ACCOUNTING FOR BILL OF EXCHANGE

❖ According to section 5 of Negotiable Instrument Act,

— A Bill of Exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a sum of money only to or to the order of a certain person or to the bearer of the instrument.

❖ Features:

Based on this definition the **following features of a bill of exchange are** noticed:

- It's an instrument in writing.
- It contains an unconditional order.
- It's signed by the maker.
- It's drawn on a specific person
- There is an order to pay a specific sum of money
- It must be dated and stamped

❖ Specimen of Bills of Exchange:

Stamp   Address of Drawer

Date

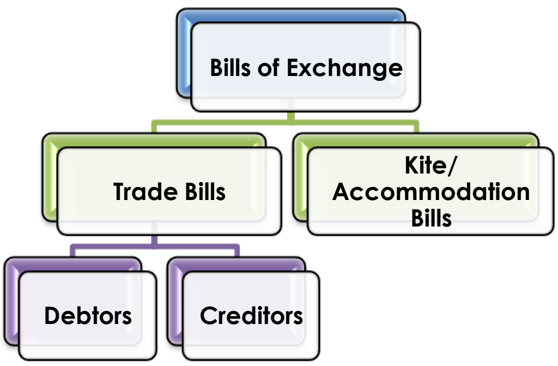
Three months after date pay to a sum of ₹50,000 (Fifty Thousands Only) for the value received.

To B accepted

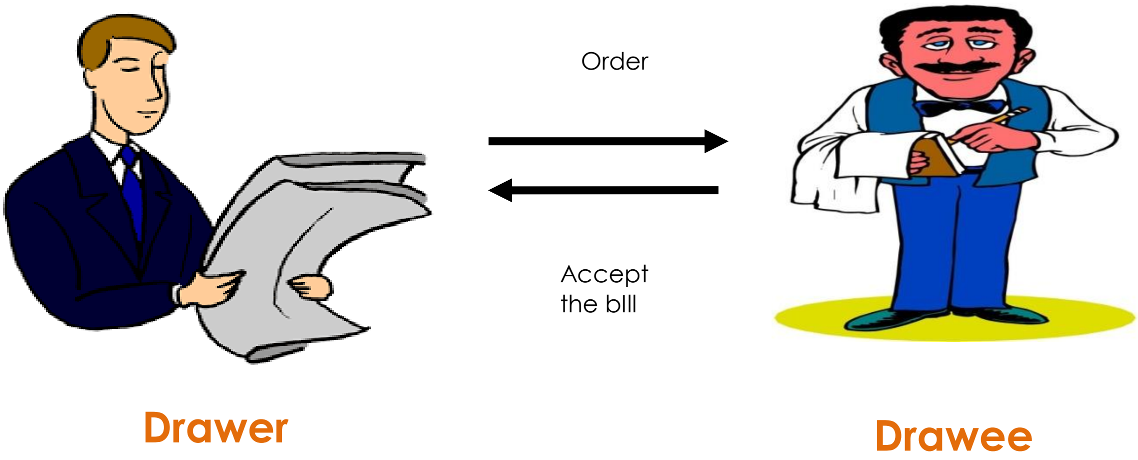
(B's Signature and Stamp)   A

(Drawer)

❖ Types of Bill



❖ Drawer and Drawee



Drawer
↓
writes out the order to pay
↓
Bills Receivable
↓
"Asset" on acceptance by Drawee
↓
Current Assets

Drawee
↓
Who is accepting the order to pay
↓
Bills Payable
↓
"Liability" on acceptance to pay as per the order
↓
Current Liabilities

❖ **HOW TO DETERMINE THE DATE OF MATURITY:**

Rules for the determination of the Date of Maturity

R1- If a negotiable instrument has been made payable after a stated number of months **"after date" or "after sight" or "after a certain event",** the period stated shall be held to terminate on the day of the month which corresponds with the day on which the instrument is dated, or presented for acceptance or sight or the event happens. The word 'month' always implies an English calendar month.

Examples:

Bill Date	30.04.2014
Bill Period	3 months
	30.07.2014
Date of Grace	3 days
Date of Maturity	02.08.2014

R2 - If the maturity day of a negotiable instrument comes out to be a **public holiday,** the instrument shall be deemed to be due on the next preceding business day. In case the date of maturity is an emergency holiday, the instrument shall fall due for payment on the next succeeding business day.

Examples:

(i) A bill of exchange dated 23rd December is payable one month after date. The instrument shall fall due for payment on 25th January (26 January being a public holiday).

(ii) A bill of exchange falls due for payment on 25th January. The Government declares the day as a holiday on account of the death of an important leader. The instrument shall fall due for payment on 24th January.

SOME IMPORTANT TERMS

The parties involved in transaction that uses bill of exchange as a mode of settlement are:

Drawer	He is a person who draws the bill. Typically, he is the seller or a creditor.
Drawee	He is the person on whom the bill is drawn. Normally, he is the buyer or debtor. He has to pay the amount of the bill to the drawer on the due date.
Payee	He is the person to whom the amount of bill is payable. He may be the drawer himself or the creditor of the drawer.
Holder	The person who is entitled to the possession of the Bill, Promissory Note or Cheque, in his own name and who has a right to receive or recover the amount due on the instrument is called the 'Holder.' A person who obtains the possession of the instrument by illegal means is not a Holder. For example, a person who has stolen a cheque cannot be its holder.
Holder in due course	The person who obtains a negotiable instrument: (i) for valuable consideration, (ii) in good faith, and, (iii) Before maturity.

	A holder in due course will have a valid title over the instrument (i.e., he can get its payment) though the title of the transferor may be defective. For example, if A gets a cheque for ₹10,000 signed by B, by threatening him, and later on endorses it to C, C will be a holder in due course if he accepts the cheque in good faith (i.e., without knowing that force was used by A), for consideration (i.e., by GIVING something in return for the cheque). In case of a Bill of Exchange, he must also get the Instrument before the date of maturity. A cheque is payable on demand and hence the condition of maturity is not applicable.
Endorsement	The payee of a negotiable instrument may not himself keep the instrument with him. He may transfer the ownership of the instrument in favour of another person. Such a person can get the payment of the instrument from the drawee. The process of transferring of ownership of the instrument is termed as "endorsement" of the instrument.
Maturity of Bill	The term maturity refers the date on which a bill of exchange or a promissory note becomes due for payment. If the instrument is payable on demand, it becomes due immediately on presentation for payment. If it is payable after the expiry of a particular period of time, the date of maturity will be calculated after three days of grace.
Dishonour	Non-payment of the amount of a Promissory Note, Cheque or Bill of Exchange on the date of maturity is called dishonour of the instrument. In the case of a Bill of Exchange, it will also said to be dishonoured if the drawee refuses to accept the Bill.
Noting	Noting is the authentic and official proof of presentment and dishonour of a negotiable instrument. It is a memorandum of a minute recorded by a notary public upon the dishonoured instrument or upon a paper attached thereto or partly upon each. Its need arises in the case of the dishonour of a Bill of Exchange or a Promissory Note. However, noting is not compulsory. It specifies the date of dishonour and reasons, if any, assigned for dishonour and the noting charges. It should be made within a reasonable time after dishonour.
Renewal of Bill	Sometimes the drawee of a bill is not able to meet the bill on due date. He may request the drawer to draw a new Bill for the amount due. Sometimes he pays a certain amount out and accepts a first bill for the balance for which he has to pay a certain amount of interest which is either paid in cash or is included with the fresh bill. This bill is known as Renewal of Bills. That, the amount of the new bill will be **Face Value of the** - **Cash Payment** + **Interest for the renewed**
Retirement of Bill	Sometimes the drawee pays the bill before the date of maturity. Under the circumstances, the drawer allows certain amount of rebate or discount which is calculated on certain percentage p.a. basis. The rebate is calculated from the date of payment to the date of maturity.

❖ Accounting Entries:

In the Books of Drawer	In the books of Drawee
(1) If the goods sold on credit: Debtors A/c …………..Dr. To, Sales A/c	**(1) If the goods purchased in credit:** Purchase A/c ………… Dr. To, Creditors A/c
(2) For Cash/ cheque received: Cash/ Bank A/c …………………Dr. To, Debtors A/c	**(2) For Payment:** Creditors A/c ……………. Dr. To, Cash/ Bank A/c
(3) For Bills Receivable received: Bills Receivable A/c …………… Dr. To, Debtors A/c	**(3) For Bills Payable Accepted:** Creditors A/c………….. Dr. To, Bills Payable A/c
(4) Bills Receivable endorsed to creditors: Creditors A/c …………. Dr. To, Bill Receivable A/c	**(4) No entry**
(5) For Bills Receivable Discounted: Bank A/c ………………… Dr. Discount on Bills A/c…….. Dr. To, Bills Receivable A/c	**(5) No Entry**
(6) For Bills Dishonored: Debtors A/c ………………….. Dr. To, Creditors A/c To, Bank A/c To, Bill for Collection A/c	**(6) For Bills Dishonoured:** Bills Payable A/c ……….. Dr. To, Creditors A/c
(7) If Drawee /customer is insolvent and is able to pay final settlement for consideration:	
Cash/ Bank A/c ………………….. Dr. Bad debts A/c ……………………. Dr. To, Debtors A/c	Creditors A/c ………………… Dr. To, Cash/Bank A/c To, Deficiency A/c
(8) If customer is paying some money as part settlement and is renewing the bill (without Interest):	
(a) Cash / Bank A/c ………… Dr Bills Receivable A/c ………… Dr To, Debtors A/c	**(a)** Creditors A/c …………………… Dr. To, Cash / Bank A/c To, Bills payable A/c

(9) Bills Receivable was retired before a month and rebate was allowed	
Cash / Bank A/c …………………. Dr Rebate allowed A/c ……………..Dr To, Bills Receivable A/c	Creditors A/c ……………………......... Dr. To, Cash / Bank A/c To, Rebate Received A/c
(10) (a) Part payment and renewed for new bill	
Cash / Bank A/c ……………………. Dr. To, Debtors A/c	Creditors A/c ………………… Dr. To, Cash / Bank A/c
(b) Interest charged on renewed bill	
Debtors A/c ……………….. Dr. To, Interest on Bills Receivable A/c	Interest on Bills Payable A/c ……………Dr To, Creditors A/c
(c) For Bills Receivable Received	
Bills Receivable A//c ……. Dr. To, Debtors A/c	Creditors A/c …… Dr To, Bills Payable A/c

Example 1

Give necessary entries as would appear in A's Books:

2014	**May,5**	**A drew three bills on B for ₹ 500, ₹400 and ₹300 payable at 4, 3 and 2 months respectively.**
	May,12	**He endorsed the first bill in favour of his creditor C at ₹475**
	May, 19	**He discounted the second bill with his banker for ₹380**
	May, 26	**He was paid the proceeds of the third bill at a rebate of 5% on the total amount of the bill.**

On due dates the first and second bills were dishonoured but the third one was paid.

Solution:

Date	Particulars	L.F.	Amount (₹)	Amount (₹)
2014 May,5	Bills Receivable A/c…………......... Dr. To, B A/c		1,200	 1,200

	(being three bills for ₹500,₹400 and ₹300 were received from B)			
May,12	C A/c ……………………………….. Dr. Discount A/c ……………………… Dr. To, Bills Receivable A/c (being the first bill for ₹500 was endorsed in favour of C for ₹475)		475 25	 500
May,19	Bank A/c…………………………… Dr. Discount A/c ……………………… Dr. To, Bills Receivable A/c (being the second bill for ₹400 was discounted with bank)		380 20	 400
May 26	Bank A/c …………………………….. Dr. Rebate allowed A/c ……………… Dr. To, Bills Receivable A/c (being the third bill was retired at a rebate of 5% on the amount of the bill)		285 15	 300
Aug 8	B A/c ……………………………….. Dr. To Bank A/c (being the second bill dishonoured on maturity)		400	 400
Sept 8	B A/c ……………………………………… Dr. To, C A/c (being the first bill dishonoured on maturity)		500	 500

Note: The third bill has been paid before maturity and the entry for its payment has been passed on May 26.

Example 2:

Sunil owed Anil ₹ 80,000. Anil draws a bill on Sunil for that amount for 3 months on 1st April 2014. Sunil accepts it and returns it to Anil. On 15th April 2014, Anil discounts it with Citi Bank at a discount of 12% p.a. On the due date the bill was dishonoured, the bank paid noting charges of ₹100. Anil settles the bank's claim along with noting charges in cash. Sunil accepted another bill for 3 months for the amount due plus interest of ₹3,000 on 1st July 2014. Before the new bill became due, Sunil retires the bill with a rebate of ₹ 500. Show journal entries in books of Anil.

Solution:

Journal entries in the books of Anil

Date	Particulars	L. F.	Dr. (₹)	Cr. (₹)
2014 April, 1	Bills Receivables A/c Dr. To, Sunil's A/c (Being acceptance by Sunil)		80,000	80,000
2014 April, 15	Bank A/c Dr. Discount A/c Dr. To, Bills Receivables A/c (Being discounting of the bill @ 12% p.a.& discounting		78,000 2,000	80,000
2014 June, 30	Sunil's A/c Dr. To, Bank A/c (Being dishonoured of the bill & noting charges paid by bank)		80,100	80,100
2014 June, 30	Bank A/c Dr. To, Cash A/c (Being cash paid to bank)		80,100	80,100
2014 July, 1	Sunil's A/c Dr. To, Interest A/c (Being interest due from Sunil)		3,000	3,000
2014 July, 1	Bills Receivables A/c Dr. To, Sunil's A/c (Being new acceptance by Sunil for ₹ 80,100 & interest of ₹ 3,000)		83,100	83,100
2014 July, 1	Bank A/c Dr. Rebate A/c Dr. To, Bills Receivables A/c (Being the amount received on retirement of the bill)		82,600 500	83,100

NEGOTIABLE INSTRUMENTS ACT

Sec. 13 of the Negotiable Instruments Act, 1881 **defines a negotiable instrument** as '**a promissory note, bill of exchange or cheque payable either to order or to bearer.'**

Characteristics of a Negotiable Instrument

(a) Free and innumerable Transfers:

- A Negotiable Instrument may be transferred by - (i) Delivery, or (ii) by Endorsement and Delivery.
- Negotiable Instruments can be transferred ad infinitum, i.e. transferred any number of times till its satisfaction.

(b) Free from defects: The Holder in due course obtains the good title to the instrument, notwithstanding any defect in a previous holder's title. A Holder in due course is one who receives the instrument -

- For Consideration,
- Before maturity, and
- Without any notice as to the defect in title of the Transferor.

(c) Holder to sue in his own name: The Holder in due course of a Negotiable Instrument can sue on the instrument in his own name.

(d) Presumptions: A Negotiable Instrument is subject to certain presumptions listed u/s 118 and 119 as to consideration, date, time of acceptance and transfer, endorsements, etc.

Note: Share Certificates with Blank Transfer Deeds, Deposit Receipts and Mate's Receipts are not Negotiable Instrument's.

Presumptions: Until the contrary is provide, the following aspects are presumed in respect of Negotiable Instruments –

Presumption as to...	Description
Consideration	• Every Negotiable Instruments was made or drawn for consideration, and • Such Negotiable Instrument was accepted, Endorsed, negotiated or transferred for consideration.
Date	Every Negotiable Instrument bearing a date was made or drawn on that date.
Time of Acceptance	Every Bill of Exchange was accepted within a reasonable time after the date mentioned therein but before the date of its maturity.
Time of Transfer	Every transfer of a Negotiable Instrument was made before its maturity.
Order of Endorsements	Endorsements appearing on a Negotiable Instrument were made in

	the order in which they appear thereon.
Stamp	That a lost Promissory Note, Bill of Exchange or Cheque was duly stamped.
Holder in due course	That the holder of a Negotiable Instruments is a holder in due course. (See Note a)
Fact of Dishonour [Sec.119]	In a suit for the dishonour of a Negotiable Instrument, the Court shall, on proof of protest, presume the fact of dishonour, unless and until it is disproved.

Types of Negotiable Instrument

Negotiable Instruments are of two types:

i) Negotiable by statute – Section 13 of the Act, provides that a negotiable Instrument include promissory note, bill of exchange and cheque, whether payable to bearer or order.

ii) Negotiable by custom or usage – Though the Act speaks of only three types of Negotiable Instrument, but it does not consider other kinds of instruments from being treated as a negotiable instrument provided they possess the characteristics of a negotiable instruments. Accordingly certain other instruments take the character of negotiable instruments by custom or usage. Dividend warrant, circular notes, bearer debentures are some of them though they are not specifically mentioned in the Act.

Classification of Negotiable Instruments

(i)	**Bearer and order instruments**	A negotiable instrument is said to be payable to bearer when (i) It is expressed to be so payable (ii) Only or last endorsement is a blank endorsement. A negotiable instrument is said to be payable to order when (i) It is expressed to be so payable (ii) Expressed to be payable to a particular person with restricting its transferability.
(ii)	**Inland and foreign instruments**	A bill, promissory note or cheque if both drawn and payable in India or drawn on a person resident in India is said to be an inland bill. A bill which is not an inland bill is deemed to be a foreign bill. Foreign bill must be protested for dishonor if such protest is required by the law of the place where it was drawn, this is not case with Inland bills where protest for nonpayment is optional as per section 104 of the Act.
(iii)	**Demand and time instruments**	An instrument is payable on demand when it is expressed to be so payable or when no time is specified on it. A cheque is always payable on demand as discussed earlier.

		A note or bill if payable after a specified period or happening of a specified event which is certain, it is a time instrument. If a promissory note or bill of exchange bears the expression "at sight" and "on presentation" mean on demand (section 21). The words "on demand' are usually found in a promissory note, where the words "at sight' are found in a bill of exchange.
(iv)	**Genuine, accommodation and fictitious bill**	When a bill is drawn, accepted, or endorsed for consideration it is a genuine bill. When it is drawn, accepted, or endorsed without consideration it is accommodation bill. When drawer or payee or both are fictitious the bill is called fictitious bill. If both drawer and payee of a bill are fictitious person, the acceptor is liable to a holder in due course, if the holder in due course can show that the signature of the supposed drawer and that of first payee are in the same handwriting.
(v)	**Clean and documentary bill**	When no documents relating to goods are annexed to the bill, it is clean bill. When documents of title or other documents relating to goods are attached, it is documentary bill.
(vi)	**Ambiguous instrument**	When an instrument due to faulty drafting may be interpreted either as bill or note, it is an ambiguous instrument. It is for holder to decide how he wants the bill to be treated. Ambiguity may also arise when the amount is stated differently in words and figures. In such case the amount stated in words will be taken into account.
(vii)	**Inchoate instrument**	An instrument incomplete in some respect is known as inchoate instrument. When a person signs and delivers to another a blank or incomplete stamped paper, he authorizes the other person to make or complete upon it a negotiable instrument for any amount not exceeding the amount covered by the stamp. The effect of such signing is that the person signing the instrument is liable upon such instrument in the capacity in which he signed it to holder in due course of the instrument.
(viii)	**Escrow Instrument**	When an instrument is drawn conditionally or for a special purpose as a collateral security and not for the purpose of transferring property therein, it is called Escrow instrument. The liability to pay in case of an Escrow instrument does not arise if the conditions agreed upon are not fulfilled or the purpose for which the instrument was delivered is not achieved.

FREQUENTLY ASK QUESTIONS ON INCOME FROM OTHER SOURCES

(1). Please advise whether, in order to declare income from card games, any conditions are to be fulfilled, and whether the income must be proved to the satisfaction of the Assessing Officer and if so, how it must be proved?

No specific conditions are required to be fulfilled before declaring income from card games. A mere declaration of the income will do, and it is up to the Assessing Officer to probe further to find out the factual correctness of the receipt of income, if he feels so. The winner need not furnish proof to corroborate the winnings with the losses incurred by others. If the Assessing Officer desires to know the names of the other participants, the winner is bound to furnish the requisite information.

(2). Under section 2(22)(d) any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possesses accumulated profits (which arose after the end of the previous year ending next before the 1st day of April, 1933) whether such accumulated profits have been capitalised or not is treated as deemed dividend. I want to know on which date deemed dividend would be calculated. Is it the date of passing of resolution which authorises the reduction of share capital or is it the date on which High Court sanctions the reduction ?

As per the Explanation 2 to section 2(22), the expression "accumulated" profits shall include all profits of the company upto the date of distribution or payment. Therefore, accumulated profits on the date of distribution will be taken into consideration.

(3). One of my clients is a closely held company. In the financial year 2013-14, the company has given a loan of ₹ 45,00,000 to one of its director who was holding 11.5 per cent share capital. During 2013-14, the company does not have any general reserve. However, there is share premium account of ₹ 50,00,000. The loan is re-paid by the director within 2 months but in the next financial year 2014-15. The Assessing Officer wants to treat share premium account as accumulated profit and wants to treat this loan as deemed dividend under section 2(22)(e). According to him it is taxable as dividend in the hands of the director under section 56(2) under the head "Income from other sources". At the same time the department wants to take action against the company for not deducting tax at source under section 194. I want your opinion whether the loan can be treated as deemed dividend under section 2(22)(e) when the company does not have accumulated profit. Is it possible to include share premium account in accumulated profit ? Is it possible to invoke section 194 for not deducting tax at source?

Section 52 of the Companies Act, 2013 deals with the application of premium received on issue of shares. It states that the premium received shall be transferred to a separate account styled 'the share premium account' and further states that the provisions relating to the reduction of the share capital of the company shall apply as if the share premium account was paid-up share capital of the company. Further, section 52 gives five purposes for which alone the share premium account may be applied without attracting the provisions of the 2013 Act relating to the reduction of the share capital. These are:

(a) to pay up fully paid bonus shares to be issued to the members;
(b) to write-off preliminary expenses of the company;

(c) to write-off expenses of issue of shares or debentures or underwriting commission paid or discount allowed on such issues;

(d) to pay premium on the redemption of redeemable preference shares or of any of debentures of the company; or

(e) to purchase of its own shares or other specified securities in terms of section 68,

barring the above five cases, any other application of the proceeds of the share premium account will be treated as a reduction of the company's share capital and the provisions of the 2013 Act dealing with this subject stand attracted. The share premium account cannot be used otherwise than for the specific purposes mentioned above. When there is a statutory bar on the share premium account being used for distribution of dividend, the deeming provisions of section 2(22)(e) cannot apply. Not only is there a prohibition on the distribution of the share premium account as dividend under the 2013 Act, the same is obliged to be treated as a part of the share capital of the company and this is made clear in section 52 of the 2013 Act which says that any payment out of the share premium account, except for purposes authorised by sub-section (2), will be treated as reduction of share capital attracting the provisions of the 2013 Act in relation thereto.

Consequently, in your case share premium account cannot be taken as part of accumulated profit. It appears from your query that there is no other accumulated profit with the company. In such a situation the deeming provision of section 2(22)(e) cannot be invoked. Nothing is, therefore, taxable in the hands of direct tax under section 56(2). Likewise, the application of section 194 is not possible.

(4). I am an employee of a company controlled by PVS Group. One of the items in our remuneration plan is gift of ₹ 30,000 from the employer company. CTC is calculated after including ₹ 30,000 in the case of each employee. During the financial year 2014-15, I can avail this perquisite. I have not received any other gift from any other person during the current year. I am not likely to get any other gift from any other person up to March 31, 2015. In other words, the total amount of gift for the financial year 2014-15 will be ₹ 30,000. According to my understanding, nothing to chargeable to tax under section 56(2)(vii), if the aggregate amount of gift received from one or more persons during a financial year is ₹50,000 or less than ₹ 50,000. Consequently, in my case nothing should be chargeable to tax. However, the Accounts Department's head of the company has a different version. He wants to deduct TDS under section 192. I am unable to understand as to how TDS provisions of section 192 is applicable in the case of income which is taxable (or which is tax-free) within the parameters of section 56(2)(vii). Does it may any difference if CTC is calculated without including the aforesaid ₹ 30,000.

Payment received from the employer by an employee is taxable in the hands of the employee under section 15 (read with section 17) under the head "Salaries". It cannot be taxed under the head "Income from other sources". To put it differently, it can be stated that if gift is received by an employee from his/her employer, it will be taxable only under the head "Salaries". If gift is received from a person other than employer, then one can invoke the provisions of section 56(2)(vii). In your case, section 56(2)(vii) is not applicable as gift is received from the employer. Section 56(2)(vii) is not applicable regardless of the fact whether ₹ 30,000 is part of CTC or CTC is calculated without including ₹ 30,000.

If gift is received in kind, ₹ 5,000 is not chargeable to tax and the value of perquisite under section 17(2)(viii) [read with rule 3(7)(iv)] will be ₹ 25,000. Conversely, however, if gift is received in cash or by cheque, the entire ₹ 30,000 will be taxable as profits in lieu of salary under section 17(3).

FREQUENTLY ASK QUESTIONS ON INCOME OF OTHER PERSONS INCLUDED IN ASSESSEE'S TOTAL INCOME

(1) A wants to create discretionary trust (as provided in section 164) for the benefit of sons and daughters of his brother B by settling a sum of ₹ 40 lakh. None of the beneficiaries is having income chargeable to tax (i.e., exceeding the maximum amount not chargeable to tax in case of an AOP) and none of them is beneficiary under any other trust. Advise—

(a) Whether income earned by the trust (not from business) will be clubbed in the hands of B as all the beneficiaries are his minor sons and daughters only although no specific share of income is attributable to any of them personally.

(b) If answer to above question is in affirmative, will it make any difference if a minor child of another relative C is also named as beneficiary.

(c) Whether there is any requirement that the beneficiaries in such type of trust should be dependent on the settler.

In CIT v. D. V. Narasimhan [1992] 196 ITR 490 (Kar.) since affirmed in CIT v. M.R. Doshi [1995] 211 ITR 1 (SC), the view taken is that through the medium of transfer to a trust for the benefit of a minor, with the rider that the same will be handed over to the minor on attaining majority, the provisions of section 64(1) may be circumvented. The provisions of the present section 64(1A) also may be circumvented as what is includable in the parent's income thereunder is the totality of the income accruing or arising to the minor. As, in case of availability of the benefit of the trusts' income being deferred till majority, no income would accrue or arise to the minor during his minority. Other cases to which reference may be made in this regard are CIT v. M.K. Doshi [1980] 122 ITR 499 (Guj.) and CIT v. T. Ponnaiah [1988] 172 ITR 269 (AP).

In view of the above, the proper course would be to constitute a trust on the lines indicated in the cases mentioned above. If that is done, recourse to alternative (2) in the query would not be necessary. Regarding (1), it would be better to indicate the shares of the beneficiaries in the trust. As regards query (3), the reply is in the negative.

(2). On November 2, 2013, A (minor child) gets a gift of ₹ 10 lakh from a person other than his relative. On the same day, the amount is deposited in a bank (interest income for the previous year ending March 31, 2015 is ₹ 12,900). Discuss whether the income would be taxable in the hands of A's father or mother under the provisions of section 64.

The clubbing provisions of section (1A) will be applicable. Consequently, the amount of income would be included in the income of A's father or mother whose income before this clubbing is higher, as follows—

	₹
Gift treated as income under section 56(2)	**10,00,000**

Bank interest	**12,900**
Total	**10,12,900**
Less: Exemption under section 10(32)	**1,500**
Income to be included in the income of A's father or mother	**10,05,400**

(3). A, having other income of ₹ 30,000 per annum is holding shares of ₹ 1 lakh and Mrs. A having no other income is also holding shares of ₹ 1 lakh in a private limited company having a paid-up share capital of ₹ 6 lakh. A is drawing a salary of ₹ 3,500 per month and Mrs. A is drawing a salary of ₹ 1,500 per month from the said company. What will be the position under section 64(1)(ii) read with Explanations / and 2 if (i) both A and Mrs. A are among the directors of the said company, or (ii) Mrs. A is a director of the said company and A is an employee with the same company as one of the professional personnel ?

A and Mrs. A are relatives within the meaning of section 2(41) and each of them (together with the other) holds a substantial interest in the company, being one-third of the total paid-up share capital. Explanation 2 to section 64(1)(ii) is clearly applicable to each of them. Aggregation of the salary of both in the hands of whichever has larger income, excluding the salary, is unavoidable, unless the salary can be attributed "to the application of his or her technical or professional knowledge and experience". Directorship has no relevance to the issue. Technical or professional qualifications will be entitled to treatment of the income derived though their application as the personal income of the spouse concerned.

(4). A has a shop. He leased out the open area above the shop to his wife on rent of ₹ 100 per month. A's wife constructed with her own independent resources a shop on the first floor and let it out on rent of ₹ 2,000 per month. Kindly advise whether such a lease is permissible and whether there is any possibility of Mrs. A's income being clubbed with that of A.

There is nothing in law which precludes a person from letting out or leasing any part of his property to his wife for a consideration. If it can be established that the wife constructed the shop on the first floor with her own independent resources, there is no question of clubbing the income from such property with that of her husband.

There does not appear to be any case law on the specific point raised. However, in case the Assessing Officer questions the adequacy of the lease rent, the case has to be defended on facts. The cases of V. Amirtham Ammal v. CIT[1976] 102 ITR 350 (Mad.) and Mammon K. Cherian v. CIT[1976] 102 ITR 553 (Ker.) may be referred to. If the Assessing Officer attempts to invoke the decision of the Supreme Court in the case of CIT v. McDowell & Co. Ltd.[1985] 156 ITR 162, the case may be contested by distinguishing the facts and claiming that there is no attempt at avoidance of tax by the assessee.

(5). X gifted ₹ 50,000 to his wife in 1990. She purchased a plot and constructed a house with that amount. The rental income was assessed in the hands of X. If the house is now sold, will the capital gains be assessed in the hands of X?

In order to attract the clubbing provisions, the connection between the transfer of assets and the income must be proximate. In the case of CIT v. Pelleti Sridevamma[1976] 105 ITR 887 (AP), the assessee made a cash gift to her minor son, and with that amount, the son purchased a house. The income from the house property was rightly assessed in the hands of the assessee, in view of the proximate connection between the gift and the income. The house was sold by the son after about 8 years. On the question whether the resultant capital gains were also assessable in the hands of the assessee, the High Court held that, in view of the time-lag involved, there was no proximate connection between the capital gains and the original cash gift and the capital gains would not be assessable in the hands of the assessee. The facts, stated by X were almost similar to the facts in the aforesaid case, and hence, X would successfully claim, on the strength of the aforesaid decision that the capital gains arising on the sale of house property were not assessable in his hands.

DUTY DRAWBACK: AN IMPORTANT ASPECT OF CUSTOMS LAW

Drawback is an incentive given to exporters. This incentive operates repayment of duty paid in relation to exports. Drawback is allowed in two cases: (a) Drawback allowable on re-export of duty-paid goods (Section 74 of Customs Act) and (b) Drawback on imported materials used in the manufacture of goods which are exported (Section 75 of Customs Act).

(a) Drawback allowable on re-export of duty-paid goods (Section 74 of Customs Act): Only imported goods on which duty has been paid on importation are eligible for drawback. Such goods are identified to the satisfaction of the Assistant or Deputy Commissioner as the goods which were imported.

Extent of drawback: (i) 98% of duty paid on importation shall be repaid as drawback.
(ii) Where imported goods have been used, the Central Government will fix the rate of drawback having regard to — (A) duration of use, (B) depreciation in value and (C) other relevant circumstances.

Drawback rates-goods taken into use- after importation:

Length of period between the date of clearance for home consumption and the date when the goods are placed under Customs control for export	Percentage of import duty to be paid as Drawback
1. Not more than three months	95%
2. More than three months but not more than six months	85%
3. More than six months but not more than nine months	75%

4. More than nine months but not more than twelve months	70%
5. More than twelve months but not more than fifteen months	65%
6. More than fifteen months but not more than eighteen months	60%
7. More than eighteen months	Nil

Goods in respect of which no duty drawback is allowed: The following goods are not eligible for drawback if they are used after import:

1. Wearing apparel;
2. Tea-chests;
3. Exposed cinematographic films passed by the Board of Film Censors of India;
4. Unexposed photographic films
5. Paper and plates and x-ray films.

(b) Drawback on imported materials used in the manufacture of goods which are exported (Section 75 of Customs Act): Drawback u/s 75 is covered by the Customs, Central Excise Duties and Service Tax Drawback Rules, 1995.

Restrictions on drawback: No drawback u/s 75 permissible if —

General	Notified Goods
Export value is < Value of imported materials used in manufacture / processing / operations. Example: import value = ₹ 10,000, drawback is eligible only if export value ≥ ₹ 10,000.	Export value is ≥ prescribed percentage of value of imported materials used in manufacture / processing / operations. Example: import value = ₹ 10,000 and prescribed percentage is 15%, drawback is eligible only if export value > ₹ 11,500.

Types of rates of drawback: Drawback u/s 75 can be granted on the basis of the following:

Type	Rate Determined by —
All Industry Rate (AIR) [Rule 3]	Central Government
Brand Rate [Rule 6]	Jurisdictional Commissioner of Central Excise / Customs, when AIR is not available
Special Brand Rate [Rule 7]	Jurisdictional Commissioner of Central Excise / Customs, when AIR determined is low, i.e. < 80% of input duties & taxes

Upper Limit of Drawback money or rate: The drawback amount or rate determined under rule 3 shall not exceed one third of the market price of the export product. [Rule 8A of the Customs, Central Excise Duties and Service Tax Drawback Rules, 1995].

- **All Industry Rate:** The drawback rate may be specified in terms of —
  - Rupee terms, i.e. amount will be mentioned;
  - Percentage terms, i.e. drawback rate will be mentioned.

  Factors Considered by Central Government: The following factors will be considered by the Central Government:
  - Inputs for goods manufactured in India;
  - Duties & taxes paid on inputs;
  - Duties & taxes paid on packing materials used for export goods;
  - Service tax paid on input services for manufacture, processing, packing etc.
  - Other informations as deemed fit by Central Government.

- **Brand Rate [Rule 6]:** Manufacturer or exporter of the goods shall make an application in writing to the Jurisdictional Commissioner of Central Excise / Customs (as the case may be), for determination of amount / rate of duty.

  Contents of Application: The application shall state all the relevant facts including —
  - proportion in which the materials, components, or input services are used in the production or manufacture of goods, and
  - Duty / tax paid on such materials, components, or input services.

- **Special Brand Rate [Rule 7]:** Manufacturer or exporter of the goods shall make an application in writing to the Jurisdictional Commissioner of Central Excise / Customs (as the case may be), for determination of amount / rate of duty.

  Contents of Application: The application shall state all the relevant facts including —
  - proportion in which the materials, components, or input services are used in the production or manufacture of goods, and
  - Duty / tax paid on such materials, components, or input services.

The only difference between Brand Rate and Special Brand Rate is the situation. Brand Rate arises when AIR is not available but Special Brand Rate arises when AIR determined is low, i.e. < 80% of input duties & taxes.

FORWARD EXCHANGE CONTRACT (ACCOUNTING STANDARD – 11)

What is forward exchange contract?

It is an agreement between two parties whereby one party agrees to buy from or sell to the other party an asset at future date for an agreed price; in case of forward exchange contract the asset is "foreign currency".

Example:

Mr. Mitra of Kolkata (India) want to import a plant worth US $ 100000 from USA, payment shall be made after three months of the import i.e. 1-6-2015.
The Exchange rate on this date is ₹ 65 per US $, which he expects to rise on the day of payment i.e. 31-8-2015. So he entered into forward buy contracts for ₹ 65.25 per US $ to cover any risk due to fluctuation of exchange rate now Mr. Mitra has ensured that he will get one dollar for ₹65.25 whatever may be actual exchange rate on the date of settlement i.e. 31-8-2015.

For the purpose of the accounting treatment forward exchange contract as been classified in two types:

- Forward exchange contract for managing risk (hedging).
- Forward exchange contract for trading or speculation.

Forward exchange contract for managing risk - The forward exchange contract which is entered into with an intention of minimizing the risk due to fluctuation in exchange on the date of the settlement of the transaction is the contract for managing the risk.

The premium or discount that arises on entering into the contract is the difference between the exchange rate at the date of the inception of the forward exchange contract and forward rate specified in the contract.

Taking the same example —

the exchange rate on the date of settlement i.e. 31-8-2015 is ₹ 67.40 per US $.
The exchange rate on 1-6-2015 - ₹ 65.00 per US $,
Forward rate booked - ₹ 65.25 per US $

In this situation:

Forward premium = (65.25 - 65.00) × US$ 1,00,000 = ₹ 25,000.

As per the accounting standard this should be expensed over the tenor of contract i.e. three months (1-6-2015 to 31-8-2015).

Exchange difference - (67.40 - 65.00) × US $ 1,00,000 = ₹ 2,40,000 (gain) should be recognized by crediting it to the profit and loss statement.

If forward exchange contract is cancelled the profit or loss arising on cancellation is recognized in profit and loss statement for the period.

Forward exchange contract for trading or speculation –

When the forward exchange contract is entered in to for earning profit by trading or speculation in foreign exchange, the accounting treatment shall be different (as the object is not to reduce the risk but to gain).

As per the accounting standard premium or discount on such forward contract not to be recognized and to be ignored.

At each balance sheet date the value of contract is marked so its current market value, gains or loss on the contract is recognized.

Example:

A dealer has bought three months forward contract for US $ 1,00,000 at ₹ 67.10 per US $ on 1-6-2015.
He closes his account on 30th June every year.
Exchange rate on 1-6-2015 was ₹ 67.02 per US $ and
On 30-6-2015 it was ₹67.15 per US $.
Two months forward contract was selling on 30-6-2015 at ₹ 67.18 per US $.

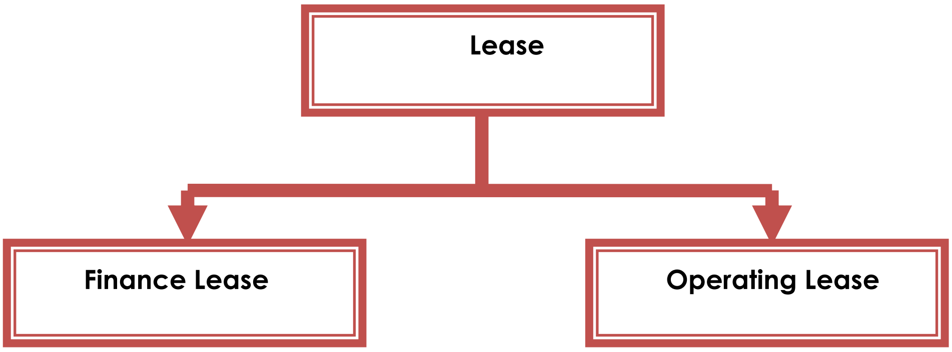
Answer:

This forward contract is entered into for speculative/trading purpose.

The dealer shall mark to market the forward contract on reporting date i.e. 30-6-2015 (67.18- 67.10) × 1,00,000= 8000 and should book the profit for ₹ 8,000 on 30-6-2015.

Suppose on 15.07.2015 the dealer sells the forward for ₹ 67.11 per US $ so on setting off the deal, he should book the loss of (67.18 - 67.11) × 1,00,000 = ₹ 7,000.

CLASSIFICATION OF LEASE (ACCOUNTING STANDARD – 19)



Finance Lease
It transfers substantially all the risks and rewards incidental to the ownership of an asset to leasee by the lessor but not the legal ownership.
The leasee will get the ownership of leased asset at the end of the lease terms
The lessee has an option to buy the leased asset at the end of term at price, lower than its expected fair value at the date on which option will be exercised.
The lease term covers the major part of the life of asset.
At the beginning of lease term, present value of minimum lease rental covers substantially the initial fair value of the leased asset.
The asset given on lease to lessee is of specialized nature and can be used by the lessee without major modification.

Operating Lease
It does not transfer substantially all the risks and rewards incidental to the ownership of an asset.

How to determine whether a lease agreement is a Finance Lease or Operating Lease

Example:

An equipment is leased for 3 years and its useful life is 5 years. Both the cost and the fair market value of the equipment are ₹6,00,000. The amount will be paid in 3 installments and at the termination of lease lessor will get back the equipment. The unguaranteed residual value at the end of 3 years is ₹80,000. The internal Rate of Return of the investment is 10%. The present value of annuity factor of ₹1 due at the end of 3rd year at 10% IRR is 2.4868. The present value of ₹1 due at the end of 3rd year at 10% rate of interest is 0.7513.
State with reason whether the lease constitute finance lease.

Answer:

IRR is 10%

Investment in lease is ₹6,00,000

If IRR is 10% that means Present Value of minimum lease payment (MLP) from lessor point of view plus unguaranteed residual value is equal to ₹6,00,000.

P.V. of unguaranteed residual value (80,000 × 0.7513) = ₹60,104

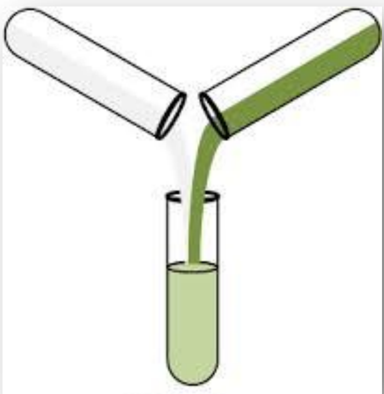
P.V. of Minimum lease Payment should be (6,00,000 – 60,104) = ₹5,39,896.

As at the beginning of lease period the P.V. of M>L>P cover substantially the initial fair value i.e. ₹5,39,896/₹6,00,000 = 89.98 % approx.

That means lease period covers major part of the lease of the asset.

Hence, it is a finance lease.

DILUTED EARNINGS PER SHARE (ACCOUNTING STANDARD -20)



When to calculate Diluted Earning Per Share?

Diluted earning per share is calculated when there are potential equity shares in capital structure of an enterprise. Potential equity shares are those financial instruments which entitle to its holder the right to acquire equity shares like convertible debentures, convertible preference shares, options, warrants etc.

How to compute Diluted Earning Per Share?

Net profit attributable to equity shareholders (after adjustment for diluted earnings) **divided by** Average number of weighted equity shares outstanding during the period (assuming the conversion of diluted potential equity.

Diluted potential equity shares - Potential equity shares are diluted **if their conversion into equity shares reduces the earning per share**.
If their conversion does not decrease the EPS, rather it increases the EPS, then the potential equity shares are not to be considered dilutive.

Steps of computing Diluted Earning

- Compute net profit or loss for the period attributable to existing equity shareholder.
- Add back dividend along with distribution tax on convertible preference shares previously deducted.
- Add back interest net of tax effect charged on convertible debenture or loans.

Potential equity share should be ranked in order of dilutive effect. Dilutive effect is determined dividing incremental net profit by incremental equity share arising out of conversion.

Example:

M Ltd. has equity capital of ₹40,00,000 consisting of fully paid equity shares of ₹10 each. The net profit for the year 2013-14 was ₹60,00,000.It has also issued 36,000, 10% convertible debentures of ₹50 each. Each debenture is convertible into five equity shares. The tax rate applicable is 30%. Compute the diluted earnings

Answer:

Computation of Diluted Earning:

Interest on Debentures @ 10% for the year	$36{,}000 \times ₹50 \times \frac{10}{100}$
	=₹1,80,000
Tax on interest @ 30%	= ₹54,000
Diluted Earnings (adjusted net profit)	= (₹60,00,000 + ₹1,80,000 - ₹54,000)
	= ₹61,26,000

and, in this case diluted earning per share is ₹61,26,000 / (4,00,000 + 1,80,000 i.e. 36,000× 5) = ₹10.56.