975-76 and subsequent assessment years, this limitation period of four years has been reduced to two years.

But this period of limitation shall not apply to a case where the company has made an application to the Board under section 107A.

Opportunity to Make a Supplementary Distribution.

According to section 105 all companies to which section 104 applies are given an opportunity to make a supplementary distribution of the amount in deficit within a period of three months from the date of receipt of a notice given by the Income-Tax Officer in this regard, *if the short disribution is not more than 10%*.

It may sometimes happen that a company has distributed the minimum required according to its own computation of the total income, but this amount falls short of the minimum arrived at on basis of the assessment made.

In such a case, the company will be given an opportunity to make a supplementary distribution, provided the computation of the distributable income by the company was *bona fide*. This opportunity will not be given if the deficiency is caused by any of the following factors :

(*a*) Where the accounts maintained by the company are correct and complete to the satisfaction of the Income-Tax Officer, but the method employed is such that the income cannot properly be deduced therefrom but has to be estimated.

(*b*) Where the accounts kept by the company are not correct and complete or where no method of accounting has been regularly employed, and the Income-Tax Officer has to make the assessment to the best of his judgment.

(*c*) Where, owing to some default on the part of the company, the Income-Tax Officer has to make the assessment to the best of his judgment.

(*d*) Where the company has failed to disclose its income fully and truly.

Where a reassessment is made in the case of a company under the provisions of section 147(b) in a case where there has been no default on the part of the company, an opportunity will be given to the company for making up the shortage in distribution.

Illustrations

(1) Z Private Ltd., in which the public are not substantially interested, carries on purely trading business. The following data are made available to you for the assessment year 1975-76 :

		Rs.
1.	Income as per return	1,00,000
2.	Added by Income-Tax Officer as income from undisclosed sources	20,000
3.	Donations under section 80G	5,000
4.	Dividend declared	24,000
5.	Expenses of revenue nature incurred by the company but disallowed by the Income-Tax Officer for various reasons, the disallowance not being disputed	15,000

The company claims that in the circumstances the provisions of section 104 are not applicable. What is your view in the matter ? In case you do not agree with the company what action would you take ?

In order to find out whether section 104 is applicable to the company or not, it is necessary to make the following computations :

1. Computation of total income :

			Rs.
Income returned			1,00,000
Add Income from undisclosed sources		20,000	
Expenses disallowed		15,000	
	Gross Total Income		35,000
			1,35,000
Deduction under section 80G in respect of charitable donations being 50% of Rs. 5,000			2,500
	Total Income		1,32,500

2. Income-tax payable by the company :

At 65% on Rs. 1,32,500	86,125
Surcharge at 5% on Rs. 86,125	4,306
Income-tax payable	90,431

3. Distributable income :

Gross Total Income		1,35,000
Less Income-tax	90,431	
Charitable donation	5,000	
Revenue expenditure disallowed	15,000	1,10,431
Distributable income		24,569

The distributable income is Rs. 24,569. The company has to distribute 60% of Rs. 24,569, *i. e.*, Rs. 14,741. But the company has declared dividend of Rs. 24,000 Therefore section 104 is not applicable to the company for the assessment year 1975-76.

(2) X Co. Private Ltd. has 20 shareholders the shares being held in the following manner :

Y Co. Ltd. (a public company)	30%
Z Co. Ltd. (a public company)	30%
Managing Director of X Co. Private Ltd.	20%
Other 17 shareholders	20%

As more than 25% of the share capital of X Co. Private Ltd. is held by public companies, according to section 43A of the Companies Act, 1956, it has become a public company.

What is its position with reference to the Income-Tax Act regarding the payment of additional income-tax on undistributed profits, assuming the company has declared a dividend equal to 40% of its profit after deduction of Income-tax ?

(*C. A. Final, Nov. 1963*)

The issue to be decided is whether X Co. Ltd. (a deemed public company) is a company in which the public are substantially interested. It satisfies all the four conditions given below :

(*a*) It is not a private company according to the Companies Act, 1956.

(*b*) Its shares carrying not less than 50% of the voting power have been held throughout the relevant previous year by two public companies.

(*c*) Its shares are freely transferable by the holder to other members of the public.

(*d*) The shares of the company carrying more than 50% of the voting power were not at any time during the relevant previous year held by five or fewer persons, as they were held by two public companies.

Therefore, X Co. Ltd. is a company in which the public are substantially interested and is not liable to any additional income-tax on its undistributed profits.

(3) P Co. Ltd. an Indian company, manufactures and produces aluminium utensils and sheets. Sixty-five per cent of its equity share capital of Rs. 10 lakhs has always been held by three individuals who promoted the company, while the balance of thirty-five per cent is held by the general public. The book-value of its plant and machinery as at the last date of the previous year for the assessment year 1975-76 was Rs. 25 lakhs :

The company furnishes the following particulars of its income for the assessment year 1975-76.

	Rs.
Manufacturing profit before allowance of depreciation and development rebate	1,00,000
Depreciation admissible	60,000
Development rebate	80,000
Income from house property	1,75,000
Dividend income	50,000

The company declares, on 30th September 1975 a sum of Rs. 20,000 as the dividend for the accounting year relating to the assessment year 1975-76.

Assuming that the company's income-tax liability for the said assessment year is Rs. 1,00,000 only, discuss the company's liability to additional income-tax, if any.
(C. A. Final, Nov. 1966)

In order to decide whether the company is liable to any additional income-tax for the assessment year 1975-76, the following facts have to be considered :

(*a*) The total income of the company for the assessment year 1975-76 is as follows :

			Rs.
Manufacturing profit		1,00,000	
Less Depreciation	60,000		
Development rebate to the extent of profit	40,000	1,00,000	Nil
Income from house property		1,75,000	
Less balance of development rebate		40,000	1,35,000
Dividend income (assumed to be gross and from Indian companies)			50,000
	Gross Total Income		1,85,000
Deduction under section 80M being 60% of Rs. 50,000			30,000
	Total Income		1,55,000

(*b*) Although the company manufactures and produces aluminium utensils and sheets, it is not an industrial company. It is an investment company, because not less than 51% of its total income is derived from house property and dividend.

(*c*) The company is a company in which the public are not substantially interested, as it is an Indian company in which equity shares carrying more than 50% of its total voting power were held throughout the previous year by less than five persons. Therefore, the company is liable to pay additional income-tax.

(*d*) The distributable income of the company for the previous year in question is :

	Rs.
Gross Total Income	1,85,000
Less Income-Tax	1,00,000
Distributable Income	85,000

(*e*) The company must distribute in dividends at least Rs. 76,500 being 90% of the above distributable income of Rs. 85,000.

(*f*) The company having distributed as dividends only Rs. 20,000, the short distribution is Rs. 76,500 – Rs. 20,000 = Rs. 56,500. The company is therefore liable to pay additional income-tax at the rate of 50% on Rs. 65,000 being distributable income of Rs. 85,000 *less* Rs. 20,000 dividends declared. The additional income-tax payable will therefore be Rs. 32,500.

(4) For the assessment year 1975-76 the total income of a "trading company" in which all the shares are held by eight individuals equally, is computed at Rs. 10,00,000 after making the undernoted additions to the book profits of Rs. 8,50,000 :

(*a*) Contribution of Rs. 10,000 to the National Defence Fund.

(*b*) Gratuity of Rs. 20,000 paid to a former managing director – disallowed on the ground that the payment was not commercially expedient.

(*c*) Rs. 8,000 out of a total debit of Rs. 18,000 for entertainment expenses—disallowed under section 37(2) of the Income-Tax Act, 1961.

(*d*) Interest of Rs. 25,000—disallowed on the ground that, although it was chargeable income in the hands of the recipient who was a non-resident, it was paid without deduction of tax at source.

(*e*) Cost of renovation amounting to Rs. 45,000—disallowed as capital expenditure debited to revenue.

(*f*) General charges of Rs. 12,000—treated as non-business expenditure.

(*g*) Loss of Rs. 30,000 on transfer of assets other than short-term capital assets treated as loss under the head "Capital Gains". The amount had been debited to the Profit & Loss account.

The tax payable by the company works out at Rs. 6,00,000.

The company has reserves of Rs. 20,000 only while its share capital is Rs. 20,00,000.

Is the company required to distribute any dividend and, if so, what is the minimum amount thereof ? What are the consequences of failure to distribute such minimum dividend ?
(C. A. Final, May 1968)

The company in question is a company in which the public are not substantially interested. The reason is this. Of course, it is not a private company, but its shares carrying more than 50% of the voting power were held throughout the previous year by five persons, each of them holding 12½% of voting power.

Therefore it is a section 104 company which must distribute in dividends at least 60% of its distributable income if it wants to escape from the imposition of additional income-tax on undistributed profits.

It is assumed that the gross total income and total income of the company are the same. The distributable income will be as under :

		Rs.
Gross Total Income		10,00,000
Less Contribution to N. D. F.	10,000	
Gratuity to former managing director	20,000	
Disallowed entertainment expenses	8,000	
Disallowed interest	25,000	
Long-term capital loss	30,000	93,000
		9,07,000
Less Income-tax payable by the company		6,00,000
Distributable income		3,07,000
Amount of minimum dividend which the company must distribute (60% of Rs. 3,07,000)		1,84,200

If the company fails to distribute the full amount of Rs. 1,84,200 as dividend within the 12 months immediately following the expiry of the previous year relevant to the assessment year 1975-76, it will have to pay additional income-tax at 37% on the distributable income of Rs. 3,07,000 as reduced by the amount of any dividends actually distributed.

Note : The following expenses will not be deducted in computing the distributable income :

(*a*) Cost of renovation amounting Rs. 45,000 as it enhances the value of an existing fixed asset.

(*b*) Non-business expenditure of Rs. 12,000.

(5) On 31st March 1975, the Balance Sheet of Ramesh Private Ltd. was as follows :

	Rs.		Rs.
Share Capital	24,000	Fixed Assets	12,000
Reserve and Surplus	4,00,000	Investments in G Private Ltd.	4,00,000
Creditors	6,000	Sundry Debtors	8,000
		Cash at Bank	10,000
	4,30,000		4,30,000

The Profit & Loss Account of the Company for the year ended 31st March, 1975 was as under :

	Rs.		Rs.
Expenses	22,000	Trading Profit	48,000
Bad Debts written off	12,000	Dividends (Net)	1,54,000
Net Profit before Taxation	1,68,000		
	2,02,000		2,02,000

Work out the amount of provision to be made for taxation and the dividend to be declared so as not to attract additional income-tax. *(C. A. Final, Nov. 1963)*

Ramesh Private Ltd. is a company in which the public are not substantially interested, and it is an investment company because not less than 51% of its income consists of dividends.

For the assessment year 1975-76 Ramesh Private Ltd. is liable to pay income-tax at 65% on its total income with a surcharge of 5% on such income-tax. Assuming that the expenses debited to the profit and loss account are all admissible as deductions, the total income of the company is as follows :

		Rs.
Business income (1,68,000 – 1,54,000)		14,000
Dividends gross after adding Rs. 46,000 tax deducted at source at 23%		2,00,000
	Gross Total Income	2,14,000
Deduction under section 80M being 60% of Rs. 2,00,000		1,20,000
	Total Income	94,000
Income-tax on Rs. 94,000 at 65%		61,100
Surcharge at 5% on Rs. 61,100		3,055
	Provision for Tax	64,155
Gross Total Income		2,14,000
Less Income-tax payable		64,155
	Distributable Income	1,49,845
Amount to be distributed as dividend to escape additional income-tax, being 90% of Rs. 1,49,845		1,34,861
Rate of dividend on share capital of Rs. 24,000		562%

Rates of Income-Tax on Companies

The rates of income-tax for the assessment year 1975-76 on companies in respect of income other than capital gains are as follows :

Class of Company and Nature of Income	Rate of Income-Tax
1. Widely-held domestic companies (including wholly-owned subsidiaries of such companies) :	
(*i*) in case where the total income does not exceed Rs. 1,00,000	45% of total income
(*ii*) in case where the total income exceeds Rs. 1,00,000	55% ,, ,,
2. Closely-held domestic companies :	
(*a*) in the case of an industrial company :	
(*i*) on first Rs. 2,00,000 of total income	55%
(*ii*) on balance of total income	60%
(*b*) in the case of a company other than an industrial company	65% of total income
3. Foreign companies :	
(*a*) on income consisting of royalties and technical service fees received from an Indian concern under agreements approved by the Central Government	50%
(*b*) on any other income included in the total income	70%

Marginal Relief. Where the total income of a widely-held domestic company exceeds Rs. 50,000, the income-tax payable by it shall not exceed the aggregate of :

(*a*) the income-tax which would have been payable if its total income had been Rs. 50,000 (the income of Rs. 50,000 for this purpose being computed as if such income included income from various sources in the same proportion as the total income of the company) and

(*b*) 80% of the amount by which the total income exceeds Rs. 50,000.

Surcharge on Income-Tax

The amount of income-tax computed at the above rates is to be increased by a surcharge of 5% of such income-tax.

Tax on Capital Gains.

Under section 115, where the total income of a company includes any long-term capital gains, the income-tax payable is the aggregate of :

(1) The amount of income-tax calculated on the amount of long-term capital gains relating to buildings or lands or any rights therein (*i*) at 47% where the company is widely held and its total income (as reduced by the amount of long-term capital gains included therein) does not exceed Rs. 1,00,000 and (*ii*) at 55% in any other case.

(2) The amount of income-tax calculated on the amount of other long-term capital gains at 45%.

(3) The amount of income-tax with which the company would have been chargeable had its total income been reduced by the amount of long-term capital gains.

It means that the short-term capital gains of a company are taxed like other ordinary income.

Tax on Inter-corporate Dividends.

Under the Income-Tax Act, a holding company and its subsidiary company are treated as separate entities for purposes of payment of taxes and are therefore taxed separately. Accordingly, when a holding company receives dividend income from its subsidiary, the holding company is liable to pay tax on such income.

The Income-Tax Act however provides for certain concessions in respect of inter-corporate dividends. A certain percentage of inter-corporate dividends is allowed as a deduction from gross total income. The percentage of deduction is higher in the case of inter-corporate dividend income of foreign companies than that of domestic companies. The percentages of deduction are as follows :

(*a*) Dividend received by a foreign company from any domestic company . 65%

(*b*) Dividend received by any domestic company from any other domestic company 60%

(*c*) Dividend received by a domestic company from a foreign company on shares In the foreign company allotted to it in consideration of the supply of technical know-how or technical services to the foreign company under agreements approved by the Central Government. 100%

SURTAX ON COMPANY PROFITS

From the assessment year 1964-65, the Companies (Profits) Surtax Act, 1964, has imposed a special tax on the excess profits of companies (other than companies which have no share capital). This surtax is in addition to the income-tax payable by a company. In connection with the levy of surtax, it is necessary to understand the terms "chargeable profits", "capital employed", "statutory deduction", and "excess profits".

Chargeable Profits.

This expression means the total income of a company as computed under the Income-Tax Act and adjusted in the following manner :

(1) The total income is to be reduced by the following amounts :

(*i*) Capital gains.

(*ii*) Compensation chargeable as business income.

(*iii*) Any taxable profit arising on the sale, discard, demolition or destruction of any building, machinery, plant or furniture.

(*iv*) Interest on tax-free government securities.

(*v*) 50% of the qualifying amount of donations.

(*vi*) Dividends from domestic companies.

(*vii*) Royalties received from Government, a local authority or any Indian concern.

(*viii*) In the case of a foreign company, its income from interest or fees for technical services received from Government, a local authority or an Indian concern.

(*ix*) Amount transferred to the statutory reserve fund of a banking company.

(2) The balance of the total income arrived at after making the above deductions is to be further reduced by (*i*) the amount of income-tax (excluding any additional income-tax payable by a company which is required to make a compulsory distribution of profits) payable by the company ; and (*ii*) the amount of foreign taxes paid less any double taxation relief.

(3) The net amount of income calculated in the above manner is to be increased by (*i*) the amount of any interest payable on debentures and other loans which are included in capital employed as explained below and (*ii*) any expenditure on account of commission, entertainment and advertisement which in the opinion of the Income-Tax Officer is excessive.

Capital Employed.

The capital employed by a company will consist of its entire paid-up share capital, its reserves (excluding the balance of profit and loss account, proposed additions to reserves and sinking funds) and also its debentures and other loans.

Debentures issued by a company will be taken into account only if they are issued to the public and according to the terms and conditions of their issue they are not redeemable before the expiry of a period of 7 years.

The other loans include moneys borrowed from Government, the IFC (Industrial Finance Corporation), the ICICI (Industrial Credit and Investment Corporation of India Ltd.) and any other financial institutions approved by the Central Government, and also loans from banks.

The borrowed money will be allowed to be included in the capital base subject to the conditions that the minimum term of their repayment should be seven years in all cases and the purpose of the borrowing should be the creation of capital assets in India. Thus, deposits taken by companies from individuals and other private bodies as well as short-term loans from banks are not to be included in the capital employed.

The capital employed will be computed on the first day of the relevant accounting year of a company, subject to adjustment for any increase or decrease of such capital during the course of the year on a proportionate basis according to the number of days.

Statutory Deduction.

This is 10% of the capital employed by a company or Rs. 2,00,000, whichever is greater. Thus, new and small companies are adequately protected, as the minimum statutory deduction has been fixed at Rs. 2,00,000.

Excess Profits.

The surtax is levied on excess profits which are the excess of chargeable profits over the statutory deduction.

Rates of Surtax

For the assessment year 1975-76 surtax will be charged on excess profits at the following rates :

(*a*) On the amount of excess profits up to 5% of capital employed 25%

(*b*) On the balance of excess profits 40%

However, in the case of a widely-held company or its wholly-owned subsidiary, where the aggregate of the income-tax and surtax payable by the company exceeds 70% of its total income, the amount of surtax payable by the company will be reduced by the amount by which such aggregate exceeds 70% of its total income. This provision will not apply if the paid-up share capital (subscribed and paid for in cash) is more than 25% of the capital employed.

Illustration

X Ltd. is a domestic company in which the public are substantially interested. From the following particulars compute the aggregate tax liability of the company for the assessment year 1975-76 :

	Rs.
(*a*) Paid-up equity share capital as on the first day of the previous year 1974	1,00,00,000
(*b*) Profits before tax derived from an industrial undertaking	30,00,000
(*c*) Dividend distributed for 1974 on equity share capital	10,00,000

	Rs.
Profits before tax derived from an industrial undertaking, being total income	30,00,000
Income-tax on total income at 55%	16,50,000
Surcharge thereon at 5%	82,500
Income-Tax Payable	17,32,500
Total income	30,00,000
Less Income-tax thereon	17,32,500
Chargeable Profits	12,67,500
Chargeable profits	12,67,500
Less Statutory deduction at 10% on Rs. 1,00,00,000 capital employed	10,00,000
Excess Profits	2,67,500
Surtax on excess profits of Rs. 2,67,500 at 25%	66,875
Income-Tax payable	17,32,500
Total tax liability	17,99,375

Note : The excess profits are less than 5% of capital employed.

Set-off of Losses.

If a company carries on two or more separate businesses it would be entitled to adjust its losses under section 70. For the purposes of an adjustment it is not essential that the business should be carried on at one and the same place or within the jurisdiction of the same Income-Tax Officer. Where a company is resident in India it will be allowed to set off its foreign business loss against its Indian business income. Different businesses do not constitute different heads of income under the law. All businesses wherever carried on constitute one head to determine what are the profits of business under section 28. Therefore, an assesee is entitled to show all his profits and set off against those profits any losses incurred by him in the same head.

Under section 79, where a change in shareholding has taken place in a previous year in the case of a company, in which the public are not substantially interested, no loss incurred in any year prior to the previous year can be carried forward and set off against the income of the previous year unless :

(*a*) on the last day of the previous year, the share of the company carrying not less than 51 per cent of the voting power were beneficially held by the same persons who held them on the last day of the previous year in which the loss was incurred ; or

(*b*) the Income-Tax Officer is satisfied that the change in the shareholding was not effected with a view to avoiding or reducing tax liability.

Obligations of Companies.

All the obligations of a company under the income-tax law are to be performed by its principal officer who may be its secretary, manager or any person connected with its management, on whom the Income-Tax Officer has served a notice of his intention to treat him as the principal officer thereof. The principal obligations of a company are :

(1) Under section 139(1), to file with the Income-Tax Officer a return of total income of the company.

(2) Under section 203, where tax has been deducted from interest on securities, dividends, etc., to furnish to the person from whose income the tax is deducted a certificate to the effect that the income-tax has been deducted and specifying the amount so deducted, the rate at which the tax has been deducted, and such other particulars as may be prescribed.

(3) Under section 206(1), to furnish to the Income-Tax Officer, within 30 days after 31st March in each year, a return showing the names and addresses of all persons who have received during the year ended 31st March from the company a prescribed amount as salary and the tax deducted therefrom.

(4) Under section 285, to furnish to the Income-Tax Officer on or before 15th June each year a return containing the names and addresses of persons to whom interest other than interest on securities (amounting to not less than Rs. 400) has been paid during the previous year together with the amount paid to each.

(5) Under section 286, to furnish to the Income-Tax Officer on or before 15th June each year a return containing the names and addresses of shareholders of the company to whom dividends have been distributed during the previous year and the amounts of dividends distributed.

Illustrations

(1) A private limited company is engaged in the manufacture and sale of oil engines. Its profit & Loss Account for the year ended 31st March 1975, which contained *Inter alia* the following items, showed a net profit of Rs. 3,85,000.

(*a*) Closing stock of finished goods Rs. 9,00,000.
(*b*) Interest paid Rs. 15,000.
(*c*) Royalty on sales Rs. 25,000.
(*d*) Salaries Rs. 3,00,000.
(*e*) Managing Director's remuneration Rs. 24,000.
(*f*) Travelling expenses Rs. 60,000.
(*g*) Depreciation of fixed assets Rs. 2,50,000.
(*h*) Development rebate reserve Rs. 30,000.
(*i*) Donations Rs. 35,000.
(*j*) Miscellaneous expenses Rs. 50,000.
(*k*) Provision for taxation Rs. 3,00,000.

The share capital of the company was held equally by A (the managing director), B his brother, and their respective wives.

In the course of assessment proceedings, the following facts were ascertained :

1. The company used to value its finished goods at cost. This year the closing stock of finished goods was valued at 10% below cost. The company has written saying that it will henceforth adopt this method of valuation.

2. Interest paid includes Rs. 2,000 penal interest on account of inadequate advance payment of tax.

3. Travelling expenses include Rs. 15,000 incurred by the managing director for going to Germany for his medical treatment. There is no contractual obligation on the company's part to meet this expenditure.

4. The admissible amount of depreciation is Rs. 2,00,000.

5. Of the amount of development rebate due, 75% has been charged to Profit & Loss Account.

6. Donations include (*i*) Rs. 5,000 to a charitable trust for the benefit of deserving Hindu boys and girls for their higher education : (*ii*) Rs. 15,000 being expenditure on the construction for a dispensary which was donated to an institution to which section 80G of the Income-Tax Act applies ; and (*iii*) Rs. 15,000 set apart for further construction to the same dispensary but not paid.

7. Miscellaneous expenses include Rs. 3,000 paid secretly to the Secretary of the labour union for calling off a threatened strike.

8. The company received during the year a sum of Rs. 20,000 as refund of import duty, which had been allowed as a deduction in the assessment year 1973-74. This refund was credited to miscellaneous expenses account.

Ascertain the company's total income for the assessment year 1975-76 giving reasons for allowance of any item.

		Rs.	Rs.
Profit as per Profit & Loss Account			3,85,000
Add (*a*)	Adjustment for under-valuation of finished goods. The fact that the company has offered to follow the new method in future is immaterial.	1,00,000	
(*b*)	Penal interest paid, not being admissible under section 37, as it is not incurred for the purpose of the business.	2,000	
(*c*)	Travelling expenses of managing director, there being no contractual obligation on the part of the company to meet this expenditure. Even if there is a contractual obligation, this expenditure would be disallowed under section 40(c)(i) if, in the opinion of the Income-Tax Officer, such expenditure is not necessary for the legitimate business needs of the company.	15,000	
(*d*)	Excess depreciation charged.	50,000	
(*e*)	Donations being application of income as explained below.	35,000	
(*f*)	Amount paid to the Secretary of the labour union, assuming that no receipt is produced for this payment.	3,000	
(*g*)	Rs. 20,000 refund of import duty would be taxable under section 41(1), but no adjustment is necessary in respect thereof because the amount has been credited to miscellaneous expenses.	—	
(*h*)	Amount transferred to development rebate reserve, as the full amount of development rebate would be allowed.	30,000	
(*i*)	Provision for taxation, not being expenditure	3,00,000	5,35,000
			9,20,000
Less	Development rebate, as the full 75% of the rebate due, has been transferred to development rebate reserve		40,000
	Gross Total Income		8,80,000

Less 50% of charitable donation of Rs. 5,000 allowed as a deduction under section 80G		2,500
	Total Income	8,77,500

Note : A charitable trust for the benefit of children is not deemed to be for the benefit of any particular community or caste.

Rs. 15,000 spent on the construction of a dispensary which is donated cannot be treated, within the meaning of section 80G, as the sum paid to the institution. Therefore it is not entitled to any deduction. Rs. 15,000 is only set apart but not paid. It is therefore disallowed.

(2) Given below is the Profit & Loss Account of Ajit Motor Garage Ltd. for the year ended 31st March 1975 :

(Rupees in thousands)

	Rs.		Rs.
Opening Stock at cost	9,87	Sales	1,28,32
Purchases	1,24,17	Workshop Receipts	1,20
Freight	38	Closing stock at cost less 10%	15,22
Gross Profit c/d	10,32		
	1,44,74		1,44,74
Salaries	1,49	Gross Profit b/d	10,32
Bonus (3 months' pay)	48	Commission	34
Rent and Rates	80		
Repairs and Renewals	9		
Printing and Stationery	9		
Travelling Expenses	25		
Advertisement	20		
Charity and Donations	20		
Legal Charges	15		
Depreciation	53		
Development Rebate Reserve	18		
Additional Income-Tax 1973-74	1,30		
Net Profit	4,90		
	10,66		10.66

Having regard to the following information, compute the total income of the company for the assessment year 1975-76 :

(*a*) Travelling expenses include a sum of Rs. 15,000 spent by a director on a trip to England for settling the terms of technical collaboration for a new department to be started for manufacturing sparking plugs.

(*b*) Advertisement expenses include Rs. 8,000 spent on entertainment in India during the previous year.

(*c*) Legal charges include Rs. 5,000 paid for drafting a deed of hypothecation of assets for the purpose of taking a loan from the Industrial Finance Corporation and Rs. 2,000 paid for defending a suit in the labour court instituted by a dismissed employee.

(*d*) Donations include Rs. 10,000 to the Jawaharlal Nehru Memorial Fund.

(*e*) Rent and rates include Rs. 10,000 for wooden partitions erected in rented premises occupied by the company.

(*f*) Details of fixed assets are as follows :

Assets	*W. D. V.*	*Additions*	*Sales*
	Rs.	Rs.	Rs.
Motor-cars	1,12,000	56,650	
	(Additions were made at the beginning of the year)		
Land	10,000		
Buildings (1st Class)	1,00,000		
Machinery	1,00,000	1,00,000	
	(Additions were made on 1st May 1974)		
Furniture and Fixtures	25,000		
Motor-trucks	25,000		35,000
	(All trucks sold at the beginning of the year)		
Typewriters	10,000		

Net Profit as per Profit & Loss Account		Rs. 4,90,000
Add Under-valuation of closing stock (1/9th of Rs, 15,22,000)		
Charity and donations	1,69,111	
Depreciation considered separately	20,000	
Development rebate reserve	53,000	
Additional income-tax	18,000	
Travelling expenses of director considered capital expenditure	1,30,000	
Profit on sale of trucks	15,000	
Entertainment expenditure	10,000	
	8,000	4,23,111
		9,13,111
Less Development rebate at 15% on new machinery	15,000	
Depreciation as calculated below	62,730	77,730
Business profits being gross total income		8,35,381
Deduct 50% of donation to J. N. M. Fund		5,000
Total Income		8,30,381
Rounded off		8,30,380

Calculation of Depreciation

	Rs.
Buildings (taken to be factory buildings) at 5% on Rs. 1,00,000	5,000
Machinery at 10% on Rs. 2,00,000	20,000
Furniture and fittings at 10% on Rs. 25,000	2,500
Motor-cars at 20% on Rs. 1,68,650	33,730
Typewriters at 15% on Rs. 10,000	1,500
No depreciation on motor-trucks as they were sold during the year	—
	62,730

Notes :

Entertainment expenditure incurred in India after 28-2-1970 is disallowed as a deduction.

The cost of wooden partitions erected in rented premises is revenue expenditure, as it is really an additional rent for the premises.

The expenses (including cost of stamps, registration fees, lawyer's fees, etc.) incurred in connection with the raising of loans is an admissible deduction (*60 ITR 52*).

Assuming the machinery purchased during the year to be new, the amount of development rebate in respect thereof at 15% is Rs. 15,000 and a reserve of Rs. 11,250 should be created. The company has transferred Rs. 18,000 to development rebate reserve. Therefore the development rebate of Rs. 15,000 is allowed.

It is assumed that the cost of trucks sold was more than Rs. 35,000.

(3) Gopal Private Ltd. deals in radios. Its Profit and Loss Account for the year ended 31st March 1975 which contained *inter alia* the following items, disclosed a profit of Rs. 63,200 :

	Rs.		Rs.
Opening Stock	72,000	Closing Stock	90,000
Directors' Salaries	14,400	Dividend from other Indian companies net	
Legal Charges	28,000	(Tax deducted Rs. 6,000)	18,000
Miscellaneous Expenses	50,000	Miscellaneous receipts	62,000
Depreciation	22,000		
Development Rebate Reserve	10,000		
Entertainment allowance paid to employees	5,000		
Entertainment expenses directly incurred by the company	30,000		
Interest paid	31,000		
Income-Tax	53,000		
Legal Charges	28,000		
Donation to National Defence Fund	6,000		
Advertisement expenses incurred outside India for promoting sales of radios	30,000		

In the course of assessment proceedings the following information was obtained.

1. Miscellaneous receipts include the following :
   (*a*) Insurance money Rs. 18,000. In the earlier years the company was also doing hotel business. As the hotel building was burnt in November 1973 that business was discontinued. The insurance money of Rs. 18,000 was received in this year from the insurance company. The written-down value of the building was nil at the end of the last year.
   (*b*) Bad debts recovered Rs. 5,000. This was in respect of bad debts written off in hotel business in an earlier year.
   (*c*) Profit on sale of shares Rs. 39,000, the interval between their purchase and sale being 66 months. The assessee is not a dealer in shares.
2. Miscellaneous expenses consist of the following :
   (*a*) Loss on sale of shares Rs. 6,000, the interval between their purchase and sale being 7 months.
   (*b*) Compensation paid for cancellation of contract Rs. 6,000. The company had ordered for machinery but later on it found that it was not economical to purchase that type of machinery. So the contract was cancelled and compensation was paid.
   (*c*) Rs. 2,000 penalty for breach of sales-tax regulations
   (*d*) Rs. 3,000 retrenchment compensation paid to hotel employees.
   (*e*) Rs. 31,500 bad debts written off. The debt arose out of loan given to a cloth dealer. Although it was not connected with the company's business, interest received from him was treated as income in earlier years.

3. Out of the four directors only two attended to the business; but in order not to discriminate between one director and another, each of them was paid of Rs. 3,600 for the year.

4. Legal expenses included income-tax appeal expenses of Rs. 800 and Rs. 2,000 for defending the managing director who was prosecuted for not deducting tax at source from salaries and dividends.

5. Interest of Rs. 15,000 was paid on loan taken for purchase of machinery and is included in the figure of Rs. 31,000 debited in the profit & loss account.

6. The opening stock is shown at cost less 10% and the closing stock is also shown at cost less 10%. Last year the undervaluation was added in the assessment order and was accepted by the assessee. The addition for undervaluation made last year was not adjusted in the accounts.

7. Depreciation debited in the accounts is the same as admissible.

8. Development rebate admissible is Rs. 12,000.

Compute the total income of the company for the assessment year 1975-76.

		Rs.
Profit as per Profit and Loss Account		63,200
Less Items considered separately :		
Dividends from other Indian companies	18,000	
Profit on sale of shares	39,000	57,000
Add On account of undervaluation of stock :		6,200
Undervaluation of closing stock	10,000	
Less undervaluation of opening stock	8,000	2,000
		8,200
Add Inadmissible items :		
Out of directors' salaries, salary paid Rs. 3,600 each of two directors who did not attend to the business	7,200	
Entertainment allowance to employees and expenditure directly incurred by the company being incurred in India	35,000	
Income-tax	53,000	
Donation to N. D. F.	6,000	
Legal expenses for defending the managing director not being incurred for the purpose of business	2,000	
Development rebate reserve	10,000	
Loss on sale of shares considered separately	6,000	
Compensation paid for cancellation of contract for purchase of machinery (*63 ITR 65*)	6,000	
Penalty for breach of sales-tax regulations (*41 ITR 350*)	2,000	
Retrenchment compensation paid after the closure of business being capital loss	3,000	
Bad debt written off, the debt not relating to the assesse's business	31,500	1,61,700
		1,69,900
Less Development rebate	12,000	
Extra deduction for advertisement expenses incurred outside India being one-third of Rs. 30,000 under section 35B.	10,000	22,000
Business Income		1,47,900

Computation of Total Income

			Rs.
1.	Business Income	1,47,900	
	Less Short-term capital loss on sale of shares held for only 7 months	6,000	1,41,900
2.	Capital gains :		
	Long-term capital gains relating to assets other than land and buildings		39,000
3.	Other Sources :		
	Dividends from Indian companies gross		24,000
	Gross Total Income		2,04,900
	Deductions :		
	Under section 80G : 50% of donation to N. D. F.	3,000	
	Under section 80M : 60% of Rs. 24,000	14,400	17,400
	Total Income		1,87,500

Notes :

1. Short-term capital loss can be set off under any head except long-term capital gains.
2. Interest of Rs. 15,000 on loan taken for purchase of machinery is allowable as a deduction.
3. Insurance money of Rs. 18,000 received and bad debts recovered of Rs. 5,000 are taxable in view of the provisions of section 41 though the hotel business was discontinued. As they are already included in miscellaneous receipts, no adjustment is necessary.

(4) X Private Ltd. is a manufacturing company. It showed a profit of Rs. 1,25,000 in its Profit and Loss Account for the year ended 30th June 1974. There are only three shareholders : X, Y and Z. Particulars noted from the company's accounts and ascertained on inquiry from the company are given below :

(*a*) The company followed the principle of valuing the stock-in-trade at the cost price or the market price whichever was the lower. It valued the stock-in-trade on 30-6-1973 at the market price which was below the cost. A part of that stock remained on hand on 30-6-1974 and the company retained its valuation at Rs. 75,000 which was the market value on 30-6-1973. The cost of such stock was Rs. 85,000 and its market value on 30-6-1974 was Rs. 90,000.

(*b*) The general reserve contained a credit for Rs. 30,000 being refund obtained from the Collector of Customs in partial reduction of a penalty of Rs. 75,000 levied for infringing customs regulations. The penalty amount of Rs. 75,000 was paid in an earlier year and was allowed by the Income-Tax Officer as expense in the relevant assessment.

(*c*) An expense of Rs. 2,00,000 was incurred in shifting the factory to a place more advantageously situated. This was debited in the Profit and Loss Account. An alternative claim was made that, if it was held to be capital expenditure, depreciation should be allowed thereon.

(*d*) Workmen and staff welfare expenses debited in the Profit and Loss Account included a sum of Rs. 50,000 being the cost of construction of a primary school exclusively for the benefit of the children of employees.

(*e*) The advertiesment expenses include expenditure of Rs. 3,000 incurred on feeding the poor on the occasion of the celebration of the Silver Jubilee of the factory.

(*f*) The miscellaneous expenses include a sum of Rs. 5,000 being the value of presents made to employees and their family members on occasions like marriage, etc.

(*g*) A motor-car purchased by the company for Rs. 15,000 was sold to an employee of the company for Rs. 8,500, 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. 13,000.

(*h*) The unclaimed wages stood as under :

	Rs.
Balance on 1-7-1973	26,800
Add Unclaimed wages for 1973-74	3,100
	29,900
Deduct payments in 1973-74	150
Balance on 30-6-1974	29,750

Compute the total income of the company for the assessment year 1975-76.

	Rs.	Rs.
Profit as per Profit and Loss Account		1,25,000
(*a*) In regard to that part of the stock as on 30-6-1973 which remained on hand on 30-6-1974, the valuation on 30-6-1974 should have been at cost (Rs. 85,000) or at market price (Rs. 90,000) whichever was the lower. The valuation should therefore be Rs. 85,000. As the company valued it at Rs. 75,000, the amount of under-valuation is added.		10,000
(*b*) The penalty of Rs. 75,000 paid in an earlier year for infringing customs regulations was not an admissible deduction and should not have been allowed in the relevant assessment. If not time-barred the assessment of that earlier year can be reopened under section 147. However, the refund of Rs. 30,000 obtained out of the penalty payment of Rs. 75,000 is not an assessable income of the company.		—
(*c*) The expense of Rs. 2,00,000 incurred in shifting the factory to a place more advantageously situated is capital expenditure, on which no depreciation is admissible as no tangible asset was acquired by the company.		2,00,000
(*d*) Cost of construction of school building is capital expenditure and is disallowed, but normal and initial depreciation is admissible thereon.		50,000
(*e*) Rs. 3,000 incurred on feeding the poor is of the nature of charity and is disallowed.		3,000
(*f*) Rs. 5,000 incurred in making presents to employees and their family members is of the nature of welfare expenses and is admissible as a deduction.		—
(*g*) As the motor-car was sold by the company to an employee for an amount equal to the written-down value, the excess of market value (Rs. 13,000) over the sale price (Rs. 8,500) is not the income of the company.		—
(*h*) No part of the unclaimed wages can be considered as the company's income.		—
Total		3,88,000

In order to arrive at the total income of the company, normal and intitial depreciation on the school building costing Rs. 50,000 will be allowed.

(5) Mohan Lal (Private) Ltd. is engaged in import and export of goods. Its Profit & Loss Account for the year ended 31st December 1974 contained, *inter alia*, the following items :

	Rs.	Rs.		Rs.
Loss on forward dealings in shares		95,000	Profit on sale of car	5,000
Remuneration to :			Profit on sale of machinery	10,000
Managing director	40,000		Hire receipts from machinery	4,000
Another director	25,000	65,000	Sundry credit balances	38,000
Rent		25,000		
Interest		60,000		
Miscellaneous charges		1,01,000		
Depreciation of Fixed assets		6,000		
Net Profit		1,25,000		

The following facts and information have been obtained from the company :

1. Interest includes (*a*) Rs. 40,000 paid under section 215 for the assessment year 1973-74 and (*b*) Rs. 3,000 remitted to X who is a non-resident the company not paying or deducting tax at source on this amount and no person in India being treated as an agent of X.

2. Miscellaneous charges include :

(*a*) Rs. 2,000 being the fees paid to a chartered accountant for sales-tax assessment of the company.

(*c*) Rs. 1,500 penalty paid to customs authorities for violation of import restrictions.

(*c*) Rs. 5,000 paid as donation to a charitable trust created for the benefit of the children and women of Jain community. The income of the trust is exempt from tax.

(*d*) Rs. 20,000 for the travelling expenses of a director who went to U.S.A. for negotiating technical collaboration in respect of a new manufacturing line.

(*e*) Rs. 7,000 on account of entertainment expenses in India.

3. The company had purchased a new car for Rs. 12,000 on 1-6-1970. It was sold on 1-4-1974 for Rs. 17,000. The company has been allowed full depreciation in the respective assessment years.

4. On 1-1-1972 the company had imported new machinery at a cost of Rs. 40,000. It was being let on hire. The company was allowed depreciation at 10% and development rebate due for the respective assessment years. The machinery was sold for Rs. 50,000 on 1-7-1974.

5. Rent includes Rs. 9,000 paid for the residential accommodation of a new director who has also been paid Rs. 25,000 as remuneration. He was appointed a director from 1-1-1974. He is the son of the managing director and was previously working as a secretary in another company on a salary of Rs. 1,000 per month.

6. Depreciation debited is according to law in respect of the fixed assets of the company, which are used by the company itself for its own business.

7. The details of sundry credit balances are as under :

(*a*) Rs. 23,000 on account of accrued liability for bonus and sales-tax provided for in the past, but now written back being in excess of the actual requirements. The whole amount was allowed as a deduction in the year in which the liability accrued.

(*b*) Rs. 15,000 represents deposits received from A to ensure fulfilment of contract and was to be forefeited on its breach. A failed to carry out the contract of sale of goods. The deposit was therefore forfeited.

Compute the total income of the company for the assessment year 1975-76 giving reasons, wherever necessary, in the support of your answer.

Computation of Company's Total Income

		Rs.
Net Profit as per Profit and Loss Account		1,25,000
Less Profit on sale of car, correct amount to be taxed	5,000	
Profit on sale of machinery, correct amount to be taxed	10,000	
Hire receipts, taxable under the head "Income from Other Sources"	4,000	19,000
		1,06,000
Add Speculation loss (*a*)	95,000	
Interest paid under section 215 regarding payment of advance tax (*b*)	4,000	
Interest remitted to non-resident (*c*)	3,000	
Penalty paid (*d*)	1,500	
Donation (*e*)	5,000	
Travelling expenses (*f*)	20,000	
Entertainment expenses (*g*)	7,000	
Remuneration and perquisite of a director (*h*)	16,000	
Profit on sale of car (*i*)	7,084	1,58,584
Income from business		2,64,584
Capital gains (*j*) long-term relating to assets other than land and buildings		15,000
Income from other sources :		
Hire receipts	4,000	
Profit on sale of Machinery (*k*)	7,600	11,600
Gross Total Income		2,91,184
Deduct 50% of charitable donation of Rs. 5,000		2,500
Total Income		2,88,684

Notes :

(*a*) Speculation loss can be set off only against speculation profits. As there is no other speculation in this case, the loss will be carried forward for 8 years for future set-off.

(*b*) Interest paid under section 215 on account of default in the payment of advance tax is not a deductible business expenditure; hence it is disallowed.

(*c*) Interest paid to a non-resident is disallowed under section 40(a)(i), as no tax has been paid or deducted therefrom and no person in India has been treated as agent.

(*d*) Penalty paid for violation of import restriction is not admissible as per Supreme Court's decision.

(*e*) The charitable trust to which the donation has been made is one, the income of which is exempt under section 11. As it is for the benefit of children, it cannot be said to be expressly for the benefit of any particular religious community or caste.

(*f*) This is capital expenditure because the director went to U.S.A. in connection with the setting up of a new manufacturing line.

(*g*) Entertainment expenditure incurred in India after 28-2-1970 is entirely disallowed.

(*h*) The new director was drawing only Rs. 12,000 per annum before he joined this company. Taking into consideration all the factors, especially the fact that he is the managing director's son, the total remuneration (Salary plus perquisite) of Rs. 34,000 is excessive. Hence Rs. 16,000 is disallowed under section 40(c)(i).

(*i*) The profit on sale of car under section 41(2) is computed as under :

		Rs.
Cost of car purchased on 1-6-1970		12,000
Depreciation for assessment year 1971-72	2,400	
,, ,, ,, ,, 1972-73	1,920	
,, ,, ,, ,, 1973-74	1,536	
,, ,, ,, ,, 1974-75	1,228	7,084
Written-down value on 1-1-1974		4,916

Therefore, out of the sale proceeds of Rs. 17,000, Rs. 7,084 (equal to the amount of depreciation allowed) will be profit taxable under section 41(2).

(*j*) The amount of capital gain is calculated as follows :

	Sale Price Rs.	Cost Rs.	Capital Gain Rs.
Car	17,000	12,000	5,000
Machinery	50,000	40,000	10,000
			15,000

(*k*) The profit on sale of machinery taxable under section 59(2) is arrived at as under :

		Rs.
Cost of machinery purchased on 1-1-1972		40,000
Depreciation for assessment year 1973-74	4,000	
,, ,, ,, ,, 1974-75	3,600	7,600
Written-down value on 1-1-1974		32,400

Therefore, out of the sale proceeds of Rs. 50,000, Rs. 7,600 (equal to the amount of depreciation allowed) will be profit taxable under section 59(2).

(*l*) The fee of Rs. 2,000 paid to a chartered accountant for sales-tax assessment of the company is an admissible deduction.

(*m*) In the assessment year 1973-74 development rebate at 20% was allowed on new machinery imported on 1-1-1972 at a cost of Rs. 40,000. But this machinery was sold on 1-7-1974 *i. e.*, before the expiry of 8 years. Therefore, the development rebate allowed will be withdrawn by revising the assessment for 1973-74. This will be done as a rectification of mistake.

(6) A limited company manufacturing and selling yarn and cloth has filed its return of income for the assessment year 1975-76 (accounting year ending 31-12-1974) showing business profits of Rs. 5,00,000. The results disclosed by its statements of account are acceptable but the following points are outstanding for determination :

(1) Subscriptions paid include Rs. 1,500 paid to the Bombay Stock Exchange for listing the company's shares.

(2) Legal expenses include the following :

(*a*) Rs. 1,500 spent to defend the company's sales manager in an action taken by the Textile Commissioner for breach of the Yarn Distribution Control Order.

(*b*) Rs. 750 spent to defend the managing director in a prohibition case.

(*c*) Rs. 5,000 paid to the company's solicitor in a suit filed by a third party attacking its title to the land on which its factory has been erected.

(3) Interest paid includes Rs. 4,000 paid to certain outsiders from whom moneys had been borrowed to buy plant and machinery in the past years.

(4) Miscellaneous expenses include the following :

(*a*) Rs, 1,500 expenditure incurred in connection with the issue of new debentures. The company intends to pay off the loans mentioned at (3) above from these debenture moneys.

(*b*) Rs. 15,000 paid to the Industrial Finance Corporation as commitment charges. On 31-12-1973 the Corporation sanctioned a loan of Rs. 15 lakhs to the company for its intended expansion. It has agreed to keep this money ready for the company's use at any time up to 31-12-1975. Moneys actually drawn will bear interest at 9% per annum but money not drawn but kept ready for the company's use will bear a commitment charge of 1%. During 1974 the company did not draw any money as it could not make progress with its expansion programme.

(*c*) Rs. 5,000 spent on the maintenance of a guest house to entertain the company's customers.

(*d*) Rs. 6,000 spent in India on day-to-day entertainment of the company's customers.

(5) Rs. 2,00,000 has been provided for payment of bonus to the company's workers for 1974.

(6) Miscellaneous receipts credited to the profit and loss account include the following :

(*a*) Rs. 5,000 income-tax refund for the assessment year 1973-74.

(*b*) Rs. 450 interest paid by the Income-Tax Department for delaying the issue of the above refund.

(*c*) Rs. 4,500 recovered from a former trade debtor. He originally owed the company Rs. 7,000, but in 1968 the company finding him unable to pay his debt wrote it off as a bad debt. However, the then Income-Tax Officer had estimated an amount of Rs. 3,500 only as irrecoverable and had added back the difference in making the assessment for 1969-70.

(7) The depreciation of Rs. 60,000 debited in the profit and loss account was found to be correctly computed except for the following items :

(*a*) During 1974 the company had built residential quarters for its employees earning less than Rs. 500 per month at a cost of Rs. 2,00,000. It has claimed only the normal depreciation on this amount.

(*b*) It includes Rs. 5,000 depreciation of the guest house.

(*c*) Certain temporary sheds were erected during the year 1974 at a cost of Rs. 20,000 and the company estimated their life at 4 years. Therefore it wrote off Rs. 5,000 and included it in the depreciation schedule.

Explain how you would deal with the above points and then compute the correct total income of the company for the assessment year 1975-76.

The several points will be dealt with in the following manner :

(1) Though this expenditure relates to the share capital of the company, yet certain advantages accrue to its day-to-day business such as getting accommodation from banks etc. Therefore, under executive instructions the fees paid to the stock exchange are an admissible expenditure.

(2) (*a*) Breach of the law is not a normal incident of business. Therefore expenditure connected with it cannot be said to be for business purposes and will be disallowed.

(*b*) The offence committed by the managing director was not in any way connected with the company's business. Hence it will be disallowed.

(*c*) This expenditure is incurred in order to preserve a fixed asset, and will be allowed as a deduction.

(3) This interest on borrowed money is allowable. It is immaterial that the money was borrowed in the past.

(4) (*a*) Borrowing money to run a business, whether it is used for purchasing fixed assets or for current expenditure, is a business purpose and the interest paid will be allowed as a deduction.

(*b*) The commitment charges of Rs. 15,000 are not allowable under section 36(1)(iii), but they are allowable under section 37(1) under executive instructions as per the Supreme Court's decision (*74 ITR 753*).

(*c*) The expenditure of Rs. 5,000 on the maintenance of the guest house is expressly disallowed under section 37.

(*d*) The entertainment expenditure of Rs. 6,000 incurred in India is expressly disallowed under section 37.

(5) Rs. 2,00,000 provided for bonus is really a liability under the Payment of Bonus Act. Assuming that the amount is reasonable it is allowable.

(6) (*a*) Rs. 5,000 income-tax refund is not income liable to tax.
(*b*) Interest of Rs. 450 for delayed refund is income liable to tax.
(*c*) As regards the recovery of bad debt, only Rs. 1,000 is liable to tax as shown below :

		Rs.
(*i*)	Original claim	7,000
(*ii*)	Already allowed	3,500
(*iii*)	Difference	3,500
(*iv*)	Subsequent recovery	4,500

Therefore under section 41(4) only the excess of (*iv*) over (*iii*), namely: Rs. 1,000 is assessable and Rs. 3,500 is to be deleted in the computation.

(7) (*a*) An initial depreciation of Rs. 40,000 (20% of Rs. 2,00,000) is also allowable in respect of residential quarters built for the low-paid staff.

(*b*) Rs. 5,000 depreciation of the guest house will be disallowed as per section 37.

(*c*) The temporary sheds are not entitled to depreciation, but only the cost of their renewal, whenever it takes place, is to be allowed. Therefore Rs. 5,000 depreciation will be disallowed.

Thus, the depreciation allowable will be as follows :

	Rs.
As provided in the accounts	60,000
Add Initial depreciation of residential quarters	40,000
	1,00,000
Less Depreciation of guest house	5,000
	95,000
Less Depreciation of temporary sheds	5,000
	90,000

Computation of Total Income

			Rs.
Net Profits as per return			5,00,000
Add Legal expenses : items (2)(a) and (b)		2,000	
Maintenance of guest house : item (4)(c)		5,000	
Entertainment expenditure : item (4)(d)		6,000	13,000
			5,13,000

Less Income-Tax refund : item (6)(a)	5,000	
Bad debt recovery : item (6)(c)	3,500	
Further depreciation Rs. 90,000 – Rs. 60,000	30,000	38,500
Total Income		4,74,500

(7) In the course of assessment of Bombay Co. Ltd. for the assessment year 1975-76 (previous year ended 31st December 1974), the following points of difference have arisen with the Income-Tax Officer. You are required to indicate the correct treatment in law in respect of such disputed items :

(*a*) The company's Financial Controller had been paid a remuneration of Rs. 50,000. In addition the company had incurred an expenditure of Rs. 20,000 in providing a rent-free (unfurnished) accommodation and Rs. 6,000 in providing a motor-car for his official-cum-personal use. The Income-Tax Officer desires to disallow Rs. 20,000 out of the remuneration and the whole of the expenses on house and car. The company contends that no part of the remuneration could be disallowed and in respect of house and car if at all anything is to be disallowed it should be with reference to value of the perquisite as quantified under Rule 3 in the assessment of the Financial Controller.

(*b*) The company has claimed development rebate amounting to Rs. 80,000 on new additions to plant and machinery. The Income-Tax Officer proposes to disallow the claim on the ground that requisite development rebate reserve has not been created. The company contends that it is not obliged to create the reserve this year in view of the fact that the assessment will result in a loss.

(*c*) The bill collector of the company had defalcated a sum of Rs. 20,000 out of the collections made by him from the constituents. The company claims this amount as a deduction. The Income-Tax Officer contends that defalcation is not incidental to the carrying on of the business of the company and hence not allowable.

(*d*) The company has a brought forward loss of Rs. 25,000 in respect of its ginning business discontinued in the year 1973. The company claims this loss for set-off in the year under assessment. The ginning machinery (written-down value Rs. 20,000) was sold for Rs. 60,000 in 1974 the original cost of which was Rs. 40,000. The Income-Tax Officer wants to tax the entire surplus on sale of ginning machinery as business profits, and at the same time to disallow the loss brought forward of that business.

(*e*) The company had agreed to sell a building for Rs. 3,00,000 in 1974 (purchased for Rs. 1,00,000 in the year 1967) under an agreement dated 1-2-1974. Pursuant to the agreement, the sale price was received in full and possession was also given to the buyer in 1974. The conveyance deed was executed in 1975. The Income-Tax Officer wants to tax the capital gain in the assessment year 1975-76.

(*C. A. Final, Nov. 1973*)

According to law the correct treatment of the disputed items would be as follows :

(*a*) Assuming that the company's financial controller is neither a director nor a substantial shareholder of the company, the Income-Tax Officer cannot disallow his salary and perquisites under section 40(c). He may however do so under section 40A(5), which applies to all employees and which provides as follows :

The maximum remuneration (exclusive of perquisites) of an employee to be allowed as a deduction is Rs. 5,000 per month or part thereof, that is to say, Rs. 60,000 per year for employment in India. Therefore the Income-Tax Officer cannot disallow Rs. 20,000 out of the Rs. 50,000 paid by the company to its financial controller.

The maximum amount of perquisites given to an employee, which is allowable as a deduction, is 20% of the employee's salary or Rs. 1,000 per month or part thereof, whichever is less. The salary for this purpose has the same meaning as for purposes of section 17 except that it does not include perquisites. Assuming that the motor-car is used equally for official and personal purposes, the amount of this perquisite is Rs. 3,000 and the total amount of perquisites is Rs. 20,000 + Rs. 3,000 = Rs. 23,000 and the amount eligible for deduction is Rs. 10,000 being 20% of salary. Therefore the Income-Tax Officer can disallow Rs. 13,000 out of Rs. 23,000.

(*b*) Section 34(3) requires the assessee to create a reserve of an amount equal to 75% of the development rebate *actually allowed*, that is, not of that part of the rebate which, being unabsorbed, is carried forward to a subsequent year. It means that, although the books may show profits, if the assessment results in nil income or loss, there is no obligation on the part of the assessee to create a reserve as a condition for carrying forward the development rebate. The reserve will have to be created in the year in which the unabsorbed development rebate is to be allowed. Therefore the Income-Tax Officer is not justified in disallowing the company's claim to carry forward the development rebate.

(*c*) The company's claim that the loss of Rs. 20,000 caused by the bill collector's defalcation is a trading loss is correct. In business it is necessary to employ subordinates, to entrust them with various duties including collection of money and to repose confidence in them. If an employee, whose duty is to collect moneys, embezzles some of the moneys collected, the loss is a trading loss and is allowable as a deduction. The Income-Tax Officer's contention is not correct.

(*d*) Under section 41(2), when any machinery used for business purposes is sold in the previous year, the profit (if any) resulting from its sale is to be dealt with as follows, even if the business for which the machinery was used was no longer in existence in that year :

1. The excess of sale proceeds over the cost of machinery sold is capital profit to be taxed under the head "Capital Gains".
2. The exceses of the cost of machinery sold over its written-down value is chargeable as income of the business of the previous year in which the machinery is sold.

According to section 72, the unabsorbed loss of a defunct business becomes a capital loss and cannot be carried forward for future set-off. But section 41(5) specifically provides that in cases where a receipt is deemed to be the income from business after the business has ceased to exist, any unabsorbed loss which arose in that business during the previous year in which it ceased to exist, may be set off against the deemed business income.

In this case Rs. 20,000 (excess of sale proceeds over the cost of machinery sold) is a capital gain ; while Rs. 20,000 (excess of cost over the written-down value) is deemed income from business.

There is an unabsorbed loss of Rs. 25,000 which arose in the year 1973 when the ginning business was discontinued. Rs. 20,000 out of this Rs. 25,000 will be set off against the deemed business income, and the balance of Rs. 5,000 will become capital loss.

Thus only Rs. 20,000 capital gain will be taxed in the hands of the company, there being no deemed business income.

(*e*) A capital gain arises on the date on which the title to property transferred passes to the buyer. Title to movable property passes to the buyer according to the provisions of the Indian Sale of Goods Act ; whereas title to immovable property passes to the buyer when the sale deed has been duly registered. In this case the conveyance deed was registered in the previous year 1975 and the capital gain arose in that year. It is immaterial that the sale price was received in full and the possession of the property was given to the buyer in 1974.

Therefore the capital gain will be taxed in the aesessment year 1976-77 and not in 1975-76. What the Income-Tax Officer wants to do is wrong.

(8) The Profit and Loss Account of Sidharth Electronics Ltd., an Indian company, engaged in the business of manufacture of radios (non-priority industry) for the year ended 31st March 1975 showed a profit of Rs. 1,50,000. A scrutiny of the profit and loss account and balance sheet revealed the following :

(*a*) A sum of Rs. 20,000 being the tax on the salary of a technician (whose terms of employment are approved by the Central Government) has been debited to the accounts.

(*b*) The company had sold an immovable property for Rs. 3,00,000, purchased in the year 1966 for Rs. 2,00,000 and the surplus was taken to the capital reserve.

(*c*) A sum of Rs. 20,000 was debited to the profit and loss account, being the penalty imposed by the Customs authorities for infringement of Import Control Regulations.

(*d*) The comany had given a donation of Rs. 25,000 to the Prime Minister's Drought Relief Fund.

(*e*) The W. D. V. of plant and machinery as at 1-4-1974 was Rs. 7,50,000. Addition of new plant and machinery to the extent of Rs. 1,60,000 was made on 28-5-1974. The rate of depreciation applicable to the machinery is 15%. Depreciation debited in the accounts was Rs. 75,000 while development rebate of Rs. 18,000 had been debited in the profit and loss account and credited to development rebate reserve.

(*f*) The company had received dividends from other Indian companies amounting to Rs. 40,000 (net). The tax deducted at source was Rs. 12,000. 20% of the dividends was out of profits exempted under section 80J.

(*g*) The company had borrowed a sum of Rs. 10 lakhs for investment in the shares of a new company which has still not paid any dividend. Interest of Rs. 1,00,000 on the loan is debited in the accounts.

Compute the total income of the company for the assessment year 1975-76. Indicate in separate notes wherever necessary your reasons for inclusion or disallowance of the relevant items. Tax need not be worked out. *(C. A. Final, May 1974)*

Company's total income for assessment year 1975-76

			Rs.
1.	Business Profits :		
	Profit as per Profit and Loss Account		1,50,000
	Less Dividends considered separately		40,000
			1,10,000
	Add Penalty for infringement of Import Control Regulations not being incurred for business purposes	20,000	
	Donation to Prime Minister's D. R. Fund, the appropriate deduction to be allowed	25,000	
	Depreciation charged, the allowable amount being deducted	75,000	
	Amount transferred to development rebate reserve, the rebate due to be allowed	18,000	1,38,000
			2,48,000
	Less Depreciation at 15% on Rs. 7,50,000 + Rs. 1,60,000 = Rs. 9,10,000	1,36,500	
	Development rebate at 15% on Rs. 1,60,000	24,000	1,60,500
			87,500

2.	Capital Gains (Long-term from the sale of immovable property) being Rs. 3,00,000 – Rs. 2,00,000		1,00,000
3.	Other Sources :		
	Dividends from Indian companies gross (Rs. 40,000 + Rs. 12,000)		52,000
	Gross Total Income		2,39,500
	Deductions :		
	Under section 80G : 50% of donation to Prime Minister's D. R. Fund	12,500	
	Under section 80K : 20% of Rs. 52,000	10,400	
	Under section 80M : 60% of Rs. 41,600 (Rs. 52,000 – Rs. 10,400 deducted under section 80K)	24,960	47,860
	Total Income		1,91,640

Notes :

1. Under section 10(6) (viia), the company is authorised to pay the tax on the salary of the technician (assumed to be foreign technician) in excess of Rs. 4,000 per month for 24 months from the date of his arrival in India. The tax so paid is part of the salary of the technician and is an admissible deduction under section 37.
2. There is a long-term capital gain of Rs. 1,00,000 on the sale of immovable property, but as it is not included in the profit and loss account it will be added in computing the total income.
3. Development rebate at 15% is allowed on the new plant and machinery as 75% of the rebate due has been transferred to development rebate reserve.
4. The interest of Rs. 1,00,000 on the loan taken to purchase investment is an allowable deduction because it is not necessary that there should be income received from the investment.
5. Assuming the company to be widely-held, the income-tax payable by it for the assessment year 1975-76 will be as follows :

   (*a*) at 47% on the amount of long-term capital gain of Rs. 1,00,000 relating to land and buildings because the total income of the company as reduced by the amount of Rs. 1,00,000 does not exceed Rs. 1,00,000 *plus*

   (*b*) at 50% on Rs. 91,640 being the balance of total income, as the total income exceeds Rs. 1,00,000, the tax so calculated being increased by a surcharge of 5% of such tax.

   From the amount of tax so calculated a deduction of Rs. 12,000 (tax deducted at source from dividends) will be allowed.

6. It is assumed that the new plant and machinery was installed before 31-5-74.

CHAPTER 26

Assessment of Co-operative Societies

Co-operative societies enjoy a privileged position under the Income-Tax Act, for it has been the Government's policy to encourage and promote certain types of co-operative activities.

According to section 2(19), a co-operative society means a co-operative society registered under the Co-operative Societies Act of 1912 or under any State law for the registration of co-operative societies.

Under section 80P, an "urban consumers' co-operative society" means a society for the benefit of consumers within the limits of a municipal corporation, municipality, municipal committee, notified area committee, town area or cantonment.

The income of a co-operative society, like that of any other assessee, is to be computed according to the provisions of the Income-Tax Act.

Deductions in Computing Total Income.

Under section 80P, the following incomes of a co-operative society (including a co-operative society carrying on insurance business), which are included in its gross total income, are to be deducted in computing its total income to the extent indicated against each :

(1) The whole of income derived from the following business carried on by a co-operative society :

(*a*) Banking or providing credit facilities to its members.
(*b*) A cottage industry.
(*c*) Marketing of the agricultural produce of its members.
(*d*) Purchase of agriculture implements, livestock or other articles intended for agriculture for the purpose of supplying them to its members.
(*e*) Processing, without the aid of power, of the agricultural produce of its members.
(*f*) Supplying milk raised by its members to a federal milk co-operative society.
(*g*) Labour Co-operative Societies.
(*h*) Co-operative societies engaged in fishing and other allied pursuits.

In the last two cases the tax concession will be available only if the bye-laws of the societies restrict the voting rights to members, the State Government and the co-operative credit societies which provide financial assistance to them.

(2) Rs. 20,000 of the profit derived from business by any society which is engaged in activities other than those mentioned in (1) above.

Where the assessee is also entitled to the deduction under section 80H or section 80HH or section 80J, the deduction under section 80P is to be allowed with reference to the income if any, included in the gross total income as reduced by the deductions under section 80H, section 80HH and section 80J.

The deduction in respect of business profits is not restricted to profits from business with members but extends to profits from any business carried on by a co-operative society under the authority of law (*44 ITR 421*). The interest earned by a banking co-operative society on deposits made out of its surplus funds is part of the profits of its banking business (*39 ITR 114*).

(3) The whole of the income by way of interest or dividends from its investments in other co-operative societies.

(4) The whole of income derived by a co-operative society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities.

(5) The whole amount of interest on securities or income from house property of a co-operative society, provided the following conditions are satisfied :

(*a*) The gross total income of the society does not exceed Rs. 20,000.
(*b*) It is not a housing society or an urban consumer's society or a society carrying on transport business.
(*c*) It is not a society engaged in the performance of any manufacturing operations with the aid of power.

As regards co-operative housing societies, section 27(iii) provides another type of concession, namely : it is the individual member to whom a house has been allotted by the society who is liable to pay tax on the income from the house property, even though the legal ownership of the house may be retained by the society for the time being.

Period of Tax-holiday.

Under section 80J, there is a five-year period of tax-holiday in the case of new industrial undertakings or ships or hotel business. But this period of tax-holiday is seven years in the case of a new industrial undertaking run by a co-operative society.

Rates of Income-Tax.

In the case of a co-operative society, the rates of income-tax for the assessment year 1975-76 are as follows :

(1) On the first Rs. 10,000 of total income	15%
(2) On the next Rs. 10,000 of total income.	25%
(3) On the balance of total income.	40%

Surcharge or Income-Tax. The amount of income-tax computed at the above rates is to be increased by a surcharge of 10% thereof.

A co-operative society has to pay income-tax on the whole of its total income, whatever its amount may be. The exemption limit of Rs. 5,000 does not apply to it.

Illustrations

(1) The Manager of Bharat Co-operative Sugar Mill Ltd. has written to you seeking your advice regarding the income-tax liability of the co-operative society owning the sugar mill. Write a letter in reply giving your advice.

Meerut, 15th April 1975

The Manager,
Bharat Co-operative Sugar Mill Ltd.

Dear Sir,

I have received your letter of the 12th April 1975 seeking my advice in regard to the income-tax liability of your co-operative society named 'Bharat Co-operative Sugar Mill Ltd'. In reply, I have to state as follows :

1. The income of your society derived from different sources will be computed in accordance with the provisions of the Income-Tax Act, 1961. But the following incomes, though included in the gross total income of your society, will be allowed as deductions in computing the total income :

(*a*) Rs. 20,000 of profits from sugar manufacturing business.
(*b*) The whole amount of interest and dividends earned by your society from its investments in other co-operative societies.
(*c*) The whole of income derived by your society from the letting of godowns or warehouses for storage, processing or marketing of commodities.

2. As your society is engaged in manufacturing operations with the aid of power, no deduction will be allowed in computing the total income in respect of its income from interest on securities or income from house property.

3. Under section 80J, a new industrial undertaking run by a co-operative society enjoys a seven-year period of tax-holiday. That is to say, for seven assessment years (beginning with the assessment year relevant to the previous year in which the manufacturing operations started) the profits of the industrial undertaking up to 6% per annum of the capital employed are allowed as a deduction in computing the total income.

Should you require any further information, I shall be glad to furnish it on hearing from you.

Yours faithfully,
.....
Chartered Accountant

(2) The Ramnagar Urban Consumers' Co-operative Society Ltd., Delhi, derived the following incomes in the year ended 31st December 1974 :

			Rs.
(*a*)	Income from business		19,000
(*b*)	Dividend (Net after deduction of income tax at 23%) on shares held in Bombay Textiles Ltd.		2,310
(*c*)	Interest on fixed deposits with :		
	(1) Ramnagar Co-operative Society carrying on banking business	1,000	
	(2) Allahabad Bank, Delhi	2,000	3,000
(*d*)	Rent in Respect of half portion of building owned by the society and let out to an outsider, the other half being used for the society's own business		3,600

The following expenses incurred for the entire building were deducted in arriving at the income from business at (*a*) above :

	Rs.
Municipal Taxes	400
Ground Rent	200
Insurance	400

Compute the total income of the society for the assessment year 1975-76 giving briefly the reasons for your answer.

			Rs.	Rs.
1.	Business :			
	Net Profit as per Profit and Loss Account			91,000
	Add Proportionate expenses relating to that part of the society's building which is let out :			
	Municipal Taxes		200	
	Ground Rent		100	
	Insurance		200	500
				19,500
2.	Property :			
	Annual value being rent received		3,600	
	Less Municipal taxes applicable to portion let out		200	
	Annual value in this case		3,400	
	Less One-sixth of repairs	567		
	Ground Rent (one-half)	100		
	Insurance (one-half)	200	867	2,533
3.	Other Sources :			
	Dividend gross		3,000	
	Interest on fixed deposits :			
	From R. Co-operative society		1,000	
	From Allahabad Bank		2,000	6,000
	Gross Total Income			28,033
	Deduction under section 80P :			
	Business Profit		19,500	
	Interest on deposit with Ramnagar Co-operative Society		1,000	20,500
	Total Income			7,533
	Rounded off			7,530

CHAPTER 27

Assessment of Charitable And Religious Trusts

The law governing the taxation of charitable and religious trusts and institutions is contained in sections 2 (41), 11, 12, 13, 160-165 and 236A.

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. To put it briefly, in a trust a person transfers his property to another person for the benefit of certain specified persons. The person who creates the trust is called the author of the trust ; the person to whom the property is transferred in trust is known as trustee ; the person for whose benefit the trust is created are the beneficiaries; and the subject matter of the trust is called trust property. The author of a trust can be a trustee as well as a beneficiary.

For purposes of taxation, a trust includes any other legal obligation such as a Muslim wakf or Hindu endowment.

A wakf means the permanent dedication (setting apart) by a Muslim of any property for any purposes recognised by the Mohammedan law as religious, pious or charitable. Under section 3 of the Musalman Wakf Validating Act, 1913, power is given to create certain wakfs for the maintenance and support of the settler's family, children or dependants, provided the ultimate benefit is reserved for charitable purposes. A private wakf for the benefit of the settler's family and dependants is known as 'wakful-aulad'. The definition of wakf, as given in section 2 (e) of the Musalman Wakf Act, 1923, includes all wakfs which may be regarded as public wakfs for the immediate appropriation to charity. It is, however, not necessary that there should be a dedication for charitable purposes of the entire property in order that the dedication may be deemed a wakf. A wakf may be partly a public wakf and partly a private wakf.

A Hindu, endowment means wealth (whether in the form of money, produce of land, movable property or immovable property) set apart permanently for any object or purpose. Thus, a religious endowment means property dedicated or set apart permanently for religious purposes. It is not necessary that an endowment should be created through the medium of a trust only. All that is required is a clear specification of the purpose and the dedication of property for that purpose.

Private and Public Trusts. The distinction between a private and a public trust is that whereas in the former the beneficiaries are specific individuals, in the latter they are general public or a class thereof. While in the

former the beneficiaries are persons who are ascertained or are capable of being ascertained, in the latter they constitute a body which is incapable of ascertainment.

Charitable Trusts.

The universal rule is that the law recognises no purpose as charitable unless it is of a public character. That is to say, a purpose must, in order to be charitable, be directed to the benefit of the community or a section of the community and not to the benefit of particular private individuals. There can be no such things as a private charitable trust.

Charitable Purposes.

Section 2(15) defines charitable purposes as including relief of the poor, education, medical relief and the advancement of any other object of general public utility not involving the carrying on of any activity for profit. This definition is inclusive and not exhaustive or exclusive.

Relief of the Poor. The relief, in order to be charitable, need not be given in the form of alms to the poor, it may be in the form of wages for work done by the beneficiaries. The relief may be of the poor generally or of a section of the poor public. Relief of a group of private individuals like poor relations of the donor would not amount to a charitable purpose.

Education. Property held for the promotion of education, literature, science or the fine arts is held for a charitable purpose. This is so even if the education is not for the poor only but might extend to the rich.

Medical Relief. This does not mean free treatment for all patients. A hospital may be established for a charitable purpose although it runs special wards for patients who pay a full price.

An Other Object of General Public Utility. These are very wide words. Their exact scope has not yet been defined. They would exclude the object of private gain such as an undertaking for commercial profit, though the undertaking may be of general public utility. These words include all objects of general public utility in the category of charitable purpose except those involving the carrying on of any activity for profit.

Where the purpose of the trust is relief of the poor, education or Medical relief, it would be a charitable purpose although the achievement of that purpose may involve the carrying on of an activity for profit. This is because the words "not involving the carrying on of an activity for profit" do not qualify these three heads of charitable purposes.

Religious Purposes.

Gifts for public religious purposes are *prima facie* gifts for charitable purposes. However, sections 11, 12 and 13 make a distinction between charitable and religious trusts. Religious purposes (which are not defined) would include the advancement, support or propagation of a religion and its tenets.

A charitable trust must always be public, but a religious trust may be private or public. The exemption granted by section 11 is confined to public religious trusts and does not extend to private religious trusts which do not ensure for the public benefit.

The income of a public religious trust or institution is entitled to exemption even though it may be for the benefit of a particular religious community or caste—section 13(b)(i).

Creation of Charitable or Religious Trusts.

No formal deed nor any other writing is necessary to constitute a charitable or religious trust, still less to constitute a 'legal obligation' binding

on the person holding the property. So long as there is a clear and unequivocal manifestation of intention to create a charitable or religious trust and there is a formal divesting of the ownership of the property on the part of the donor and vesting of the same in another or even in the donor himself as a trustee, the dedication is complete.

Although the Indian Trusts Act does not apply to charitable trusts, it is clear that the three certainties there described are required to create a charitable trust. They are : (*i*) a declaration of trust which is binding on the settler ; (*ii*) setting apart definite property and the settler depriving himself of the ownership thereof ; and (*iii*) a statement of the objects for which the property is thereafter to be held.

An allocation of definite property or fund is essential for creating a valid charitable trust as well as for effecting an endowment. Merely making an entry in the donor's own account books to the credit of a charity or a temple, without setting aside or appropriating the sum credited, does not create an endowment or a trust or any other legal obligation.

TAX EXEMPTION FOR TRUSTS AND INSTITUTIONS

Sections 11 and 12 (read with sections 12A and 13) provide for exemption from tax of (*i*) income derived from property held under trust or any other legal obligation for charitable and religious purposes and (*ii*) income derived from voluntary contributions by charitable and religious trusts and institutions.

Income derived from property held under trust.

Under section 11, subject to the provisions of sections 60-63, the income derived from property by a charitable or public religious trust is to be excluded from the total income of trust.

Sections 60—63 merely shift the tax liability from the beneficiary on to the settler ; they do not charge income which is exempt from tax under any other provision of the Income-Tax Act. Therefore, after the income is deemed to be the settler's income under these sections, the question of exemption under section 11 would apparently still survive (*Kanga & Palkhivala, Income-Tax ; 6th Edition p. 245*).

The exemption of income under section 11 is subject to the following conditions, namely :

(1) The property from which the income is derived must be held under trust or other legal obligation such as a Muslim wakf or a Hindu endowment. The property itself should be made the subject of a trust and the income should arise from such property.

The word "property" is a word of very wide import and it signifies every interest which a person can acquire, hold and enjoy. Property includes a business or a partner's share in a partnership business. However, where the trust property consists of a business, any excess of the profits computed in accordance with the provisions of the Income-Tax Act over the profits shown in the business accounts would be regarded as income applied to non-charitable purposes and would be taxable accordingly.

(2) The income from property held under trust *wholly* (or *partly* in the case of a trust created before 1-4-1962) will be exempt from tax only to the extent such income is actually applied to the purposes of the trust in India during the year in which it arises or within three months of the expiry thereof. The remainder of the income which is accumulated will be charged to tax in the hands of the trustees at rates applicable to an association of persons.

Accumulation of Income. However it is open to the trustees to accumulate a part of the income for a specific period not exceeding ten years and for a specific purpose (say, for the construction of a school or hospital

building), provided they give due notice to the Income-Tax Officer both of the specific purpose and of the period of accumulation and the money so accumulated is invested as follows :

(*a*) Invested in Government securities or other approved securities.

(*b*) Deposited with post-office savings bank or any bank or a co-operative society carrying on banking business.

(*c*) Deposited with an approved financial corporation.

But in the event of the following defaults the income so accumulated shall be deemed to be the income of the trustees of the previous year in which the default takes place :

(*a*) It is applied to purposes other than charitable or religious purposes.

(*b*) It ceases to remain invested or deposited as stated above.

(*c*) It is not utilised for the purpose for which it is accumulated during the 10-year period or in the year immediately following the expiry thereof.

Note : In a case 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 gains arising from the transfer will be regarded as having been applied to charitable or religious purposes.

Income from voluntary contributions.

The voluntary contributions mean money gifted, given gratuitously without consideration, *e. g.*, donations to a school or offerings to an idol or a deity. They do not include annual subscriptions paid for value received or expected to be received by the party paying.

Under section 12, any voluntary contributions received by a trust created wholly for charitable or religious purposes or by an institution established wholly for such purposes, shall be regarded as income derived from property held under trust wholly for charitable or religious purposes. But contributions made with a specific direction that they shall form part of the corpus of the trust or institution will not be treated as income derived from property.

The voluntary contributions received by a trust or institution will qualify for exemption from income-tax only if the conditions specified in section 11 regarding application of income or accumulation thereof are satisfied.

Conditions for exemption.

Section 12A, provides that exemption from income-tax in respect of income derived from property or by way of voluntary contributions by charitable or religious trusts and institutions will be available *only* if the following conditions are fulfilled :

(*i*) The person in receipt of the income makes an application for registration of the trust or the institution to the Commissioner of Income-Tax before 1st July 1973 or before the expiry of a period of one year from the date of the creation of the trust or the establishment of the institution, whichever is later. The Commissioner of Income-Tax is however empowered to admit, in his discretion belated applications for registration in deserving cases.

(*ii*) Where the total income of the trust or institution (without giving effect to the provisions of sections 11 and 12) exceeds Rs. 25,000 in any previous year, the accounts of the trust or institution for that year have been audited by a chartered accountant or a certified auditor, and the person in receipt of the income furnishes along with the return of income the report of such audit

in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed.

Forfeiture of Exemption.

According to section 13, the tax exemption available under sections 11 and 12 is to be forfeited in the following circumstances :

(1) Where any part of the income derived from property or from voluntary contributions by a private religious trust does not enure for the benefit of the public.

(2) Where any income of a charitable trust or institution created or established after 31-3-1962 is for the benefit of any particular religious community or caste. A trust or institution created or established for the benefit of scheduled castes, backward classes, scheduled tribes or women and children of a particular religious community or caste, are not hit by this provision.

A charitable trust or institution created or established before 1-4-1962 is entitled to exemption even if it is for the benefit of any particular religious community or caste.

(3) Where, in the case of a trust or institution created or established after 31-3-1962, under the terms of the trust or the rules governing the institution, any part of the trust income *enures* for the direct or indirect benefit of the author of the trust or founder of the institution or certain persons connected with them as stated below.

Where, in the case of a trust or institution (whenever created or established), *any part of the trust income or any property is used or applied* during the relevant year for the direct or indirect benefit of the persons referred to above. But this disability will not apply in the case of a trust or institution created or established prior to 1-4-1962 if the use of trust income or property is in accordance with a mandatory provision in the terms of the trust or the rules governing the institution.

The trust income or property will be regarded as having been used or applied for the benefit of certain specified persons if the trust or institution engages in certain categories of transactions. These transactions are as follows :

(*a*) Lending of the income and property of the trust or institution to any one of the specified persons without adequate security or adequate interest or both.

(*b*) Making available land, building or other property of the trust or institution for the use of any of the specified persons, without charging adequate rent or other compensation.

(*c*) Payment of excessive remuneration to any of the specified persons for *services* rendered by him to the trust or institution.

(*d*) Making the services of the trust or institution available to any of the specified persons without adequate remuneration or other compensation.

(*e*) Purchase of shares, securities or other properties for the trust or institution from any of the specified persons for more than adequate consideration.

(*f*) Sale of shares, securities or other properties of the trust or institution to any of the specified persons for less than adequate consideration.

(*g*) Diversion of a portion of the income or property of the trust or institution in favour of any of the specified persons where the aggregate of the income or property exceeds Rs. 1,000.

(*h*) Investment of the trust funds in any concern in which any of the specified persons has a substantial interest.

The persons specified for the purposes of the above-mentioned transactions are :

(*a*) The author of the trust or the founder of the institution.

(*b*) Any person who has made a substantial contribution to the trust or institution.

(*c*) Where such author, founder or person is a Hindu undivided family, any member of the family.

(*cc*) Any trustee of the trust or manager (by whatever name called) of the institution.

(*d*) Any relative of any such author, founder, person or member.

(*e*) Any concern in which any of the above-mentioned persons has a substantial interest.

A person will be regarded as having a substantial interest in a concern in the following circumstances :

(*a*) In a case where the concern is a company, equity shares in the company carrying not less than 20 per cent of the voting power are beneficially owned by such person or partly by him and partly by other such persons.

(*b*) In any other case, where such person is entitled or such person and one or more of other such persons are entitled in the aggregate to not less than 20 per cent of the profits of the concern.

Where the trust funds are invested in any concern in which any of the specified persons has a substantial interest, and the quantum of the investment does not exceed 5 per cent of the capital of the concern, the trust or institution will lose the exemption from tax only in respect of the income arising from such investment.

Relative. For the purposes of sections 11, 12, 12A and 13, the term 'relative' in relation to an individual means :

(*i*) spouse of the individual,
(*ii*) brother or sister of the individual,
(*iii*) brother or sister of the spouse of the individual,
(*iv*) any lineal ascendant or descendant of the individual,
(*v*) any lineal ascendant or descendant of the spouse of the individual,
(*vi*) spouse of a person referred to in (*ii*), (*iii*), (*iv*) and (*v*) above, and
(*vii*) any lineal descendant or a brother or sister of either the individual or of the spouse of the individual.

Assessment of Trusts

In the case of a trust (whether public or private, charitable or religious) whose income is not exempt under section 11 or 12 or becomes assessable on the transferor under sections 60—63, the income is assessed on the trustee, manager or other person concerned like any other assessee. The machinery for such assessment is provided by sections 160—165. It is a representative assessment and this special machinery is to facilitate the collection of tax. The representative (trustee, manager or other person) is taxed on the ground that he receives or is entitled to receive the income on behalf of and for the benefit of beneficiaries. The liability of the representative is co-extensive with that of the beneficiary. But it is open to the Income-Tax Officer to tax the beneficiaries directly. If a person is a trustee of several beneficiaries, separate assessment will be made on the trustee in respect of the income of each beneficiary.

Return of Income. Section 139 (4A) provides that the trustees of a charitable or religious trust or the manager of an institution shall, if the income of the trust or institution (before making any deduction under sections 11 and 12) exceeds the minimum taxable limit, be bound in law to file

voluntarily the return of income of the trust or institution within the time allowed under section 139(1) accompanied by such particulars as may be prescribed. In other respects such a return will be treated as if it were a return under section 139(1).

Rates of Tax. Under section 164, tax is leviable on and recoverable from the trustees or manager at the flat rate of 65% or at rates applicable to the total income as if it were the total income of an association of persons, whichever course is more advantageous to revenue. But in the following cases the flat rate of 65% will not apply and the income will be chargeable to tax as if it were the total income of an association of persons :

(1) Where none of the beneficiaries has any other income chargeable to income tax.

(2) Where the income is receivable under a trust declared by will.

(3) Where the trust was created by a non-testamentary instrument before 1-3-1970 and the Income-Tax Officer is satisfied that the trust was created *bona fide* exclusively for the benefit of the relatives of the settler or where the settler is a Hindu undivided family for the benefit of the members of such family in circumstances where such relatives or members are mainly dependent on the settler for their support and maintenance.

Where a part of the income is specifically receivable on behalf of any one person or on behalf of beneficiaries whose individual shares are determinate and known, and the other part of the income is not so receivable, it is only the latter part of the income which is liable to tax on the basis laid down in section 164.

Under section 165, where part only of the trust income is chargeable to tax, the beneficiary's share of the income should be taken to be derived proportionately from the chargeable and non-chargeable portions of the trust income and should be assessed accordingly in the hands of the trustee.

Relief under Section 236A. A charitable institution or fund holding shares in a company and receiving a dividend on equity shares from the company is entitled to a credit in its assessment for a proportionate amount of the tax payable by the company in respect of the dividend on equity capital declared or distributed by it during the previous year relevant to the assessment year 1966-67 and onwards.

In order to be eligible for this tax relief, the institution or fund must satisfy the following conditions :

(*a*) It must be established in India for a charitable purpose and its income from dividend must be exempt under section 11.

(*b*) It must have held beneficially at least 75% of the share capital of the company throughout the previous year.

Political Parties

Since political purpose is not a charitable purpose, income derived by political parties (such as the Indian National Congress, the All-India Hindu Mahasabha, etc.) are not exempt from income-tax.

Donations and subscriptions received by political parties are exempt as they are capital or casual receipts, but income from investments and property derived by them is subject to income-tax.

A political party would be assessed as an association of persons.

Exempt Trusts and Institutions

As already explained in an earlier chapter dealing with the computation of total income, under section 10 complete exemption is granted to the following

trusts and institutions, and the provisions of sections 11-13 do not apply to them :

1. A scientific research association—section 10(21).
2. Any university or other educational institution—section 10(22).
3. A hospital or other similar institution—section 10(22A).
4. An association for regulation of games and sports—section 10(23).
5. Any recognised association for control of the profession of law, medicine, accountancy, engineering, architecture etc.—section 10(23A).
6. A trade union registered under the Trade Unions Act—section 10(24).
7. A recognised provident fund or approved superannuation fund or an approved gratuity fund—section 10(25).

It is not necessary for such organisations to apply their income to the objects of the trust within the time-limit mentioned in section 11 or to get themselves registered with the Commissioner of Income-Tax or to get their accounts audited. The restrictions laid down in section 13 against investments in prohibited concerns or use of their funds for the benefit of certain privileged persons do not apply to them.

CHAPTER 28

Assessment of Insurance Business

The taxable income of an insurance company is not computed in accordance with the provisions of sections 30-43A, but it is computed in accordance with the rules set out in the first Schedule to the Income-Tax Act, 1961.

Life insurance business in India is now carried on by a State-owned corporation called the Life Insurance Corporation of India, which is liable to tax.

Life Insurance Business

The taxable income of a life insurance business is computed either on the basis of its investment income or on the basis of its valuation surplus. It is considered that the computation of the profits on the basis of the valuation report is the most reliable method of computation in the case of a life insurance company, whereas the amount of interest earned on investment is not by itself a reliable datum for such ascertainment. The investment income can, of course, be easily ascertained but there are different views as to the deductions that should be allowed therefrom in ascertaining the assessable income.

According to Rule 2 of the Schedule, the profits of a life insurance business are taken to be either of the following amounts whichever is greater :

(*a*) The gross external incomings of the preceding year less management expenses of the preceding year ; or

(*b*) The adjusted annual average actuarial surplus of the last valuation period ending before the assessment year.

Gross External Incomings Basis. This is the investment income basis. In computing the taxable income on this basis, the following provisions must be taken into account :

1. "Gross external incomings" mean all earnings from interest, dividends, fine and fees, from whatever source derived except premiums and profits on the sale of investments and other assets. Any income from house property should be computed in accordance with the provisions of sections 24. The use of the term 'incomings' as distinguished from the term 'income' might perhaps suggest that even non-revenue receipts are to be included in gross external earnings, but the further qualification 'from whatever source derived,' would indicate that incoming must be from some definite source. Hence, the receipts to be included in gross external incomings must be of a revenue nature.

2. "Preceding year" means that year for which annual accounts are required to be prepared under the Insurance Act of 1938 immediately preceding the financial year for which the assessment is to be made.

3. "Management expenses" means the full amount of expenses (including commissions) incurred exclusively for life insurance business.

Bonuses to policy-holders, depreciation of and losses on the sale of securities and other assets and any other expenditure which cannot be allowed

under sections 30-43A are not management expenses. Moreover the maximum amount of management expenses admissible is restricted to the total of the following :

(*a*) An amount equal to 7½% of the first year's premiums received on single premium policies ; plus

(*b*) An amount equal to the product of 7½% of the first year's premiums received on policies whose duration is less than 12 years multiplied by the number of years of each policy ; plus

(*c*) An amount equal to 90% of the first year's premiums received on all other life policies ; plus

(*d*) The maximum amount which can be allowed as management expenses in respect of renewal premiums in such percentage as is admissible under the Insurance Act of 1938. This should enable new companies with small business to get management expenses up to a maximum of 20 per cent of the renewal premiums.

The aggregate of the above four amounts is the maximum figure of expenses allowed to be deducted. If the actual expenses fall short, it is only such lesser amount that can be deducted from the gross external incomings. After deducting the allowable management expenses the balance of gross external incomings is the assessable profit of the life insurance business.

This is one method of ascertaining the taxable profits of a life insurance company and should be available even from the second year of the working of the company and even before the first actuarial has taken place.

Actuarial Surplus Basis. This is the other alternative method of ascertaining the assessable profits of a life insurance company. Actuarial valuation means actuarial valuation made in accordance with the Insurance Act of 1938 in respect of the last intervaluation period. In computing the taxable income on this basis the actuarial surplus is to be adjusted as follows :

1. Any expenditure which cannot be allowed under sections 30-43A must be disallowed.

2. The deficit or unappropriated surplus of any period preceding the intervaluation period under consideration must be excluded from the deficit or surplus shown in the actuarial valuation balance sheet on the last day of the intervaluation period.

3. Four-fifth of the amount paid to or reserved for or expended on behalf of policy-holders should be allowed as a deduction.

4. Any amount written off or reserved in the accounts on account of the depreciation of or loss on sale of securities and other assets is to be allowed as a deduction. This is a mandatory provision. The option is of the assessee either to write off or to carry to reserve. The reserve created must be equivalent to the amount of depreciation or loss but no more. This is a peculiar provision of the law. Ordinarily in computing business profits for tax purposes sums placed to reserve are not permissible deductions. It may be justified on the ground that a life insurance company is bound by law to invest a certain portion of its life fund in specified securities, whereas in other businesses no such restriction prevails.

5. Any sum taken credit for in the accounts on account of appreciation of and profit on sale of securities and other assets should be added to the actuarial surplus.

The interest received during the intervaluation period in respect of tax-free securities issued by the Central Government (but not those issued by a State Government) shall not be excluded but, the assessee shall be entitled to a deduction from the amount of income-tax with which he is chargeable on his total income of an amount calculated at 27·5% on the annual average of the amount of such interest.

6. A great portion of the income of a life insurance company is derived from interest and dividends from which income-tax is deducted at source and otherwise paid. Therefore, the whole amount of income-tax so deducted or paid during the intervaluation period must be added back to the actuarial surplus, because the actuarial surplus is arrived at on the basis of the income from interest and dividends.

Where the actuarial surplus has been adjusted in the manner outlined above it is divided by the number of years included in the intervaluation period and the result is then the adjusted annual average surplus, which is the profit on which tax will have to be levied for the next few years till the next valuation takes place. Though the quantum of profit is fixed in this way, the rates of tax may vary according to the annual Finance Act of each year.

If the intervaluation period exceeds 12 months, credit will be given (against the gross tax computed on the annual average surplus) for the amount of the annual average income-tax deducted at source or paid otherwise during the said intervaluation period.

It must, however, be noted that whereas the annual average surplus is a constant figure during an intervaluation period, the gross external incomings minus expenses may vary from year to year during this period and be higher or lower than the annual average surplus. Therefore for each assessment year a computation of profit on each of the above, two bases will have to be made in order to ascertain the higher figure of income to be taxed.

Rates of Tax.

For the assessment year 1975-76 the Life Insurance Corporation of India is required to pay tax at the following rates :

(*i*) On that part of its total income which consists of profits from life insurance business, at 52·5%.

(*ii*) On the balance (if any) of the total income, at the rate of tax applicable to the total income of a domestic company in which the public are substantially interested.

There is a surcharge of 5% on income-tax calculated in the above manner.

Non-life Insurance Business

As regards non-life insurance business (fire, marine, motor-car, burglary etc.) the profit disclosed in the annual accounts prescribed under the Insurance Act, 1938, after adjustment on account of expenses not admissible under sections 30-43A are to be treated as income for assessment purposes. Profits and losses on the realisation of investments and depreciation and appreciation in the value of investments are to be taken into account.

In dealing with non-life insurance business, a fair and proper reserve (including any additional reserve) for unexpired risks is to be allowed with proper safeguard to prevent manipulation of accounts. The amount of reserve which is admissible for this purpose is 100% of the year's premium income in the case of marine insurance business and 50% of the year's premium income in the case of other kinds of general insurance business such as fire, motor, etc.

Foreign Insurance Business

The taxable income of the Indian branches of non-resident foreign insurance companies doing non-life insurance business in India is taken to be the proportion of the total world income corresponding to the proportion which their Indian premium income bears to their total premium income. The total world income is computed for this purpose in the same manner as the total income of a resident insurance company as explained above.

Chapter 29

Assessment of Non-residents

It must be noted at the outset that a resident is not necessarily an Indian national nor a non-resident necessarily a foreigner. However, for practical purposes, most of the foreigners who visit India would come under the category of non-residents owing to the fact that they may not fulfil the necessary conditions required to make a person resident.

Non-resident foreigners are either casual visitors or those with more permanent interest *i.e.*, those having income-earning ties with India. Tourists and members of various foreign delegations who visit India are casual visitors. Their stay in India in most cases would not exceed the six months required to make them residents. Even if the stay exceeds six months, it is very unlikely that the entire stay would fall within the same previous year. Take for example, a tourist who comes to India on 1st December 1970 and stays here till 30th June 1971. Though his entire stay in India is for 212 days, yet he cannot be deemed a resident since the total stay in each of the two previous years (the first previous year ending on 31st March 1971 and the second previous year ending on 31st March 1972) is less than 182 days. Even if this stay extends to more than six months in the same previous year he would only be a person not ordinarily resident.

As already stated in a previous chapter, a non-resident is chargeable on all income :

(*i*) received or deemed to be received in India irrespective of whether it accrued or arose within or without India ; and

(*ii*) accruing or arising or deemed to accrue or arise in India irrespective of whether it is received within or without India.

Non-residents are not liable to pay tax on their foreign income, even if it is brought into or remitted to India. The foreign income of a non-resident is taxable if it is received in India, but it is not taxable if it is brought into India. There is a point of difference between "receipt" and "bringing in". Receipt means the first receipt. Income once received cannot be received a second time and income having been received outside India, its remittance to India cannot be a second receipt but it would be a bringing in.

The section under which income is deemed to accrue or arise in India, and which concerns non-residents most is section 9(1) which is very wide in operation. It is so worded as to bring into the net of taxation as much of a non-resident's profits from trading in India as possible. Five specific types of income whenever arising are deemed to accrue in India, namely :

(*i*) **Income from any Business Connection in India.** The meaning of the term "business connection" is important. This phrase has not been defined and the courts have given decisions after consideration of the particular facts

of each case. Business connection denotes some elements of continuity in the relationship between the person in India who makes the profits and the non-resident who receives or realises them. An isolated transaction would not normally create business connection.

According to judicial decisions, the following are examples of business connection :

(*a*) Maintaining in India a branch office for the purchase or sale of goods or transacting other business.

(*b*) Appointing an agent in India for the purchase or sale of goods or transacting other business.

(*c*) Having in India factory where the raw materials purchased in India are worked into a form suitable for export abroad.

(*d*) There being a close financial association between a resident and a non-resident company.

(*e*) Granting a continuing licence to a resident to exploit for profit an asset belonging to a non-resident.

(*f*) Forming an Indian subsidiary company to sell the products of the non-resident holding company.

Thus, business connection would include a branch, agency, factory or management. A business connection may exist even without any regular branch, agency or other definite organisation (*20 ITR 331*).

The mere fact that a substantial part of a non-resident's output finds its way into the Indian market or is sold directly or through brokers to various customers in India, or the mere rendering of services outside India to a person carrying on business in India do not amount to a business connection in India.

Thus, incomes arising from a business connection are liable to tax. While this principle is generally sound for developing countries, it is found necessary in the context of our present drive for higher exports to exempt from tax such *income arising from purchase in India of goods which are exported.* Therefore, in the case of a non-resident, no income shall be deemed to accrue or arise in India through or from operations which are confined to the purchase of goods in India for the purpose of export, even though the goods are subjected to some kind of manufacturing process before being exported from India.

(*ii*) **Income from any Property in India.** The word property is used as an ordinary English word and is not confined to building property. The word property includes both movable and immovable property, but it means something *tangible e. g.*, furniture or machinery situated in India, which has been hired under an agreement by which the hire is payable outside India.

(*iii*) **Income from any Asset or Source of Income in India.** Intangible property like a debt or other chose in action is not property within the meaning of (*ii*) above, but it is covered by the words "any asset or source of income."

(*iv*) **Income from any Money lent at Interest and Brought into India in Cash or in Kind.** The interest on money lent abroad and brought into India *with the knowledge of the lender* would be income deemed to accrue in India. However if the borrower without the knowledge of the lender brings the money borrowed into India and that money earns income here, then the lender is not liable to pay tax on the interest which he receives on the money lent.

(*v*) **Income from Transfer of a Capital Asset in India.** Capital gains arising from the transfer of a capital asset situate in India at the time of the transfer, are deemed to accrue in India, irrespective of the place where the agreement of transfer is made or the consideration for the transfer is payable.

Section 9(1) applies to both residents and non-residents, but having regard to the several categories of income specified in this section, its application to residents must be rare, and it may be said that the large majority of persons falling within this section would be non-residents.

Determination of Income of Non-residents.

According to Rule 10 of the Income-Tax Rules, 1962, in any case in which the Income-Tax Officer is of opinion that the actual amount of the income accruing or arising to any non-resident person, whether directly or indirectly, from the sources enumerated above cannot be definitely ascertained, the amount of such income for the purposes of assessment may be calculated :

(*a*) at such percentage of the turnover so accruing or arising as the Income-Tax Officer may consider to be reasonable ; or

(*b*) on any amount which bears the same proportion to the total profits of the business of such person (such profits being computed in accordance with the provision of the Act), as the receipts so accruing or arising bear to the total receipts of the business ; or

(*c*) in such other manner as the Income-Tax Officer may deem suitable.

Artificial Arrangement between a Resident and a Non-resident. Business may be carried on by a person who is not resident or not ordinarily resident in India with a person resident in India and, owing to the close connection between such persons, the business may be so arranged that the resident makes either no profits or less than the ordinary profits in that business. Such an arrangement would deprive the Indian revenue of the full share of the tax which would otherwise be payable by the resident.

In such cases section 92 provides that the resident would be chargeable in respect of the profits which might reasonably be expected to be derived from that business but for the artificial arrangement. The profits derived from any business carried on in this manner are to be determined according to Rule 10 as explained above.

Apportionment of Profits. The explanation to section 9(1)(i) makes a provision for the apportionment of profits in respect of different operations of a single business. It provides that in the case of a business, of which some of the operations are carried out within and some without India, the profits of the business should be apportioned and only that portion of the profits which is reasonably attributable to the operation carried out in India should be deemed to accrue in India. The Supreme Court has held that this principle applies where the goods are manufactured in one place and sold in another and that the profits may be apportioned between the manufacturing and the selling operations (*1950 ITR 472*).

Thus, if a non-resident has a business connection in India (*e. g.*, a branch or an agency), he is taxable only in respect of that part of the profit, made out of the connection, which is attributable to the operations in India. If his business consists of buying goods in India through a branch or an agency and selling them outside, he will be assessable only in respect of that part of the profit which is attributable to the buying operations. On the other hand, if the business consists of buying goods outside India and selling them inside, the full profit arises in India, because the profit has been created by sales and sales have taken place in India. In the first case, the profit is deemed to accrue in India by virtue of section 9(1), while in the second case the income arises outright in India, and is taxable by virtue of section 5.

The Indian branch of a non-resident firm or company is liable to pay income-tax in India on the profits pertaining to that branch. In order to

ensure proper assessment in such cases, the Income-Tax Officer would require the production of the Balance Sheet and the Profit & Loss Account of the firm or company as a whole in addition to those of the Indian branch. If the Income-Tax Officer is unable to find out the share of the profit properly due to the Indian branch, he has powers under a special rule to determine how the profits of the Indian branch are to be calculated. This rule enables him to fix the income of the Indian branch for assessment purposes either as a percentage on the turnover of the business done by the branch, or where this procedure proves unsuitable, as a portion of the world income equal to the ratio which the Indian receipts bear to the total receipts of the firm or company. When even this method is found unsatisfactory, he can adopt such other method as he considers suitable.

Illustrations

(1) A non-resident, not having any branch or agency in India, buys goods here and sells them outside. No profit arises in India because there is no business connection here.

(2) A non-resident, having a branch office in India buys goods in India for the purpose of exporting them outside India. He is not liable to Indian income-tax on the profit made by him on such exports, as such income is not deemed to accrue or arise in India.

(3) An assessee's business consists of buying goods outside India and selling them in India. The full profit arises in India and is taxable, because the full profit has been created by sales, and the sales have taken place in India.

(4) An assessee (who is resident) has a big paper business in Delhi and also a branch in Nepal. The branch deals in paper. There is no remittance of profits from Nepal to Delhi. As there is a business connection between the head office in Delhi and the branch in Nepal the profits earned by the Nepal branch are deemed to accrue in India by reason of section 9(1) and would be taxable to the extent of the amount attributable to Indian connection.

(5) X Ltd. (an Indian company) carries on business as marine engineers. Two non-resident British companies engaged in the business of plying ships beneficially own the entire share capital of X Ltd. Under an agreement entered into with the non-resident companies, the X Ltd. repaired their ship at cost and charged no profit.

It was held that X Ltd., was chargeable to tax under section 92 in respect of the profits which it would make by repairing the ships of the non-resident companies (*35 ITR 369*).

(6) X Co. Ltd. is an Indian company in which P Co. Ltd. a company incorporated in the U.K. holds 95% of the shares carrying voting rights. The Indian company is a supplier of iron ores and among its customers is P Co. Ltd., but while the margin of profit on sales by X Co. Ltd, to others is 10% it is only 5% on the sales to P. Co. Ltd.

P Co. Ltd. maintains an office of its own in India for purchase of the iron ores from X Co. Ltd. and from others, and for export of the same to its Head Office at London. It has no other activities in India.

The Income-Tax Officer wants to tax a portion of the profits P Co. Ltd. as deemed to accrue or arise in India because of its operations in India and the maintenance of an office in this country, and further to make an addition to the total income of the Indian company of a sum equal to 5% of the sales made by it to the U.K. company.

Discuss the correctness or otherwise of the two proposals of the Income-Tax Officer.

(C. A. Final, May 1969)

Obviously P Co. Ltd. is not resident in India, because it is not an Indian company nor is its management situated wholly in India. According to section 9(1)(i), incomes arising to a non-resident from a business connection in India are liable to tax ; but explanation (b) appended to this section specially provides that in the case of a non-resident no income shall be deemed to accrue or arise in India through or from operations which are confined to a purchase of goods in India for the purpose of export, even though the non-resident may have an office or agency in India and even though the goods purchased are subjected to same kind of manufacturing process before being exported from India.

Therefore the proposal of the Income-Tax Officer to tax a portion of the profits of P Co. Ltd. as deemed to accrue or arise in India is not correct, because no income of P Co. Ltd. accrues or arises in India.

Business may be carried on by a person who is not resident or not ordinarily resident in India with a person resident in India and, owing to the close connection between such persons, the business may be so arranged that the resident makes either no profits or less than the ordinary profits in that business. Such an arrangement would deprive the Indian revenue of the full share of tax which would otherwise be payable by the resident. Therefore section 92 provides that the resident would be chargeable in respect of the profits which might reasonably be expected to be derived from that business but for the artificial arrangement.

Thus, the proposal of Income-Tax Officer to make an addition to the total income of the Indian company of a sum equal to 5% of the sales made by it to the U.K. company, is correct.

Tax Liability of Foreign Collaborators

Rates of Income-Tax.

The tax liability which a foreign investor has to bear on various types of income derived by him from his investment in India depends to some extent on the size of the profits of the company which manages the joint enterprise set up by him and the Indian entrepreneur. Normally such a joint venture company will be a domestic industrial company and the rate of tax will vary, depending upon whether it is a widely-held company or a closely-held company. In the former case the present rate of tax is 45% if the total income does not exceed Rs. 1,00,000, but it is 55% when the total income exceeds Rs. 1,00,000. In the case of a closely-held industrial company, the rate of tax is 55% on the first Rs. 2 lakhs and 60% on the balance. If such a company is not an industrial company, the rate of tax is 65% irrespective of the size of its total income.

Dividend on Shares Held in the Indian Company.

In computing the total income of a foreign investor, the following deductions are allowed from the gross total income :

(1) In the case of a foreign investor (whether a company or not), the full amount of dividend attributable to the tax-holiday profits of the Indian company running a new industrial undertaking or shipping or hotel business.

(2) Up to Rs. 3,000 of the dividend (along with certain other investment income) received by a foreign investor who is an individual.

(3) 65% of dividend received by a foreign company from an Indian company.

Fees for Technical Services Rendered.

Fees received by a foreign collaborator for technical services rendered to an Indian enterprise are taxable in India if either the services are rendered in India or the fees are received in India. Fees attributable to services rendered outside India are not liable to Indian income-tax in the hands of the foreign collaborator if the amount is also received abroad.

Difficulties do not arise in determining the tax liability when the payments for the two types of services are clearly settled in the agreement. Where however the agreement is for the payment of a sum for all the services wherever they might be rendered and some of them are rendered in India, the tax authorities make a reasonable allocation of the income for all the services rendered in India on the basis of the available information. Foreign collaborators would be well advised to clearly specify in the agreement the place where the services are rendered and to arrange for the receipt of the fees outside India.

If the recipient of fees for technical services is a foreign company and the arrangement is approved by the Government of India, the fees are taxed at a concessional rate of 50%. The amount subjected to tax is itself determined after deduction from the fees the actual revenue expenditure incurred by the foreign collaborator in rendering technical services.

If the foreign collaborator is not a company, the income from fees for technical services will be charged, after giving a deduction for the actual revenue expenditure, to tax at the appropriate rate applicable to his Indian income.

Royalties for the use of Patents, Copyrights, Trade-marks, Processes or Formulae, etc.

Royalty arises wholly in the country in which the patent, trade-mark, process, etc., is actually exploited. Thus royalty received by a foreign patentee for the use of the patent in India is considered to arise in India, though the patent may be registered in another country. Income from royalty is determined and taxed broadly in the same way as income from fees for technical services. The income is determined after deducting from the royalty current expenditure incurred by the tax-payer for earning it. Capital expenditure incurred for development or improvement of the patent or process is not deductible.

If the tax-payer is a company and the collaboration agreement has been approved by the Government of India, the concessional rate of tax of 50% is applicable. If the tax-payer is not a company, the income will be taxed at the rate appropriate to the total Indian income.

Amount received for Assignment of Patents, Trade-marks or for the Sale of Technical know-how.

Payment received by a foreign collaborator for the sale of technical know-how, secret process, etc., would not be taxable if it is a capital receipt. Whether it is a capital receipt or a revenue receipt would depend upon the facts of each case. If payment is not received as a lump sum, but is periodical and related to turnover or production, it may be revenue receipt and taxed like royalty payable for the use of a patent or trade-mark. Even if it is a revenue receipt, it would not be taxable if the technical know-how is delivered abroad and the payment is also received abroad.

Interest on Loans Advanced to an Indian Enterprise.

Interest received by a foreign investor, whether a company or an individual, from an industrial undertaking in India, on money borrowed or debt incurred by the Indian firm in a foreign country for purchase of capital plant and machinery or raw materials from abroad, is exempt to the extent of approved rate. If the actual rate of interest under the agreement is higher than the rate approved by the Government of India for purposes of exemption from tax, the excess is chargeable to tax at the rate of 70% in the case of a foreign collaborator being a company and at the appropriate rate in the case of others. Interest from loans which are not approved by the Government of

India or which have been taken for purposes other than those mentioned above is taxed in the same way.

Interest payable by Government or a local authority on moneys borrowed from sources outside India is also exempt in the case of non-resident recipients.

Profit on Sale of Plant and Machinery Supplied.

If the foreign supplier is a dealer in machinery, the profits from sale of machinery supplied to an Indian enterprise will be his business income. Such profits are taxable if they arise in India or are received in India. Whether the profits arise in India or are received in India is a matter which has to be decided in the light of facts of each case.

As a general rule, profits arise at the place where the contracts of sale are made or the sales are effected. A sale is treated as completed when the property in the goods passes on to the buyer. However, though the sale may take place outside India, the profits may be received in India if the sale proceeds are received in India. In that case the profits will be taxable on the basis that they are received in India.

The foreign suppliers would be well advised to execute the contract of sale outside India and arrange the delivery of the goods and the receipt of the sale proceeds outside India.

Consideration Received by Allotment of Shares to Foreign Collaborators.

Many foreign collaboration agreements provide for the allotment of shares in the joint venture company to the foreign collaborator by way of part or full satisfaction of the consideration payable for supply of machinery, assignment of patent rights, etc.

The allotment of shares by the Indian company would be ordinarily treated like receipts of sale proceeds in India and as such would be liable to Indian tax. In practice, however the tax authorities make no attempt to charge the profits of the non-residents to tax in India merely on the ground that the *situs* of the share was in India.

Illustration

Manufacturers Ltd. an Indian company, entered into a collaboration agreement with Hydraulics Ltd., a company incorporated at London having no branch in India, some of the terms whereof were as follows :

(*a*) Hydraulics Ltd. was to supply machinery, delivery to be made to the Indian company's agents in the United Kingdom, price to be paid through letters of credit opened at London by the Indian company in favour of the foreign company.

(*b*) Hydraulics Ltd. was to allow some of its patents to be used by Manufacturers Ltd. in India for which the former was to receive a royalty.

During the calendar year 1974 the cost to Manufacturers Ltd. of the machinery purchased from Hydraulics Ltd. was Rs. 20,00,000 and moreover, the Indian company paid a royalty of Rs. 50,000 to the foreign company. It was found that on its world sales Hydraulic Ltd. had been making a net profit of 10% of the sales.

Discuss whether any income of Hydraulics Ltd. is chargeable to Indian income-tax. (*C. A. Final, May 1967*)

The residential status of Hydraulics Ltd. London, is obviously that of a non-resident. A non-resident is liable to Indian income-tax only in respect of (*i*) income accruing or arising or deemed to accrue or arise in India ; and (*ii*) income received or deemed to be received in India.

The profit earned by Hydraulics Ltd. on the machinery supplied to Manufacturers Ltd. arises in the U. K., because the machinery is delivered there and the payment in respect thereof is received there. But by virtue of section 9(1), such profit is deemed to accrue or arise in India, as Hydraulics Ltd. has a business connection in India when it has entered into a collaboration agreement with Manufacturers Ltd. It has been held that there is a business connection when a close financial association exists between a resident and a non-resident company and also when a licence is granted to a resident to exploit for profit an asset belonging to a non-resident.

Therefore, Rs. 2,00,000 (10% on Rs. 20,00,000) is the profit deemed to accrue of arise in India which is liable to Indian income-tax.

Also the full amount of royalty paid by Manufacturers Ltd. to Hydraulics Ltd. is liable to Indian income-tax, as this income arises in India.

Thus the total income of Hydraulics Ltd. which is liable to income-tax in the assessment year 1975-76 is Rs. 2,50,000.

Mode of Assessment.

The law provides that a non-resident can be taxed either direct or through his agent. Where there is no duly constituted agent in India, the Income-Tax Officer may statutorily treat any of the persons enumerated below as the agent of a non-resident. The person so treated as agent is a representative assessee only in respect of that income of the non-resident which is deemed to accrue or arise in India.

Section 163 contemplates five classes of persons who may be treated as agents of a non-resident, namely :

(*i*) Any person employed by a non-resident.
(*ii*) Any person having a business connection with the non-resident.
(*iii*) Any person through whom the non-resident receives any income.
(*iv*) Any person who is the trustee of the non-resident.
(*v*) Any person who has acquired by means of a transfer a capital asset in India. Such person may be resident or non-resident.

The Income-Tax Officer must serve on the resident person a notice of his intention of treating such person as the agent of non-resident thus giving him an opportunity of being heard as to his liability.

If a person is appointed the statutory agent of a non-resident in relation to one assessment year, advance tax in respect of the income of the non-resident for the subsequent assessment year (though that tax is payable in the financial year) cannot be recovered from the agent unless there is a fresh appointment of that person as a statutory agent for that subsequent assessment year as well. Although a person may fail in a particular year to resist the claim that he is an agent, circumstances may alter in the next year and he may be able to resist the claim then. Hence notice shall have to be given by the Income-Tax Officer for each assessment year to appoint a person as agent (*71 ITR 457*).

It has been held that a person may be appointed the agent of a non-resident before the commencement of the relevant assessment year and as such made liable for advance payment of tax under section 210 in respect of the non-resident's income (*59 ITR 656*).

Where a person who has been appointed and assessed as the agent of a non-resident, denies his liability to be assessed, he is entitled to appeal under section 246, *after* the assessment is made, against the order apppointing him as agent, and he may file such an appeal on the ground that he is not liable to be assessed as agent, even though he may not appeal against the quantum of the income assessed or the tax determined. But no appeal would lie by such an agent *before* any assessment is made on him in such capacity (*11 ITR 553*).

A broker in India, who carries on ordinary brokery business through nôn-resident brokers, cannot be deemed to be an agent in respect of such transactions, because in such cases there is no method of ascertaining what profit the principal makes and how much tax should be retained. In such cases the foreign principal will be taxed direct in respect of his Indian profits.

When a person has been treated as the agent of a non-resident for purposes of income-tax, he has right, under section 162, to deduct from payments to the non-resident the tax which he estimates he will have to pay on the profits made by the non-resident in India. If the non-resident principal and the resident agent cannot agree on the estimated amount to be retained, the resident person can get a certificate from the Income-Tax Officer as to the amount which is considered reasonable to be retained pending the settlement of the matter, and if he obtains such certificate he will not be liable to pay tax as agent for any greater sum.

The liability of the statutory agent appointed under section 163 and assessed under section 161 is personal and not conditional upon his having in hand any funds of the non-resident. The Supreme Court has held that if he is unable to recover from the non-resident the amount of tax, he cannot claim it as a bad debt or as a business loss on ordinary principles of commercial accounting (*41 ITR 545*).

Computation of Tax.

Non-company Assessees. Such non-resident assessees are to be assessed on their income assessable in India at the same rates of income-tax as apply to resident assessees. However, in computing their total income no deduction is allowed in respect of the following :

(*a*) Expenditure incurred on the medical treatment of a handicapped dependant.
(*b*) Premium paid or contributions made for securing retirement annuities in the case of partners of registered professional firms.
(*c*) Foreign remuneration of a professor, teacher or research worker.

Companies. In the case of companies, residence or non-residence does not affect the rate of tax. All companies are liable to tax at the rates applicable to them as explained in a preceding chapter dealing with the assessment of companies.

Recovery of Tax.

When the tax payable by a non-resident has not been deducted at source or when there is no resident agent from whom it may be recovered, any arrears of tax may be recovered from any assets of the non-resident which are or may at any time come within India. There is no time limit to such recovery.

In many cases a non-resident pays tax twice or certain portions of his income in his own country as well as in India. Therefore, to afford some relief in such cases there are arrangements for double taxation relief with several foreign countries, so that the whole burden of tax on the foreign income does not fall on the non-resident assessee. The provisions governing double taxation relief have already been explained in a previous chapter.

Shipping Business of Non-residents

The tax liability in respect of shipping business of non-residents is governed by section 172 which provides as follows :

(1) The provisions of this section apply for the purposes of levy and recovery of tax in the case of any ship, belonging to or chartered by a non-resident, which carries passengers, live-stock, mail or goods shipped at a port in India.

(2) Where such a ship carries passengers, live-stock, mail or goods shipped at a port in India, $7\frac{1}{2}$ per cent of the amount paid or payable on account of such carriage to the owner or the charterer or to any person on his behalf, whether the amount is paid or is payable in or out of India, shall be deemed to be income accruing in India on account of such carriage.

The above provisions will take effect from 1st June 1975 and will therefore apply in relation to the carriage of passengers, livestock, mail or goods shipped at Indian ports on or after that date by ships belonging to or chartered by a non-resident.

(3) Before any such ship departs from an Indian port, the master of the ship shall prepare and furnish to the Income-Tax Officer a return of the full amount paid or payable to the owner or charterer or any person on his behalf, on account of the carriage of all passengers live-stock, mail or goods shipped at that port since the last arrival of the ship thereat.

However, where the Income-Tax Officer is satisfied that it is not possible for the master of the ship to furnish the return before the departure of the ship from the Indian port, and that the master of the ship has made satisfactory arrangements for the filing of the return and payment of the tax by any other person on his behalf, the Income-Tax Officer may, if the return is filed within 30 days of the departure of the ship, deem the filing of the return by the person so authorised as sufficient compliance with the above requirement.

(4) On receipt of the return, the Income-Tax Officer shall assess the income and determine the tax payable thereon at the rates in force applicable to a company which has not made the prescribed arrangements for the declaration and payment of dividends in India, and such sum shall be payable by the master of the ship. For the purpose of determining the tax payable, the Income-Tax Officer may call for such accounts or documents as he may require.

(5) A port clearance certificate shall not be granted to the ship until the Collector of Customs or other officer duly authorised to grant the same is satisfied that the tax assessable under the section has been duly paid, or that satisfactory arrangements have been made for the payment thereof.

(6) The owner or charterer of a ship may claim, *before the expiry of the assessment year relevant to the previous year in which the date of departure of the ship from the Indian port falls*, that an assessment be made of his total income of the previous year and the tax payable be determined in accordance with the other provisions of the Act. If he so claims, any payment made under this section during that previous year shall be treated as a payment in advance of the tax leviable for that assessment year, and the difference between the sum so paid and the amount of tax found payable by him on such assessment shall be paid by him or refunded to him, as the case may be.

Note : Section 172 applies to the taxation of income from tramp ships which do not run on regular lines, and which only call occasionally at Indian ports. Such ships, unlike regular liners, are not likely to have any agent in India who can be taxed under the ordinary procedure. Hence, special device is enacted to levy assessment on tramps.

Tax Concessions to Foreigners

Due to our limited capital resources and technical personnel, we have to depend very largely on foreign capital and foreign technicians for the industrialisation of India. The Government of India has been and is extremely anxious to attract foreign capital and foreign technical 'know-how'.

Foreign Capital.

The following tax concessions are granted in order to attract foreign capital to India :

(1) In the following cases the interest income of a non-resident is excluded from his total income :

(*a*) Interest on bonds (or premium received on their redemption) issued by the Central Government under a loan agreement between the Central Government and International Bank for Reconstruction and Development or under a loan agreement between the Central Government and the Development Loan Fund of U.S.A.

(*b*) Interest on bonds issued by any industrial undertaking or financial corporation in India under a loan agreement with the said Bank or Fund which is guaranteed by the Central Government.

(*c*) Interest on moneys standing to the credit of a non-resident's account in any bank in India in accordance with the Foreign Exchange Regulation Act, 1947.

(2) In computing the total income of a foreign investor, the following deductions are allowed from the gross total income :

(*a*) Full amount of dividend attributable to the tax-holiday profits of the Indian company running a new industrial undertaking or shipping or hotel business.

(*b*) Up to Rs. 3,000 of the dividend (along with certain other investment income) received by a foreign investor who is an individual.

(*c*) 65% of dividend received by a foreign company from an Indian company.

(3) A foreign investor does not have to pay tax in India on his foreign income.

Foreign Skill.

The following tax concessions are granted in order to attract foreign technical 'know-how' or skill to India :

(1) The remuneration of a foreign technician employed in India is not included in his total income for a specified period as explained in an earlier chapter dealing with computation of total income.

(2) The salary income earned in India by visiting professors and teachers of foreign nationality, whose services are utilised in any university or educational institution, is excluded from their total income under certain conditions as explained in a previous chapter dealing with computation of total income.

(3) Remuneration received by a non-Indian employee of a foreign enterprise not engaged in any business in India, serving temporarily in India is excluded from his total income, if his stay in India does not exceed 90 days.

(4) The value of free or concessional passage granted to a foreign employee proceeding on home leave is not included in his total income.

(5) Royalties and technical service fees received by a foreign company from an Indian concern under an agreement approved by the Central Government, are taxed at a concessional rate of 50%.

Illustrations

(1) X is a resident of Nepal. On 1st April 1974 he purchased house property worth Rs. 2,00,000 in Lucknow. He also advanced a sum of Rs. 1,00,000 to a Lucknow firm on the same day at 6% per annum interest. The house property fetches him a taxable income of Rs. 10,000 a year.

According to the instructions of X, the rent and interest due to him are remitted by the tenants and the Lucknow firm direct to him in Nepal.

When required to submit his return for purpose of income-tax assessment, X denies his liability to tax on the ground that the income is received by him direct in Nepal, and the money was also advanced by him in that country, and that he has no business connection in India.

How would you proceed with the assessment of X, and how can the tax, if any, levied on him be recovered ?

Since the contracts with the tenants and the Lucknow firm have been made in Nepal and since the rent and interest are also payable there, the income from such rent and interest cannot be said to accrue or arise in India ; but by virtue of section 9(1)(i) such income is deemed to arise in India. Therefore, X's total income of Rs. 16,000 is liable to tax. The assessment of X would be made either in his own name or in the name of his agent through whom he received the rents and interest.

The Income-Tax Officer must serve on the resident person a notice of his intention to treat such person as the agent of X thus giving him an opportunity of being heard as to his liability. The person treated as the agent of X for purpose of income-tax has a right to deduct from payments due to X, the amount of tax which he estimates he will have to pay on X's Indian Income.

When the tax payable by X has not been deducted at source or when there is no resident agent from whom it may be recovered, any arrears of tax can be covered from any assets of X which are or may at any time come within India. There is no time limit to such recovery.

In this case either the Lucknow firm or any of the tenants of X can be treated as his agent and the amount of tax due from X can be easily recovered from such agent.

(2) B, an individual who wants to go to Canada has applied to the Income-Tax Officer for a tax clearance certificate under section 230, and he has furnished the following information :

(*a*) B had gone to Canada on 1-4-1967 after selling his dwelling-house in India, and thereafter he came to India for the first time on 1-10-1974 to attend the marriage of his niece. He is staying with his brother at Agra, who is separate from him. He is to leave on 30-3-1975 by air for Canada.

(*b*) B has fruit orchards in Canada since he went there from which his annual income is Rs, 20,000. While coming to India, B brought Rs. 30,000 with him, which amount is credited to his account in an Indian bank.

(*c*) A friend of B who happened to visit Canada arranged for a loan of Rs. 25,000 there from B for purchase of machinery for his (friend's) business in India. The loan was given in Canada on 1-5-1973 at the rate of 6% per annum. The friend purchased machinery for Rs. 25,000 and had it shipped to India. Interest for the first year ending 30-4-1974 was remitted to B in Canada before he left for his visit to India.

(*d*) While in India, B had taken up employment for two months on a monthly salary of Rs. 2,000, with a conveyance allowance of Rs. 60 per month.

What is the residential status of B ? Is he liable to any tax in India ? If so, compute his total income.

In the case of B, the previous year is the financial year ended 31st March 1975 and the relevant assessment year is 1975-76.

During the previous year 1974-75 B would be in India from 1-10-1974 to 30-3-1975 *i. e.*, for 180 days. If he leaves India on 30-3-1975 he would be in India for a period of less than 182 days. Nor had B any dwelling-place in India during the previous year 1974-75 as he had sold his house in India before 1-4-1967. The four

previous years preceding the previous year 1974-75 are 1970-71 to 1973-74. During these four years B was never in India.

Therefore, by every test, B is a non-resident for the previous year 1974-75.

Yes, B is liable to tax in India and his total income is as follows :

		Rs.
1.	Salary for service in India (after standard deduction of Rs. 800)	3,200
2.	Income from other sources : Interest on loan given to a friend in India, which is income deemed to accrue or arise in India under section 9(1)(i) for one year	1,500
	Total income for assessment year 1975-76	4,700

In the case of a non-resident, any foreign income brought into India does not attract tax in India. Therefore Rs. 30,000 brought by B to India is not liable to tax.

As the total income of B does not exceed Rs. 6,000, no income-tax is payable by him for the assessment year 1975-76.

(3) BZ Ltd. is a company incorporated in the U.K. with its Head Office in London. It carries on the business of manufacture and sale of rolling stock in U.K. It has no activity or source of income in India.

BZ Ltd. started negotiations for acquisition of all the shares of PK Ltd. a company incorporated in India on 1st April 1966 with its Head Office at Bombay for the manufacture of rolling stock in India. Its subscribed and paid-up capital consists of 50,000 equity shares of Rs. 100 each. Its factory at Bombay was newly constructed and it was equipped with buildings, machinery and plant which were all new. In this factory where more than 500 workers were employed, the company commenced manufacturing rolling stock from 1st April 1967 with the aid of electric power.

Both BZ Ltd. and PK Ltd. have the year ended 31st March as their accounting year. The general meetings and the directors' meetings of PK. Ltd. are all held at its head office at Bombay.

PK Ltd. declared dividends at 6 per cent on the value of its shares for each of the years ended 31st March 1972 to 31st March 1975.

Before finalising the negotiations, the directors of BZ Ltd. have sought your advice as to whether any liability to Indian income-tax would arise to it if it acquired all the shares of PK Ltd., or whether it would be entitled to the benefit of any tax concession provided in the Income-Tax Act.

Write a letter to the Directors of BZ Ltd., London, giving such advice as you consider necessary. (*C. A. Final, Nov. 1962*)

Western Kutchery Road,
Meerut.
15th July 1975.

The Directors,
BZ Ltd., London.

Dear Sirs,

In reply to your letter dated 8th July 1975, I am writing to inform you that in the circumstances mentioned therein, the position of BZ Ltd. in regard to Indian taxation will be as follows :

1. According to section 9(1)(iv) of the Income-Tax Act, 1961, a dividend paid by an Indian company outside India is deemed to accrue or arise in India. Therefore, the amount of dividends which BZ Ltd., will receive from PK Ltd. will be its income arising in India and liable to Indian income-tax.

2. Under section 80J, PK Ltd. enjoyed a tax-holiday for a period of five assessment years which expired on 31st March 1973. Therefore no tax-holiday concession will be available to BZ Ltd. in respect of dividends to be received from PK Ltd.

3. 65% of the dividends received by BZ Ltd. from PK Ltd. will be allowed as a deduction in computing the total income of BZ Ltd.

4. Under the present law, BZ Ltd. will have to pay income-tax on its total income at 7% with a surcharge of 5% on such income-tax.

5. As BZ Ltd. is a company incorporated in the U.K. it will be assessed in the status of a company in India.

Should you desire any further information, I shall be glad to furnish it on hearing from you.

Yours faithfully,

.....

Chartered Accountant

(4) X paid Rs. 10,000 to Y (non-resident) as interest on capital borrowed for purposes of business, but failed to deduct income-tax therefrom. What would be the consequences to X ?

Section 36(1)(iii) allows the deduction from profits of interest paid on capital borrowed for business purposes, but in the case of interest paid to a non-resident section 40(a)(i) provides that the deduction will not be allowed unless income-tax has been deducted or there is a resident agent who may be assessed in respect of the income of the non-resident. Therefore Rs. 10,000 will not be allowed as a deduction in computing the taxable profits of X's business.

Under section 201(1), X would be deemed to be an assessee in default in respect of the tax and would be personally liable to pay the tax.

Under section 201(1A), he would be liable to pay simple interest at 12% per annum on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually paid.

Thus X loses the benefit of the deduction of Rs. 10,000 in his own assessment and also incurs the liability of paying the tax and interest thereon.

Under section 276B, X is also punishable, on conviction before a court, with rigorous imprisonment up to six months and shall also be liable to fine which shall not be less than a sum calculated at the rate of 15% per annum on the tax in default for the period from the date on which such tax was deductible up to the date of the payment of the tax to Government.

CHAPTER 30

Computation of Income-Tax

The Income-Tax Act, 1961, deals merely with the basis, the methods and the machinery of assessment. It does not contain a schedule of rates at which income-tax is to be charged. The rates of tax are determined by the Finance Act, passed annually by Parliament in March or April. Should the passing of the annual Finance Act be delayed, the tax is charged under section 294 according to the rates fixed by the Finance Act of the preceding year or according to the rates proposed in the Finance Bill then pending before Parliament, whichever is more favourable to the assessee.

Rounding-off. Under section 288B, fractions of a rupee contained in the amount of tax (including advance tax and tax deducted at source), penalty, interest, etc., and refunds should be rounded off to the nearest rupee by ignoring amounts less than 50 paise and by increasing amounts of 50 paise or more to one rupee.

Rates of Tax for Assessment Year 1975-76

In the case of every (*i*) individual (*ii*) Hindu undivided family (having no member with independent total income exceeding Rs. 6,000) (*iii*) unregistered firm (*iv*) other association of persons or body of individuals and (*v*) artificial juridical persons :

First Rs. 6,000 of total income	Nil
Next Rs. 4,000 of total income	12%
Next Rs. 5,000 of total income	15%
Next Rs. 5,000 of total income	20%
Next Rs. 5,000 of total income	30%
Next Rs. 5,000 of total income	40%
Next Rs. 20,000 of total income	50%
Next Rs. 20,000 of total income	60%
Balance of total income	70%

Surcharge. The income-tax calculated at the above rates is increased by a surcharge of 10% of such income-tax.

Hindu Undivided Families. In the case of Hindu undivided families having at any time during the previous year at least one member with independent total income exceeding Rs. 6,000, the rates of income-tax applicable on each slab will be the same as the rates of tax applicable in respect of the next higher slab in the case of other Hindu undivided families. The surcharge on income-tax will be 10%.

Note : The rates of income-tax and surcharge for the assessment year 1975-76 applicable to registered firms, companies and co-operative societies have already been given in preceding chapters dealing with their assessment.

Computation of Assessment

In order to prepare the assessment of an assessee for the assessment year 1975-76, the following steps have to be taken :

(1) Compute the total income in the manner explained in a previous chapter after making the admissible deductions from the gross total income. These deductions are allowed under sections 80C—80U.

(2) Calculate the amount of income-tax on the total income at the prescribed rates. The amount of income-tax so calculated should then be increased by the percentage of surcharge on income-tax.

(3) Work out the average rate of income-tax by dividing the total amount of income-tax as calculated in (2) by the total income.

(4) Ascertain the amount of income (if any) included in the total income on which a rebate of tax is allowable and then calculate the amount of the rebate.

(5) From the amount of income-tax determined in (2) deduct the following amounts :

(*a*) Amount of income-tax rebate due.
(*b*) Amount of tax deducted at source and paid in advance.
(*c*) Amount of double taxation relief, if any.

(6) To the figure arrived at in (5) add the amount of any penalty, fine or interest and the result will then be the amount of the demand or the amount refundable.

Illustrations

(1) Work out the amount of income-tax payable by the following Hindu undivided families for the assessment year 1975-76 :

(*a*) Total income Rs. 15,000. No member having any independent income.
(*b*) Total Income Rs. 15,000, one member having an independent total income of Rs. 5,000.
(*c*) Total income Rs. 15,000, one member having an independent total income of Rs. 9,000.

(*a*)

	Rs.
Income-tax on Rs. 15,000	1,230
10% surcharge	123
Income-tax payable	1,353

(*b*) Same as in (*a*)

(*c*)

Income-tax on Rs. 15,000 :		
On first Rs. 6,000	—	
On next Rs. 4,000 at 15%	600	
On next Rs. 5,000 at 20%	1,000	1,600
10% surcharge		160
Income-tax payable		1,760

(2) The taxable income of Shrimati Dr. Shanti Sharma for the previous year ended 31st March, 1975 consisted of the following :

	Rs.
1. Income from government securities (net)	770
Income-tax deducted at source	230
2. Income from house property	1,800
3. Income from profession	12,000
4. Dividends from Indian companies (net)	2,310
Income-tax deducted at source	690
5. Interest on bank deposits	800

During the previous year she paid Rs. 6,000 premium for an insurance policy on the life of her eldest son and donated Rs. 21,000 to Delhi University.

Work out the tax payable by her for the assessment year 1975-76.

			Rs.
1.	Income from government securities gross		1,000
2.	Income from house property		1,800
3.	Income from profession		12,000
4.	Income from other sources :		
	Dividends gross	3,000	
	Interest on bank deposits	800	3,800
	Gross Total Income		18,600
Deductions :			
	For Rs. 5,580 life insurance premium limited to 30% of gross total income :		
	First	2,000	
	50% of Rs. 3,000	1,500	
	40% of Rs. 580	232	3,732
	For charitable donation, being 55% of Rs. 1,187 limited to 10% of gross total income as reduced by Rs. 3,732 and Rs. 3,000		653
	For interest on securities, dividends and bank interest (maximum)	3,000	7,385
	Total Income		11,215
	Rounded off		11,220
Income-tax on Rs. 11,220 :			
	On first Rs. 6,000	—	
	On next Rs. 4,000 at 12%	480	
	On balance of Rs. 1,220 at 15%	183	663
	Surcharge at 10%		66
			729
	Less Tax deducted at source (Rs. 230+Rs. 690)		920
	Amount of refund due		191

Agricultural Income

From 1st April 1974 a special provision has been made for the calculation of tax in the case of individuals, Hindu undivided families, unregistered firms or other associations of persons or bodies of individuals and artificial juridical persons, *whose total income exceeds Rs. 6,000* and who also have net agricultural income which is to be computed according to prescribed rules.

Under this provision the net agricultural income of a tax-payer will be taken into account only for determining the rate of income-tax to be applied to his total income. This will be done in the following manner :

(1) The agricultural and non-agricultural components of the tax-payer's income will first be aggregated and income-tax (including surcharge) calculated on the aggregate as if such aggregate were the total income.

(2) Income-tax (including surcharge) will then be calculated on the net agricultural income as increased by an amount of Rs. 6,000 as if such increased net agricultural income were the total income.

(3) The amount by which the income-tax (including surcharge) calculated under (1) exceeds the amount calculated under (2) will be the income-tax (including surcharge) payable by the tax-payer on his total income.

Illustration

In the following cases calculate the amount of tax payable by an individual for the assessment year 1975-76 :

(*a*) Total income Rs. 4,000. Agricultural income Rs. 1,00,000.
(*b*) Total income Rs. 7,000. Agricultural income Rs. 3,000.
(*c*) Total income Rs. 10,000. Agricultural income Rs. 8,000.
(*d*) Total income Rs. 10,000. Agricultural income Rs. 15,000.

(*a*) No income-tax is payable as the total income does not exceed Rs. 6,000.

	Rs.	
(*b*) Income-tax on aggregate income of Rs. 10,000	480	
Surcharge at 10%	48	
	528	(A)
Income-tax on agricultural income increased by Rs. 6,000 (*i.e.*, on Rs. 9,000)	360	
Surcharge at 10%	36	
	396	(B)
Income-tax payable (A)—(B)	132	
(*c*) Income-tax on aggregate income of Rs. 18,000	1,830	
Surcharge at 10%	183	
	2,013	(A)
Income-tax on agricultural income increased by Rs. 6,000 (*i.e.*, on Rs. 14,000)	1,080	
Surcharge at 10%	108	
	1,188	(B)
Income-tax payable (A)—(B)	825	
(*d*) Income-tax on aggregate income of Rs. 25,000	3,730	
Surcharge at 10%	373	
	4,103	(A)
Income-tax on agricultural income increased by Rs. 6,000 (*i. e.*, on Rs. 21,000)	2,530	
Surcharge at 10%	253	
	2,783	(B)
Income-tax payable (A)—(B)	1,320	

Chapter 31

Wealth-Tax

The imposition of a tax on wealth was one of the several measures suggested by Dr. Kaldor in his "*Indian Tax Reform*". Therefore, a Bill to provide for a tax on the net wealth of individuals, Hindu undivided families and companies was introduced in Parliament on 15th May 1957. This Bill was passed by both Houses of Parliament and received the assent of the President on 12th September 1957, and became the Wealth-Tax Act, 1957.

This Act came into force on 1st April 1957, and it applies to the whole of India including the State of Jammu and Kashmir. It has been amended several times since it was enacted.

Some Definitions

Assessee.

This term includes (*i*) persons who are liable to pay wealth-tax on their own net wealth, (*ii*) persons liable to pay wealth-tax on the net wealth of other persons, and (*iii*) persons deemed to be assessees in default under the Act.

Assets.

The term "assets" includes property of every description movable or immovable, and property includes everything which is owned by a person or in which he has a valuable interest. Thus all the worldly possessions (corporeal or incorporeal, tangible or intangible) are included in property.

Where an amount is payable to the assessee in instalments, instalments payable after the valuation date are to be included as an asset for the purpose of charging wealth-tax (*50 ITR 216*).

A contingent asset is an asset. Under a trust created by A's wife, A was entitled to the entire trust property if he survived his wife. It was held that A's interest was a contingent interest and an asset (*69 ITR 288*).

Exempted Assets. Section 2(e) expressly excludes certain assets from the definition of "assets". These are discussed later.

Valuation Date.

As w alth-tax can be levied only on the net wealth of a person as on a particular date, a date has been fixed in regard to each assessment year, and this date is called the valuation date.

The valuation date for wealth-tax purposes is the last day of the previous year for income-tax assessment. If different previous years are adopted by the assessee for different sources of income for purposes of income-tax

assessment, the last day of such previous years would be the valuation date. For instance, if a person adopts the year ended 31st March as his previous year for his salary income and the year ended 31st December for his business income, the valuation date would be the 31st March.

According to the Supreme Court, once the previous year of the assessee has been changed for the purpose of income-tax with the consent of the Department, it becomes incumbent on the part of the wealth-tax authorities to take the last date of that year as the valuation date. For example, where the assessee, whose previous year for the purpose of income-tax was originally the financial year, got it changed to the year ended 30th June 1973, for the assessment year 1973-74, the valuation date for purposes of wealth-tax would be 30th June 1973 for which the assessment year would be 1974-75 and not 1973-74 and no assessment could be made under the Wealth-tax Act on the assessee for the assessment year 1973-74 (*84 ITR 269*).

In the case of a person who is not an assessee under the Income-Tax Act, the valuation date is the 31st March, immediately preceding the assessment year.

In the case of assessments on executors, the valuation date would be the same as that of the deceased if he were alive.

Where there is a change in the net wealth of an assessee during the valuation date itself, *e. g.*, by a acquisition or transfer of assets on that date, it is the net wealth as it stood at the last moment of the valuation date that has to be adopted for purposes of assessment to wealth-tax (*62 ITR 304*).

Charge of Wealth-Tax

According to section 3, the charge of wealth-tax is governed by the following principles :

(*a*) The wealth-tax is to be charged for every assessment year commencing on 1st April.

(*b*) It is charged in respect of the net wealth of the assessee on the valuation date corresponding to that assessment year.

(*c*) It is charged on every individual, Hindu undivided family and company. However, wealth-tax on companies was discontinued with effect from 1st April 1960.

(*d*) It is charged at the rates specified in the Schedule to the Act.

(*e*) The above provisions are subject to the other provisions of the Act.

Individuals. Wealth-tax is payable by every individual in respect of his net wealth on the valuation date. The word "individual" has been given a very wide meaning for purposes of wealth-tax. It includes a body of individuals (*e. g.*, a body of joint trustees etc.) and the mutawalli of a wakf.

Hindu Undivided Families. As a Hindu undivided family is assessed as such to wealth-tax in respect of the wealth belonging to the family, there is a provision for exempting a coparcener's interest in the joint family property from the assets of the coparcener in his individual assessment.

As regards impartible estates, though the ownership of the corpus of the estate vests in the impartible Hindu undivided family, yet section 4(6) specifically provides that the holder of an impartible estate should be deemed to be the individual owner of all the properties of the estate for the purposes of wealth-tax.

When a coparcener having a wife and two minor daughters and no son receives his share of joint family properties on partition, such property in the hands of the coparcener, belongs to the Hindu undivided family of himself, his wife and minor daughters and cannot be assessed as his individual property for the purposes of wealth-tax (*74 ITR 190*).

Where a Hindu widow who had succeeded to the properties which her deceased husband had obtained on partition and had become the absolute owner of such properties under section 14 of the Hindu Succession Act, 1956, had a minor unmarried daughter entitled to maintenance, it was held that the widow and her minor unmarried daughter did not constitute a Hindu undivided family and the widow had to be assessed as an individual for purposes of wealth-tax in respect of the properties inherited by her from her husband (*54 ITR 430*).

According to the Supreme Court, the expression "Hindu undivided family" includes a Jain undivided family. The word "Hindu" preceding the words "undivided family" signifies that the undivided family should be of those to whom Hindu Law applies. Even though Jains may not be Hindus by religion they are governed by the same laws as Hindus (*83 ITR 720*).

In view of the fact that members of a Hindu undivided family governed by Dayabhaga School of Hindu law are co-owners of the family property having definite and ascertained shares therein, the property, even though held jointly by the members of such family is not assessable in the hands of the Hindu undivided family (*71 ITR 20*).

Firms and Associations. The net wealth of a firm or association as such is not taxed but the value of the interest of each partner of the firm or member of the association is included in the net wealth of the partner or member. The method of ascertaining the value of a partner's or member's interest has been prescribed by rules and is explained later.

Sections 3, 4, 5, 6 and 7 deal with the scope of liability to wealth-tax and are the most important, as they contain the substantive provisions of the wealth-tax law.

Section 3 is the charging section. The wealth-tax is levied in respect of the "net wealth" of the assessee as it existed on the valuation date. The assessees whose net wealth is chargeable are individuals and Hindu undivided families.

Section 4 specifies certain assets to be included in the net wealth of the assessees, though such assets do not legally belong to him on the valuation date. These are the assets transferred by the assessee to his wife or her husband or minor child, or under a revocable transfer.

Section 5 enumerates items of property which have to be excluded in the computation of net wealth. Section 6 also relates to exclusion of assets and debts located outside India. It specifies in what circumstances and under what conditions the assets and debts located outside India should be included in the calculation of net wealth.

Section 7, an important section, lays down the method of valuing the assets of the assessee for the purpose of levying the charge of wealth-tax.

Scope of Liability to Wealth-Tax.

According to section 6, the scope of liability to wealth-tax of an assessee depends upon two factors, namely : citizenship and residential status.

Citizenship. The term "citizen of India" is defined in Article 5 of the Indian Constitution. Under this Article, to be a citizen of India, a person must have his domicile in India and he must further fulfil *one* of the following three conditions :

(*a*) He must have been born in India ; or

(*b*) Either of his parents must have been born in India ; or

(*c*) He must have been ordinarily resident in India for not less than 5 years before the 26th January 1950.

A person's domicile is in that country in which he either has or is deemed by law to have his permanent home.

A person ceases to be a citizen of India if he has voluntarily acquired the citizenship of any foreign State.

Further provisions relating to citizenship and its acquisition and termination are contained in the Citizenship Act.

Residential Status. An assessee may be resident, not ordinarily resident or not resident in India. The residential status of an assessee is determined in the same manner as for income-tax purposes, and *it is to be calculated as in the previous year ending on the valuation date.*

Scope of Liability. According to section 6, the scope of liability to wealth-tax, depending upon citizenship and residential status is as follows :

(1) An individual who is not a citizen of India is liable to wealth-tax only in respect of his assets in India other than loans and investments in India from foreign sources, interest on which is excluded from the total income under the Income-Tax Act. Foreign debts are also to be ignored.

He is not liable to wealth-tax in respect of his assets located outside India and his loans and investments in India referred to above.

This is so whatever the residential status of the non-citizen may be, whether resident, not ordinarily resident or non-resident.

Where a non-citizen is not resident in India he has to pay wealth-tax at half the prescribed rates. This concession is not available where he is not ordinarily resident in India.

(2) An individual who is a citizen of India and a Hindu undivided family, when they are not resident or not ordinarily resident in India, are liable to wealth-tax to the same extent as a non-citizen individual, but they have to pay wealth-tax at the full prescribed rates.

(3) An individual who is a citizen of India and a Hindu undivided family, when they are resident in India, are liable to wealth-tax in respect of all their assets whether in India or outside India. Foreign debts are also deductible.

But they are entitled to a rebate of wealth-tax at half the average rate on the value of their foreign assets as reduced by foreign debts.

Illustration

How would you compute the net wealth of an assessee in the following case ?

	Located in India	Located outside India
Assets	Rs.	Rs.
Debts	3,00,000	2,60,000
Give explanation for your computation.	1,00,000	2,80,000

Under section 6, assets and debts located outside India are not taken into account in computing the net wealth of : (*a*) a non-citizen individual, and (*b*) a non-resident or not ordinarily resident individual (an Indian citizen) and a Hindu undivided family. In the case of such assessees, the net wealth will be :

	Rs.
Indian assets (assuming that they do not include any loans or investments from foreign sources, interest on which is excluded from total income under the Income-Tax Act)	3,00,000
Less Indian debts	1,00,000
Net Wealth	2,00,000

The net wealth of an individual (a citizen of India) or a Hindu undivided family *resident* in India will be :

		Rs.
Indian assets		3,00,000
Foreign assets		2,60,000
		5,60,000
Less Indian debts	1,00,000	
Foreign debts	2,80,000	3,80,000
Net Wealth		1,80,000

The Hindu undivided family is not liable to any wealth-tax as its net wealth does not exceed Rs. 2,00,000.

The resident individual or Hindu undivided family is not entitled to any rebate of wealth-tax on his or its foreign assets as reduced by foreign debts, because the foreign assets are less than foreign debts.

Prevention of Avoidance of Wealth-Tax

In computing the net wealth of an assessee on the valuation date, only the assets which belong to him on that date can be taken into account. Therefore he is entitled to make effective transfers of his assets until the last day of the previous year in order to avoid wealth-tax. In order to prevent avoidance of wealth-tax in this way, section 4 makes the following provisions :

1. Transfer of Assets.

Under section 4(1) (*a*), in computing the net wealth of an individual, there shall be included, as belonging to that individual, the value of the assets which on the valuation date are held by the following persons :

(*i*) By the spouse of such individual to whom such assets have been transferred by the individual, directly or indirectly, otherwise than for adequate consideration or in connection with an agreement to live apart.

The word 'spouse' in this context means a person who is lawfully wedded. The assets may be transferred by husband to wife or by wife to husband. The relationship of husband and wife must exist on the date of the transfer as well as on the valuation date.

An indirect transfer would include a transfer through the medium of a trust or transfer to a benamidar who would ostensibly hold the property for himself but in trust for the beneficiary.

(*ii*) By a minor child (not being a married daughter) of such individual, to whom such assets have been transferred by the individual, directly or indirectly, otherwise than for adequate consideration. The word 'child' means a legitimate child and it includes an adopted child but does not include a grandchild.

If the child attains majority or the minor daughter gets married before the valuation date, this section is not applicable.

Pre-nuptial settlements and settlements made before adoption of children are not within section 4, even though on the valuation date the transferee has become the wife or child of the transferor.

(*iii*) By a person or association of persons to whom such assets have been transferred by the individual, otherwise than for adequate consideration for the immediate or deferred benefit of the individual, his or her spouse or minor child (not being a married daughter) or both.

For example, A gifts a house to his major son B, but the arrangement is that the father should live in that house till his death. The value of the house will be included in the net wealth of A because it is a transfer for the benefit of A.

This provision would also apply to transfers by way of trust for the benefit of the individual, his or her spouse or minor children, and it would apply even if the beneficiary is given a right to enjoy the income of property transferred for life.

Where A transferred properties to B to be held as trustee for B's wife and minor child, and B on the same date made a similar transfer to A as trustee for the benefit of A's wife and minor child, it was held that the properties transferred by A cannot be included in his assets, as the above provision does not cover indirect benefits received by wife or minor child. Moreover, the properties were not *held* by the wife or minor child of A (*C. I. T. v. A. N. Chowdhury—69 ITR : Short Notes, page 33*).

(*iv*) By a person or association of persons to whom such assets have been transferred by the individual otherwise than under an irrevocable transfer. An irrevocable transfer is one which is not revocable for a period exceeding six years or during the lifetime of the transferee, and under which the transferor derives no direct or indirect benefit, and which does not contain a provision for the transferor to reassume power over the corpus or income.

Even with regard to irrevocable transfers, the transferred assets will be included in the transferor's assets when the transferor gets the power to revoke the transfer.

Mere investments in the name of wife or son or unmarried daughters cannot be treated as gifts unless there is proof of intention to give delivery of possession and acceptance by the donees ; nor can entries in accounts or declaration before a magistrate be treated as gifts.

Gifted Property. Under the proviso to section 4(1)(a), transfer of assets in ragard to which gift-tax is chargeable or which are specifically exempt from gift-tax for the assessment year 1964-65 or any subsequent assessment year up to and including the assessment year 1971-72 are outside the scope of the above provisions, that is to say, the assets transferred by way of gift are not to be included in the net wealth of the transferor.

But assets which are the subject of a transfer in respect of which gift-tax is chargeable in the assessment year 1972-73 or in any later year will be included in the net wealth of the individual making the transfer.

2. Converted Property.

Under section 4(1A), where an individual converts, after 31-12-1969, his separate property into joint family property of the Hindu undivided family of which he is a member, he is deemed to have transferred the converted property, through the family, to the members of the family for being held by them jointly.

In such a case the share in the converted property, insofar as it is attributable to the interest of the individual, his spouse or minor children (other than married daughters) will be included in the net wealth of the individual himself.

Further, in the event of a partial or total partition in the Hindu undivided family, the share allotted to the spouse or minor children in the converted property will also be included in the net wealth of the individual.

However, the converted property, on being included in the net wealth of the individual, will be excluded from the net wealth of the family or the spouse or minor children of the individual.

3. Members of Co-operative Housing Societies.

Under section 4(7), a member of a co-operative housing society to whom a building or part thereof is allotted or leased under a house building scheme of the society, will be regarded as the owner of that building or part, but in determining the value of such building or part for purposes of inclusion in the net wealth the discounted value of any outstanding instalments of the amount payable by the member to the society towards the cost of such building or part (including the land appurtenant thereto) under the house building scheme of the society, will be deducted.

Since the member is considered as owner of such house or flat, he is also entitled to the exemption in respect of residential house up to the value of Rs. 1,00,000 in the computation of his net wealth.

4. Interest in a Firm or Association.

Under section 4(1)(b), in computing the net wealth of an individual, who is a partner in a firm or a member of an association of persons (not being a co-operative housing society) there shall be included as belonging to that individual the value of his interest in the firm or association determined in the prescribed manner.

Other Provisions.

The other provisions of section 4 regarding the transferred assets are as follows :

Individual. Section 4 applies only to transfers made by an 'individual'. Therefore a transfer of joint family property made by the karta of a Hindu undivided family to a coparcener's wife or minor child or even to his own wife, *as karta of the family*, is not affected by this section.

As belonging to. It is only for the purposes of wealth-tax that the transferred assets should be treated as belonging to the transferor. In other respects the transfer would be valid in the eye of the law. It is implied from section 4 that such assets should not be included in the net wealth of the transferee.

Are held by. In order that the transferor may be assessed to wealth-tax in respect of the transferred assets, it is necessary that such assets must be 'held' by the transferee at the valuation date. If the assets have been lost or given away by the transferee to third persons before the valuation date, such assets cannot be included in the transferor's assets. But the assets need not be held in the form in which they were transferred.

Transfer. The word 'transfer' includes any disposition, trust, covenant, agreement or arrangement. A purchase of an asset by an individual in the name of his wife or husband or minor child with his or her own funds amounts to a transfer.

Adequate Consideration. Transfers for adequate consideration even to one's spouse or minor child are not hit by section 4. Whether the consideration is adequate is a question to be decided on the facts of each case. Love and affection are not adequate consideration, though they are good consideration in the eye of the law. Settlements which are made in connection with marriage or adoption, before the marriage or adoption, are supported by adequate consideration.

Change of Form of Assets. If the form of assets transferred is changed before the valuation date, section 4 will apply to the substituted assets. If a substituted asset is one, which is exempt from wealth-tax (*e. g.*, animals), it will not be included in the net wealth of the transferor.

Where the transferred asset is lost or destroyed, there is no question of its inclusion in the net wealth of the transferor, as it is not held by the transferee.

Transfers before 1st April 1956. Transfers of assets made before 1st April 1956 are outside the scope of section 4. For Goa and Pondicherry this date is 1st April 1963. But benami or sham transfers are of no effect.

Application of Section 5. The provisions of section 5 relating to exemptions in respect of certain assets will also apply in relation to those assets which, though not belonging to the assessee, are included in his net wealth, as if such assets were assets belonging to the assessee.

Debts Incurred by Transferee. All debts referable to the transferred assets, whether incurred by the transferor or the transferee which are payable on the valuation date will be deducted from the value of the transferred assets.

Holder of an Impartible Estate. The holder of an impartible estate is to be treated as the individual owner of all the properties of the estate.

Liability of Transferee to Pay Wealth-Tax. As stated above, though the transferred assets are treated as assets of the transferor in certain circumstances, wealth-tax in respect of such assets can also be recovered from the transferee. Under section 33, the notice of demand can be served on the transferee and the wealth-tax can be recovered even from the private properties of the spouse or minor child as the case may be.

Exempted Assets

Assets which are exempted from wealth-tax fall into three classes, namely :

(1) Assets which are expressly excluded by section 2(e) from the definition of assets.
(2) Assets which are exempted from wealth-tax and which are not to be included in the net wealth under section 5.
(3) Assets which are to be included in the net wealth but which are not chargeable to wealth-tax under section 5(2).

Section 2(e).

Under this section, the following kinds of property are to be excluded from the term "assets" and they are therefore to be left out in the computation of net wealth of an assessee :

(*i*) **Animals.** Animals of all descriptions (even costly animals like race horses, prize stud bulls, elephants, etc.) are exempt.

(*ii*) **Annuities.** Annuities are to be excluded from assets only in cases where they are not commutable into a lump sum at any time.

However, the value of a tax-payer's right to receive an annuity purchased by him or purchased by any other person in pursuance of a contract with the tax-payer, will be regarded as an "asset", irrespective of whether the annuity is commutable or not.

An annuity for life granted by an employer to an employee (or to his wife or widow) in respect of past services of the employee is exempted under section 5(1)(vii).

Annuities receivable in respect of annuity deposits under the Income-Tax Act, have been exempted under section 5(1)(via).

In *Ahmad G. H. Ariff v. C. W. T.* (*76 ITR 471*), the Supreme Court has held that the right of a beneficiary to receive an aliquot part of the net income of properties comprised in a wakf is "property" and is covered by the definition of "assets" in section 2(e) of the Wealth-Tax Act, 1957 and the capitalised value of the right is assessable to wealth-tax. This would be so even if the aliquot share of the income was intended merely for the maintenance and support of the beneficiary. Such a right is not a mere "annuity".

(*iii*) **Short-term Interest in Property.** An interest in property which is available to the assessee only for a period not exceeding six years from the date the interest vests in the assessee, is to be excluded from assets.

Thus, the interest of a lessee under a lease for 25 years, which could under its terms be terminated at any time at the option of either party, is not an interest available for a period exceeding six years, and therefore it cannot be included in the lessee's assets (*54 ITR 687*). This decision has been confirmed by the Supreme Court (*72 ITR 801*).

Section 5(1).

This section provides that, subject to the provisions of section 5(1A), wealth-tax shall not be payable by an assessee in respect of the following assets which shall not be included in his net wealth :

(*i*) **Property Held in Trust.** Any property held by an assessee under trust or other legal obligation for any public purpose of a charitable or religious nature in India is exempt. This exemption does not extend to property held under trust for a private religious purpose.

Any purpose directed for the benefit of the community or a section of the community is a public purpose. It need not benefit the public as a whole but the beneficiaries should not be private individuals.

Trusts for the benefit of the settler's family or a club or employees of a company are not public trusts. Political purpose is not a public purpose. Charitable purpose is always a public purpose, but religious purpose, may be public or private. Property dedicated to an idol to which public have free access is a public religious trust.

If the dominant motive of a trust is charitable the mere fact that it provides for preference being given to the poor relations of the settler will not change its charitable nature. Where the main motive of a trust is to support the settler's descendants it is not a trust of a public nature.

(*ii*) **Interest in Coparcenary Property.** The interest of an assessee in the coparcenary property of a Hindu undivided family is exempt, because the family itself is liable to wealth-tax.

(*iii*) **One Official Residence of Ruler.** Any *one* building in the occupation of a Ruler of an erstwhile Indian State is exempt where it is declared by the Central Government as his official residence.

Where several palaces declared by the Central Government are in the occupation of a Ruler, the exemption is available only in respect of *one* of such palaces. The choice of this one residence was left to the Rulers who conveyed their option to the Board.

(*iv*) **Residential House.** One house or part of a house belonging to the assessee and used by him for residential purposes or let out, provided that where the value of such house or part exceeds Rs. 1,00,000, the amount that shall not be included in the net wealth of the assessee shall be Rs. 1,00,000.

The selection of one particular house for claiming exemption from out of more than one such houses is not limited in any way. It is open to the assessee to choose the particular house for exemption.

(*iva*) **Agricultural Land.** The separate exemption in respect of agricultural land belonging to the assessee has been withdrawn, but it is linked with the exemption in respect of certain financial assets as specified in section 5(1A) explained later on. A tax-payer can claim a maximum deduction of Rs. 1,50,000 in the aggregate in respect of any one or more of the specified financial assets and agricultural land.

(*ivb*) **Farm Building.** One building or a group of buildings owned by a cultivator or a receiver of rent or revenue out of agricultural land, if such building or group of buildings is in immediate vicinity of the land and is

required by the owner as a store house or for keeping livestock. There is no exemption if it is used as a dwelling-house. A tax-payer who owns a farm house in addition to a house property can claim exemption only in respect of *one* of these properties up to a total value of Rs. 1,00,000 as already stated above in (*iv*).

(*v*) **Patents and Copyrights**. Rights under patents and copyrights belonging to the assessee are exempt under the following conditions :

(*a*) They should not be held as assets of a business, profession or vocation ; and

(*b*) No income or benefit should accrue to the assessee from them.

If either of these two conditions is not satisfied, this exemption is not available. That is to say, if the asset is held as an asset of a business, profession or vocation it will be included, even though it produces no income ; and if it is not held as an asset of a business, profession or vocation it will be included if it produces any income.

(*vi*) **Policies of Insurance**. The right or interest of an assessee in any policy of insurance is exempt only so long as the moneys covered by the policy have not become due and payable to the assessee.

The value of a tax-payer's right or interest in a policy of insurance will be exempt only if the premia are payable over a period of ten years or more. In cases where premia are payable over a period of less that ten years, only a proportionate amount of the value of the tax-payer's right or interest in the policy of insurance will be exempt.

What is exempted is not merely the right in any policy but also the interest of the assessee in any policy. The word 'interest' would cover the interest of a pledgee or a mortgagee to whom the policy might have been assigned.

This exemption is not confined to life insurance only ; it extends to any policy of insurance.

If loans are raised on the security of life insurance policies and utilised for acquiring assets, the assets are to be included in the net wealth (*66 ITR 338*).

(*vi-a*) **Annuities**. The right of the assessee to receive any annuity under the annuity deposit scheme of income-tax law.

(*vii*) **Right to Receive Pension or Life Annuity**. The right of the assessee to receive a pension or other life annuity in respect of past services under an employer is exempt. It means that the value of this right is exempt, but the pension when actually received is included in net wealth.

This exemption extends to the commuted amount of the pension or life annuity as well.

Only life annuities are exempted under this head. As regards other annuities, section 2(e) provides that they will be excluded from the assets in every case where they are not commutable into a lump sum.

Right to an aliquot share in the income of property is not an annuity. An annuity must be a fixed sum. The mere fact that an annuity is payable every month does not take it out of the definition of an annuity.

This exemption is available only for pensions and annuities in respect of past services under an employer. The fact that pension is payable for past services is not sufficient ; it must be payable for past services under an employer. However, the receiver of the pension or annuity may be the widow or wife of the employee and need not be the employee himself.

(*viii*) **Furniture, Household Utensils, etc.** The items exempted under this head are furniture, household utensils, wearing apparel, provisions and

other articles intended for the personal or household use of the assessee. *But jewellery for personal use is not exempt.*

The term "jewellery" is given an extended meaning so as to include: (*a*) ornaments made of gold, silver, platinum or any other precious metal ; and (*b*) precious or semi-precious stones whether or not set in any furniture, utensil or other article or sewn into any wearing apparel intended for personal use.

Motor-cars and other mechanically propelled vehicles, aircraft and boats intended for personal use are exempt only up to an aggregate value of Rs. 30,000.

(*viii-a*) **Growing Crops**. This exemption is available in respect of growing crops (including fruits on trees) on agricultural land and grass on such land.

(*ix*) **Agricultural Tools, etc.** This exemption is limited to the tools, implements and equipment used for the cultivation, conservation, improvement or maintenance of agricultural land, or for the raising or harvesting of any agricultural or horticultural produce on such land.

This exemption does not extend to plant and machinery used in a tea or other plantation in connection with the processing of any agricultural produce or in the manufacture of any article from such produce. But plant and machinery used for raising of agricultural produce in a plantation is entitled to exemption.

With regard to building, plant and machinery permanently fixed on agricultural land, they fall within the expression, "agricultural land".

(*x*) **Professional Tools and Instruments**. Only such tools and instruments as are necessary to carry on the assessee's profession or vocation are exempted up to Rs. 20,000. Tools and instruments of a business carried on by the assessee are not exempt.

(*xi*) **Scientific Apparatus**. Only instruments and apparatus used by the assessee for purposes of scientific research are exempted.

(*xii*) **Works of Art, etc.** Under this head, works of art, archaeological, scientific or art collections, books or manuscripts belonging to the assessee and *not intended for sale*, are exempt. The essential condition for exemption is that they should not be intended for sale. In old age, when a man's income ceases, he may decide to sell away his art collections, but in such cases it cannot be said that the articles are intended for sale.

(*xiii*) **Heirlooms**. This term includes all personal property that has been in the family for generations, *e. g.*, drawings, paintings, photographs, prints, etc., not falling under (*xii*) above and not intended for sale, but not including jewellery.

(*xiv*) **Jewellery of Rulers**. Rulers of former Indian States are given two special exemptions—one in respect of an official residence, and another in respect of heirloom jewellery. The conditions for exemption of jewellery are :

(*a*) It must be in the Ruler's possession, but it must not be his personal property ; and

(*b*) It must have been recognised as his heirloom by the Central Government or by the Central Board of Direct Taxes.

Jewellery dedicated to idols in temples is not liable to wealth-tax, because an idol is not an individual but is a recognised juristic entity and the Wealth-Tax Act does not apply to it. It has, however, been held that in the case of a wakf the mutawalli can be assessed as an individual though the property vests in the "Almighty".

(*xv*) **Five-year Deposits**. This exemption is in respect of deposits under the "Five-year Deposit Scheme" made by the Central Government.

This scheme has been explained in a preceding chapter dealing with computation of total income.

(*xvi*) **Savings Certificates and Deposits.** Under this head, the following investments are exempt :

1. Ten-year treasury savings deposit certificates.
2. Fifteen-year annuity certificates.
3. Deposits in post-office savings banks.
4. Post-office cash certificates.
5. Post-office national savings certificates.
6. Post-office national plan certificates.
7. Twelve-year national plan savings certificates.
8. Ten-year defence deposit certificates.
9. Twelve-year national defence certificates.

This exemption is available not only in respect of securities standing in the name of the assessee but also in respect of securities of which he is the beneficial owner.

This exemption is available only when the certificates and deposits have been held by the assessee for at least six months before the valuation date, and it is limited to the maximum amount permitted to be invested or deposited.

(*xvi-a*) **Gold Bonds.** 6½% Gold Bonds 1977, 7% Gold Bonds 1980 and National Defence Gold Bonds 1980 are exempt under this head.

(*xvii*) **Provident Fund Deposits.** The amount standing to the credit of a salaried employee in any provident fund to which the Provident Funds Act, 1925, applies or which is a recognised provident fund. The whole of such amount is exempt. When the provident fund amount is received it becomes taxable. The amount retained by a retired government employee in the Government provident fund is exempt from wealth-tax under executive instructions.

However, when the employee is a member of an unrecognised provident fund, his own contributions and interest thereon are to be included in his net wealth.

(*xvii-a*) **Public Provident Fund Deposits.** The amounts standing to the credit of an assessee in the public provident fund are exempted from wealth-tax. What is a public provident fund has already been explained in a previous chapter dealing with the assessment of salary income.

(*xvii-b*) Property held by the trustees of a provident fund to which the Provident Funds Act of 1925, applies or which is a recognised provident fund.

(*xvii-c*) Property held by the trustees of an approved gratuity fund.

(*xvii-d*) Property held by the trustees of an approved superannuation fund.

(*xviii*) **Gallantry Awards.** Property received by an assessee from Government in pursuance of any gallantry merit award is exempt. The award is exempted in the hand of the recipient only. If the property awarded is alienated by the recipient or if it descends to his heirs after his death, it will cease to be exempt.

(*xix*) **Shares Held by a Company.** Shares held by a company in other companies. The shares must be held from the date of the first issue or for a period of at least six months before the valuation date.

(*xx*) **Equity Shares.** Equity shares in an industrial company, exempted under section 45(d), which form part of the initial issue of share capital made *before 1-6-1971.*

A section 45(d) company is a company established with the object of carrying on an industrial undertaking in India where the company is not formed by the splitting up or reconstruction of a business already in existence.

This exemption is available for five successive assessment years commencing with the assessment year next following the date on which such company commences operations.

(*xxa*) The value of shares in any new industrial company established for the purpose of carrying on the business of manufacture or production of any one or more of the articles or things specified in the Ninth Schedule to the Income-Tax Act, will be exempt from wealth-tax for a period of five years, provided the shares formed part of the initial issue of equity share capital made after 28-2-1975. This period of five years will be computed from the assessment year next following the date on which such shares were first issued by the company.

(*xxi*) **New Units of Industrial Companies.** The exemption granted to industrial companies by section 45(d) made it equitable to give similar concession to new units established by industrial companies for expansion of their business in cases where the company itself might not be qualified for such exemption.

Note : The exemptions mentioned in (*xix*) and (*xxi*) above relate to companies on which wealth-tax has been abolished.

(*xxii*) **Government Securities.** Any security of the Central Government or a State Government, not being a security referred to in (*xvi*) and (*xvi-a*) above.

(*xxiii*) **Shares in Companies.** Any shares, not being shares referred to in (*xx*) or (*xxa*) above, in any Indian company where the assessee is an individual or Hindu undivided family.

(*xxiv*) **Notified Debentures.** Such debentures of co-operative societies (including co-operative land mortgage banks and co-operative land development banks) or of other institutions or authorities as may be notified by the Central Government.

(*xxv*) **Units in Unit Trust.** Units in the Unit Trust of India.

(*xxvi*) **Bank Deposits.** Deposits with banking companies and co-operative societies carrying on banking business (including co-operative land mortgage banks and co-operative land developement banks).

(*xxvii*) **Deposits with Financial Corporations.** Any deposits with a financial corporation which provides long-term finance for industrial development in India and which is approved by the Central Government.

(*xxviii*) **Shares in Co-operative Societies.** Any shares in any co-operative society.

(*xxix*) **Deposits with a Co-operative Society.** Any deposits with a co-operative society, not being deposits referred to in (*xxvi*) or (*xxx*), made by a member of the society.

(*xxx*) **Deposits with a Co-operative Housing Society.** Any deposits with a co-operative housing society by a member of the society to whom a building or part thereof is allotted or leased under a house building scheme of the society where such deposits have been made under such scheme.

(*xxxi*) **Assets of an Industrial Undertaking.** The value of assets (not being any land or building or any rights therein or assets which are otherwise exempt) which form part of an industrial undertaking belonging to the assessee.

(*xxxii*) **Interest of Assessee in Assets of an Industrial Undertaking.** The value of the interest of the assessee in the assets (not being any land or building or any rights therein or assets which are otherwise exempt) which form part of an industrial undertaking belonging to a firm or an association of persons of which the assessee is a partner or member.

Note : An industrial undertaking means an undertaking engaged in the business of generation or distribution of electricity or any other form of power or in the construction of ships or in the manufacture or processing of goods or in mining.

Section 5(1A).

Under this section there is an overall limit of Rs. 1,50,000 on the exemption in respect of investments mentioned in (*iv-a*), (*xv*), (*xvi*), (*xxii*), (*xxiii*), (*xxiv*), (*xxv*), (*xxvi*), (*xxvii*), (*xxviii*), (*xxix*), (*xxxi*) and (*xxxii*) above. This limit of Rs. 1,50,000 does not apply to cumulative time deposits in post-office savings banks.

Besides the above overall exemption limit of Rs. 1,50,000, an additional exemption up to Rs. 25,000 is allowed in respect of investment in the units of the Unit Trust of India.

As investments mentioned in (*xv*) and (*xvi*) may in some cases exceed the limit of Rs. 1,50,000, such investments made before 1-3-1970 will continue to enjoy the exemption even if they exceed the overall limit of Rs. 1,50,000.

Section 5 (2).

The section specifies another class of assets which are exempt from wealth-tax but which are to be included in the net wealth for determining the rate of wealth-tax applicable to that part of net wealth which is taxable.

Under this section wealth-tax is not payable by an assessee in respect of any deposit made by him with Government or in any security of the Government or of a local authority (not covered by any of the above exemptions) which the Central Government notifies to be exempt from wealth-tax provided the deposit or security has been held for at least six months before the valuation date.

No such notification has been issued so far by the Central Government.

Section 5 (3).

The exemption of investments mentioned in (*xv*), (*xvi*), (*xix*), (*xxa*), (*xxii*), (*xxiii*), (*xxiv*), (*xxv*), (*xxvi*), (*xxvii*), (*xxviii*) and (*xxix*) gives an opportunity to avoid wealth-tax by converting taxable assets into exempted investments before the valuation date. With a view to prevent such transformation and to confine the exemption to *bona fide* investments, section 5(3) provides that to qualify for the exemption, the following conditions must be fulfilled :

(*a*) In the case of shares in companies, the shares must have been owned from the date of the first issue of such shares or for at least six months before the valuation date ; and

(*b*) In the case of other investments, they must have been owned for at least six months before the valuation date.

Note : In a case where exemption from wealth-tax in respect of any asset is available subject to the condition that such asset should have been owned by the assessee for a period of at least six months ending with the valuation date, the exemption will not be forfeited merely because such asset has not been so owned if such asset has been acquired by the conversion of or in exchange for or with the proceeds of or with the money constituting any other asset exempt from wealth-tax within a period of one month of the conversion, exchange etc.

Location of Assets and Debts

The legal conception of property, whether movable or immovable, involves the legal conception of its existence somewhere. The determination of location of assets and debts is necessary for the following reasons, namely :

(*a*) Under section 6, the assets and debts located outside India of non-citizens and of non-resident and not ordinarily resident Indian citizens have to be left out of account in computing the net wealth.

(*b*) Under section 31(7), the payment of wealth-tax may be held in abeyance where the assets taken into account for assessment are located outside India and the income from such assets cannot be remitted to India owing to prohibition or restriction on remittances.

(*c*) Under the rate schedule, a rebate of wealth-tax is granted to resident individuals and Hindu undivided families in respect of their assets located outside India as reduced by their debts outside India.

Assets consists of immovables, movables and debts and actionable claims. Debts may be unsecured and secured ; they may be secured by pledge of movables or mortgage of immovables.

For the purposes of the Wealth-Tax Act, the Board has issued instructions for determining the location of certain assets and debts. These instructions provide as follows :

(*a*) Tangible immovable property (*e.g.*, lands and buildings) is situated in India if the property lies in India.

An usufructuary mortgagee and a mortgage by way of conditional sale hold and possess immovable property.

(*b*) Rights or interests in or over immovable property (otherwise than by way of security) or benefits arising out of immovable property are located in India if the immovable property to which the rights are attached or out of which the benefits arise lies in India.

Examples of rights and interests are easements of light and air, right of way, ferry, right to fishery, etc.

Benefits arising out of immovable property are right to collect market dues at a fair held on a plot of land, a right to levy toll, a right to use water of a lake or tank for irrigation, etc.

(*c*) Rights or interests (otherwise than by way of security) in tangible movable property are located in India if such property is located in India or if it is in transit to India.

(*d*) Debts, secured or unsecured (other than those dealt with below) are located in India if they are contracted to be repaid in India or if the debtor is residing in India.

(*e*) Moneys kept in a Bank account are located in India, if the branch of the bank at which the account is kept is situated in India.

(*f*) Securities issued by Government or local authorities in India are located in India unless they are inscribed for payment outside India.

(*g*) Shares, stocks, debentures or debenture stock of a company are located at the place where the company is incorporated.

(*h*) Ships or aircraft are located in India if they are registered in India.

(*i*) Copyright or licence to use any copyright material, patent, trade-mark or design is located in India if the right arising therefrom are exercisable in India.

(*j*) Patents, trade-marks and designs are located in India if they are registered in India.

(*k*) Rights of action, not included in any of the items mentioned above, are situated in India if they are enforceable in India.

It is not possible to give an exhaustive list of assets and the principles to be applied in determining the location of all such assets. For assets which are not covered by the above items, the location has to be fixed having regard to the nature of the assets.

Valuation of Assets

Section 3, the charging section, imposes a tax on the net wealth of the assessee and section 2(m) defines net wealth as the net aggregate *value* of the assets of the assessee. Section 7 enunciates what that "value" is and it lays down the method of its determination.

Under section 7(1), subject to any rules made in this behalf, the value of any asset, other than cash, shall be estimated to be the price, which in the opinion of the Wealth-Tax Officer it would fetch if sold in the open market on the valuation date.

Under section 7(3), notwithstanding the above provision, where the valuation of any asset is referred by the Wealth-Tax Officer to the Valuation Officer, the value of such asset shall be estimated to be the price which in the opinion of the Valuation Officer it would fetch if sold in the open market on the valuation date.

There is no question of valuing the legal tender coins and currency notes which make up the cash of an assessee. Coins and currency notes (Indian or foreign), which are not legal tender, have to be valued by an estimate, the value of coins being based upon their metal content.

The law requires the opinion of the Wealth-Tax Officer in regard to the price which the asset, if sold on the valuation date in the open market, would have fetched. The opinion which does not take this principle into account is valueless. The opinion is a judicial opinion based on well known rules of law and has to be stated with reasons.

The expression "open market" denotes that the sale is held under conditions enabling every person desirous of purchasing to come in and make an offer. The price at which the property has been actually sold under open market conditions a short time after the valuation date may afford a true measure of the value as on the valuation date.

Under section 7, the assessing authorities are bound to determine the value of an asset as that sum which the asset, if sold on the valuation date, would have fetched in the open market. The burden is upon the taxing department to find out the true net value assessable. The assessee is not liable to pay tax for any amount in excess of the true net value. There should be an earnest endeavour on the part of the Department to conform to the provisions of the statute, and in discharging this duty the Department should not even unconsciously overvalue the asset. It may be that the assessee would endeavour to underestimate the value, but that is certainly not a ground why the Department should not arrive at the true value.

Valuation of Particular Assets.

According to section 7(2), Wealth-Tax Rules and executive instructions issued by the Board, certain assets are to be valued in the following manner :

Business Assets. Where the assessee is carrying on a business for which accounts are maintained regularly, the Wealth-Tax Officer may determine the net value of the assets of the business as a whole, having regard to the

balance sheet of such business as on the valuation date and after making the following adjustments :

(1) The value of an asset disclosed in the balance sheet shall be taken to be :

(*a*) In the case of an asset on which depreciation is admissible, its written-down value.

(*b*) In the case of an asset on which no depreciation is admissible, its book value.

(*c*) In the case of closing stock, its value adopted for income-tax purposes.

However, if the market value of such assets exceeds the value as determined above by more than 20%, their market value shall be taken to be their value.

(2) The value of an asset not disclosed in the balance sheet shall be as follows :

(*a*) In the case of a book debt, the amount due to the assessee less bad debts allowed for income-tax purposes.

(*b*) In the case of goodwill purchased by the assessee, its market value or the price paid whichever is less.

(*c*) In the case of any other asset, its market value on the valuation date.

(3) The value of the following assets disclosed in the balance sheet shall not be taken into account :

(*a*) Any amount paid as advance tax.

(*b*) The value of any asset exempt from wealth-tax.

(*c*) Debit balance of profit and loss account and all fictitious assets.

(4) The following liabilities shown in the balance sheet shall not be taken into account :

(*a*) Capital employed in the business other than borrowed funds.

(*b*) Reserves by whatever name called.

(*c*) Provisions for meeting any future or contingent liabilities. But the provisions for sales tax and for labour bonus are deductible debts (*67 ITR 122*).

(*d*) Any debt owed by the assessee which has been utilised for acquiring an asset exempt from wealth-tax.

(5) Any debt relating to the business owed by the assessee, which is not disclosed in the balance sheet, shall be allowed as a deduction.

(6) Where the Wealth-Tax Officer is of the opinion that any asset or liability shown in a balance sheet does not really pertain to the business as such he may exclude it.

Interest in a Firm or Association. The value of the interest of a person in a firm of which he is a partner or in an association of persons of which he is a member, shall be determined in the following manner :

The net wealth of the firm or association on the valuation date shall first be determined. That portion of the net wealth of the firm or association, which is equal to the amount of its capital, shall be allocated among the partners or members in the proportion in which capital has been contributed by them. The residue of the net wealth of the firm or association shall be allocated among the partners or members in accordance with the agreement for the distribution of assets in the event of the dissolution of the firm or association or, in the absence of such agreement, in the proportion in which the partners or members are entitled to share profits. The total of the amounts

so allocated to a partner or member shall be treated as the value of his interest in the firm or association.

Where the net wealth of a firm or association computed in the above manner includes any assets located outside India, the value of the interest of a partner or member in the assets located in India shall be determined having regard to the proportion which the value of the assets located in India diminished by the debts relating to those assets bears to the net wealth of the firm or association.

Shares and Debentures. Shares and debentures which are quoted on a recognised stock exchange are valued on the basis of the closing price quoted on the stock exchange on the valuation date.

Unquoted Preference Shares. The paid-up value of an unquoted preference share will be taken to be its value if the rate of dividend payable under terms of issue or as increased by the Preference Shares (Regulation of Dividends) Act 1960, is 8% or more.

Where the dividend payable or as increased under the above-mentioned Act is less than 8%, a proportionate reduction will be allowed from the paid-up value.

Where no dividend has been paid by a company for not less than three accounting years ending on or before the valuation date, the following reduction will be allowed from the paid-up value or the adjusted paid-up value in the case of non-cumulative preference shares :

(*a*)	If no dividend is paid for three years	10%
(*b*)	If no dividend is paid for four years	20%
(*c*)	If no dividend is paid for five years	30%
(*d*)	If no dividend is paid for six years or more	40%

In the case of a cumulative preference share, the reduction will be one-half of the above rates.

Unquoted Equity Shares. In the case of unquoted equity shares of companies (other than investment companies) the value will be determined by taking the break-up value on the basis of the balance sheet of the company drawn up on or before the valuation date and by reducing it by 15%. Where no balance sheet has been drawn up on or before the valuation date, the balance sheet drawn up immediately after the valuation date is to be taken.

The break-up value has to be worked but on the basis of the book value of the assets and liabilities after making the following adjustments :

(1) The following amounts shown as assets will be ignored :
- (*a*) Any amount paid as advance tax.
- (*b*) Miscellaneous expenditure.
- (*c*) Debit balance of profit and loss account.

(2) The following amounts shown as liabilities will be omitted :
- (*a*) Paid-up equity share capital.
- (*b*) Reserves and surplus.
- (*c*) Proposed dividends.
- (*d*) Any excess provision for taxation.
- (*e*) All contingent liabilities except arrears on cumulative preference shares.

Where the company has not declared dividends continuously for three or more accounting years ending on or before the valuation date, the break-up value would be further reduced by the following percentages :

(*a*)	If no dividend is paid for three years	2½%
(*b*)	If no dividend is paid for four years	5%
(*c*)	If no dividend is paid for five years	7½%
(*d*)	If no dividend is paid for six years or more	10%

For example, if the break-up value of the equity share of a company, which has not declared any dividend for four continuous accounting years, is Rs. 90, its maket value will be as follows :

	Rs.
Break-up value on balance sheet basis	90·00
Less 15% of Rs. 90	13·50
	76·50
Less 5% of Rs. 90	4·50
Market value	72·00

Unquoted Debentures. In the case of unquoted debentures, their paid-up value will be the market value.

Land and Buildings. The value of lands and buildings should be estimated with due regard to the nature, size and locality of the property, the amenities available and the price prevailing for similar assets in the same locality or in the neighbourhood of that locality.

Where the value is not easily ascertainable in this manner, the Wealth-Tax Officer may take the municipal valuation of the property (if it is not too low in view of the rents actually received) and multiply it, say 20 times, in order to determine the value of the property. But this method can be adopted only where other modes of determining the true market value fail.

Apart from the rental method of valuation it is permissible to value a building on the basis of the land value and the construction cost.

In the case of buildings which are in the possession of tenants and the tenants cannot be either evicted or the rent payable by them enhanced except in accordance with the provisions of the Rent Control Act, the only appropriate method of valuation is to capitalise the annual rent by certain number of years' purchase. The method of valuing the site and the building separately and adding up the values would be improper in such cases. The power conferred upon the Wealth-Tax Officer under section 7 is a judicial power ; it has to be exercised in a judicial manner and the exercise of that power is open to review in appeal (*63 ITR 103*).

Patents, Copyrights, Trade-marks, Designs, etc. These are all intangible assets. Generally speaking, the average annual income for a period of three to five years from the invention or book is ascertained and this is capitalised at 8 to 12 per cent to ascertiain the value of the patent or copyright. A patent or copyright will lose its value after some time and some allowance should be made for this factor. In exceptional circumstances, the rate of capitalisation is determined having regard to the nature of the invention which has been patented or the nature of the book in which there is a copyright. The individual circumstances concerning a particular invention, book, etc., should be taken into account before ascertaining the value of the patent or copyright.

Computation of Net Wealth

As regards wealth-tax, the concept of "net wealth" is very important, because net wealth is the tax base. The expression "net wealth" is found in section 3 (charging section), section 4 (including section), section 5 and 6 (excluding sections) and in several other sections of the Wealth-Tax Act.

According to section 2(m), the "net wealth" of a person is the value of the excess of his "assets" over his "liabilities" on the valuation date.

For the purpose of computing net wealth, the assets (*i*) should belong to the assessee, (*ii*) may be located anywhere in India or outside India, (*iii*) include assets required to be included by the Act, and (*iv*) should exist on the valuation date.

The liabilities to be taken into account are all the debts owned by the assessee on the valuation date with the exception of certain specified liabilities.

Assets.

All assets belonging to the assessee and wherever located are to be taken into account with the following exceptions, namely :

(1) Three kinds of assets (*e. g.*, animals) are to be excluded as per section 2(e).

(2) A number of other assets are to be excluded according to section 5(1).

(3) Under section 6, assets located outside India and certain loans and investments even located in India are to be excluded in the case of non-citizens and Indian citizens and Hindu undivided families not resident or not ordinarily resident in India.

The assets should exist at the last moment of the valuation date. Therefore assets lost, stolen or destroyed on the valuation date are to be ignored.

The assets should belong to the assessee. That is to say, the assessee should have a beneficial interest in the assets. He may be the absolute owner thereof or he may have the right to use them.

As regards assets required to be included, section 4 enumerates certain assets which have to be included in the net wealth of an individual, even though he may have actually transferred them to another, such as to a spouse or minor child.

If the assets of an assessee include any debts due to him by others, such debts should be enforceable by law, and they should be included in the net wealth after deducting any bad debts.

Liabilities.

The aggregate value of the debts owned by the assessee on the valuation date has to be deducted from the aggregate value of the assets on that date in order to compute the net wealth. The debts must be owed at that date, that is to say, they must be legally enforceable against the assessee. Anticipatory liabilities cannot be deducted. Moreover, section 2(m) expressly provides that the following debts are not deductible :

(*i*) Under section 6, in the case of non-citizens and Indian citizens and Hindu undivided families not resident or not ordinarily resident in India, debts located outside India are not to be taken into account, because in these cases the assets located outside India are also to be ignored.

(*ii*) No deduction is allowed in respect of debts which are secured on, or which have been incurred in relation to any property not chargeable to wealth-tax, *e. g.*, a loan taken on the security of a life insurance policy or a loan taken from a provident fund.

However if such loans are utilised for acquiring taxable assets, such assets are to be included in the net wealth. For example, if a loan taken from a provident fund is used for purchasing shares in companies, the loan itself will not be allowed as a deduction in computing the net wealth, but the shares will be included in the net wealth.

(*iii*) No deduction is allowed in respect of taxes, penalty or interest payable under orders passed under the various taxation laws :

(*a*) which are disputed by the assessee in appeal, revision, etc., or

(*b*) which are outstanding for more than 12 months on the valuation date.

However to encourage assessees to pay disputed taxes at the earliest opportunity, section 35(2) provides that if an assessee pays out of disputed taxes any amount within six months of the first appeal or revision, the original assessment would be amended to give equivalent deduction from taxes originally disallowed.

In order to be outstanding for more than 12 months, the amount must be such as the assessee is obliged to pay prior to the relevant valuation date and not an amount which the assessee has the right to pay subsequent to the valuation date. An amount which according to the instalment scheme the assessee has an option or right to pay on a date subsequent to the relevant valuation date cannot be said to be outstanding on the relevant valuation date, and therefore it is deductible (*77 ITR 159*).

Thus, all liabilities are not deductible under section 2(m). Only those liabilities, which have matured into debts payable at present or in future are deductible. A sum payable upon a contingency is not a debt and does not become a debt until the contingency has happened.

Liability for Income-Tax. According to a decision of the Supreme Court (*59 ITR 767*), the estimated liability for income-tax existing on the valuation date is a debt owed within the meaning of section 2(m) on the valuation date and is therefore deductible in computing the net wealth. The liability to pay income-tax is a present liability though the tax becomes payable after it is quantified in accordance with ascertainable data. There is a perfected debt on the last day of the accounting year and not a contingent liability. The rate of tax is always easily ascertainable.

Liability for Wealth-Tax. According to a decision of the Supreme Court, the wealth-tax liability of an assessee as on the valuation date for the assessment year following is a "debt owed" within the meaning of section 2(m), and it should be deducted from the value of the assets as on the valuation date. *For this purpose, the wealth-tax liability is to be calculated on the basis of the wealth-tax return filed by the assessee* (*69 ITR 864*).

Advance Tax Payable. With regard to advance tax payable, there is no difficulty. Advance tax payable becomes a debt due as soon as the demand notice is served on the assessee by the Income-Tax Officer. If there is any advance tax outstanding on the valuation date, it is deductible in computing net wealth.

Liability for Estate Duty. A liability to estate duty, which is neither ascertained nor quantified on the valuation date is not a debt within the meaning of section 2(m) and cannot be taken into account in computing the net wealth (*84 ITR 959*).

Liability to Pay Bonus. Liability to pay bonus is a debt and not a contingent liability, and is therefore deductible (*67 ITR 122*).

Liability for Gratuity. It has been held by the Supreme Court that the liability of an assessee to pay gratuity to his employees on determination of employment is a mere contingent liability which arises only when the employment of an employee is determined by death, incapacity, retirement or resignation. The liability is not a present liability. Therefore, the provision made for gratuity cannot be deducted as a debt in computing the net wealth of the assessee.

Illustration

Consider the admissibility of the undernoted items as debts owing on 31st March 1975, the valuation date of a resident and ordinarily resident Indian Citizen for the purposes of his assessment to wealth-tax for the assessment year 1975-76 :

(*a*) Loan of Rs.10,000 taken against the security of shares in limited companies of the market value of Rs. 25,000 which had been transferred by the individual to his wife as a gift on 31st March 1965.

(*b*) Loan of Rs. 20,000 taken against the security of a life insurance policy on his own life, the surrender value of the policy being Rs. 30,000.

(*c*) Outstanding income-tax liability of Rs. 15,000 for the assessment year 1972-73 the demand having become payable on 20th January 1975 and is not disputed.

(*d*) Outstanding income-tax liability of Rs. 40,000 for the assessment year 1973-74, the demand having become payable on 15th March 1975 but disputed in appeal to the extent of Rs. 30,000.

(*e*) Unassessed liability to income-tax for the assessment year 1974-75 estimated at Rs. 35,000.

(*f*) Estimated liability to income-tax for the assessment year 1975-76 amounting to Rs. 60,000. Advance tax of Rs. 40,000 was paid against this liability in the year ended 31st March 1975.

(*g*) Loan of Rs. 15,000 taken against the mortgage of a house property at Calcutta of the value of Rs. 50,000 used for his own residence, the loan being utilised for purchasing shares of equal value and such shares forming part of net wealth on the valuation date.

(*h*) Loan of Rs. 40,000 taken on personal security in the United Kingdom for constructing a house in London. The money was deposited in the assessee's bank account in London and expenses on construction amounting to Rs: 15,000 had been paid up to 31st March 1975 leaving a balance of Rs. 25,000 still deposited. (*C. A. Final, May 1968*)

(*a*) As the shares had been transferred by the individual to his wife as a gift their value of Rs. 25,000 is to be included in his net wealth under section 4(1)(a)(i). Therefore the loan of Rs. 10,000 taken against the security of these shares is admissible as a debt owing on the valuation date.

(*b*) As the surrender value of the life insurance policy is not to be included in the net wealth of the individual, the loan of Rs. 20,000 taken against the security of the policy is not admissible as a debt owing on the valuation date.

(*c*) The outstanding income-tax liability of Rs. 15,000 for the assessment year 1972-73 is admissible as a debt owing on the valuation date, because it is not disputed in appeal and is not outstanding for more than 12 months.

(*d*) Out of the outstanding income-tax liability of Rs. 40,000, Rs. 30,000 is disputed in appeal. Therefore Rs. 30,000 is not admissible as a debt owing on the valuation date. But the balance of Rs. 10,000 which is outstanding for only 16 days is deductible as a debt.

(*e*) The unassessed liability to income-tax for the assessment year 1974-75 estimated at Rs. 35,000 is admissible as a debt owing on the valuation date, because the liability to pay income-tax is a present liability though the tax becomes payable after it is quantified.

(*f*) The estimated liability to income-tax for the assessment year 1975-76 amounting to Rs. 60,000 is admissible as a debt owing on the valuation date, since the liability to pay income-tax is a present liability though the tax becomes payable after it is quantified. Rs. 40,000 tax paid in advance will be included in the net wealth as an asset.

(*g*) As the house property at Calcutta valued at Rs. 50,000 and used for the residence of the assessee is not included in his net wealth, the loan of Rs. 15,000 taken against its mortgage is not admissible as a debt owing on the valuation date.

(*h*) As the assessee is resident and ordinarily resident Indian Citizen, his foreign assets (building Rs. 15,000 and bank balance Rs. 25,000) are to be included in the net wealth. Therefore the loan of Rs. 40,000 taken in the U. K. is admissible as a debt owing on the valuation date.

Summary

The procedure for the computation of net wealth of an assessee may be summarised as follows :

(1) Determine the scope of the assessee's liability to wealth-tax according to his citizenship and residential status. This means finding out which property of a particular assessee is liable to wealth-tax, and which debts are deductible.

(2) Add together the values of (*i*) those assets which belong to the assessee on the valuation date ; and (*ii*) those assets which do not belong to him but which are required to be included in his net wealth under section 4. In doing so, leave out those assets which are exempt from wealth-tax under sections 2(e) and 5(1).

(3) Then, from the figure arrived at in the above manner deduct those liabilities existing on the valuation date, which are deductible under section 2(m), and the result will be the amount of the net wealth chargeable to wealth-tax.

Computation of Wealth-Tax

Rates of Wealth-Tax. The rates of ordinary wealth-tax applicable in the case of individuals and Hindu undivided families not having one or more members with independent net wealth exceeding Rs. 1,00,000, are as follows :

On the first Rs. 5,00,000 of net wealth	1%
On the next Rs. 5,00,000 of net wealth	3%
On the next Rs. 5,00,000 of net wealth	4%
On the balance of net wealth	8%

However, no wealth-tax is payable in a case where the net wealth of an individual does not exceed Rs. 1,00,000 and that of a Hindu undivided family does not exceed Rs. 2,00,000.

It is also provided by way of marginal relief that the wealth-tax payable shall not exceed 10% of the amount by which the net wealth exceeds the exemption limit of Rs. 1,00,000 or Rs. 2,00,000 as the case may be.

The rates of ordinary wealth-tax applicable in the case of Hindu undivided families having one or more members with independent net wealth exceeding Rs. 1,00,000 are as follows :

On the first Rs. 5,00,000 of net wealth	3%
On the next Rs. 5,00,000 of net wealth	4%
On the balance of net wealth	8%

However, no wealth-tax will be payable in a case where the net wealth does not exceed Rs. 2,00,000.

It is also provided by way of marginal relief that the wealth-tax payable shall not exceed 10% of the amount by which the net wealth exceeds Rs. 2,00,000.

Concessions regarding Wealth-Tax. The following concessions are granted in respect of wealth-tax payable by certain assessees :

(*a*) An individual who is not a citizen of India and who is not resident in India has to pay wealth-tax at half the above-mentioned rates.

(*b*) An individual who is a citizen of India and a Hindu undivided family, when they are resident in India, are granted a rebate of wealth-tax at half the average rate on the value of their foreign assets as reduced by foreign debts.

Besides the ordinary wealth-tax at the above rates an additional wealth-tax is charged on the value of urban land and buildings as explained below.

Additional Wealth-Tax on Urban Assets

The expression "urban assets" refers to lands and buildings or any right therein situated in an urban area. The meaning of the term "urban area" is explained below. Business premises (other than guest houses) are excluded from urban assets.

Additional wealth-tax at the rates specified hereafter is charged on the value of urban assets included in the net wealth of individuals and Hindu undivided families. Where the tax-payer is a partner in a firm or a member of an association of persons or a shareholder in a closely-held company owning urban assets, the proportionate value of such urban assets will be taken into account in computing the value of urban assets falling within the scope of the additional wealth-tax in the hands of the individual or Hindu undivided family.

The term "urban area" means the area situated within the limits of any municipality or a cantonment board having a population of 10,000 or more. It will also include any such areas lying within a distance of 8 kilometres from the local limits of any such municipality or cantonment board as the Central Government may notify in this behalf.

In computing the value of urban assets any debt incurred for the purpose of acquiring, improving, constructing, repairing, renewing or reconstructing the urban assets will be deducted from the gross value of the assets ; but any other debts which are deductible in computing the net wealth will be deducted from such gross value only if, and to the extent that such debts exceed the aggregate gross value of the other assets.

Rates of Additional Wealth-Tax. From 1st April 1971 the additional wealth-tax on urban assets will be charged at the following rates :

(1) On first Rs. 5,00,000 of the total value as computed above	Nil
(2) On next Rs. 5,00,000 of the total value as computed above	5%
(3) On balance of the total value as computed above	7%

Wealth-Tax Authorities

The various wealth-tax authorities are as follows :

1. The Central Board of Direct Taxes.
2. Directors of Inspection.
3. Commissioners of Wealth-Tax.
4. Additional Commissioners of Wealth-Tax.
5. Assistant Commissioners of Wealth-Tax, who may be either Appellate Assistant Commissioners of Wealth-Tax, or Inspecting Assistant Commissioners of Wealth-Tax.
6. Wealth-Tax Officers.
7. Inspectors of Wealth-Tax.
8. Valuation Officers.

The corresponding income-tax authorities perform the functions of wealth-tax authorities. Thus the Income-Tax Officer, on his appointment, automatically becomes the Wealth-Tax Officer as well, and so on.

Under section 13A, the Director of Inspection, the Commissioner of Wealth-Tax and the Inspecting Assistant Commissioner of Wealth-Tax are competent to make any inquiry under the Wealth-Tax Act and for this purpose they have all the powers which a Wealth-Tax Officer has.

The Central Board of Direct Taxes is the highest executive authority for the administration of the Wealth-Tax Act. In addition to its administrative control over all the subordinate authorities, the Board has been given power to issue general orders, instructions and directions to guide the subordinate officers in the performance of their duties.

Under section 12A, the Central Government may appoint as many Valuation Officers as it thinks fit. A Wealth-Tax authority may appoint as many overseers, surveyors and assessors as may be necessary to assist the Valuation Officers in the performance of their functions.

Assessment Procedure

Return of Wealth. Under section 14(1), where the net wealth of a person (or the net wealth of any other person for which he is assessable) on the valuation date is of such an amount as to render him liable to wealth-tax, he shall, before 30th June of the relevant assessment year, furnish to the Wealth-Tax Officer a return in the prescribed form setting forth his net wealth.

Where the net wealth of an assessee includes the value of assets held in a business or profession for which the accounts are closed after the 31st December preceding the assessment year, the assessee is allowed to furnish the return of his net wealth up to the date by which he is required to furnish his return of income in respect of such business or profession under the Income-Tax Act. Where the time for furnishing the return of income is extended by the Income-Tax Officer, such extension will be operative also for furnishing the return of net wealth in such cases.

An assessee who fails to submit a return voluntarily without reasonable cause would render himself liable to a penalty under section 18(1)(a). He would not, however, be liable to a best judgment assessment.

Under section 14(2), where the Wealth-Tax Officer is of opinion that any person is assessable, he may serve a notice upon such person requiring him to furnish within 30 days a return in the prescribed form together with such other particulars as may be required by the notice.

Under section 15, the assessee may submit a return at any time before the assessment is made, though he has failed to furnish the return in time under section 14(1) or (2). Likewise, if the assessee discovers that the return which he has furnished is wrong or defective, he may furnish a revised return at any time before the assessment is made.

Self-Assessment.

Under section 15B, an assessee who has filed a return under section 14 or 15 and the wealth-tax payable on the basis of his return exceeds Rs. 500, is required to pay the tax on the basis of the return *suo motu*, within 30 days of furnishing the return. If he does not pay the tax during that period, it will be open to the Wealth-Tax Officer in a case of continuing default to levy penalty from time to time subject to a maximum amount of 50 per cent of the tax in default.

The amount of tax so paid shall be deemed to have been paid towards the provisional assessment or regular assessment.

Provisional Assessment.

Under section 15C, the Wealth-Tax Officer may, at any time after the receipt of a return, make in a summary manner a provisional assessment of the wealth-tax payable by the assessee, on the basis of his return and the accounts and documents accompanying it.

Any amount of tax paid towards the provisional assessment is deemed to have been paid towards the regular assessment, and credit for the same is given to the assessee in his regular assessment.

While making a provisional assessment, the Wealth-Tax Officer determines only the tax payable but he does not determine the net wealth of the assessee. Therefore the provisional assessment does not prejudice the determination of any issue which may arise in the course of the regular assessment.

There is no right of appeal against a provisional assessment, and the amount of tax determined on such assessment must be paid within the time specified in the notice of demand.

Regular Assessment.

An assessment made under section 16 is known as the regular assessment, which may be made as follows :

(1) If the Wealth-Tax Officer is satisfied, without requiring the presence of the assessee or production by him of any evidence, that the return is correct and complete, he will assess the net wealth of the assessee and determine the amount of wealth-tax payable by him or the amount refundable to him.

In such a case it is not open to the assessee to quarrel with the Wealth-Tax Officer on the ground that the return was incorrect. His remedy is to appeal to the Appellate Assistant Commissioner, urging that by mistake he had included in his total wealth amounts which were not really taxable.

(2) Under section 16(2), if the Wealth-Tax Officer is not satisfied that the return is correct and complete, he shall serve a notice on the assessee either to attend in person at his office on a date to be specified in the notice or to produce or cause to be produced on that date any evidence on which the assessee may rely in support of his return.

Section 16(4) enables the Wealth-Tax Officer to call upon the assessee to produce his accounts, records and other documents. Such a notice may be served either after the assessee has filed his return voluntarily or after the Wealth-Tax Officer has called upon the assessee to submit a return.

Under section 16A, the Wealth-Tax Officer may make a reference to the Valuation Officer for the valuation of any asset. Such a reference may be made by the Wealth-Tax Officer either (*i*) where he considers the value estimated by the registered valuer to be less than the fair market value or (*ii*) where he considers it necessary to do so on account of the nature of the asset and other relevant circumstances or where he is of the opinion that the fair market value of the asset exceeds the value returned by such percentage of the returned value or by such amount as may be prescribed by rules.

The Valuation Officer will then proceed to value the asset after giving notice to the assessee to produce or cause to be produced before him such records and other documents as the Valuation Officer may require. For this purpose the Valuation Officer has all the powers of a court.

The Wealth-Tax Officer, after hearing such evidence as the assessee may produce and such other evidence as he may require on any specified points

and after taking into account all relevant material which he may have gathered, shall by order in writing assess the net wealth of the assessee and determine the amount of wealth-tax payable by him or the amount refundable to him on the basis of such assessment.

(3) Under section 16(5), the Wealth-Tax Officer has to make a best judgment (or *ex-parte*) assessment in the following circumstances :

(*a*) Where the assessee has failed to make a return in response to a notice under section 14(2).

(*b*) Where he has failed to produce or cause to be produced any evidence as required under section 16(2).

(*c*) Where he has failed to produce accounts, records or other documents as required under section 16(4).

In these circumstances, the Wealth-Tax Officer has no other alternative than to make an assessment to the best of his judgment having regard to the material available to him on the basis of his own inquiry. However, this does not mean that the Wealth-Tax Officer can arbitrarily fix the amount of net wealth ; he must act in accordance with principles of equity and justice.

There is no provision for the reopening of a best judgment assessment by the Wealth-Tax Officer. Therefore the remedy of an assessee aggrieved by such an assessment is to appeal to the Appellate Assistant Commissioner.

Wealth Escaping Assessment.

Section 17 gives power to the Wealth-Tax Officer to assess net wealth which escaped assessment in past assessment year. This additional assessment may be made in the following cases :

(1) Where the assessee has failed to make a return of his net wealth.

(2) Where he has not disclosed fully and truly all material facts necessary for assessment of his net wealth.

(3) Where the Wealth-Tax Officer has received information of escape of net wealth, though there has been no default on the part of the assessee.

In the first two cases the period for initiation of proceeding is *eight* years from the end of the relevant assessment year (*i. e.*, the assessment year in which the net wealth ought to have been taxed) ; while in the third case the period is *four* years.

Before the Wealth-Tax Officer can proceed under section 17, he must give a notice to the assessee within the period of eight years or four years. These time-limits do not apply to the reopening of an assessment for any year by reason of an order on appeal, revision or reference.

There is no time-limit for completing an assessment under section 17.

Penalties and Prosecutions

Penalties.

Under section 18(1), if the Wealth-Tax Officer, Appellate Assistant Commissioner, Commissioner or Appellate Tribunal, in the course of any proceedings, is satisfied that any person has committed the following defaults, he may impose a penalty on such person :

(*a*) Failure to furnish the return of wealth voluntarily under section 14(1) or when required by notice under section 14(2) or section 17 or failure without reasonable cause to furnish it within the time allowed or in the prescribed manner.

(*b*) Failure without reasonable cause to comply with a notice under section 16(2) or (4).

(*c*) Concealment of the particulars of any assets or furnishing inaccurate particulars of any assets or debts.

Quantum of Penalty. The amount of penalty, in addition to the wealth-tax payable by a person, which can be imposed on him in respect of the above defaults, is as follows :

(*i*) In cases referred to in (*a*), the penalty imposable shall be, for every month during which the default continued, equal to ½% of

(A) the net wealth assessed under section 16 as reduced by Rs.1,00,000 in the case of an individual and by Rs. 2,00,000 in the case of a Hindu undivided family, or

(B) the net wealth assessed under section 17 as reduced by (*a*) the net wealth (if any) assessed previously or (*b*) Rs. 1,00,000 in the case of an individual and Rs. 2,00,000 in the case of a Hindu undivided family, whichever is greater.

(*ii*) In the cases referred to in (*b*), the scale of penalty will be a minimum of 1% of the "assessed net wealth" and a maximum of an amount equal to the "assessed net wealth". For this purpose, the "assessed net wealth" will be taken to be the net wealth determined on assessment as reduced by the net wealth declared in the return, if any, furnished by the tax-payer. Where the case is one of reassessment of wealth which had escaped assessment at the time of an earlier assessment, the "assessed net wealth" for the purpose of the above-mentioned penalty provision will be taken to be net wealth determined on reassessment as reduced by the net wealth assessed previously or the net wealth declared in the return, if any, whichever is greater.

(*iii*) In the cases referred to in (*c*), the scale of penalty leviable for concealment or understatement of wealth (through concealment of assets or understatement of the value thereof or overstatement of the amount of a debt) is a minimum of an amount equal to the concealed wealth or the amount by which the wealth is found to be understated and a maximum of twice that amount.

The Wealth-Tax Officer is required to refer to the Inspecting Assistant Commissioner, for imposition of penalty for concealment (including under-statement) of wealth, cases where the amount in respect of which such penalty is imposable, as determined by the Wealth-Tax Officer on assessment, exceeds Rs. 25,000.

Presumption of Concealment. If the value of any asset returned is less than 75% of the value of such asset as determined on assessment, or the net wealth returned is less than 75% of the correct net wealth, or the value of any debt exceeds the correct value by more than 25%, the assessee will be deemed to have concealed particulars of assets or given inaccurate particulars of assets or debts, unless the assessee proves that he was not guilty of fraud or gross or wilful neglect. In such cases the burden of proof will be on the assessee ; he must prove that he was not guilty of fraud or gross or wilful neglect.

Note : No order imposing a penalty shall be made unless the person concerned has been given a reasonable opportunity of being heard.

Reduction of Penalty for Voluntary Disclosure. With a view to encourage voluntary disclosure of undisclosed wealth, section 18(2A) empowers the Commissioner, in his discretion, to reduce or waive the amount of minimum penalty imposable under section 18(1)(i) or (iii) in the case of a person who has voluntarily and in good faith made a full and true disclosure of his net wealth before detection of the same by the Wealth-Tax Officer and in addition has co-operated in any inquiry relating to the assessment of the concealed wealth and has either paid or made satisfactory arrangements for payment of any tax or interest which may become payable in respect of the assets concealed.

(*d*) He owned furniture and other household goods of the value of Rs. 80,000 and gold ornaments of the value of Rs. 10,000 intended for the personal use of his wife.

(*e*) He is entitled to a pension at the rate of Rs. 30,000 per annum due on 31st December each year from his former employer. The pension for the year ended 31-12-1974 was received on 31-3-1975.

(*f*) He is the sole beneficiary to the corpus of a trust on its coming to an end not earlier than 31-3-1985. The trust properties are of the value of Rs. 10,00,000 as on 31-3-1975. The interest of the life tenant in the trust is valued at Rs. 4,00,000. (C. *A. Final, May 1973*)

According to the Wealth-Tax Act, the treatment to be given to the various items will be as follows :

(*a*) Under section 5(1)(iv), the value of the house let out is exempt up to Rs. 1,00,000 and the balance of Rs. 20,000 is to be included in net wealth.

(*b*) The exemption under section 5(1)(xx) in respect of equity shares in an industrial company forming part of the initial issue of share capital is available only in the case of share capital issued before 1-6-1971. In this case this exemption is not available because the shares were issued after that date. Therefore Rs. 8,00,000 is to be included in the net wealth.

(*c*) As the loan of Rs. 5,00,000 was taken on the security of shares which are includible in the net wealth, the amount of the loan will be allowed as a deduction in computing the net wealth of the assessee. But the fixed deposit of Rs. 5,00,000 with a company will be included in the net wealth.

(*d*) Under section 5(1)(viii), furniture and other household goods of the value of Rs. 80,000 are exempt and will not be included in the net wealth ; but jewellery valued Rs. 10,000 for personal use will be included therein.

(*e*) Under section 5(1)(vii), the right to receive a pension from an employer for past services is exempt. Therefore the value of this right will not be included in the net wealth. But Rs. 30,000 received on 31-3-1975 being an asset will be included in the net wealth.

(*f*) The assessee's right to the corpus of the trust is a valuable right, the present value of which would be included in the net wealth. After deducting Rs. 4,00,000 (value on life tenant's interest) from the trust properties of Rs. 10,00,000, the assessee has a future right to Rs. 6,00,000. The present value of this future right will be ascertained by actuarial methods, and supposing that this present value is Rs. 4,00,000, then Rs. 4,00,000 will be included in the net wealth.

(12) Adarsh, a practising doctor and a resident and ordinarily resident Indian citizen, gives you the following particulars and requests you to advise him on the treatment to be given to each of the items for the purpose of his wealth-tax assessment as at valuation date 31st March 1975 :

(*a*) He owned 2,500 shares of the face value of Rs. 100 each in India International Private Ltd., a company with a subscribed and paid-up capital of Rs. 5 lakhs divided into 5,000 shares of Rs. 100 each. The net assets of the company as at 31st March 1975 are valued at Rs. 6 lakhs. The company has not declared any dividend since 1969.

(*b*) He owned a house in Bombay, given on rent, of the value of Rs. 1,20,000. He owned another house of the value of Rs. 80,000 used for his residence.

(*c*) He is entitled to an annuity of Rs. 10,000 per year for a period of 20 years. The market value of this right is estimated at Rs. 1,20,000.

(*d*) Luxury drawing-room furniture (value Rs. 1,20,000) and other household goods (value Rs. 30,000).

(*e*) Instruments and equipments used by him for his profession valued at Rs 50,000.

(*f*) Unassessed income-tax liability Rs. 40,000. A penalty of Rs. 50,000 imposed on him on 1-12-1974 for concealment of wealth is outstanding. In respect of assessment year 1974-75 a refund of Rs. 6,000 was intimated as due to him in March 1975 but the amount is not yet received.

(C. A. Final, Nov. 1973)

For the purpose of wealth-tax assessment of Dr. Adarsh for the assessment year 1975-76, the following treatment will be given to the various items :

(*a*) The value of shares in India International Private Ltd. will be computed in the following manner :

	Rs.
Net assets of the company on valuation date	6,00,000
Break-up value of 2,500 shares being 2,500/5,000 of Rs. 6,00,000	3,00,000
Less 15% thereof	45,000
	2,55,000
Less 10% of Rs. 3,00,000 because the company has not continuously paid and dividend for six accounting years	30,000
Value of 2,500 shares	2,25,000

After allowing the exemption of Rs. 1,50,000 under section 5(1A), the balance of Rs. 75,000 will be included in the net wealth.

(*b*) Under section 5(1)(iv), after allowing the exemption of Rs. 1,00,000, the balance of Rs. 20,000 out of the value of the Bombay house will be included in the net wealth, and Rs. 80,000 being the value of the house in which he resides will also be so included. Thus the total value of house properties to be included in the net wealth will be Rs. 1,00,000.

(*c*) Assuming that the annuity of Rs. 10,000 is not commutable into a lump sum at any time during 20 years, the right to receive the annuity will not be included in the net wealth, for such an annuity is not an asset by virtue of section 2(e).

(*d*) Under section 5(1)(viii), Rs. 1,50,000 being the value of luxury drawing room furniture and other household goods intended for the personal use of the assessee is exempt and will not be included in the net wealth. However, if the luxury furniture contains some precious metal by way of embedding, it will be treated as jewellery and its value Rs. 1,20,000 will be included in the net wealth even though it is intended for personal use.

(*e*) Under section 5 (1)(x), professional instruments and equipments are exempt up to Rs. 20,000 and the balance of Rs. 30,000 will be included in the net wealth.

(*f*) Unassessed income-tax liability of Rs. 40,000 and the penalty of Rs. 50,000 (not outstanding for more than 12 months and assumed to be not disputed in appeal) are debts within the meaning of section 2(m) and are allowable as deductions. The assessee's wealth-tax liability for the assessment year 1975-76 will also be allowed as a deduction.

Rs. 6,000 being the amount of tax refund due is an asset and will be included in the net wealth.

(13) Amichand, a resident and ordinarily resident Indian citizen, gives you the following details with regard to his wealth position as at 31st March 1975 :

(*a*) He is entitled to income for a period of five years from 1-4-1972 from a trust created by his father. The capitalised value of the income for the unexpired period is Rs. 25,000. After the period of five years the entire income and the trust corpus are to be held for the benefit of his wife.

(*b*) He had gifted to his wife in July 1962, 1,000 shares of Simon India Ltd. In 1972 his wife was allotted 500 shares by way of bonus shares. The shares are quoted on the stock exchange at Rs. 20 per share on 31st March 1975.

(*c*) He owns a house in Delhi of the value of Rs. 80,000, half of which is used for his residence and the other half is used for his business. He also owns agricultural land in Calcutta of the value of Rs. 80,000. His net business assets are worth Rs. 1,20,000 including a motor-car of the value of Rs. 30,000.

(*d*) He is entitled to a pension at the rate of Rs. 1,000 per month for life from his former employer. The commuted value of the pension as at 31-3-1975 is Rs. 50,000.

(*e*) He held shares in joint stock companies of the value of Rs. 1,75,000. Of these, shares of the value of Rs. 45,000 were purchased by him on 31-12-1974, payment for which was made on encashment of a fixed deposit in a bank made in December 1973.

(*f*) He had a bank balance equivalent of Rs. 75,000 in a Swiss bank.

(*g*) On 1-7-1974 he had impressed with the character of H.U.F. property his self-acquired property of the value of Rs. 1,00,000. The value of the property as at 31-3-1975 is Rs. 1,20,000. The family consists of Amichand, his wife, a major son, a major daughter and a minor unmarried daughter.

You are requested to advise him as to the treatment to be given to each item for the purpose of wealth-tax assessment for the assessment year 1975-76, indicating your reasons.

(C. A. Final, May 1974)

The treatment to be given to each of the items mentioned for the purpose of wealth-tax assessment will be as under :

(*a*) According to section 2(*e*), an interest in property which is available to the assessee only for a period not exceeding six years from the date the interest vests in the assessee, is not an asset and is therefore excluded from the net wealth.

(*b*) Under section 4(1)(a)(i), Rs. 20,000 being the value of shares gifted by the assessee to his wife is includible in his net wealth because it was a transfer without adequate consideration. But the value of the bonus shares received by the wife cannot be so included as they were not an asset transferred by the assessee to his wife. They were merely an accretion to the asset transferred and are outside the purview of section 4(1)(a)(i).

(*c*) Under section 5(1)(iv), the value of one house or part of a house belonging to the assessee and used as a residence or let out or used for any other purpose, is exempt from wealth-tax up to Rs. 1,00,000. Therefore the whole of Rs. 80,000 is to be excluded from the net wealth.

From 1-4-1975 the separate exemption in respect of agricultural land has been withdrawn and it is linked with the exemption in respect of certain financial assets specified in section 5(1A). The maximum amount of such exemption is Rs. 1,50,000.

Rs. 80,000 being the value of agricultural land will therefore be included in the net wealth since the full amount of exemption (Rs. 1,50,000) will be availed of in respect of shares held in companies as stated in item (e) on the next page.

Rs. 1,20,000 being the value of business assets will be included in the net wealth, Rs. 30,000 value of the motor-car is not entitled to exemption as the car is not for the personal use of the assessee. When the motor-car is for personal use, its value is exempt up to Rs. 25,000.

(*d*) Under section 5(1)(vii), the right of an assessee to receive a pension in respect of past services is exempt. Therefore the commuted value of the pension will not be included in the net wealth.

(*e*) Under section 5(1) (xxiii), shares held by an individual assessee in Indian companies are exempt if they have been held for at least six months before the valuation date. In this case shares valued Rs. 45,000 have not been held for six months as they were purchased on 31-12-1974; but because they were purchased with the proceeds of a bank fixed deposit (an exempted asset) within a month from the date of encashment of the bank deposit which was held for a year, the exemption in respect of Rs. 45,000 shares will not be forfeited.

The maximum amount of exemption under section 5(1A) in respect of all the financial assets specified therein together with the value of agricultural land is Rs. 1,50,000. Therefore Rs. 25,000 out of Rs. 1,75,000 will be included in the net wealth besides Rs. 80,000 being so included for agricultural land.

(*f*) Under section 6, as the assessee is a resident and ordinarily resident Indian citizen, Rs. 75,000 being the balance in a Swiss Bank will be included in the net wealth. But this amount is entitled to a rebate of wealth-tax at half the average rate.

(*g*) Under section 4(1A), where an individual converts, after 31-12-1969, his separate property into joint family property of a H.U.F. of which he is a member, he is deemed to have transferred the converted property, through the family, to the members of the family for being held by them jointly. In such a case the share in the converted property of the individual, his spouse or minor children (other than married daughters) will be included in the net wealth of the individual.

On the valuation date the value of the converted property is Rs. 1,20,000 and the share of the assessee, his wife and major son is Rs. 40,000 each, the daughters not being entitled to any share.

Therefore Rs. 40,000 being the assessee's share and Rs. 40,000 being the share of his wife will be included in the net wealth of the assessee.

CHAPTER 32

Gift-Tax

The gift-tax is levied under the provisions of the Gift-Tax Act, 1958 which came into force on 1st April 1958, and which applies to the whole of India except the State of Jammu and Kashmir. This Act has been amended from time to time since it was passed.

The object of this Act is to levy a tax on gifts in whatever form made by one person to another, and thereby to fill a gap in the existing system, which made it possible to avoid or reduce tax liability by gratuitous transfers of property.

Agricultural Land.

Is a gift of agricultural land exempt from gift-tax ? There is no express exemption granted in respect of a gift of agricultural land, and there is a conflict of judicial opinion on this point. Therefore, a gift of agricultural land is fully taxable under the Gift-Tax Act.

Previous Year.

In each assessment year gift-tax is levied on all gifts made by an assessee during the previous year. The previous year would be the same as adopted for income-tax assessment. If for income-tax assessment there are different previous years for different sources of income, the previous year for gift-tax assessment would be the previous year which expired last.

If an assessee has no income chargeable under the Income-Tax Act, the previous year for gift-tax assessment will be the financial year immediately preceding the assessment year. Once an assessment has been made under the Gift-Tax Act on the basis of a particular previous year, the same previous year will be applicable to the assessee's future assessment to gift-tax. The assessee can, however, change his previous year with the approval of the Gift-Tax Officer.

The first assessment for gift-tax was made in the financial year beginning on 1st April 1958, but no person was required to pay tax on gifts made prior to 1st April 1957, whatever the previous year for income-tax might have been.

Person.

The definitions of "person" and "property" are important, since the charge of gift-tax is on a person and in respect of property gifted.

The term 'person' includes a Hindu undivided family, a company, an association of persons or a body of individuals. A firm is not included in this definition. It therefore follows that a firm as such cannot be charged to gift-tax though it might become chargeable as an association of persons.

Gift-tax is not a tax on property but is a tax on the transaction of gift. If two or more persons execute one deed of gift in favour of the same person in respect of properties which belong to them individually or in which they have separate and distinct interests, they cannot be assessed to gift-tax as an association of individuals (*72 ITR 579*).

Property.

Property includes any interest in property, movable or immovable. Gifts of all forms of property are chargeable to gift-tax.

Who can be a donee ?

A donee means any person who acquires any property under a gift, and where a gift is made to a trustee for the benefit of another person, the trustee and the beneficiary are both donees.

Any living person is competent to be a donee, unless he is subject to any legal disqualification *e. g.*, legal practitioner is not allowed to receive any share or interest in any actionable claim. A minor can be a donee, for a minor can accept a benefit though he cannot incur an obligation. A guardian of a minor or lunatic can accept a gift on behalf of the minor or lunatic. A child in womb can also be a donee and a guardian on behalf of such a child can accept the gift.

The donee must be alive at the date of the gift. If at the date when the gift becomes operative he is dead, the gift lapses.

Deemed Donees. Besides the donee of a direct gift and the trustee-donee or beneficiary donee in the case of an indirect gift by way of a trust, section 4 deems certain transactions to be gifts. Thus, a deemed donee is a person in whose favour the following transactions are made :

(*a*) A transfer of property otherwise than for adequate consideration.

(*b*) A transfer of property for consideration which has not passed or is not intended to pass.

(*c*) A release, discharge, surrender, forfeiture or abandonment of any debt, contract or other actionable claim or any interest in property, where the Gift-Tax Officer is not satisfied that it is *bona fide*.

(*d*) A joint vesting by the absolute owner of any property in himself and another person without adequate consideration and the latter appropriating out of the said property.

(*e*) A conversion by a member of a Hindu undivided family of his separate property into the joint family property.

In each of the above cases, the gift-tax may be recovered from the deemed donee, if in the opinion of the Gift-Tax Officer the tax cannot be recovered from the donor.

Who can be a donor ?

A donor is the person who makes a gift. Any person who is competent to contract can make a gift of his property. Trustees cannot make a gift out of the trust property unless authorised to do so by the terms of the trust. If a trustee makes a gift, being authorised to do so, the beneficiary under the trust would be the donor and not the trustee. A company may not gift away its property unless specially authorised to do so by its memorandum and articles of association.

A coparcener in a Mitakshara Hindu undivided family cannot make a gift of his interest in the coparcenary property ; but a father in such a family can make a gift of the family property out of natural love and affection, within

reasonable limits. A Hindu can dispose of by gift his self-acquired property. A Hindu female can dispose of her stridhan by gift.

What is gift ?

The term "gift" is defined as a transfer by one person to another of any existing movable or immovable property made voluntarily and without consideration in money or money's worth, and it includes the transfer or conversion of any property referred to in section 4 and deemed to be a gift under that section.

Property transferred may be agricultural or non-agricultural and it also includes an interest in property.

Before a transfer of property can attract gift-tax liability, the following conditions must be satisfied, namely :

(*a*) The transfer must be voluntary ;
(*b*) The transfer must be of existing property ; and
(*c*) The transfer must be without consideration in money or money's worth.

The subject-matter of the gift-tax is the gratuitous transfer of property by one person to another, either made directly by means of a conveyance or assignment or delivery or made indirectly through the medium of a trust or settlement.

For example, the pujari of a temple teaches Gita and X who attended his classes gave him a cash gift of Rs. 501. This is not a gift for the pujari carries on a vocation and the teaching given to the donor is sufficient consideration.

The distinguishing features of the definition of 'gift' under the Transfer of Property Act and the Gift-Tax Act are as follows :

(*a*) Gift under the Transfer of Property Act, is the transfer of certain existing movable or immovable property made voluntarily and without consideration by one person called the donor to another person called the donee, *and accepted by or on behalf of the donee*. But gift under the Gift-Tax Act, is the transfer of existing movable or immovable property by any person made voluntarily and without consideration in money or money's worth and includes the transfer of any property deemed to be a gift under section 4.

(*b*) Under the transfer of Property Act, acceptance of the gift by the donee or on his behalf is necessary ; but under the Gift-Tax Act, such acceptance is not necessary.

(*c*) Under the Transfer of Property Act, no transaction can be deemed to be a gift ; whereas under the Gift-Tax Act, transactions specified in seetion 4 are deemed to be gifts.

Note : The Kerala High Court has recently held that for the purpose of the Gift-Tax Act it is essential that the donee should have accepted the gift (*96 ITR 365*). But this view may be challenged in the Supreme Court.

Method of Making Gifts. Gifts may be made in the following manner :

1. Gift of Immovable Property. A gift of immovable property (whatever the amount) can be made by executing a deed of transfer in writing registered and attested by at least two witnesses. If these formalities are not observed the gift would be incomplete and can be revoked by the donor; but this power of revocation would not be available on the ground that the deed has not been registered, if other formalities have been fulfilled.

2. Gift of Movable Property. A gift of movable property may be made either by executing registered document or by delivering the property to the donee. If the property is an actionable claim, the gift must be made by a written instrument assigning the actionable claim.

A gift of money by cheque is not complete unless the cheque is cashed; but when cashed the gift relates back to the date of delivery of the cheque. A gift of a bank fixed deposit receipt would be complete by an endorsement on the receipt by the holder thereof to pay the sum mentioned therein to the donee followed by the delivery of the receipt so endorsed to the donee.

A gift of shares in a company would be complete when the donor has executed a correct instrument of transfer and handed it over to the donee along with the relevant share certificate. It is not necessary that the shares should be transferred in the name of the donee in the books of the company.

Mere entries in the books of account are not sufficient for completing a gift of movable property.

Void and Voidable Gifts. A gift is void *ab initio* if it is made for any illegal or immoral purpose or if it is opposed to public policy.

A gift is voidable at the instance of the donor where (*i*) a power of revocation is reserved to the donor at the time of making the gift, (*ii*) it is vitiated by fraud, undue influence, coercion or misrepresentation, and (*iii*) it is intended to defraud creditors of the donor.

For purposes of gift-tax it is immaterial that a gift is void or voidable. The Gift-Tax Act is not concerned with the validity or invalidity of a transaction; it looks at facts as they are. If the facts of a transaction fall within the definition of gift, gift-tax is leviable on it.

Transfer of Property.

According to section 2(xxiv), transfer of property means any disposition, conveyance, assignment, settlement, delivery, payment or other alienation of property and includes :

(*a*) the creation of a trust in property ;

(*b*) the grant or creation of any lease, mortgage, charge, easement, licence, power, partnership or interest in property ;

(*c*) the exercise of a power of appointment of property vested in any person, not the owner of the property, to determine its disposition in favour of any person other than the donee of the power ; and

(*d*) any transaction entered into by any person with intent thereby to diminish directly or indirectly the value of his own property and to increase the value of the property of any other person.

It is a fundamental and well-accepted principle of Hindu Law that an adopted son acquires the rights of a natural son and becomes a member of the Hindu undivided family. The adoption of a son cannot be treated as a voluntary act of transfer of property and as amounting to a gift. On the adoption of a son, a coparcener is introduced and the interest of the sole surviving coparcener is halved.

Formation of Partnership. When the sole proprietor of a business converts it into a partnership by taking his son or other near relative as a partner giving him a share in the profits and a share in the assets of the business as well, there is a gift of such share of the assets to the son or other relative. Such gift is chargeable to gift-tax.

Change in Shares of Partners. The right of a partner to share in the profits of a firm is as much property as his right to share in the assets of the firm, capable of transfer at least as between the partners by common consent, and hence a redistribution of the shares of the profits as between one partner and other partners, involves a transfer of the right which has the effect of diminishing a partner's interest and correspondingly increasing the quantum of the shares held by the other partners. Thus, the distribution by way of

re-alignment of the one-third share of a partner by which he took only a one-ninth share and the balance, two-ninths, was taken by the two other partners, involves a transfer of property amounting to a gift chargeable to gift-tax (*73 ITR 761*). How is this gift to be valued ? Section 6(3) contemplates rules to be prescribed for valuing a property, the value of which cannot be estimated under section 6(1). In the absence of any rule framed, section 6(3) may really serve no purpose.

Rights Shares. The right to obtain a specified number of rights shares under section 81 of the Companies Act, 1956, in a fresh issue of capital is a tangible right and is existing property. Therefore when this right is renounced in favour of others, the difference between the price obtained for such renunciation and the market quotation of the right is a gift liable to gift-tax (*70 ITR 397*).

Unequal Shares in Partition. If in the partition of a Hindu undivided family a greater share is allotted to a coparcener than that to which he is entitled, is there a gift to the extent of the excess ? It has been decided by the Supreme Court for the following reasons that there is no gift liable to gift-tax :

(*a*) The partition does not effect any transfer and does not therefore fall within the definition of gift.

(*b*) The partition in the family cannot be considered to be a disposition, conveyance, assignment, settlement, delivery, payment or other alienation of property.

(*c*) The partition is not a transaction entered into by a coparcener with intent thereby to diminish the value of his own property and to increase the value of the property of any other person (*82 ITR 599*).

If in a *partial* partition of a Hindu undivided family a mother or wife gives up her share, there is no taxable gift of such share. Until the total partition by metes and bounds takes place, the mother or wife has no actual right in property, but she has only the right of maintenance. By agreeing not to claim any share at the time of the partial partition she does not give up her right to be maintained out of the rest of the joint family properties. This is why there is no taxable gift under such circumstances (*74 ITR 211*).

Date of Gift.

For an assessment under the Gift-Tax Act, the date of gift is material for the following purposes :

(*a*) In determining the liability to assessment itself, the date of the gift must be within the previous year concerned.

(*b*) In order to ascertain whether the advance payment of gift-tax (as contemplated in section 18) has been made within the prescribed time, which is a necessary condition to be satisfied for the grant of rebate.

(*c*) To ascertain the value of gifts, because a gift is to be valued as on the date on which it is made.

Valuation of Gifts

Section 6 and Rules 10 and 11 of the Gift-Tax Rules lay down the method of valuing property gifted. This method is as follows :

(1) The value of any property other than cash transferred by way of gift is estimated to be the price which, in the opinion of the Gift-Tax Officer, it would fetch if sold in the open market on the date on which the gift is made.

In determining the value of property which has been transferred by way of gift, the charges and liabilities that exist on the property must be deducted from the market value of the property, even though they are not mentioned in the gift deed (*55 ITR 146*).

(2) Where a person makes a gift which is not revocable for a specified period, the value of the property gifted shall be the capitalised value of the income from the property gifted for the period for which the gift is not revocable. The capitalised value is to be calculated at 4% per annum. – The calculation can be made only by reference to advanced mathematics tables.

(3) Where the value of any property cannot be estimated because it is not saleable in the open market, the value is to be determined by the Board.

(4) The value of a policy of insurance shall be its cash surrender value on the date on which the gift was made. The face value or the paid-up value of a life insurance policy is immaterial.

(5) Where the value of the shares in a private company, cannot be ascertained by reference to the value of the total assets of the company, it shall be estimated by taking into account the restriction on the transfer of shares, but the fact that a special buyer would for his special reasons give a higher price shall be disregarded.

However, in valuing shares of private companies on the basis of the Balance Sheet, any provision made for taxation has to be deducted in determining the break-up value, but the proposed dividend is not to be so deducted (*53 ITR 411*).

(6) The value of an interest in a firm or an association of persons is to be determined in the following manner :

(*a*) The excess of the market value of the assets of the firm or association over its capital and liabilities should be allocated amongst the partners or members in accordance with the provisions of their agreement for distribution in the event of dissolution, or in the absence of an agreement in their profit-sharing ratio.

(*b*) The amount allocated under (*a*) to each partner or member together with the capital contributed by him shall be treated as the value of his interest.

Prevention of Avoidance of Gift-Tax

In order to provide against legal avoidance to gift-tax, section 4 which is a deeming section, extends the meaning of the term 'gift' in the following cases :

(1) Transfer for Inadequate Consideration. Under section 4(1)(a), where property is transferred otherwise than for adequate consideration, the difference between the market value of the property on the date of transfer and the value of the consideration received is deemed to be a gift by the transferor to the transferee.

For example, if A sells his house worth Rs. 50,000 to his son-in-law for Rs. 15,000, the difference of Rs. 35,000 is deemed to be a gift made by A.

The words "adequate consideration" mean a money consideration and not a mere sentimental consideration such as natural love and affection.

Where there is a sale between two persons who are not relatives or friends with intention to buy and sell and the consideration happens to be less than the full value of the property, the inadequacy of consideration would be incidental and not contemplated, and there would be no charge of gift-tax.

The above-mentioned provision does not apply in cases where the property is transferred to Government or where the value of the consideration for the transfer of the property is determined or approved by the Central Government or the Reserve Bank of India.

(2) Transfer for Consideration not Passing. Under section 4(1)(b), where property is transferred for a consideration which has not passed or is not intended to pass either in full or in part, the amount of consideration which has not passed or is not intended to pass, is deemed to be a gift by the transferor to the transferee.

For example, A transfers a house worth Rs. 20,000 to B and in consideration B transfers to A the debt of Rs. 20,000 due from C to B but C is insolvent and unable to pay anything. This is a gift of Rs. 20,000 made by A to B.

Where the consideration is untrue in respect of a part, the transaction would be regarded as gift to the extent of that part.

Sometimes an exaggerated consideration is stated in the document of sale to suit the purposes of the transferee, but the transferee pays only the real market value of the property. Such a transaction should not be treated as a gift.

(3) Transactions of Extinctive Nature. Under section 4(1)(c), where there is a release discharge, surrender, forfeiture or abandonment of any debt, contract or other actionable claim or of any interest in property by any person, the value of the release, discharge, surrender, forfeiture or abandonment *to the extent it is not bona fide*, is deemed to be a gift.

In such cases, there is no transfer or assignment at all, but the owner of the right or interest merely extinguishes his right or interest by way of release, discharge, surrender, forfeiture or abandonment. The extinguishment may take place in respect of a debt, contract, an actionable claim or any interest in property.

Release is a renunciation of a claim upon another person or upon any property. In a contract a promisee may dispense with or remit the performance of the promise. This would be a discharge. Surrender is the giving up of a right, interest, or claim to another *e. g.*, surrender of a lease before expiry of its term. Forfeiture means the loss of all interest in the property owing to a breach of the condition. In an abandonment there must be an intention to do so ; mere non-user is not enough. The following are some examples of extinguishing transactions :

(*a*) A agrees to sell his house to B for Rs. 50,000 and receives Rs. 2,000 as earnest money. Owing to the default of B the sale is not completed and the earnest money is forfeited. This is a forfeitute of B's interest. B is deemed to have made a gift of Rs. 2,000 to A.

(*b*) A advanced a loan of Rs. 10,000 to his friend B. He took no steps to recover it. Immediately after the expiry of three years, he wrote it off as time-barred. This is surrender of interest and there is a gift of Rs. 10,000 made by A to B.

Before an extinctive transaction can be deemed to be a gift, there should be a valid release, discharge, surrender, forfeiture or abandonment in the eye of law.

The purpose of the words *"to the extent it is not bona fide"* is to rope in so-called business transactions which are really gifts in a camouflaged form. It is not, however, the intention to penalise cases where the release, discharge, surrender, forfeiture or abandonment has been made for *bona fide* reasons. For example, a debt may be abandoned because it is genuinely irrecoverable and the person may not have taken legal steps to recover the amount as it would have meant only throwing good money after bad. Such an abandonment will not be treated as a gift. This provision would be invoked only in cases where the circumstances, justify an inference of collusion between the person who makes the discharge, surrender or abandonment, etc., and the person in whose favour the discharge, surrender, abandonment, etc., has been made.

The criterion for exemption from the provision mentioned in (3) above, is that the transaction should be proved to the satisfaction of the Gift-Tax Officer to have been *bona fide*. In other words, it is not the intention to impose a tax in respect of genuine transactions which have been undertaken in the ordinary course of business.

Illustration

Discuss the chargeability or otherwise of the following item under the Gift-Tax Act :

Remission of Rs. 10,000 allowed to a trade debtor by a businessman when the latter found that such remission enabled him to recover the balance of the debt of which the said sum of Rs. 10,000 only formed a part. If he had not made the remission, recovery of any part of the debt would have involved the businessman in costly litigation.

(*C. A. Final, Nov. 1966*)

This remission of Rs. 10,000 allowed to a trade debtor has been made for *bona fide* reasons for the purpose of recovering the balance of the debt. There is no collusion between the debtor and the businessman. Therefore, this remission of debt cannot be deemed to be a gift under section 4.

(4) Transfer in Joint Names. Under section 4(1)(d), where a person absolutely entitled to some property transfers it to himself and any other person jointly without any consideration, and such other person makes any appropriation out of such property for his own benefit or for the benefit of any other person, the amount of benefit so appropriated is deemed to be a gift by the person who was the absolute owner of the property.

This provision will apply only where the other person appropriates the property for his own benefit or for the benefit of a third party, and not when he uses it for the benefit of the original sole owner. For example :

(*a*) A has a deposit in his own name in a bank. He transfers the deposit to an account in the joint names of A and B without any consideration from B, the joint account being payable to either or survivor. B withdraws Rs. 5,000 for his own use and Rs. 10,000 for the benefit of his son. There is a gift of Rs. 15,000 by A to B.

(*b*) A with his own money opens a bank account in the joint names of himself and his wife, being payable to either or survivor. The wife withdraws Rs. 5,000 from the account for household expenditure. This Rs. 5,000 cannot be deemed a gift by A to his wife because A is as much interested in running the household, and the use of the money by the wife for household expenditure would not be for her benefit.

(5) Converted Property. Under section 4(2), where a member of a Hindu undivided family converts his self-acquired property into joint family property, he is deemed to have made in favour of the family a gift of so much of that property as the other members of the family would be entitled to, if a partition of that property took place immediately after such conversion of the property.

Illustration

A Hindu undivided family consists of A, his widowed mother, his wife, his two sons and an unmarried daughter. A converts his self-acquired property valued Rs. 2,00,000 into joint family property. What is the gift-tax liability of A ?

On partition of the converted property the shares of the various members will be as follows :

A's widowed mother 1/2
A 1/4 of 1/2
A's wife 1/4 of 1/2
First son 1/4 of 1/2
Second son 1/4 of 1/2

The daughter is not entitled to any share.

That is to say, the other members of the family would be entitled to 7/8 of Rs. 2,00,000 or Rs. 1,75,000. Therefore gift-tax would be payable on Rs. 1,75,000 – Rs. 5,000 basic exemption = Rs. 1,70,000.

Exempted Gifts

Sections 5 (1) and 45 provide that certain gifts shall not be chargeable to gift-tax. The provisions of these sections are as follows :

Section 5 (1).

Clauses (i) to (xvi) of this sub-section specify the following gifts as exempt from gift-tax :

(*i*) **Gifts of immovable Property**. A gift of immovable property situate outside India (*i. e.*, India minus the State of Jammu and Kashmir) is exempt. The exemption is unqualified and citizenship and residential status of the donor are immaterial. The location of property is to be ascertained in the same manner as for wealth-tax purposes.

A partnership firm had immovable properties outside India. It has been held that a partner's interest in such a firm is not immovable property and hence a gift of it is not exempt. This is because whatever be the character of the property brought in by the partners or acquired in the course of the business, it becomes the trading asset of the firm and a partner is entitled only to a share in the moneys realised which represented the value of the property (*72 ITR 1*).

(*ii*) **Gifts of Movable Property**. A gift of movable property situate in Jammu and Kashmir or elsewhere outside India is exempt under two conditions, namely :

1. If the donor is an individual (a natural person), he is not either (*i*) a citizen of India or (*ii*) ordinarily resident in India during the previous year of gift.
2. If the donor is any kind of assessee (such as a company, Hindu undivided family, an association of persons, etc.), it is not resident in India during the previous year in which the gift was made.

On the other hand, if the movable property situate in Jammu and Kashmir or elsewhere outside India is gifted by an individual who is both a citizen of India and also ordinarily resident in India, then the gift will be chargeable.

It follows from the above that, if the movable property is situate in India minus Jammu and Kashmir, a gift of that property is liable to gift-tax, whether the donor is a citizen or non-citizen and whether resident, not ordinarily resident or non-resident during the relevant previous year.

The residential status of an assessee is the same as for income-tax purposes.

Illustration

Examine the liability to gift-tax in respect of the following gifts made by X, a non-Indian-citizen ordinarily resident in Calcutta :

(*a*) Gift of immovable property situated in London.

(*b*) Gift of shares in a company registered in New York, but doing business in India. (*C. A. Final, May 1973*)

(*a*) According to section 5(1) (*i*), there is no liability to gift-tax in respect of the gift of immovable property situated outside India. This exemption is available irrespective of the citizenship or the residential status of the donor.

(*b*) Shares in a company registered outside India are foreign movable property, because the shares in a company are located at the place where the company is incorporated. The fact that the company is doing business in India is immaterial

Under section 5(1)(*ii*)(*a*), a gift of foreign movable property is exempt from gift-tax if the donor (being an individual) is not a citizen of India or he is not ordinarily resident in India. X is not a citizen of India though he is ordinarily resident in India. Therefore there is no liability to gift-tax in respect of the gift of shares.

(*ii-a*) **Gifts of Foreign Exchange.** Exemption is granted to gifts of foreign currency or other foreign exchange if the donor was not resident in India, the donee was resident in India and the gift was made during the period from 26-10-1965 to 28-2-1966 or such later date as may be notified by the Central Government in this behalf. This period has not been extended.

(*iii*) **Gifts of Savings Certificates.** Savings certificates are exempt from gift-tax if these are issued by the Central Government and are specially notified as exempt from gift-tax. Neither such certificates nor notification has been issued by the Central Government. Thus, there are no savings certificates exempt from gift-tax.

(*iii-a*) **Gifts of National Defence Gold Bonds.** A gift of National Defence Gold Bonds, 1980, is exempt if these bonds are for not more than five kilograms of gold and if the donor is the person who has initially subscribed to the bonds.

(*iv*) **Gifts of Government.** All gifts to the Government or any local authority are exempt, irrespective of the amount. Government includes both Central and State Governments. A local authority includes a municipality, municipal corporation, zila parishad, cantonment board and notified area committee.

(*v*) **Gifts to Charitable Institutions.** Gifts made to a charitable institution or fund, to which the provisions of section 80G of the Income-Tax Act, 1961, apply are exempt. The institution or fund must be established in India for charitable purposes, its income must be exempt from income-tax and it should not be for the benefit of any particular religious community or caste.

A charitable purpose does not include a purpose which is wholly or mainly of a religious nature.

An initial gift made for the purpose of starting or constituting a fund for charitable purposes is entitled to exemption in the same manner in which subsequent gifts would be exempt (*58 ITR 140*).

Gifts made by any person to an association or institution established in India for the control, supervision, regulation or encouragement of specified sports and games in India and which is exempt from income-tax, will also be exempt from gift-tax.

Gifts made to charitable institutions are exempt under this clause. Gifts made by such institutions are exempted by section 45.

(*v-a*) **Gifts to Notified Temples, etc.** Gifts to a temple, mosque, gurdwara, church or other place are exempt if the temple, mosque, gurdwara, church or other place is notified by the Central Government as a place of public worship or renown.

The gifts to such institutions may be made direct or by way of settlement on trust of the property gifted.

(*vi*) **Gifts for Other Charitable Purposes.** Gifts made for any charitable purposes not falling under (*v*) above are exempt ; but the exemption is made dependent upon whether the gift was made before 1-4-1958 or at any time later. If the gift was made before 1-4-1958, the entire gift is free of gift-tax. If, on the other hand, the gift is one made on or after 1-4-1958, each gift is exempt up to Rs. 100, and if several gifts are made to the same donee the exemption would be increased up to a maximum of Rs. 500 in respect of that donee.

There is no limit to the number of gifts that may be made during the previous year. For example, if six gifts of Rs. 200 each are made to six different charities, only Rs. 600 would be exempt. However, if all the six gifts were made to the same charity, Rs. 500 would be exempt.

For this purpose it is necessary that the charity should not be wholly or mainly of a religious nature.

(*vii*) **Marriage Gifts.** Under this clause, exemption is given to gifts up to a maximum of Rs. 10,000 on the occasion of the marriage of each relative (male or female) dependent upon the donor for support and maintenance. If the gift exceeds this amount only the excess would be considered in computing the taxable gifts. Normal expenditure incurred on the marriage itself, like expenses of feasts, etc., will not be taken into account in computing the value of the gift.

This exemption is also available in cases of gifts made by a Hindu undivided family on the occasion of the marriage of any member of the family dependent upon the family for support and maintenance.

The word 'relative' is not defined in the Act. It should therefore be construed liberally so as to include not only relations by blood but also those by marriage, since it is customary in India to make gifts on the occasion of marriages of relatives on both sides.

(*viii*) **Gifts to Spouse.** Gifts to spouse (husband or wife) are exempt up to a certain limit. During the entire period of married life, after 1st April 1958 when the Gift-Tax Act came into force, a husband can make gifts in one or more previous years up to Rs. 50,000 in value to his wife (or wives) and *vice versa*, without incurring any gift-tax liability.

Any further gift over and above the maximum limit of Rs. 50,000 will be chargeable to tax after allowing the basic exemption for each previous year.

As explained later, the basic exemption before 1st April 1971 was Rs. 10,000 ; but it has been reduced to Rs. 5,000 from 1st April 1971.

For the purpose of this exemption, the relation of husband and wife must exist at the time the gift is made. Any ante-nuptial gift would not be entitled to this exemption of Rs. 50,000.

Under section 5(3), if out of the gift received from the spouse the husband or wife makes any further gift, such further gift is chargeable to gift-tax in full without deducting therefrom (*i*) the basic exemption, and (*ii*) any gifts specifically exempted under section 5(1).

Illustrations

(1) X made the following gifts to his wife :

(*a*) Rs. 40,000 in the previous year ended 31st March 1973.

(*b*) Rs. 20,000 in the previous year ended 31st March 1974.

(*c*) Rs. 30,000 in the previous year ended 31st March 1975.

What will be his gift-tax liability for the assessment years : 1973-74, 1974-75 and 1975-76 ?

1973-74. No gift-tax liability for this assessment year, as Rs. 40,000 is less than the maximum exempt amount of Rs. 50,000.

1974-75. There is gift-tax liability for this assessment year as shown below :

	Rs.
Total gifts made to wife (Rs. 40,000+Rs. 20,000)	60,000
Less Maximum amount exempt	50,000
	10,000
Less Basic exemption	5,000
Taxable Gift	5,000

1975-76. For this assessment year gift-tax will be payable on Rs. 25,000 (Rs. 30,000 – basic exemption of Rs. 5,000). The maximum limit of Rs. 50,000 exempted under clause (viii) had already been exhausted.

(2) P being absolutely entitled to a sum of Rs. 2,00,000 standing to the credit of his bank account, causes it to be transferred to the joint names of himself and his two major sons : A and B, each having the power to operate on the new joint banking account opened for this purpose on 1st October 1967.

A transfers on 1st April 1968 a sum of Rs. 75,000 from this account to the credit of his wife as a gift to her, he having made no other gift to his wife previously.

B withdraws from the joint account a sum of Rs. 40,000 on 1st May 1968 out of which he makes a gift of Rs. 25,000 to his niece who is not dependent on him, the occasion of the gift being niece's marriage on 1st June 1968. B spends the balance of Rs. 15,000 for acquiring defence savings certificates in his own name.

P withdraws Rs. 50,000 from the joint account on 1st July 1968 and gives it to his married daugher D on 1st August 1968 to enable her to purchase a house.

Examine each of the above-noted transactions and discuss the liability to gift-tax, if any.

(C. A. Final, May 1968)

In the case of the above transactions, the liability to gift-tax is as follows :

(*a*) Rs. 75,000 withdrawn from the joint account by A on 1st April 1968 is a gift made by P to A on which gift-tax is payable by P.

(*b*) Out of Rs. 75,000 gifted by A to his wife on 1st April 1968 only Rs. 25,000 (being excess over the exempt amount of Rs. 50,000) is liable to gift-tax payable by A because A had not made any other gift to her previously.

(*c*) Rs. 40,000 withdrawn from the joint account by B on 1st May 1968 is a gift made by P to B on which gift-tax is payable by P.

(*d*) The gift of Rs. 25,000 made by B to his niece on the occasion of her marriage on 1st June 1968 is liable to gift-tax payable by B, because the niece is not dependent on B.

(*e*) Rs. 50,000 withdrawn by P from the joint account and gifted to his married daughter on 1st August 1968 is liable to gift-tax payable by P.

Thus gift-tax will be payable as follows for the assessment year 1969-70 :

P is liable to pay gift tax on Rs. 1,55,000 (Rs. 75,000+Rs. 40,000+Rs. 50,000 less the basic exemption of Rs. 10,000).

A will pay gift-tax on Rs. 15,000 (Rs. 75,000 – Rs. 50,000 – basic exemption of Rs. 10,000).

B will pay gift-tax on Rs. 15,000 (Rs. 25,000 – basic exemption of Rs. 10,000).

(3) On 1st January 1956, Shrimati S received as gift from her husband two small bungalows valued at Rs. 15,000 each. A gift of Rs. 50,000 was later received from him in June 1973. These gifts comprised her only assets.

She has three daughters A, B and C, who were married respectively in November 1973, May 1974 and May 1975.

In cases of voluntary disclosure the Commissioner will be required to obtain the previous approval of the Board for the waiver or reduction of penalty imposable for concealment (including understatement) of wealth where the amount of the wealth in respect of which the penalty is imposable for any one of the assessment years covered by the disclosure exceeds Rs. 5,00,000.

Any order passed under the above provision shall be final and shall not be called in question before any court of law or any other authority.

Time-Limit. The time-limit for making an order imposing penalty will ordinarily be *two* years from the end of the financial year in which the proceedings in the course of which action for imposition of penalty has been initiated are completed. However, where the relevant assessment is the subject-matter of an appeal to the Appellate Assistant Commissioner or an appeal by the Wealth-Tax Officer to the Appellate Tribunal, such time-limit will be either the period of two years as stated above or six months from the end of the months in which the order of the Appellate Assistant Commissioner or the Appellate Tribunal is received by the Commissioner, whichever is later.

The time taken in rehearing the assessee (due to change of Wealth-Tax Officer or Appellate Assistant Commissioner having jurisdiction) and any period during which the penalty proceedings have been stayed by an order of a court is to be excluded in computing the period of limitation.

Prosecutions.

Under section 36(1), if a person fails without reasonable cause (*a*) to furnish in due time any return mentioned in section 14, (*b*) to comply with any notice under section 16(2) or (4), or (*c*) to furnish within the time specified any statement or information which such person is bound to furnish to the Wealth-Tax Officer under section 38, he shall be punishable with fine up to Rs. 10 for every day of default.

Under section 36(2), if a person makes a statement in a verification which is false and which he either knows or believes to be false, he shall be punishable with rigorous imprisonment up to two years, provided that in the absence of special and adequate reasons to the contrary such imprisonment shall not be for less than 6 months.

Under section 36(3), if a person abets or induces in any manner another person to make and deliver an account, statement or declaration relating to the particulars of any net wealth, which is false and which he knows to be false, he shall be punishable with rigorous imprisonment up to two years, provided that in the absence of special and adequate reasons to the contrary such imprisonment shall not be for less than 6 months.

Assessment in Special Cases

Deceased Person. Under section 19, where a person dies, his executor, administrator or other legal representative shall be liable to pay, out of the estate of the deceased person (to the extent to which the estate is capable of meeting the charge), the wealth-tax assessed as payable by such person if he had not died. Such representatives stand in the shoes of the deceased.

This section only applies to bring to tax the net wealth on the valuation date of the year of death of the deceased, and not the net wealth on the valuation date of any subsequent year.

Under section 19A, the net wealth of the estate of a deceased person is chargeable to wealth-tax in the hands of the executor or executors who are treated as an individual and whose residence and citizenship shall be the same as those of the deceased on the valuation date immediately preceding his death. The term 'executor' includes an administrator or other person administering the estate.

The executor has to submit a return of net wealth held by him as executor in respect of all valuation dates falling after the death of the deceased and before the completion of distribution of the estate to the beneficiaries. Separate assessments are made in respect of the net wealth as on each valuation date.

The assessment of an executor under this section shall be made separately from any assessment that may be made on him in respect of his own net wealth.

Assessment after Partition of a Hindu Undivided Family. Under section 20, where at the time of making an assessment, it is brought to the notice of the Wealth-Tax Officer that a partition had taken place among the members of the Hindu undivided family, and the Wealth-Tax Officer is satisfied after inquiry that the joint family property has been partitioned as a whole in definite portions he shall record an order to that effect and shall make assessment on the net wealth of the Hindu undivided family as such, and each member shall be liable jointly and severally for the tax assessed on the net wealth of the family.

Where the Wealth-Tax Officer is not so satisfied, he may declare that such family shall continue to be a Hindu undivided family liable to be assessed as such.

Assessment of Representative Assessees. Under section 21, in the case of a representative assessee (being a trustee appointed under a trust declared by a duly executed instrument in writing or a court of wards or an administrator-general or an official trustee or any receiver or manager appointed by an order of the court), where the shares of persons on whose behalf or for whose benefit assets are held are indeterminate or unknown, wealth-tax shall be charged at a flat rate of 1½% or at the prescribed rates applicable to the net wealth whichever course is more advantageous to revenue.

Moreover, in computing the net wealth in such cases any assets referred to in clauses (xv), (xvi), (xxii) (xxiii), (xxiv), (xxv), (xxvi), (xxvii), (xxviii) and (xxix) of section 5(1) will *not* be excluded.

However, in the following types of cases, wealth-tax will be charged at the prescribed rates instead of at the flat rate of 1½% and also the financial assets stated in the above paragraph will be excluded from the net wealth :

(*i*) A testamentary trust.

(*ii*) A non-testamentary trust created before 1-3-1970 for the benefit of the relatives of the settler or members of the Hindu undivided family which created the trust, where such relatives or members were mainly dependent on the settler for their support and maintenance.

(*iii*) Provident funds, superannuation funds, gratuity funds, pension funds and other funds created *bona fide* by a person carrying on a business or profession exclusively for the benefit of persons employed in such business or profession.

Any person who pays any sum by virtue of the above provision shall be entitled to recover the sum so paid from the beneficiary.

Assessment of Charitable Trusts. Under section 21A, in a case where any part of the income or property of a charitable or religious trust or institution is used for the benefit of the author of the trust, founder of the institution, trustee etc., for any period during the previous year, such a trust or institution will be liable to pay wealth-tax on the value of the entire property at the rate of 1·5% or the rate applicable in the case of an individual, whichever is beneficial to revenue.

The provisions in this behalf are broadly on the line of the provisions in section 13 of the Income-Tax Act.

Assessment of Persons residing outside India. Under section 22, where the person liable to wealth-tax resides outside India, the tax may be levied upon and recovered from his agent and the agent shall be deemed to be the assessee in respect of such tax. Any of the following persons may be appointed by the Wealth-Tax Officer as the agent of the outsider by giving a notice to him :

(*a*) An employee of the outsider.
(*b*) A person through whom the outsider receives any income.
(*c*) A person who is in possession or custody of any asset of the outsider.

No person can be appointed as the agent of an outsider unless he has had an opportunity of being heard. The agent has a right to recover from the outsider any tax paid by him and he can retain sufficient funds in his hands belonging to the outsider.

Appeals, Revision and References

Sections 23-29B provide for appeals, revision and references, where an assessee feels aggrieved by the order of the Wealth-Tax Officer. The provisions of these sections are the same as in the case of income-tax.

Payment and Recovery of Wealth-Tax

Notice of Demand. Under section 30, where any tax, interest, penalty, fine or any other sum is payable in consequence of any order passed under the Act. the Wealth-Tax Officer shall serve upon the assessee a notice of demand in the prescribed form specifying the sum so payable.

Tax Held in Abeyance. Under section 31(7), the wealth-tax may be held in abeyance where the assets taken into account of assessment are located outside India and the income from such assets cannot be remitted to India owing to prohibition or restriction on remittances. This abeyance will last till the prohibition or restriction on remittances is removed.

Liability of Transferees. As a general rule, no transferee of property is liable to pay taxes due by the transferor in respect of a transferred asset, but section 33 provides an exception to this rule so far as wealth-tax is concerned. If an individual transfers his assets to his or her spouse or minor child, or to a person or association of persons for the benefit of his or her spouse or minor child, or under a revocable transfer, the transferred asset is included, under section 4, in the net wealth of the transferor and the transferor is assessed to wealth-tax in respect thereof. Under section 33, out of the tax so assessed in the hands of the transferor, that portion thereof which is attributable to the transferred asset may be recovered from the transferee.

Before taking any steps against the transferee, a notice of demand in the prescribed form must be served on the transferee.

Modes of Recovery. The provisions relating to the modes of recovery of income-tax apply also to the recovery of wealth-tax.

Restriction on Registration of Transfers of Property. Section 230A of the Income-Tax Act, 1961, applies to wealth-tax as well.

Refund of Wealth-Tax

Under section 34A, where as a result of any order passed in appeal or other proceeding (including a rectification proceeding), refund, of any amount becomes due to the assessee, the Wealth-Tax Officer shall refund the amount to the assessee without his having to make any claim in that behalf.

Where an order giving rise to a refund is the subject matter of an appeal or further proceeding or where any other proceeding is pending and the

Wealth-Tax Officer is of the opinion that the grant of the refund is likely to affect the revenue adversely, he may with the previous approval of the Commissioner withhold the refund till such time as the Commissioner may determine.

Where a refund is due to the assessee in pursuance of an order passed in appeal or other proceeding, and the Wealth-Tax Officer does not grant the refund, the Government shall pay to the assessee simple interest at 9% per annum on the amount of refund due from the date immediately following the expiry of six months to the date on which it is granted.

Where a refund is withheld the Government shall pay similar interest on the amount of refund ultimately determined to be due after the expiry of six months from the date of order withholding it to the date the refund is granted.

Where a refund is found due to any person, the Wealth-Tax Officer, the Appellate Assistant Commissioner or Commissioner may, in lieu of payment, set off the amount of refund against the amount, if any, payable under the Act by the person, after giving a written intimation to such person.

Miscellaneous Provisions

Transfers to Defraud Revenue.

Under section 34B, where during the pendency of any proceeding under the Wealth-Tax Act an assessee creates a charge on or parts with the possession (by way of sale, mortgage, exchange or otherwise) of any of his assets in favour of any other person with the intention to defraud the revenue, such charge or transfer shall be void. But such charge or transfer will not be void if made for valuable consideration and without notice of the proceedings under the Act.

Rectification of Mistakes.

Under section 35(1), with a view to rectifying any mistake apparent from the record, the Wealth-Tax Officer, the Valuation Officer, Appellate Assistant Commissioner, Inspecting Assistant Commissioner, Commissioner and the Appellate Tribunal may amend any order passed by him or by it. The mistakes apparent from the record may be mistakes of fact and sometimes of law.

Under section 35(2), if the assessee pays any amount of tax, penalty or interest in dispute, as determined in the first appeal or revision, within six months from the date of the order passed in such appeal or revision, the sum so paid would be a permissible deduction for debt owed. This deduction will be allowed as a deemed rectification of mistake.

The tax authorities or the Tribunal may make rectification *suo motu* and they shall do so when the mistake is brought to their notice by the assessee. If the rectification results in enhancement of assessment, the assessee must be given an opportunity of being heard.

The time-limit for rectification is four years from the date of the order passed in the first appeal or revision, and in other cases it is four years from the date of the order sought to be amended.

Authorised Representatives.

Under section 44, an assessee may be represented in wealth-tax proceedings by a person who would be entitled to represent him before any income-tax authority or the Appellate Tribunal under section 288 of the Income-Tax Act, 1961.

Rounding-off.

Under section 44C, the net wealth computed by the Wealth-Tax Officer will be rounded off to the nearest multiple of Rs. 100 by ignoring an amount less than Rs. 50 and increasing amounts ranging between Rs. 50 and 99 to Rs. 100.

Under section 44D, the amount of wealth-tax, interest, penalty or any other sum payable and the amount of refund due will be rounded off to the nearest multiple of a rupee.

Illustrations

Important Note :

In the following illustrations, where the amount of wealth-tax payable on the valuation date is not given, the net wealth computed will be subject to the deduction of wealth-tax payable.

(1) D, an Indian citizen carrying on a business in East Africa, discloses the following particulars of his assets and liabilities as on 31st March 1975 :

1. Assets of the East African business

	Rs.
Land and Buildings	1,00,000
Stock	2,50,000
Sundry Debtors	3,50,000
Cash	50,000

Sundry Debtors include an advance of Rs. 2,00,000 given to an Indian party with whom the assessee has business dealings. In terms of the agreement, the advance is repayable in India and interest is payable on such advance in Indian rupees to the assessee's father living in India. All the other business assets are situated in East Africa.

	Rs.
2. Business liabilities in East Africa	4,50,000
3. House property at Agra maintained by him for his use for residential purposes whenever he comes to India	80,000
4. Furniture in the Agra house	10,000
5. Household utensils in the Agra house	5,000
6. Jewellery in the Agra house	50,000
7. Agricultural lands in U. P.	25,000
8. Tools and implements used by him for raising agricultural produce	10,000
9. Bullocks and cows at Agra and in West Bengal	6,000

D spends two months every year in India while for the rest of the year he stays in East Africa.

Compute his net wealth for the assessment year 1975-76 on the basis of the above-noted data. *(C. A. Final, Nov. 1967)*

The first thing to consider in this case is the residential status of D. In the previous year ended 31st March 1975 and in the preceding nine previous years, D has been resident in India because he has maintained a dwelling-house in India for himself and has been in India for 30 days each year. But in the seven previous years preceding the previous year ended 31st March 1975, he has not been in India for 730 days or more. Therefore, his residential status is that he is not ordinarily resident in India.

According to section 6 of the Wealth-Tax Act, D is not liable to wealth-tax in respect of his (*i*) assets located outside India and (*ii*) loans and investments in India made from foreign sources, interest on which is excluded from the total income under hte Income-Tax Act, 1961. Foreign debts are also to be ignored.

The loan of Rs. 2,00,000, given by D from his East African sources to the Indian party is a loan interest on which is *not* to be excluded from the total income under the Income-Tax Act. Therefore, this loan is liable to wealth-tax.

The net wealth of D will be as follows :

1.	East African business assets except the loan to the Indian party are to be ignored ; but the loan to the Indian party is to be included in net wealth	2,00,000
2.	Business liabilities in East Africa to be ignored	—
3.	Residential house property at Agra exempt under section 5(1)(iv)	—
4.	Furniture in the Agra house exempt under section 5(1)(viii)	—
5.	Household utensils in the Agra house exempt under section 5(1)(viii)	—
6.	Jewellery in the Agra house	50,000
7.	Agricultural land is exempt up to Rs. 1,50,000 under section 5(1A)	—
8.	Agricultural tools and implements exempt under section 5(1)(ix)	—
9.	Bullocks and cows excluded from the definition of assets and hence exempt under section 2(e)	—
	Net Wealth	2,50,000

(2) Given below are the particulars of some of the assets and liabilities of P (a resident Indian citizen) as on 31st March 1975. He is a scientist residing in the city of Madras.

(*a*) A sum of Rs. 36,000 in a London Bank for meeting his son's educational expenses in the U.K.

(*b*) A building valued at Rs. 1,00 000 at Madras housing his apparatus used by him for research purposes and valued at Rs, 2,00,000.

(*c*) Two patents evolved by him valued at Rs. 25,000 and Rs. 50,000, the former being used by a scientific research association free of any charge and the latter by an engineering concern against payment of royalty.

(*d*) Three houses besides the laboratory, all in Madras, one for his own residence valued at Rs. 80,000, one let to tenants valued at Rs. 75,000 and the last one his own residential garden-house valued at Rs. 30,000.

(*e*) A loan of Rs. 50,000 taken against mortgage of the residential house of Rs. 80,000 value.

(*f*) A loan of Rs. 60,000 taken against his own life insurance policy for Rs. 2,00,000, the surrender value being Rs. 1,00,000. The sum of Rs. 60,000 has been paid to a land agent as advance against purchase of a plot of land.

(*g*) By a settlement dated 1st April 1968 P is entitled to receive the dividend on certain shares belonging to his father-in-law for a period of five years ending on 31st March 1975. The market value of the shares is Rs. 2,00,000.

Discuss, in respect of each of the above-noted items the manner of treatment for P's wealth-tax assessment for the assessment year 1975-76. (*C. A. Final, Nov. 1968*)

(*a*) Under section 6, a resident Indian citizen is liable to wealth-tax in respect of all his assets, whether in India or outside India. Therefore Rs. 36,000 in a London bank is to be included in his net wealth. He is however entitled to a rebate of wealth-tax at half the average rate on the value of his foreign assets as reduced by foreign debts.

(*b*) The laboratory building at Madras valued Rs. 1,00,000 is liable to wealth-tax. Only the apparatus valued Rs. 2,00,000 and used for scientific research is exempt from wealth-tax under section 5(1)(xi).

(*c*) Under section 5(1)(v), the patent valued Rs. 25,000 is exempt from wealth-tax as it does not produce any income, but the other patent valued Rs. 50,000 in liable to wealth-tax because it produces royalty income.

(*d*) Of the three houses besides the laboratory, only the residential house valued at Rs. 80,000 is exempt from wealth-tax under section 5(1)(iv) ; while the remaining two houses valued Rs. 1,05,000 are to be included in the net wealth.

(*e*) The loan of Rs. 50,000 taken against mortgage of the residential house of the value Rs. 80,000 will not be allowed as a deduction in the computation of net wealth, as the loan is secured on exempted property as provided in section 2(m)(ii).

(*f*) The life insurance policy for Rs. 2,00,000 is exempt from wealth-tax under section 5(1)(vi). Therefore, according to section 2(m)(ii) the loan of Rs 60,000 taken against this exempted asset is not to be deducted in computing the net wealth. However, the advance of Rs. 60,000 against purchase of a plot of land is an asset liable to wealth-tax.

(*g*) Under section 2(e)(iii) the term 'asset' does not include any interest in property where the interest is available to an assessee for a period not exceeding six years from the date the interest vests in the assessee. Therefore the right to dividend is not an asset liable to wealth-tax.

(3) Shrimati R, a resident Indian citizen, furnishes the following particulars concerning her wealth-tax assessment for the year 1975-76 relating to the valuation date 31st March 1975 :

1. A house property at Calcutta was given to her as a gift by her husband on 1st July 1963. She with her husband and children lives in the house. Its value on 31st March 1975 was Rs. 1,25,000.
2. She has another house property at Darjeeling given to her as a gift by her father on 1st January 1969 on the occasion of her 30th birthday. This house is also used by her as her own residence where she lives in summer. The value of this property is Rs. 90,000. The father paid the requisite gift-tax.
3. Jewellery received from her father at the time of her marriage was of the value of Rs. 50,000 on the valuation date.
4. She has a bank account at London having a balance of Rs. 48,000 on 31st March 1975.
5. She owns a house property at London which is let out to tenants and is valued at Rs. 1,00,000.
6. She acquired certain shares in companies registered in the U.K. These shares, kept for safe custody at the bank in London, were of the value of Rs. 20,000 on the valuation date.
7. Twelve-year National Defence Certificates acquired on 1st January 1975 and valued at Rs. 12,000 were kept by her in a safe deposit vault in Calcutta.
8. She took a loan mortgaging her house at Darjeeling. The amount of the outstanding loan on 31st March 1975 was Rs. 45,000.
9. Unpaid income-tax assessed liability on 31st March 1975 was Rs. 15,000, the amount being disputed in appeal. Unassessed liabilities to income-tax and wealth-tax for outstanding assessments yet to be completed were Rs. 40,000 and Rs. 4,000 respectively.

Compute the net wealth for the assessment year 1975-76 taking due account of all the data stated above giving your reasons wherever necessary. Indicate the nature of relief, if any, in the computation of tax. (*C. A. Final, May 1969*)

Net Wealth of Shrimati R on 31 March 1975

		Rs.	Rs.
1.	As the Calcutta house property was transferred to her by her husband in 1963 without adequate consideration, the value of this property (in excess of Rs. 1,00,000) will be included in the net wealth of the husband by virtue of sections 4(1)(a)(i) and 5(1)(iv), because he is also using it as his residence. The value of this property will not therefore be included in the net wealth of Shrimati R.		—
2.	As the gift of Darjeeling house property was made to her on 1st January 1969 and gift-tax was paid by the donor for the assessment year 1969-70, the proviso to section 4(1)(a) is applicable and the value of this property is not to be included in the net wealth of her father. This property is includible in the net wealth of Shrimati R, but as she uses it for her residence, it will not be included in her net wealth.		—
3.	As the jewellery gifted by Shrimati R's father is held by his married daughter on the valuation date, it cannot be included in the net wealth of her father, but it is includible in her own net wealth.		50,000
4.	Balance in a London Bank		48,000
5.	House property at London		1,00,000
6.	Shares in U.K. companies		20,000
7.	Twelve-year National Defence Certificates, as they were not held for at least 6 months before the valuation date		12,006
			2,30,000
Deductions :			
(*a*)	Loan of Rs. 45,000 on the mortgage of Darjeeling house property is not deductible as that property is not included in the net wealth.	—	
(*b*)	Unpaid assessed Income-tax liability of Rs. 15,000 is not deductible as it is disputed in appeal	—	
(*c*)	Unassessed income-tax and wealth-tax liability	44,000	44,000
	Net Wealth		1,86,000

In the computation of wealth-tax, Shrimati R is entitled to a rebate of wealth-tax at half the average rate on the value of her foreign assets, that is, on Rs. 1,68,000.

(4) Discuss, giving full reasons, the treatment of the following items for the purpose of the wealth-tax assessment of an Indian citizen, resident and ordinarily resident in India, for the assessment year 1975-76, the valuation date being 31st March 1975 :

(*i*) Certain properties fetching an annual income of Rs. 10,000, settled in 1970 for a period of five years in favour of the assessee. The interest vested on 1st April 1970 and is due to expire on 31st March 1975.

(*ii*) Penalty of Rs. 20,000 imposed for default in timely submission of income-tax return. The penalty became payable on 15th March 1975 but was paid on 4th April 1975. No appeal was filed.

(*iii*) Agricultural land of value of Rs. 50,000 owned by the assessee and situated in Pakistan.

(*iv*) Loan of Rs. 20,000 taken on the security of the agricultural land in Pakistan and outstanding on the valuation date.

(*v*) House property of value of Rs. 1,50,000 on valuation date gifted to wife on 30th September 1962. Gift-tax chargeable thereon was duly paid. The house property is let out to tenants.

(*vi*) The assessee took a loan of Rs. 30,000 from a recognised provident fund of which he is a member. The loan is outstanding on the valuation date. It was utilised for acquiring certain quoted shares the value whereof on the valuation date is Rs. 45,000. The provident fund balance on 31-3-1975 is Rs. 80,000.

(*vii*) A house property at Bombay of value of Rs. 1,75,000 on 31-3-75 owned by him and used for his personal residence.

(*C. A. Final, Nov. 1969*)

The treatment of the various items for the purpose of the wealth-tax assessment for the assessment year 1975-76 will be as follows :

(*i*) According to section 2(e), the term 'assets' includes property of every description, movable or immovable, but does not include any short-term interest in property where the interest is available to the assessee for a period not exceeding six years from the date the interest vests in the assessee.

Therefore the assessee's interest in the settled properties is not an asset and is not to be included in his net wealth.

(*ii*) Section 2(m) provides that, in computing the net wealth of an assessee, taxes, penalty or interest payable under orders passed under the various taxation laws are not deductible where they are disputed in appeal or revision or where they are outstanding for more than 12 months on the valuation date.

The penalty of Rs. 20,000 is not disputed in appeal nor is it outstanding for more than 12 months on the valuation date. Therefore it is deductible in computing the net wealth of the assessee.

(*iii*) Agricultural land valued Rs. 50,000 is to be excluded from net wealth because its value is less than the exemption of Rs. 1,50,000 allowed by section 5(1A). It is immaterial that the land is situated in Pakistan.

(*iv*) The loan of Rs. 20,000 taken on the security of the agricultural land in Pakistan and outstanding on the valuation date is a deductible debt in computing the net wealth of the assessee under section 2(m).

(*v*) The house property valued Rs. 1,50,000 on the valuation date and gifted to wife on 30-9-1962 is to be included in the net wealth of the assessee under section 4(1)(a)(*i*), because the proviso to section 4(1)(a) is not applicable in this case, since the property was not gifted during the previous year of the donor relevant to the gift-tax assessment year 1964-65 or a subsequent assessment year.

If this property had been gifted in September, 1963, it would not have been included in the net wealth of the assessee.

(*vi*) The amount standing to the credit of the assessee in the recognised provident fund is exempt from wealth-tax under section 5(1)(xvii). Therefore the loan of Rs. 30,000 taken from the provident fund is not deductible in computing the net wealth under section 2(m), as the loan has been incurred in relation to property not chargeable to wealth-tax.

On the other hand, shares valued Rs. 45,000 on the valuation date will be included in the net wealth.

(*vii*) The value of the house property in Bombay is Rs. 1,75,000 of which Rs. 1,00,000 is exempt under section 5(1)(iv). Therefore Rs. 75,000 will be included in the net wealth.

(5) S, an Indian citizen ordinarily resident in India, declares the following particulars for the purposes of his wealth-tax assessment, the valuation date being 31st March 1975 :

1. He is a member of a Mitakshara joint Hindu family having one-fourth share in the family properties, the total value of such properties in India and outside India being Rs. 8,00,000 and Rs. 2,00,000 respectively.
2. By mortgaging his undivided interest in the family he had taken a loan of Rs. 80,000 which was outstanding on the valuation date.
3. He was the member of a provident fund maintained by his employer but not constituted under an irrevocable deed of trust ; the balance to his credit was Rs. 50,000 of which one-half represented the employee's contribution and interest thereon.
4. A life-insurance policy for Rs. 75,000 on his own life matured on 15th March 1975 but was paid on 30th April 1975.
5. He had a motor-car of the value of Rs. 15,000 which he used only for his personal purposes.
6. He had valuable paintings worth Rs. 2,50,000 for the sale of which he was negotiating with a museum.
7. His unpaid income-tax liability already assessed in October 1974 and accepted by him amounted to Rs. 45,000.
8. His unassessed liabilities for income-tax and wealth-tax amounted to Rs. 40,000 and Rs. 5,000 respectively.

Compute the net wealth of S on the basis of these data indicating your reasons wherever necessary. *(C. A. Final, May 1970)*

Net Wealth of S on 31st March 1975

		Rs.	Rs.
1.	Interest of S in coparcenary property of the Hindu undivided family is exempt under section 5(1)(ii) because the family itself is liable to wealth-tax.		—
2.	His contribution to unrecognised provident fund and interest thereon is not exempt. Only the balance standing to the credit of an employee in a provident fund to which the Provident Funds Act, 1925 applies or which is a recognised provident fund is exempt under section 5(1)(xvii).		25,000
3.	Amount due from insurance company, the life policy having matured.		75,000
4.	Motor-car valued up to Rs. 25,000 and used for personal purposes is exempt under section 5(1)(viii).		—
5.	Paintings intended for sale. Only works of art not intended for sale are exempt under section 5(1)(xii).		2,50,000
			3,50,000
Deduct :			
	Income-tax liability already assessed, neither disputed nor outstanding for more than 12 months	45,000	
	Unassessed liability for income-tax	40,000	
	Unassessed liability for wealth-tax	5,000	90,000
	Net Wealth		2,60,000

The loan on the mortgage of S's undivided interest in the joint family will not be allowed as a deduction, for it is secured on property not chargeable to wealth-tax.

(6) R, a non-Indian citizen but resident in India declares the following particulars of his assets and liabilities on the valuation date 31st March 1975 :

1. He is the registered owner of a house property of the value of Rs. 1,00,000, but his ownership is disputed in a court of law. R claims exemption on the ground that the court's decision may be adverse.

2. He owns a business in India, the value of the net assets being Rs. 3,00,000. In computing such value no account has been taken of provisions for sales tax on sales already made (tax not yet assessed by the authorities) and for labour bonus, the respective amounts being Rs. 50,000 and Rs. 40,000.
3. R's father transferred a house (present value Rs. 1,25,000) to R on 31st March 1962, but himself continued to enjoy the benefit. R lives in a rented house.
4. R owns a motor-car of the value of Rs. 10,000 which he uses for business purposes, but the value of which is not recorded in the business books and is not included in the sum of Rs. 3,00,000 referred to in 2 above.
5. R's household furniture was of the value of Rs. 20,000.
6. He has two bank accounts, one in London and one in Delhi, the respective balances to his credit being Rs. 20,000 and Rs. 15,000.
7. He has an insurance policy in the U. K. for Rs. 3,00,000. The surrender value is Rs. 2,00,000. He has taken a loan of Rs. 1,50,000 against the security of the policy and with that sum acquired shares in a U. K. company doing business in India. The market value of the shares is Rs. 1,75,000.
8. R's unassessed income-tax and wealth-tax liabilities relating to all periods up to 31st March 1975 amount to Rs. 30,000 and Rs. 5,000 respectively, there being no demand outstanding.

Compute R's net wealth for the assessment year 1975-76 after discussing in respect of each item of information given above. Indicate the effect of his residential status on the assessment. *(C. A. Final, Nov. 1970)*

A non-Indian citizen is not liable to wealth-tax in respect of his assets located outside India, whatever his residential status may be. His foreign debts are also to be ignored.

Net Wealth of R on 31st March 1975

		Rs.
1.	House property of which he is the registered owner. It is immaterial that his ownership is disputed in a court of law.	1,00,000
2.	Business assets in India after deducting provisions for sales-tax and for labour bonus (Rs. 3,00,000 — Rs. 90,000)	2,10,000
3.	As the house was transferred to R by his father on 31st March 1962 without adequate consideration and the father continued to enjoy the benefit of the house, the value of this property (Rs. 1,25,000) will be included in the net wealth of the father by virtue of section 4(1)(a)(iii). The value of this house will not therefore be included in the net wealth of R.	—
4.	Motor-car not being for the personal use of R	10,000
5.	Household furniture is exempt.	—
6.	Bank balance in Delhi, the bank balance in London being exempt.	15,000
7.	Shares in a U. K. company being foreign movable property are exempt.	—
		3,35,000
	Deduct income-tax and wealth-tax liabilities as they are debts owing on the valuation date.	35,000
	Net Wealth	3,00,000

As the life insurance policy is exempt under section 5(1)(vi), the loan taken on its security is not deductible. Moreover, the asset acquired with the amount of the loan is also exempt because it is foreign movable property.

(7) T, an Indian national resident and ordinarily resident in India discloses the following particulars concerning his wealth-tax assessment for the assessment year 1975-76, the valuation date being 31st March 1975 :

	Fair market value on valuation date
	Rs.
1. Agricultural land in Maharashtra	2,00,000
2. Shares in tea companies earning their entire income in India but incorporated outside India	25,000
3. Shares in Indian companies earning their entire income outside India	20,000
4. House property in Delhi one-third of which is used for business purposes and the rest for T's own residence	3,00,000
5. Wrist watch, fountain pens, cameras and other articles for T's personal use	2,000
6. Furniture for T's personal use	4,000
7. Tractor used for agricultural purposes	5,000
8. Cash and bank balances in India	10,000
9. Deposit in Post-Office Savings Bank Account made on 1-1-1975 and earning interest at 5% per annum	12,000
10. Loan taken outside India against pledge of the tea company shares referred to in (2)	9,000
11. Taxation liability	15,000

Compute the net wealth of T for the assessment year 1975-76, stating your reasons wherever necessary. (*C. A. Final, May 1971*)

Net Wealth of T on 31-3-1975

		Rs.
1.	Agricultural land after deducting the exemption of Rs. 1,50,000 under section 5(1A).	50,000
2.	Shares in tea companies incorporated outside India. This movable property is located outside India but it is includible as T is an Indian national resident in India.	25,000
3.	Shares in Indian companies not being exempt as the full exemption of Rs. 1,50,000 availed of in respect of agricultural land	20,000
4.	House property in Delhi of which Rs. 1,00,000 is exempt for residential house under section 5(1)(iv) Rs. 3,00,000 – Rs 1,00,000.	2,00,000
5.	Articles for personal use exempt under section 5 (1)(viii).	—
6.	Furniture for personal use exempt under section 5 (1)(viii).	—
7.	Tractor used for agricultural purposes exempt under section 5(1)(ix).	—
8.	Cash and Bank balances.	10,000
9.	Deposit in P. O. S. B. Account being less than six months old. 12,000	
	Interest accrued for 3 months at 5% 150	12,150
		3,17,150
	Less Deductions :	
	Loan taken outside India against pledge of tea company shares 9,000	
	Taxation liability 15,000	24,000
	Net Wealth	2,93,150
	Rounded off	2,93,200

(8) The particulars of assets and liabilities of Dr. Mandal, a resident ordinarily resident Indian national practising as a radiologist, were as under on 31st March 1975, the valuation date :

		Fair Market Value as on 31-3-1975
		Rs.
(*a*)	Furniture and household utensils	12,000
(*b*)	Agricultural land in West Bengal	1,00,000
(*c*)	Self-occupied residential house at Calcutta	80,000
(*d*)	X-ray equipments and ancillaries used by him for professional work	75,000
(*e*)	Current account bank balance	10,000
(*f*)	Fixed deposits in bank (excluding interest accruing at 5% since 1-1-1974)	50,000
(*g*)	Unassessed liability for income-tax and wealth-tax for the assessment year 1975-76	25,000

Compute Dr. Mandal's net wealth for the assessment year 1975-76 stating your reasons wherever necessary. (*C. A. Final, Nov. 1971*)

Net Wealth of Dr. Mandal on 31-3-1975

			Rs.
(*a*)	Furniture and household utensils exempt under section 5(1)(viii), it being assumed that they do not contain any precious metal.		—
(*b*)	Agricultural land valued Rs. 1,00,000 is exempt under section 5 (1A)		—
(*c*)	Self-occupied residential house at Calcutta its value being less than Rs. 1,00,000 is exempt.		—
(*d*)	X-ray equipments and ancillaries used for professional work in excess of Rs. 20,000		55,000
(*e*)	Bank current account balance	10,000	
(*f*)	Fixed deposits in bank	50,000	
	Accrued interest for 15 months	3,125	
		63,125	
	Balance of exemption under section 5(1A), Rs. 1.00,000 being availed of in respect of agricultural land	50,000	13,125
			68,125

Deduct unassessed liability for income-tax and wealth-tax for the assessment year 1975-76	25,000
Net Wealth	43,125
Rounded off	43,100

As the amount of net wealth does not exceed the basic exemption limit of Rs. 1,00,000, no wealth-tax is payable for the assessment year 1975-76.

(9) V, a resident and ordinarily resident Indian citizen, gives the undernoted particulars in regard to his assets and liabilities as at the valuation date 31st March 1975 :

	Rs.
(*a*) Loan granted by V to the Hindu undivided family VWX	25,000
(*b*) One house property at Delhi belonging to the Hindu undivided family VWX, which V uses exclusively for his own residential purposes	2,50,000
(*c*) One house property at Bombay belonging to V also used by him for his own residence when he stays at Bombay.	1,25,000
(*d*) Agricultural land in Jammu and Kashmir.	80,000
(*e*) Agricultural land in West Bengal	60,000
(*f*) Furniture and household utensils intended for personal use	10,000
(*g*) Shares in Indian companies established before 1960 (quoted on the stock exchange) all held since 1-4-1974	1,00,000
(*h*) Debentures in Indian companies acquired on 1-12-1974	25,000
(*i*) Units in the Unit Trust of India held since 1-7-1974	10,000
(*j*) Fixed deposit in the State Bank of India held since 1-9-1974	30,000
(*k*) A printing machine on the high seas on its way to India sent from London	2,00,000
(*l*) Credit balance in current account with the State Bank of India, the minimum balance since 1-10-1974 being Rs. 25,000	35,000
(*m*) Income-tax and wealth-tax liabilities for all periods up to 31-3-1975 :	
(*i*) Assessed and disputed	10,000
(*ii*) Assessed and outstanding for more than 12 months but not disputed	15,000
(*iii*) Assessed and outstanding for 4 months but not disputed	6,000
(*iv*) Yet to be assessed	8,000

He is a member of the Hindu undivided family VWX, his interest in the coparcenary property being one-fourth.

Compute his net wealth for the assessment year 1975-76 indicating the reasons for your treatment of each item.

(C. A. Final, May 1972)

Net Wealth of V as on 31-3-1975

		Rs.
1. Loan granted to the Hindu undivided family VWX, being an asset of V		25,000
2. House property at Bombay	1,25,000	
Less Exemption under section 5(1)(iv)	1,00,000	25,000

3.	Agricultural land in Jammu and Kashmir not being an asset for purposes of wealth-tax according to section 2(e).		—
4.	Agricultural land in West Bengal is exempt under section 5(1A) as the value is less than Rs. 1,50,000.		—
5.	Furniture and household utensils being exempt under section 5(1)(viii).		—
6.	Debentures of Indian companies		25,000
7.	Printing machine on the high seas is located outside India, but it is liable to wealth-tax as V is a resident and ordinarily resident Indian citizen.		2,00,000
8.	Investments and deposits held for six months or more :		
	Shares in Indian companies	1,00,000	
	Units in Unit Trust	10,000	
	Fixed deposit in bank	30,000	
	Minimum balance in current account at bank	25,000	
		1,65,000	
	Less Exemption under section 5(1A) after deducting Rs. 60,000 availed of in respect of agricultural land from Rs. 1,50,000	90,000	75,000
9.	Balance in Bank current account being less than six months old (Rs. 35,000 – Rs. 25,000)		10,000
			3,60,000
	Less Liabilities deductible under section 2 (m) :		
	Tax assessed and outstanding for 4 months but not disputed	6,000	
	Tax yet to be assessed	8,000	14,000
	Net Wealth		3,46,000

Notes :

1. The Delhi house belonging to the Hindu undivided family VWX is not to be included in the net wealth of V because it will be included in the net wealth of the family.
2. V's share in the coparcenary property of the Hindu undivided family is not to be included in his net wealth as it will be included in the net wealth of the family.
3. The printing machine is an asset located outside India, but it is included in the net wealth of V who will be entitled to a rebate of wealth-tax at half the average rate on its value of Rs. 2,00,000.

(10) P, a citizen of Canada, asks you to compute his net wealth for the assessment year 1975-76 (for which the relevant valuation date is 31st March 1975) from the following particulars :

1. He owned shares in companies of the market value of Rs. 80,000.
2. On 1-12-1974 he closed his post-office savings bank account (which he had since 1973) and deposited the amount of Rs. 50,000 obtained by so closing the account into his savings account with Dena Bank which had at that time a balance of Rs. 500. Since then there were no transactions in that bank account.

3. He held an interest in a trust created by his uncle in India, under which he was entitled to an annuity of Rs. 3,000 per year.
4. He held a house property in Montreal valued at Rs. 1,10,000 which was self-occupied.
6. He held an undivided interest in the properties belonging to his Hindu joint family (of which the other members were his wife and his minor son) and valued at Rs. 1,80,000.
6. He had a house property in Delhi which was occupied by him during his visits to India and which was valued at Rs. 2,30,000.
7. On 1-4-1974 he had gifted to his wife jewellery valued at Rs. 1,00,000.

(C. A. Final, Nov. 1972)

P is not a citizen of India and as such he is not liable to wealth-tax in respect of his assets located outside India, his residential status being immaterial.

Net Wealth of P (Non-citizen) as on 31st March 1975

1. Shares ni companies, even if they are in Indian companies, are exempt under section 5(1)(xxiii) as their amount together with the balance in Dena Bank does not exceed Rs. 1,50,000.	—
2. Assuming that the balance of Rs. 500 in savings account with Dena Bank has been held for at least six months on the valuation date, it is exempt under section 5(1)(xxvi). The further Rs. 50,000 deposited in that account on 1-12-1974 is also exempt for the reason given in the note given below.	—
3. Assuming that the terms of the annuity preclude its commutation into a lump sum, it is not an asset under section 2(e).	—
4. House property in Montreal, being foreign property, is not to be included in net wealth.	—
5. Interest in the properties belonging to the Hindu joint family is exempt under section 5(1)(ii).	—
6. Value of residential house in Delhi (in excess of exempt amount of Rs. 1,00,000) is to be included in net wealth under section 5(1)(iv).	1,30,000
7. Value of jewellery gifted to wife is includible in net wealth under section 4(1)(a). Assets which are the subject of a transfer in respect of which gift-tax is chargeable in the assessment year 1972-73 or in any later year are included in the net wealth of the individual making the transfer.	1,00,000
	2,30,000

Net Wealth

Note : According to the explanation to section 5(3), if an exempted asset is disposed of and with the proceeds thereof a new asset is acquired within one month, the new asset will also be exempt even if it has not been held for six months on the valuation date. For this reason the Rs. 50,000 deposited in Dena Bank is exempt.

(11) Sohanlal, a resident and ordinarily resident Indian citizen, gives you the following particulars and requests you to advise him on the treatment to be given to each of the items under the Wealth-Tax Act, as at valuation date 31st March 1975 :

(*a*) He owned a house of the value of Rs. 1,20,000 (given on rent) in a village with a population of 8,000. He also owned agricultural lands in the same village of the value of Rs. 1,40,000.

(*b*) He held equity shares (of the market value of Rs. 8,00,000) forming part of initial issue in an industrial company incorporated in June 1973. The company commenced operations for which it was established in January 1975. The shares were purchased by him in January 1974.

(*c*) He had obtained a loan of Rs. 5,00,000 on the security of the share mentioned at (*b*) above. This amount was kept in fixed deposit with a limited company.

In March 1975 she gifted one bungalow and Rs. 10,000 in cash to A and B each. In May 1975 when C was married, she gifted to her Rs. 25,000 in cash.

To what extent are the gifts made by Shrimati S liable to tax under the Gift-Tax Act, 1958 ? Give reasons.

(*a*) Gifts in March 1975 : two bungalows valued at Rs. 30,000 and cash Rs. 20,000.

The bungalows were received by Shrimati S as gift from her husband before 1st April 1958 when the Gift-Tax Act came into force. Therefore the gift made in January 1956 was not covered by section 5(3).

Assuming that the value of bungalows remained unchanged in March 1975 Rs. 30,000 will be a taxable gift subject to the basic deduction of Rs. 5,000, the assessment year being 1975-76. This gift was not made on the occasion of the marriage of A and B.

The cash gift of Rs. 20,000 to the daughters was made out of the gift received by Shrimati S from her husband. Therefore Rs. 20,000 is liable to gift-tax without any deduction.

Therefore, for the assessment year 1975-76 the taxable gifts would be Rs. 25,000 + Rs. 20,000 = Rs. 45,000.

(*b*) Gift in May 1975 : Rs. 25,000 in cash.

As this gift was made by Shrimati S out of the gift received from her husband in June 1973 ; the full amount of Rs. 25,000 is liable to gift-tax. The basic exemption of Rs. 5,000 and the specific exemption up to Rs. 10,000 under section 5(1)(vii) on account of gift on the occasion of C's marriage are not available.

Therefore, for the assessment year 1968-69 the taxable gifts will be Rs. 25,000.

(4) In June 1974 X gave a gift of Rs. 25,000 to his wife Y for the first time, and on the next day Y added Rs. 25,000 his own money to her husband's gift and donated Rs. 50,000 to the local municipality for the construction of a girls school building.

Examine the gift-tax liability of X and Y for the assessment year 1975-76.

Under section 5(1)(viii), X is not liable to any gift-tax in respect of his gift of Rs. 25,000 to his wife, as it is less than Rs. 50,000.

But Y's gift-tax liability is as follows :

As regards Rs. 25,000 received as a gift from her husband, she is liable to gift-tax on the full amount without deduction of the basic exemption of Rs. 5,000 and in spite of the fact that the gift to the municipality is exempt under section 5(1)(iv).

But as regards the gift of her own money of Rs. 25,000 she is not liable to pay any tax under section 5(1)(iv).

(*ix*) **Gifts of Insurance Policies or Annuities.** Gifts of policies of insurance or annuities to any person dependent on the donor (other than the wife) are exempt up to a maximum of Rs. 10,000 in value in the aggregate in one or more previous years after 1-4-1957. This maximum exemption is available in respect of each dependent person. As soon as the value of Rs. 10.000 is reached, the exemption ceases and any excess becomes liable to gift-tax subject to the basic exemption of Rs. 5,000.

Where a person effects a nomination under a policy, it will not be a gift. There must be an assignment to make a gift of the policy.

The value of a policy of insurance for purposes of gift-tax is its surrender value, and not its face or paid-up value.

A life insurance policy under the Married Women's Property Act is equivalent to trust in favour of wife or children. Where such a policy is taken initially under that Act, the annual premium paid would be a gift.

An annuity is a regular periodic payment over a series of years. The periodic payment would be exempt from gift tax up to the assessment year in which the total of annuities paid does not exceed Rs. 10,000. Where a person buys an annuity from an insurance company and makes a gift thereof, the cost of purchase of the annuity will be the amount of the gift.

Illustrations

(1) S assigns an endowment policy on his own life in favour of his son, a Gazetted Officer, two years before it is due to mature and when its surrender value is Rs. 50,000. He had made no such gift previously. Discuss the chargeability to gift tax, if any, in respect of the assignment.

(*C. A. Final, Nov. 1971*)

Under section 5(1)(ix) of the Gift-Tax Act, gifts of policies of insurance to any person dependent on the donor are exempt up to a maximum of Rs. 10,000 in value in the aggregate in one or more previous year after 1-4-1957.

In this case, the son being a Gazetted Officer is not dependent upon S. Therefore the above exemption is not available. S will have to pay gift-tax on Rs. 45,000 (Surrender value Rs. 50,000 minus the basic exemption of Rs. 5,000).

(2) **X,** a non-Indian citizen ordinarily resident in Calcutta, made a gift of his life policy to his dependent mother. The policy was taken from the L. I. C. in 1965 for Rs. 80,000 and is due to mature in 1988. Examine the liability to gift-tax in respect of this gift.

(*C. A. Final, May 1973*)

This is a gift of movable property situated in India and is liable to gift-tax. It is immaterial that the donor is a non-Indian citizen. Gift-tax will be charged on the surrender value of the policy. Assuming that X did not make any gift of insurance policies or annuities to his dependent mother in any earlier previous year, he is entitled to an exemption of Rs. 10.000, under section 5(1)(ix) and to the basic exemption of Rs. 5,000 under section 5(2). In other words, gift-tax will be payable on the amount of the surrender value as reduced by Rs. 15,000.

(*x*) **Gifts Under a Will.** Gifts under a will are exempt, because such gifts would be liable to estate duty.

(*xi*) **Gifts Mortis Causa.** Gifts made in contemplation of death are exempt, as such gifts are liable to estate duty.

(*xii*) **Gifts for Education of Children.** Gifts for the education of the assessee's children are exempt to the extent they are reasonable in amount having regard to the circumstances of the case.

Children need not be minor children. Children include, children in the first generation. Grand-children do not come within the meaning of the word. Children would include step-children and adopted children.

There is no fixed limit for this exemption. It is left to the satisfaction of the Gift-Tax Officer to decide the amount of the exemption having regard to the circumstances of the case.

According to executive instructions, normally an individual provides for the expenses of educating his children from month to month. Such expenses cannot be called gifts. The occasion for making a gift may arise when the individual desires to give his son or daughter education in India or abroad. He may like to gift a lump sum towards such expenses. Only such special allocations whether made for education abroad or in India will be treated as gifts. The Gift-Tax Officer will take into consideration the income of the donor and the nature of education that is being or proposed to be given to the child, and then decide whether and how far the gift is reasonable.

Sometimes settlements are made of large sums for the education of children and exemption under section 5(1)(xii) is claimed in respect of such settlements. Such claims for exemption should be examined carefully and in

deciding the quantum for the purpose of exemption, it should be seen in each case whether the gift is reasonable. The deeds should be carefully examined and for the purpose of determining the reasonableness of the gift the financial status of the person making the settlement, the number of children whose education is covered by the deed, their age, the nature of education they receive or is provided to be given to them, the number of years for which the children are to be educated and similar other relevant factors should be taken into account.

(*xiii*) **Gifts to Employees.** Exemption is granted for reasonable gifts made by an employer (by way of bonus, gratuity or pension) to an employee or to the dependents of a deceased employee, solely in recognition of services rendered.

Such a gift is eligible for exemption only when it is made solely in recognition of the services rendered by the employee. If the gift is prompted by any other motive, it would not be entitled to exemption.

The reasonableness of the amount will be decided by the Gift-Tax Officer after taking into consideration all the circumstances of the case. Where the quantum of the bonus, gratuity or pension is fixed by a conciliation officer or by an award of a labour tribunal, no question of its reasonableness would arise.

This exemption is available only when there is employer-employee relationship between the donor and donee.

Illustration

P and Q are two employees of X, P being X's brother-in-law. They have been working in similar capacities in X's business for twenty years both having joined on the same day. Both of them retire from X's employment on 31st October 1967 and receive gratuities from X in recognition of past services. The amounts of gratuity given to P and Q are Rs. 40,000 and Rs. 30,000 respectively.

Discuss whether X has made any gift to P and/or Q. (*C. A. Final, Nov. 1968*)

Under section 5(1)(xiii), no gift-tax is chargeable in respect of any gift made by an employer to any employee (by way of bonus, gratuity or pension) to the extent to which the payment of such bonus, gratuity or pension is reasonable having regard to the circumstances of the case and is made solely in recognition of the services rendered by the employee.

In this case, the gratuity has been paid to both employees in recognition of their past services. The amount of gratuity paid to Q is Rs. 30,000, which is the maximum amount to be excluded from the total income under the Income-Tax Act and which may therefore be considered reasonable.

On the other hand, the gratuity of Rs. 40,000 paid to P is excessive by Rs. 10,000. Therefore, Rs. 10,000 is a gift made by X to P, but he has not made any such gift to Q.

(*xiv*) **Business Gifts.** *Bona fide* gifts made in the course of carrying on any business, profession or vocation are exempt. It is not enough that the gift is made in the course of carrying on the business, profession or vocation, but it should be made for the purpose of such business, profession or vocation.

As pointed out by the Supreme Court, the expression "for the purpose of the business" is wider in scope than the expression "for the purpose of earning profits" and may include measures for the preservation of the business and for the protection of its assets and property.

If a gift is dictated by any extra-commercial consideration, it would not be eligible for exemption.

A *bona fide* gift for business purposes would not include gifts which are illegal or opposed to public policy *e. g.*, a bribe to a public servant would

not be a *bona fide* gift. However, the following are examples of gifts which may be for business purposes and hence exempt from gift-tax :

(*a*) Donations to political parties by non-company assessees if made for the purpose of advancing the trade of the assessee. Donations to political parties by companies are now prohibited under the Companies Act.

(*b*) Ex-gratia payments made on the occasion of national calamities, disasters or accidents.

Illustration

An individual who was the sole proprietor of a business, converted it into partnership by taking his two daughters as partners. The capital of the firm was Rs. 4 lakhs out of which each daughter contributed Rs. 25,000. The amount of Rs. 25,000 was given to each daughter by the father. It was proved that the partnership was created in order to ensure the continuity of the business and to prevent its extinction on the death of the father.

The goodwill of the business was valued at Rs. 1,60,000. Are the gifts of Rs. 50,000 and of the share of goodwill liable to gift-tax ?

The fact that the donor made a gift of Rs. 50,000 to his daughters while he was carrying on the business was not sufficient to bring the gift within the exemption under section 5(1)(xiv). There was no cogent material to come to the conclusion that the gift of Rs. 25,000 each to the two daughters was "in the course of carrying on the business of the assessee and was for the purpose of the business". The real intention of the assessee was to take his daughters into the firm with the object of conferring benefit on them for their advancement. Therefore the gift of Rs. 50,000 is liable to gift-tax.

Of course, no gift-tax is payable on the goodwill of the assessee's business.

The above answer is based on a decision of Supreme Court (*83 ITR 403*).

(*xv*) **Gifts to Bhoodan or Sampattidan Movement.** Gifts made to any person in charge of such *bhoodan* or *sampattidan* movement as the Central Government may specify, are exempt.

(*xvi*) **Gifts Out of Privy Purse.** Gifts made by a Ruler of an erstwhile Indian State out of his privi purse, are exempt in the following cases :

(*a*) Where the gift is made for the maintenance of any relatives dependent on him for support and maintenance ; or

(*b*) Where the gift is made for the performance of any Official ceremonies.

If the gift is made, even out of privy purse, to a dependent relative not for his maintenance but, say, for his marriage, then the exemption in (*vii*) above would apply and the gift would be exempt up to Rs. 10,000.

However, the gifts made out of privi purse are exempt only if such gifts are made in accordance with the practice, usage or tradition of the family to which the Ruler belongs.

Section 45

Gift-tax is payable by all persons (individuals, Hindu undivided families, companies and other associations of persons) making gifts taxable under the Gift-Tax Act.

But, Under section 45, gifts made by the following donors are not liable to gift-tax :

(*a*) Government companies.

(*b*) Statutory corporations.

(*c*) Public companies whose affairs are controlled by, or the shares in which carrying more than 50% of the voting power are held by, six persons or more.

(*d*) Subsidiary companies of the companies referred to in (*c*).

(*e*) Any company, not being a company referred to in (*c*) or (*d*) above, which transfers its assets to an Indian company in a scheme of amalgamation.

(*f*) Any institution or fund whose income is exempt from income-tax under sections 11 and 12 of the Income-Tax Act, 1961. A charitable institution or fund will not forfeit the exemption from gift-tax in respect of gift made by it merely because (*a*) subsequent to the gift any income of the institution or fund becomes chargeable to income-tax or (*b*) the institution or fund forfeits exemption in respect of a part of its income.

Basic Exemption.

With effect from 1st April 1971 section 5(2) provides that, over and above the exemptions specified in section 5(1), a person is not required to pay any gift-tax if the total value of gifts liable to gift-tax in any previous year does not exceed Rs. 5,000. If it exceeds Rs. 5,000, the gift-tax has to be paid only on the excess of the value of gifts. In other words, there is a basic exemption of Rs. 5,000.

However, this basic exemption of Rs. 5,000 is not available in respect of any gift made by a person out of the gift made to that person by his or her spouse.

Before 1st April 1971 this basic exemption was Rs. 10,000.

Computation of Taxable Gifts

The amount of taxable gifts, on which gift-tax is calculated at the prescribed rates, is computed as follows :

(*a*) Add the value of all the gifts made during the previous year after leaving out the gifts which are exempt from gift-tax.

(*b*) Then deduct the available basic exemption of Rs. 5,000 from the figure arrived at in (*a*), and the balance will be the amount of taxable gifts.

Rates of Gift-Tax

The rates of gift-tax in force from 1st April 1971 are given below. The value of taxable gifts is arrived at after deducting the basic exemption of Rs. 5,000 from the value of all gifts liable to gift-tax.

(1)	On first Rs. 20,000 of taxable gifts	5%
(2)	On next Rs. 30,000 of taxable gifts	10%
(3)	On next Rs. 50,000 of taxable gifts	15%
(4)	On next Rs. 1,00,000 of taxable gifts	20%
(5)	On next Rs. 3,00,000 of taxable gifts	25%
(6)	On next Rs. 5,00,000 of taxable gifts	30%
(7)	On next Rs. 5,00,000 of taxable gifts	40%
(8)	On next Rs. 5,00,000 of taxable gifts	50%
(9)	On balance of taxable gifts	75%

Gift-Tax by Whom Payable.

According to section 29, gift-tax is payable by the donor, but when in the opinion of the Gift-Tax Officer the tax cannot be recovered from the donor, it may be recovered from the donee. Where the donees are more than one, they shall be jointly and severally liable for the amount of tax determined to be payable by the donor ; but the amount of tax which may be recovered from each donee shall not exceed the value of the gift made to him as on the date of the gift.

The donor is primarily liable for payment of gift-tax under this section. It is only when the Gift-Tax Officer is of opinion that the tax cannot be recovered from the donor, that it can be recovered from the donee. Where the Gift-Tax Officer has not applied his mind to all the facts and formed an opinion definitely that the tax cannot be recovered from the donor, the issue of the demand notice to the donee is pre-mature and the tax cannot be recovered from the donee *(45 ITR 80)*. It was also held that the penalty levied on the donor for his defaults cannot in any case be recovered from the donee.

Rebate on Advance Payment of Gift-Tax

Under section 18, if a person making a taxable gift pays into the Government treasury, within 15 days of his making the gift, the amount of tax due on the gift calculated at the specified rates, he shall, at the time of assessment, be given credit for an amount equal to the amount of tax so paid plus a rebate of 10% thereon. He will, therefore, get a benefit equal to 10% of the tax paid by him in advance.

Under the Gift-Tax Act, an assessee is not bound to make any advance payment of gift-tax. It is left to his choice.

If a person makes more than one taxable gift in the course of a previous year, the amount of gift-tax due on the second gift will be calculated after taking into account the gift-tax paid in advance on the first gift, and so on.

Under executive instructions, the rebate of 10% of the advance gift-tax paid is admissible, even though the advance tax has been paid by the assessee according to his own valuation.

Illustration

During the financial year 1974-75 X made a gift to his major son of a house which he valued at Rs. 10,000 and also made a cash gift of Rs. 20,000 to him. He paid advance gift-tax within the stipulated time.

In the regular assessment for 1975-76 the Gift-Tax Officer valued the house gifted at Rs. 15,000, Calculate the amount of gift-tax to be demanded from X.

The advance gift-tax paid on Rs. 25,000 (Rs. 10,000 + Rs. 20,000 − Rs. 5,000 basic exemption) at the prescribed rates comes to Rs. 1,500 which X paid within the stipulated time. Therefore he is entitled to rebate under section 18.

Gift-Tax Assessment for 1975-76

		Rs.
1. Value of house gifted		15,000
2. Cash gifted		20,000
		35,000
Less Basic exemption		5,000
Value of taxable gifts		30,000
Gift-Tax on Rs. 30,000 at prescribed rates		2,000
Less advance tax paid under section 18	1,500	1,650
10% of advance gift-tax paid	150	
Gift-Tax to be demanded		350

Stamp duty on Instruments of Gift.

According to section 18A, where under the law of any State in India, stamp duty is payable in respect of any instrument of gift, such stamp duty is deductible from the amount of gift-tax payable ; but this relief is subject to the following two conditions namely :

(*a*) This relief is available only where the gift-tax payable in respect of property gifted exceeds Rs. 1,000, and

(*b*) The relief is restricted to the stamp duty paid or one half of the amount by which the gift-tax payable (before allowing this deduction) exceeds Rs. 1,000, whichever is less.

Illustration

During the year ended 31st March 1975, D made certain taxable gifts on which the gift-tax at the usual rates works out at Rs. 10,000. It is found that stamp duty of Rs. 4,000 had to be paid on the gifts. Determine the amount of reduction, if any, in gift-tax in respect of such stamp duty. *(C. A. Final, May 1972)*

Under section 18A, as the amount of gift-tax payable exceeds Rs. 1,000, D is entitled to a reduction from the gift-tax payable by him of Rs. 4,000 being the lower of the following two sums :

(*a*) Amount of stamp duty paid Rs. 4,000 ; and

(*b*) One-half of (Rs. 10,000 − 1,000) *i. e.*, Rs. 4,500.

The gift-tax payable by D will therefore be Rs. 10,000 − Rs. 4,000 = Rs. 6,000.

Gift-Tax Authorities

The various gift-tax authorities are as follows :

1. The Central Board of Direct Taxes.
2. Directors of Inspection.
3. Commissioners of Gift-Tax.
4. Additional Commissioners of Gift-Tax.
5. Assistant Commissioners of Gift-Tax, who may be either Appellate Assistant Commissioners or Inspecting Assistant Commissioners of Gift-Tax.
6. Gift-Tax Officers.
7. Inspectors of Gift-Tax.
8. Valuation Officers.

The corresponding income-tax authorities perform the functions of gift-tax authorities. Thus the Income-Tax Officer, on his appointment, automatically becomes the Gift-Tax Officer as well, and so on.

Under section 12A, the Commissioner of Gift-Tax and the Inspecting Assistant Commissioner of Gift-Tax are competent to make any inquiry under the Gift-Tax Act and for this purpose they have all the powers which a Gift-Tax Officer has. Under section 9A, the Director of Inspection has also the same powers.

The Central Board of Direct Taxes is the highest executive authority for the administration of the Gift-Tax Act. In addition to its administrative control over all the subordinate authorities, the Board has power to issue general orders, instructions and directions to guide the subordinate officers in the discharge of their duties.

Assessment Procedure

Return of Gifts. Under section 13(1), every person who during a previous year has made any taxable gifts (or is assessable in respect of the

taxable gifts made by any other person) shall, before 30th June of the corresponding assessment year, furnish voluntarily to the Gift-Tax Officer a return in the prescribed form and verified in the prescribed manner.

There are two sections which require the assessee to pay gift-tax in respect of gifts made by any other person. One is section 19 which makes the executor, administrator or other legal representative of a deceased person so liable, and the other is section 21A which makes the donee liable when the donor cannot be found. Thus, the executor, administrator or other legal representative or the donee become the assessee.

This return is to be signed in the same manner as in the case of a return of income for income-tax purposes.

Under section 13(2), in the case of any person who, in the Gift-Tax Officer's opinion is assessable whether in respect of gifts made by him or by any other person during the previous year, the Gift-Tax Officer may before the end of the relevant assessment year serve a notice upon him requiring him to furnish within 30 days from the date of service of the notice a return of gifts made by him or by such other person during the previous year in the prescribed manner and setting forth such other particulars as may be prescribed.

If any person has not furnished a return within the time allowed, or having furnished a return discovers any omission or a wrong statement therein, he may furnish a return or a revised return at any time before the assessment is made.

Asssesment. There is no provision for self-assessment or provisional assessment in regard to gift-tax. It is only the regular assessment which is made under section 15 in the following manner.

(1) If the Gift-Tax Officer is satisfied, without requiring the presence of the assessee or production by him of any evidence, that the return is correct and complete, he will assess the value of taxable gifts made by the assessee and determine the amount of gift-tax payable by him or the amount refundable to him on the basis of such return.

(2) If the Gift-Tax Officer is not satisfied that the return is correct and complete, he shall serve a notice on the assessee either to attend in person at his office on a date to be specified in the notice or to produce or cause to be produced on that date any evidence on which the assessee may rely in support of his return.

The Gift-Tax Officer has the power to call by a written notice upon the assessee to produce his accounts, records and other documents. Such a notice may be served either after the assessee has filed his return voluntarily or after the Gift-Tax Officer has called upon the assessee to submit a return.

Under section 15(6), the Gift-Tax Officer may make a reference to the Valuation Officer for the valuation of any property transferred by way of gift. Such a reference may be made by the Gift-Tax Officer either (*i*) where he considers the estimate made by the registered valuer to be less than the fair market value or (*ii*) where he considers it necessary to do so on account of the nature of the property and other relevant circumstances or where he is of the opinion that the fair market value of the property exceeds the value returned by such percentage of the returned value or by such amount as may be prescribed by rules.

The Gift-Tax Officer, after hearing such evidence as the assessee may produce and such other evidence as he may require on any specified points and after taking into account all relevant material which he may have gathered, shall by order in writing assess the value of taxable gifts made by the assessee and determine the amount of gift-tax payable by him.

(3) If any person fails to make a return when called upon to do so by the Gift-Tax Officer, or fails to comply with the terms of any notice served upon him by the Gift-Tax Officer, the Gift-Tax Officer, after taking into account all relevant material which he has gathered, shall estimate the value of taxable gifts to the best of his judgment and determine the amount of gift-tax payable by the person.

This is called the best judgment assessment. There is no provision for the reopening of such an assessment by the Gift-Tax Officer, the remedy of the aggrieved party being to appeal to the Appellate Assistant Commissioner.

Gifts Escaping Assessment.

Section 16 gives power to the Gift-Tax Officer to assess any taxable gifts which have escaped assessment in a past assessment year. This additional assessment may be made in the following cases :

(*a*) Where the assessee has failed to make a return of his taxable gifts.
(*b*) Where he has not disclosed full and truly all material facts necessary for assessment of the gifts made by him.
(*c*) Where the Gift-Tax Officer received information of escape of taxable gifts, though there has been no default on the part of the assessee.

In the first two cases the period for starting proceedings under this section is *eight* years from the end of the relevant assessment year ; while in the third case the period is *four* years.

Before the Gift-Tax Officer can proceed under this section, he must give a notice to the assessee within the period of eight years or four years. These time-limits do not apply to the reopening of an assessment for any year by reason of an order on appeal, revision or reference.

There is no time-limit for completing an assessment under section 16.

Penalties and Prosecutions

Penalties.

Under section 17(1), if the Gift-Tax Officer, Appellate Assistant Commissioner, Commissioner or Appellate Tribunal, in the course of any proceedings, is satisfied that any person has committed the following defaults, he may impose a penalty on such person :

(*a*) Failure to furnish the return of gifts voluntarily under section 13(1) or when required by notice under section 13(2) or section 16 or failure without reasonable cause to furnish it within the time allowed or in the prescribed manner.
(*b*) Failure without reasonable cause to comply with a notice under section 15(2) or (4).
(*c*) Concealment of the particulars of any gifts or furnishing inaccurate particulars thereof.

Quantum of Penalty. The amount of penalty, in addition to the gift-tax payable by a person, which can be imposed on him in respect of the above defaults, is as follows :

(*i*) In cases referred to in (*a*), a sum equal to 2% of the tax for every month during which the default continued, but not exceeding in the aggregate 50% of the tax.

Tax means the gross amount of gift-tax payable on assessment as reduced only by the amount for which credit is allowed under section 18 on account of advance payment of gift-tax.

(*ii*) In cases referred to in (*b*), a sum equal to not less than 10% and not more than 50% of the tax which would have been avoided if the return made by such person had been accepted as correct.

(*iii*) In cases referred to in (*c*), a sum equal to not less than 20% and not more than 150% of the tax which would have been avoided if the return made by such person had been accepted as correct.

Where the minimum penalty imposable for default (*c*) is more than Rs. 1,000, the Gift-Tax Officer is required to refer the matter to the Inspecting Assistant Commissioner concerned and a penalty can be imposed in such a case only by the latter and not by the Gift-Tax Officer.

No order imposing a penalty can be made unless the person concerned has been given a reasonable opportunity of being heard.

Prosecutions.

Under section 35(1), if a person fails without reasonable cause : (*a*) to furnish in due time any return of gift mentioned in section 13(*b*) to comply with any notice under section 15(2) or (4), or (*c*) to furnish within the time specified any statement or information which such person is bound to furnish to the Gift-Tax Officer under section 37, he shall be punishable with fine up to Rs. 10 for every day of default.

Under section 35(2), if a person makes a statement in a verification which is false and which he either knows or believes to be false, he shall be punishable with simple imprisonment up to one year or with fine up to Rs. 1,000 or with both.

Under section 35(3), if a person abets or induces in any manner another person to make or deliver an account, statement or declaration relating to any gifts, which is false and which he knows to be false, he shall be punishable with simple imprisonment up to six months or with fine up to Rs. 1,000 or with both.

Assessment in Special Cases

Deceased Donor. Under section 19, where a donor, on whom gift-tax has been assessed for any assessment year, dies before paying the tax, his executor, administrator or other legal representative will be liable to pay such tax out of his estate to the extent to which the estate is capable of meeting the charge.

Where a donor dies before his gift-tax assessment is completed, his executor, administrator or other legal representative will step into his shoes and the proceedings will be taken against such representatives. The burden of the gift-tax assessment is thrown upon them.

Assessment of Persons Leaving India. Section 19A provides for the payment of gift-tax by persons who are leaving India for good. In such cases, without waiting for the arrival of the relevant assessment year, the gifts are charged to tax in the previous year in which they are made. The gifts that fall within the scope of the accelerated assessment under this section are the gifts made by individuals only.

Assessment after Partition of a Hindu Undivided Family. Under section 20, where at the time of making an assessment, it is brought to the notice of the Gift-Tax Officer that a partition had taken place among the members of a Hindu undivided family, and the Gift-Tax Officer is satisfied after inquiry that the joint family property has been partitioned amongst the various members in definite portions, he shall record an order to that effect and shall make assessment on the value of the taxable gifts made by the family as such, as if no partition had taken place, and each member shall be liable jointly and severally for the tax assessed on the family as such.

Where the Gift-Tax Officer is not so satisfied, he may declare that such family shall continue to be a Hindu undivided family.

Discontinued Firm or Association. Under section 21, where a firm or association of persons liable to pay gift-tax has been discontinued or dissolved,

the Gift-Tax Officer shall determine the gift-tax payable by the firm or association as such, as if no discontinuance or dissolution had taken place.

Every person who was a partner of the firm or a member of the association at the time of discontinuance or dissolution shall be liable jointly and severally to pay the tax and the penalty.

Assessment where Donor cannot be found. Under section 21A, where the Gift-Tax Officer using all due and reasonable diligence cannot find the donor who has made any taxable gift, he may make an assessment of the value of all such taxable gifts on the donee or donees.

The donee would be liable to pay the gift-tax. If there are two or more donees they would be jointly and severally liable for the entire amount of tax ; but no donee shall be called upon to pay tax in excess of the value of the gift received by him as on the date of the gift.

Appeals, Revision and References

Section 22-28B provide for appeals, revision and reference where an assessee is aggrieved by the order of the Gift-Tax Officer. The provisions of these sections are the same as in the case of income-tax.

Payment and Recovery of Gift-Tax

Gift-Tax by whom Payable. Under section 29, the gift-tax is payable by the donor ; but when in the opinion of the Gift-Tax Officer the tax cannot be recovered from the donor, it may be recovered from the donee. Where the donees are more than one, they shall be jointly and severally liable for the full amount of the tax, but the amount of tax which may be recovered from a donee will not exceed the value of the gift made to him as on the date of the gift.

Gift-Tax, a Charge on Property Gifted. Under section 30, gift-tax payable in respect of any gift comprising immovable property shall be a first charge on that property, but any such charge shall not affect the title of a *bona fide* purchaser for valuable consideration without notice of the charge.

The tax which is a first charge on immovable property is the tax payable in respect of any gift *comprising* immovable property. The word 'comprising' means that along with immovable property, movable property might also be included in the same gift.

Notice of Demand. Under section 31, where any tax, interest, penalty, fine or any other sum is payable, the Gift-Tax Officer shall serve upon the assessee a notice of demand in the prescribed form specifying the sum so payable. The amount specified in the notice of demand is payable within 35 days of the service of notice.

Modes of Recovery. Under section 33, the provisions relating to the modes of recovery of income-tax apply also to the recovery of gift-tax.

Refund of Gift-Tax

Under section 33A, where as a result of any order passed in appeal or other proceeding, refund of any amount becomes due to the assessee, the Gift-Tax Officer shall refund the amount to the assessee without his having to make any claim in that behalf.

Where an order giving rise to a refund is the subject matter of an appeal or further proceeding or where any other proceeding is pending and the Gift-Tax Officer is of the opinion that the grant of the refund is likely to affect the revenue adversely, he may with the previous approval of the Commissioner withhold the refund till such time as the Commissioner may determine.

Where the Gift-Tax Officer does not grant the refund to the assessee, within a period of six months from the date of the order granting the refund,

the Government shall pay to the assessee simple interest at 9% per annum on the amount of refund due from the date immediately following the expiry of six months to the date on which it is granted.

Where a refund is withheld the Government shall pay similar interest on the amount of refund ultimately determined to be due after the expiry of six months from the date of order withholding it to the date the refund is granted.

Where a refund is found due to any person, the Gift-Tax Officer, the Appellate Assistant Commissioner or the Commissioner may, in lieu of payment, set off the amount of refund against the amount, if any, payable by the person, after giving a written intimation to such person.

Rectification of Mistakes

Under section 34, with a view to rectifying any mistake apparent from the record, the Gift-Tax Officer, the Appellate Assistant Commissioner, the Inspecting Assistant Commissioner, the Commissioner or the Appellate Tribunal may amend any order passed by him or it.

The authority concerned may make the rectifications *suo motu* and shall make it when the mistake is brought to its notice by the assessee. No rectification under this section can be made after the expiry of four years from the date of the order sought to be amended.

Where an amendment is made an order shall be passed in writing by the authority concerned. Where an amendment reduces the assessment, the Gift-Tax Officer shall make any refund that may be due to the assessee. Where the amendment enhances the assessment or reduces a refund already made, the Gift-Tax Officer shall serve on the assessee a notice of demand specifying the amount payable.

Authorsied Representatives

Under section 43, an assessee may be represented in gift-tax proceedings by a person who would be entitled to represent him before any income-tax authority or the Appellate Tribunal under section 288 of the Income-Tax Act, 1961.

Rounding-off

Under section 44A, the amount assessed as being the value of all taxable gifts will be rounded off to the nearest multiple of Rs. 10.

Under section 44B, the amount of gift-tax, interest, penalty or any other sum payable and the amount of refund due will be rounded off to the nearest multiple of a rupee.

Illustrations

(1) A purchased a plot of land for Rs. 20,000 and spent Rs. 50,000 in constructing a house thereon. The house was completed in January 1971. He transferred the same to his married daughter in December 1974 for Rs. 60,000. At the time of such transfer, the market value of the house was Rs. 1,00,000. A had also made a gift of Rs. 50,000 to his son in January 1975. Calculate the gift-tax payable by A for the assessment year 1975-76.

Taking the previous year of A as ending on 31st March 1975, the Gift-Tax payable by him for the assessment year 1975-76 will be as under :

		Rs.
(*a*) Gift to married daughter in December 1974 :		
Market value of house gifted	1,00,000	
Less consideration received	60,000	
		40,000

(*b*) Gift to son in January 1975		50,000
		90,000
Less Basic exemption		5,000
Taxable gifts		85,000
Gift-tax payable		9,250

(2) To what extent is gift-tax chargeable on gifts of movable and immovable properties situated outside India ?

In the previous year ended 31st March 1974 A made a gift of Rs. 50,000 to his wife, and in the previous year ended 31st March 1975 A sold to his wife a house for Rs. 20,000 which she paid out of the past gift. On inquiry it was found that the market value of the house on the day of the gift was Rs. 25,000. Is A liable to any gift-tax for the assessment year 1975-76 ?

If A made another gift of Rs. 25,000 to his wife in the previous year ended 31st March 1975, what will be his liability to gift-tax ?

Gifts of immovable property situated outside India are not liable to gift-tax. Gifts of movable property situated outside India are also not liable to gift-tax except where the person making the gift :

(*a*) being an individual, is a citizen of India and is resident in India ; or

(*b*) not being an individual, is resident in India in the previous year in which the gift is made.

Gifts in favour of spouse are exempt up to a maximum of Rs. 50,000 in the aggregate in one or more previous years. Any excess amount of such gift over Rs. 50,000 is chargeable to gift-tax subject to the basic exemption of Rs. 5,000.

In this case, a house had been sold at below the market rate. Therefore the difference of Rs. 5,000 between the market rate and the selling price is deemed to be a gift made to the wife. But as it is equal to the basic exemption of Rs. 5,000, it is not liable to gift-tax.

If A made another gift of Rs. 25,000 to his wife in the previous year ended 31st March 1975, the total taxable gifts made to the wife will be Rs. 5,000+Rs. 25,000 =Rs. 30,000, and he will have to pay gift-tax on Rs. 25,000 (*i. e.*, Rs. 30,000—the basic exemption of Rs. 5,000).

(3) M, a citizen of India and resident in India, has made the following gifts in the previous year ended 31st March 1975 :

(*a*) A house of the market value of Rs. 50,000 situated in Nepal.

(*b*) Rs. 80,000 to his wife, to whom he had made a gift of Rs. 30,000 in the preceding previous year.

(*c*) Rs. 10,000 to the Jawaharlal Nehru Memorial Fund.

(*d*) Rs. 30,000 to his dependent daughter at the time of her marriage.

(*e*) Transfer of his shares in companies to his son for Rs. 50,000, the market value thereof on the date of transfer being Rs. 80,000.

Calculate the amount of taxable gifts of M for the assessment year 1975-76.

			Rs.
(*a*) Gift of immovable property situated outside India is exempt		30,000	
(*b*) Gift to wife : in 1973-74		80,000	
in 1974-75			
		1,10,000	
Less Exempted		50,000	60,000

(*c*) Gift to the Jawaharlal Nehru Memorial Fund is exempt —

(*d*) Gift to dependent daughter at the time of her marriage in excess of Rs. 10,000. 20,000

(*e*) Gift to son being the excess of market value of shares over the sale price 30,000

1,10,000

Less Basic Exemption 5,000

Taxable Gifts 1,05,000

(4) A scrutiny of the affairs of X, a wealthy assessee, reveals the following facts :

(*a*) His previous year is the year ending on 31st March.

(*b*) He purchased on 15-1-1975 a painting from Y for Rs. 30,000. It is ascertained that Y had purchased it for Rs. 5,000 two years before.

(*c*) He opened a bank account in the joint names of himself, his wife and his son Z on 31-12-1972 and deposited a sum of Rs. 1,40,000 in the account on that date. On 30-11-1974 Z withdrew Rs. 20,000 for the purchase of shares in his own name, and X's wife drew a cheque for Rs. 30,000 on the same date in favour of her brother M.

(*d*) X paid Rs. 20,000 to the local municipality to be used in any manner it thought fit. He mentioned it, however, that he would appreciate if it were used for repairing the road on which his shop was situated.

(*e*) He gave a cash gift of Rs. 12,000 to his grand-niece whom he had brought up, on the occasion of her marriage on 1-12-1974.

(*f*) He gave a gratuity of Rs. 20,000 on 1-6-1974 to the widow of his nephew who died after serving in his factory for three years on a salary of Rs. 500 per month.

Compute the taxable gifts of X for the assessment year 1975-76, giving reasons for the inclusion or exclusion of the items.

	Rs.
1. X purchased for Rs. 30,000 a painting from Y, who had purchased it two years previously for only Rs. 5,000. The value of the painting cannot increase so much in two years. Therefore, the excess of Rs. 25,000 is treated a gift.	25,000
2. The money deposited in the joint account at a bank belonged to X. Therefore, the money withdrawn by the son for his own benefit and by the wife for the benefit of her brother are deemed to be gifts made by X. If the wife had withdrawn the money for her own benefit it would have been exempt as a gift to wife.	50,000
3. The donation of Rs. 20,000 to the local authority is exempt. The benefit, which would accrue to X if the road by his shop were repaired, is incidental.	—
4. As the grand-niece is a dependant, Rs. 10,000 of the gift is exempt.	2,000
5. In view of the fact that the deceased employee was getting a salary of Rs. 500 per month and had served for only three years, the gratuity of Rs. 20,000 is very excessive. The deceased was a nephew of the assessee. It is obvious that the payment was not made solely in recognition of his services but involves an element of gift. Assuming that the terms of his service entitled him to gratuity and considering the circumstances of the case, Rs. 2,000 may be taken as the reasonable amount of gratuity, the balance being a gift.	18,000
	95,000
Less Basic Exemption	5,000
Taxable Gifts	90,000

(5) The following particulars are available regarding the gifts made by M (an Indian citizen resident in India) during the previous year ended 31st March 1975 :

(*a*) On 1-1-1974 he made a gift of Rs. 75,000 to his wife for the first time and on 1-3-1975 he made another gift of Rs. 30,000 to her.

(*b*) On 1-7-1974 he settled a debt of Rs. 50,000 due from his son B for Rs. 45,000.

(*c*) On 1-10-1974 he transferred his bank balance in U. K. (equivalent of Rs, 15,000) to his son C.

(*d*) He contributed Rs 500 per month to a charitable institution from 1-1-1974 to 31-12-1974.

(*e*) He made a gift of Rs. 15,000 to his daughter on 1-12-1974 on the occasion of her marriage.

(*f*) On 15-12-1974 he made a gift of Rs. 500 to one of the employees of his business on the occasion of his marriage.

(*g*) On 16-12-1974 he made a gift of Rs. 60,000 to his son D and on 31-12-1974 he paid Rs. 5,500 as advance gift-tax in respect of this gift.

Determine the amount of taxable gifts and the gift-tax payable by M for the assessment year 1975-76.

		Rs.
(*a*) Gift to wife made in the previous year 1974-75, a gift of Rs. 75,000 having been already made in 1973-74.		30,000
(*b*) Excess of debt due from his son B over the amount received being treated as a gift.		5,000
(*c*) Transfer of bank balance in U.K. to his son C is not exempt as M is a citizen of India and is resident in India.		15,000
(*d*) Contributions to charitable institution during the previous year for 9 months	4,500	
Less Maximum amount which is exempt	500	4,000
(*e*) Gift to daughter on the occasion of her marriage in excess of Rs. 10,000		5,000
(*f*) Gift to an employee of business is exempt		—
(*g*) Gift to his son D		60,000
		1,19,000
Less Basic Exemption		5,000
Taxable Gifts		1,14,000

Gift-tax on Rs. 1,14,000 at prescribed rates		14,300
Less Gift-tax paid in advance	5,500	
10% rebate under section 18	550	6,050
Gift-tax payable		8,250

(6) X, who is the sole proprietor of a cloth shop and who is a citizen of India and is ordinarily resident in India, made in the previous year ended 31st March 1975 certain transfers of property and/or donations or payments, particulars of which are given below :

(*a*) Gift to his wife of 12-year National Plan Certificates of the value of Rs. 25,000. In the period 1-4-1971 to 31-3-1974 cash gifts on different occasions amounting to Rs. 90,000 had been made by X to his wife.

(*b*) A house situated in France and valued Rs. 50,000 was gifted to his eldest son.

(*c*) A second-hand motor-car, the market value of which was Rs. 10,000, was sold to an old business associate for Rs. 7,500.

(*d*) A gratuity of Rs. 2,500 paid to the widow of the deceased manager of his shop who had worked with him for over 15 years prior to his sudden death, in recognition of the services rendered by him.

(*e*) Gift of Rs. 15,000 to his daughter on the occasion of her marriage.

(*f*) Gift of Rs. 5,000 to National Defence Fund.

(*g*) Gift of land valued at Rs. 5,000 to his brother.

Compute the value of taxable gifts, giving brief reasons for your answer.

	Rs.
(*a*) No exemption is available under section 5(1)(iii) in respect of the gift of 12-year National Plan Certificates and the exemption of Rs. 50,000 under section 5(1)(viii) has already been exhausted.	25,000
(*b*) Gift of house situated in France is exempt under section 5(1)(i).	—
(*c*) On the sale of a motor-car valued Rs. 10,000 for Rs. 7,500 there is a taxable gift under section 4(a).	2,500
(*d*) Gratuity of Rs. 2,500 to the widow of the deceased manager is exempt under section 5(1)(xiii), as the amount is reasonable	—
(*e*) Gift to daughter on the occasion of her marriage is exempt up to Rs. 10 000 under section 5(1)(vii). Excess is taxable.	5,000
(*f*) Donation to National Defence Fund is exempt under section 5(1)(v).	—
(*g*) Gift of agricultural land to his brother is not exempt.	5,000
	37,500
Less Basic Exemption	5,000
Taxable Gifts	32,500

(7) D, an ordinarily resident Indian citizen, made the following gifts during the year ended 31st March 1975 :

(*a*) Charities of Rs. 300 each to six institutions established for charitable purposes, to four of which the provisions of section 80G of the Income-Tax Act apply, while to the other two such provisions do not apply. — Rs. 1,800

(*b*) Gift to his wife. It is found that he had made similar gifts of Rs. 15,000 each in the years to 31st March 1973 and 31st March 1974. No other gifts had ever been made to the wife previously. — 25,000

(*c*) Gifts of policies of insurance to his three sons, all dependent upon him for support and maintenance, of the value of Rs. 15,000 each. One of these sons only had received a similar gift of Rs. 15,000 in the year ended 31st March 1973. — 45,000

It was also found that during the year D had sold a house property to his separated son for Rs. 20,000 at a time when the fair market value thereof was Rs. 50,000.

Compute the total value of gifts chargeable under the Gift-Tax Act.

(*C. A. Final, May 1967*)

	Rs.
(*a*) Under section 5(1)(v), gifts made to a charitable institution, to which the provisions of section 80G of the Income-Tax Act apply, are totally exempt : while under section 5(1)(vi), in the case of gifts to other charitable institutions, each gift is exempt up to Rs. 100. Therefore the taxable gifts amount to	400
(*b*) Under section 5(1)(viii), the total gifts made to the donor's wife are exempt up to Rs. 50,000. In this case, the gifts made to wife amount to Rs. 55,000. Therefore the excess of Rs. 55,000 over Rs. 50,000 is taxable.	5,000
(*c*) Gifts to sons (as explained below)	25,000
(*d*) Under section 4(a), where property is transferred otherwise than for adequate consideration, the difference between the market value and the consideration received is deemed to be a gift from transferor to the transferee. Hence Rs. 50,000 — Rs. 20,000 is taxable	30,000
	60,400
Less Basic Exemption	5,000
Value of taxable gifts	55,400

Note : Under section 5(1)(ix), gifts of insurance policies to any person dependent on the donor (other than his wife) are exempt up to a maximum of Rs. 10,000 in value in the aggregate in one or more previous years in respect of each donee. Therefore, the taxable amount of policies gifted is as under :

	Rs.
First son who had received a similar gift in 1972-73	15,000
Second son (Rs. 15,000 — Rs. 10,000)	5,000
Third son (Rs. 15,000 — Rs. 10,000)	5,000
	25,000

In the case of the first son, Rs. 5,000 (Rs. 15,000 — Rs. 10,000) must have been charged to gift-tax in the assessment year 1973-74.

(8) Sri Framji, an Indian citizen ordinarily resident in India, gives the details of the under-noted transactions in the year ended 31st March 1975 :

(*a*) He made a gift of Rs. 40,000 to his wife on 1st June 1974, having made no such gift ever before.

(*b*) Srimati Framji (wife of Sri Framji) paid a sum of Rs. 25,000 out of the said gift to the Bombay University as a donation for purchase of books.

(*c*) Sri Framji had acquired National Defence Gold Bonds, 1980 for the weight of one kilogram of gold, the value being Rs. 50,000 and donated the Bonds to a society serving the needs of the Parsi community.

Discuss the liability to gift-tax (if any) in respect of the above-noted transactions.

(*C. A. Final, Nov. 1967*)

(*a*) Under section 5(1)(viii), no gift-tax is payable in respect of a gift made by any person to his or her spouse (subject to a maximum of Rs. 50,000 in value in the aggregate in one or more previous years). Therefore the gift of Rs. 40,000 made by Sri Framji to his wife is not liable to gift-tax.

(*b*) Under section 5(3), if out of the gift exempted under section 5(1)(viii), the husband or wife makes any further gift, such further gift will be chargeable to gift-tax in full without deducting the basic exemption of Rs. 5,000 or any specific exemption under section 5(1). Therefore, this gift of Rs. 25,000 made by Srimati Framji to the Bombay University is liable to gift-tax in full in her assessment.

(*c*) Under section 5(1)(iiia), no gift-tax is payable in respect of a gift of property in the form of National Defence Gold Bonds, 1980, not exceeding the value of such Bonds for an aggregate weight of five kilograms of gold ; but this exemption is available only to a person who has initially subscribed to the said Bonds.

Therefore, this gift of Rs. 50,000 Gold Bonds made to a society is not liable to gift-tax.

(9) S, a resident individual and a citizen of India, entered into the under-noted transactions during the year to 31st March 1975 :

(*a*) S was maintaining a banking account in the U. K. and out of that account he paid a sum of Rs. 30,000 to his son who was studying in the U.K. to defray his educational expenses of Rs. 500 per month and meet other personal expenses.

(*b*) He transferred a house property at Kanpur valued Rs. 1,50,000 to his wife for a consideration of Rs. 80,000, he having made no gift to his wife in the past. He also gave his wife thereafter during the same year a sum of Rs. 20,000 as a gift. The wife donated during the same period a sum of Rs. 15,000 out of the said cash gift to a public hospital.

Discuss the chargeability or otherwise of the gifts, if any, arising out of the above-noted three transactions.

(*C. A. Final, May 1969*)

(*a*) The sum of Rs. 30,000 paid by S to his son is a gift ; but under section 5(1)(xii) gifts for the education of the assessee's children are exempt to the extent they are reasonable in amount having regard to the circumstances of the case.

As the son is studying in the U. K. this amount of Rs. 30,000 is reasonable in amount. Therefore this gift is not liable to gift-tax.

(*b*) Rs. 70,000, being excess of Rs. 1,50,000 over Rs. 80,000 is deemed to be a gift made by S to his wife. The total gifts made to wife during the previous year amount of Rs. 70,000 plus Rs. 20,000 or Rs. 90,000, out of which Rs. 50,000 is exempt under section 5(1)(viii) and the excess of Rs. 40,000 is liable to gift-tax subject to the basic exemption of Rs. 5,000. That is to say, gift-tax is payable by S on Rs. 40,000 – Rs. 5,000 = Rs. 35,000.

Under section 5(3), if out of the gift exempted under section 5(1)(viii), the husband or wife makes any further gift, such further gift will be chargeable to gift-tax in full without deducting the basic exemption of Rs. 5,000 or any specific exemption under section 5(1). Therefore, the gift of Rs. 15,000 to a public hospital made by the wife is liable to gift-tax in full in her assessment.

(10) Discuss the effect of the under-noted transactions under the Gift-Tax Act, 1958 :

(*a*) Gift of Rs. 50,000 made by an ordinarily resident, individual, who is a citizen of India, out of his bank balance in London to the University of London for establishing an educational scholarship.

(*b*) Assignment by a father in India of two policies of insurance on his own life to his major son and major daughter both of whom are dependent on him. The particulars of the policies are as under :

Donee	Sum assured	Paid-up value on date of assignment	Cash surrender value on date of assignment
	Rs.	Rs.	Rs.
Son	50,000	30,000	18,000
Daughter	25,000	12,000	8,000

(*C. A. Final, Nov. 1969*)

(*a*) Under section 5(1)(v), gifts made to charitable institution to which the provisions of section 80G of the Income-Tax Act, 1961 apply, are exempt. The institution must be established in India for charitable purposes and its income must be exempt from income-tax. The University of London is not covered by this exemption. Therefore, this gift of Rs. 50,000 is not exempt from gift-tax under clause (v).

However, under section 5(1)(vi), gifts made for any charitable purpose not falling under clause (v) are exempt up to Rs. 100 for each donee. Therefore Rs. 100 out of Rs. 50,000 would be exempt from gift-tax, and the taxable gift would be Rs. 49,900.

(*b*) Under section 5(1)(ix), gifts of policies of insurance to any person dependent on the donor (other than his wife) are exempt up to a maximum of Rs. 10,000 in value in the aggregate in one or more previous years after 1-4-1957. This maximum exemption is available in respect of each dependent person.

The value of a policy of insurance on the life of the donor for purposes of gift-tax is its cash surrender value and not its face or paid-up value.

Therefore, as regards the policy assigned to the son, its value is Rs. 18,000 out of which Rs. 10,000 is exempt and the balance of Rs. 8,000 is a taxable gift. As regards the policy assigned to the daughter, its value is Rs. 8,000 the whole of which is exempt from gift-tax.

Note : If both the transactions given in (*a*) and (*b*) took place in the same previous year (say, that ended on 31-3-1975) the basic exemption of Rs. 5,000 will also be available and the gift-tax will be payable on the following amount :

	Rs.
Gift to University of London	49,900
Gifts to son	8,000
	57,900
Less Basic exemption	5,000
Amount liable to gift-tax	52,900

(11) D, a resident Indian citizen, gives the following particulars of certain transactions during the year to 31st March 1975 :

(*a*) Four students of the University in indigent circumstances were paid a sum of Rs. 200 each to help them prosecute their studies.

(*b*) On the occasion of the marriages of his dependent nephew and niece he made gifts of Rs. 6,000 and Rs. 12,000 to them respectively.

(*c*) Mrs. D made a gift of Rs. 20,000 to her husband having made no other gift to him in the past. D gave away this sum to a public hospital in India.

Discuss how these transactions are affected by the provisions of the Gift-Tax Act.

(*C. A. Final, May 1970*)

(*a*) Under section 5(1)(vi), gifts made for any charitable purpose, other than those to a charitable institution or fund to which the provisions of section 80G of

the Income-Tax Act apply, are exempt up to Rs. 100 for each gift, and if several gifts are made to the same donee the exemption would be increased up to a maximum of Rs. 500 in respect of that donee.

Therefore out of Rs. 800 given to four students, only Rs. 400 is exempt and the balance of Rs. 400 is liable to gift-tax.

(*b*) Under section 5(1)(vii), exemption is given to gifts up to a maximum of Rs. 10,000 on the occasion of the marriage of each relative (male or female) dependent upon the donor for support and maintenance. If a gift exceeds this amount, only the excess is liable to gift-tax.

Therefore Rs. 2,000 out of the gift of Rs. 12,000 to the niece is liable to gift-tax.

(*c*) Under section 5(1)(viii), gifts to spouse (husband or wife) made during the entire period of married life are exempt up to Rs. 50,000 Any further gifts (over and above the maximum limit of Rs. 50,000) will be chargeable to gift-tax after allowing the basic exemption of Rs. 5,000 for each previous year.

However, under section 5(3), if out of the gift received from the spouse the husband or wife makes any further gift, such further gift is chargeable to gift-tax in full without deducting therefrom the basic exemption of Rs. 5,000 and any gifts which are specifically exempted under section 5(1).

Therefore Mrs. D is not liable to pay any gift-tax on the gift of Rs. 20,000 made by her to her husband ; but D will have to pay gift-tax on the full amount of Rs. 20,000 gifted to a charitable hospital.

To sum up : the amount of D's taxable gifts will be as under :

		Rs.
1.	Gifts to students	400
2.	Gift on the occasion of the marriage of dependent niece	2,000
3.	Gift to public hospital made out of the gift of Rs. 20,000 received from wife	20,000
		22,400
	Less Basic Exemption	2,400
	Taxable Gifts	20,000

In this case the basic exemption is limited to Rs. 2,400 only.

(12) M, an ordinarily resident Indian citizen, effected the following transactions during the year to 31st March 1975 :

(*a*) He transferred to his wife for a consideration of Rs. 40,000 certain shares in U. K. companies, their market value on the date of transfer being Rs. 1,00,000. He had made no gift to the wife previously.

(*b*) He spent a sum of Rs. 20,000 on the occasion of his dependent son's marriage, Rs. 8,000 being for ceremonies and Rs 12,000 given for a car to the son by him.

(*c*) He paid to a female relative dependent on him a sum of Rs. 2,000 to enable her to prosecute studies in medicine.

(*d*) Lying seriously ill he made on 30th December 1974 a gift in contemplation of death of his personal effects of the value of Rs. 20,000 to his son. M died of the illness on 2nd January 1975.

Compute the aggregate value of the chargeable gifts made by M stating your reasons wherever necessary.

(C. A. Final, Nov. 1970)

(*a*) Under section 4(a) Rs. 60,000 being the excess of Rs. 1,00,000 over Rs. 40,000 is deemed to be a gift made to the wife. But Rs. 50,000 out of Rs. 60,000 Rs.

is exempt under section 5 (1)(viii) and only Rs. 10,000 is liable to gift-tax. 10,000

(*b*) Rs. 8,000 spent on ceremonies is not a gift, but Rs 12,000 given to the son for a car is a gift. Out of this Rs. 12,000, Rs. 10,000 is exempt under section 5(i)(vii). Therefore Rs. 2,000 is liable to gift-tax. 2,000

(*c*) Assuming that the dependent female relative is not M's daughter, the exemption under section 5(1)(xii) for gifts for education of children is not available. This is then a charitable gift and only Rs. 100 out of it is exempt under section 5(1)(vi), and the balance of Rs. 1,900 is liable to gift-tax. 1,900

(*d*) This gift of Rs. 20,000 is a gift *mortis causa* which is exempt under section 5(1)(xi), because it is liable to estate duty. —

	13,900
Deduct basic exemption	5,000
Taxable Gifts	8,900

(13) V, an Indian citizen resident and ordinarily resident in India, entered into the following transactions during the previous year ended 31st March 1975 :

(*a*) He purchased an annuity at a cost of Rs. 12,000 for his aged father who is dependent on him for his support and maintenance. He had purchased no such annuity for his father in the past, but for his dependent mother he had made such a purchase for Rs. 9,000 on 31st July 1973.

(*b*) He threw his self-acquired property of the value of Rs. 1,00,000 into the hotchpot of the Hindu undivided family of which his parents and himself with his wife and a son are members.

Discuss whether these transactions attract any liability to gift-tax.

(C. A. Final, May 1971)

(*a*) Under section 5(1)(ix), a gift of an annuity to any person dependent on the donor (other than the wife) is exempt up to Rs. 10,000 in value in the aggregate in one or more previous years. This exemption is available in respect of each dependent person. Therefore the gift to the father of the annuity costing Rs. 12,000 is exempt up to Rs. 10,000 and Rs. 2,000 is liable to gift-tax. The gift of an annuity of Rs. 9,000 to the mother in the previous year 1973-74 does not affect the gift to the father.

(*b*) Under section 4(2), where a member of a Hindu undivided family converts his separate property into joint family property, he is deemed to have made a gift in favour of the family of so much of that property as the other members of the family would be entitled to if a partition of the converted property took place immediately after such conversion.

On partition of the converted property the shares of the various members will be as follows :

His father 1/3
His mother 1/3
V himself 1/3 of 1/3
His wife 1/3 of 1/3
His son 1/3 of 1/3

That is to say, the other members of the family would be entitled to 8/9 of Rs. 1,00,000 or Rs. 88,889. Therefore Rs. 88,889 is liable to gift-tax.

V's gift-tax liability will be as under :

	Rs.
1. Annuity to aged father	2,000
2. Converted property	88,889
	90,889
Less Basic exemption	5,000
Taxable Gifts	85,889

(14) (*a*) On 1-11-1974 R impressed his self-acquired property with the character of property of his Hindu joint family consisting of his father, his wife and two sons. R's previous year under the Gift-Tax Act is the year ending on 31st March each year.

Compute the value of R's taxable gift for the assessment year 1975-76.

(*b*) On 15-1-1975 S created a trust for Rs. 2,00,000 on which he paid stamp duty of Rs. 6,000. He paid advance gift-tax of Rs. 30,500 on 28-1-1975. According to the Schedule to the Gift-Tax Act, the gross amount of gift-tax on a gift of Rs. 2,00,000 is also Rs. 30,500.

Work out the position of gift-tax of S on the completion of his regular assessment.

(C. A. Final, Nov. 1972)

(*a*) R is deemed to have made in favour of the family a gift of so much of the converted property as the other members of the family would be entitled to, if a partition of that property took place immediately after such conversion of the property.

Now R's share in the joint family property is one-fourth of one-half of it, that is to say, one eighth. Therefore seven-eighths of the value of converted property is a gift made by R to the Hindu joint family, on which he will have to pay gift-tax after deducting the basic exemption of Rs. 5,000.

(*b*) The gift-tax liability of S for the assessment year 1975-76 is as follows :

	Rs.
Gift-tax on Rs. 1,95,000 (Rs. 2,00,000 – basic exemption of Rs. 5,000)	30,500
Less 10% rebate for advance payment of gift-tax	3,050
	27,450
Less Deduction for stamp duty paid	6,000
Gift-tax payable	21,450
Gift-tax paid	30,500
Refund due	9,050

As the gift-tax payable exceeds Rs. 1,000, the deduction for the stamp duty paid is the lower of the following two amounts :

(*a*) Amount of stamp duty paid (Rs. 6,000) and

(*b*) One-half of the amount by which the gift-tax payable (before allowing this deduction) exceeds Rs. 1,000 *i.e.*, one-half of Rs. 27,450 – Rs. 1,000 =Rs. 13,225.

(15) From the following particulars compute the total gifts liable to gift-tax for the assessment year 1975-76, (the previous year being year ending 31-3-1975) :

(*a*) On 1-2-1975, the assessee R drew a sum of Rs. 5,000 from his business books and credited it in a bank account in the name of his nephew. The nephew was at the time abroad and was not even aware of this. It is claimed on behalf of R that a gift under the Transfer of Property Act is not complete till it is accepted by the donee.

(*b*) R gifted National Defence Gold Bonds, 1980, for an aggregate weight of 4 kilogrammes of gold, on 15-6-1974 to his married daughter. He had himself purchased the bonds in the market in 1973. The market rate of the bonds on the date of the gift was Rs. 98 per unit of 10 grammes. Exemption from tax is claimed on this gift.

(*c*) On the occasion of the marriage of his son on 9-9-1974, R presented Rs. 20,000 to the son for buying a car. The son was in the last year of his university education at the time and was dependent on the father for support and maintenance.

(*d*) In October 1974 R had to distribute Diwali presents totalling Rs. 2,000 to various employees of his business clients, a customary practice in his line of business to maintain smooth relations with his customers.

(*e*) On 15-4-1974 R transferred his entire interest in a partnership concern outside India, valued at Rs. 1,50,000, to his eldest son. He claims exemption on the ground that the partnership assets consisted almost entirely of immovable property outside India.

(*f*) On 6-7-1974 R made a declaration throwing shares in companies worth Rs. 50,000 into the common stock of his Hindu undivided family consisting of himself, his wife and two sons. He claims that this is not a gift liable to tax.

(*g*) R gave a present of Rs. 5,000 to his wife on her birthday which fell on 17-9-1974. In their married life of 25 years he had given a similar present only once before to her of Rs. 10,000 in 1964.

(*h*) He presented his grandson some shares in companies on 6-12-1974 when their market value was Rs. 8,500, but he claims that their value as on 31-3-1975 which was only Rs. 6,000 should be adopted in the gift-tax assessment.

Computation of Taxable Gifts for assessment year 1975-76

	Rs.
(*a*) For a gift under the Gift-Tax Act, it is not necessary that the gift should be accepted by the donee. Therefore the gift of Rs. 5,000 made by R to his nephew is liable to gift-tax.	5,000
(*b*) A gift of National Defence Gold Bonds is exempt only in the case of a person who has initially subscribed to the bonds—section 5(1)(iiia). The market value of the bonds as on the date of gift is therefore liable to gift-tax. This value would be 98 × 400	39,200
(*c*) Gift of car to R's son on the occasion of the latter's marriage after deducting the exempt amount of Rs. 10,000 under section 5(1)(vii).	10,000
(*d*) Diwali presents to employees of business clients exempt under section 5(1)(xiv).	—
(*e*) Interest in partnership is movable property even if the firm owns immovable property. Hence the gift of assessee's movable property situated outside India is liable to gift-tax because he is ordinarily resident in India.	1,50,000
(*f*) Under section 4(2), where a member of a Hindu undivided family converts his self-acquired property into joint family property, he is deemed to have made in favour of the family a gift of so much of that property as the other members of the family would be entitled to if a partition of that property took place immediately after such	

conversion. Therefore Rs. 50,000—R's one-fourth share amounting to Rs. 12,500= Rs. 37,500 is liable to gift-tax.

(*g*) Gift of Rs. 5,000 to wife is exempt under section 5(1)(vii) because the aggregate of all gifts made to her is less than Rs. 50,000.

(*h*) Shares gifted to grandson are to be valued as on the date of the gift under section 6(1).

37,500
—
00
2,50,200
5,000
2,45,200

Less Basic exemption under section 5(2)

Taxable gifts

It is assumed that R is an Indian citizen and is ordinarily resident in India.

(16) Examine the extent of liability to gift-tax in the following cases :

(*a*) John Smith, a resident and ordinarily resident British citizen in India gifts a sum of £ 1,000 to his son who is also a resident in India. The gift was effected by an inter-bank transfer from Smith's account with the Bank of India, London, to his son's account with the same bank.

(*b*) Ramkumar had taken out an endowment assurance policy of Rs. 1,00,000 for a term of 20 years in 1962. The annual premium is Rs. 5,200. The policy was gifted by him to his son on 1st January 1975. The bonus accrued on the policy as at that date amounted to Rs. 20,000.

(*c*) Jung Bahadur Rana, a resident citizen of Nepal, gifts a house situated in Bombay to his son, also a resident citizen of Nepal. The value of the house is Rs. 50,000.

(*d*) Murlidhar Sharma made a gift of Rs. 50,000 to his son. By the time the gift-tax assessment came to be made, the donor had left the country and the Gift-Tax Officer was unable to recover the gift-tax from him. The Gift-Tax Officer wants to recover the gift-tax from the son.

(*C. A. Final, May 1974*)

(*a*) Under section 5(1)(ii), movable property situated outside India is liable to gift-tax only if the donor is a resident and ordinarily resident Indian citizen. Smith is not a resident Indian citizen, and the property gifted is movable property outside India. Therefore the gift is not liable to gift-tax in India.

(*b*) According to Gift-Tax Rules, the value of a life insurance policy is its cash surrender value on the date the gift was made. The face value of the policy is immaterial. In determining the surrender value the bonus added to the policy is taken into account. Therefore the amount of the surrender value to the policy gifted would be liable to gift-tax. However, if the son was dependent upon his father for support and maintenance, and if he had not received any gift of insurance policies from his father earlier, Ram kumar would be entitled to exemption under section 5(1)(ix) to the extent of Rs. 10,000, and only the excess of the surrender value over Rs. 10,000 will be liable to gift-tax.

(*c*) Under section 5(1)(i), gift of immovable property situated outside India (*i.e.*, India minus the State of Jammu and Kashmir) is exempt, the citizenship and the residential status of the donor being immaterial. In this case the immovable property is situated in Bombay. Therefore Rs. 50,000 being the value of the property gifted is liable to gift-tax.

(*d*) Under section 29, the gift-tax is payable by the donor, but when in the opinion of the Gift-Tax Officer the tax cannot be recovered from the donor, it may be recovered from the donee. The donee's liability is however restricted to the value of the gift made to him as on the date of the gift. Therefore in this case the Gift-Tax Officer can recover the gift-tax from the son.

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