



## **RETIREMENT OF PARTNERS - PART I**



When one or more partners leave the firm and the remaining partners continue to do the business of the firm, it is known as retirement of a partner. Amit, Sunil and Ashu are partners in a firm. Due to some family problems, Ashu wants to leave the firm. The other partners decide to allow him to withdraw from the partnership. Thus, due to some reasons like old age, poor health, strained relations etc., an existing partner may decide to retire from the partnership. Due to retirement, the existing partnership comes to an end and the remaining partners form a new agreement and the partnership firm is reconstituted with new terms and conditions. At the time of retirement the retiring partner's claim is settled.

A partner retires either:

- (i) With the consent of all partners, or
- (ii) as per terms of the agreement; or
- (iii) at his or her own will.

### **PROBLEMS ARISING ON RETIREMENT OR DEATH**

The following points arise on retirement of a partner:

- a) New profit sharing ratio and gaining ratio.
- b) Goodwill
- c) Adjustment of changes in the value of Assets and liabilities



- d) Treatment of reserve and accumulated profits.
- e) Settlement of retiring partners dues,
- f) New capital of the continuing partners.

### **TOTAL AMOUNT TO BE PAID TO A RETIRING PARTNER**

The amount payable to a retiring partner includes the following:

- 1) The credit balance of his Capital Account. Also the credit balance of his Current Account, if any
- 2) Interest on capital from the date of commencement of accounting year till the date of his retirement.
- 3) Salary payable to the retiring partner, if any, for taking active part in management of the business.
- 4) Partner's loan, if any and interest on such loan.
- 5) His drawings and interest on drawings, if chargeable.
- 6) If the assets and liabilities are to be revaluated at the time of retirement, then share in any profit or loss arising out of such revaluation.
- 7) His share in profit of the business of the firm till the date of retirement.
- 8) His share in the firm's goodwill.

### **NEW PROFIT-SHARING RATIO RETIREMENT**

As soon as a partner retires the profit sharing ratio of the continuing partners get changed. The share of the retiring partner is distributed amongst the continuing partners. In the absence of information, the continuing partners take the retiring partner's share in their profit sharing ratio or in an agreed ratio. The ratio in which retiring partner's share is distributed amongst continuing partners are known as gaining ratio. It is

$$\text{Gaining Ratio} = \text{New Ratio} - \text{Existing Ratio}$$

**Various Cases of new ratio and gaining ratio are illustrated as follows**

**Case 1 :** Retiring partner's share distributed in Existing Ratio



**Example:**

Tanu, Manu and Rena are partners sharing profits and losses in the ratio of = 4 : 3 : 2. Tanu retires and remaining partners decide to take Tanu's share in the existing ratio i.e. 3 : 2. Calculate the new ratio of Manu and Rena.

**Answer:**

Existing Ratio between Manu and Rena =  $3/9$  and  $2/9$

Tanu's Ratio (retiring partner) =  $4/9$

Tanu's share taken by the Manu and Rena in the ratio of 3 : 2

Manu's gets =  $4/9 \times 3/5 = 12/45$

Manu's New Share =  $3/9 + 12/45 = 27/45$

Rena's gets =  $4/9 \times 2/5 = 8/45$

Rena's New Share =  $2/9 + 8/45 = 18/45$

New ratio between Manu and Rena is  $27/45 : 18/45 = 27 : 18 = 3 : 2$ .

Gaining Ratio = New Ratio – Existing Ratio

Manu Gain =  $27/45 - 3/9 = 12/45$

Rena Gain =  $18/45 - 2/9 = 8/45$

$12/45 : 8/45$

3 : 2

You may note that the new ratio is similar to existing ratio that existed between Manu and Rena before Tanu's retirement.

**Note:** In absence of any information in the question, it will be presumed that retiring partner's share has been distributed in existing ratio.

**Case 2:** Retiring partner's share distributed in Specified proportions

**Example:**

A B and C are partners in the firm sharing profits in the ratio of 3 : 2 : 1. B retired and his share was divided equally between A and C. Calculate the new profit sharing ratio of A and C.

**Answer:**

B's Share =  $2/6$

B's share is divided between A and C in the ratio of 1 : 1.



A gets  $1/2$  of  $2/6 = 2/6 \times 1/2 = 1/6$   
A's New Share =  $3/6 + 1/6 = 4/6$   
C's gets  $1/2$  of  $2/6 = 2/6 \times 1/2 = 1/6$   
C's New share =  $1/6 + 1/6 = 2/6$

Gaining Ratio

Gaining Ratio = New Ratio – Existing Ratio

Gain of A =  $4/6 - 3/6 = 1/6$

Gain of C =  $2/6 - 1/6 = 1/6$

$1/6 : 1/6$

1 : 1 i.e, equal.

**Case 3:** Retiring Partner's share is taken by one of the partners

**Example:**

**Ashish, Barmon, and Chander are partners sharing profits and losses in the ratio of 2 : 1 : 2 respectively. Chander retires and Ashish and Barman decide to share the profits and losses equally in future. Calculate the gaining ratio.**

**Answer:**

Gaining ratio = New Ratio – Existing Ratio

Hence, Ashish gets =  $1/2 - 2/5 = 1/10$

Barman gets =  $1/2 - 1/5 = 3/10$

Gaining ratio between Ashish and Barman is 1 : 3

**Treatment of Goodwill on Retirement:**

A retiring partner should get his share in the goodwill of the firm as he must have also taken pains in bringing the firm to a profitable stage. Secondly, the continuing partner will get an additional share in the profit, which the retiring partner will lose; the latter must be compensated for the same. Hence, goodwill must be paid to him. Let us discuss the treatment of goodwill under two headings.

1. When goodwill does not exist in the books and
2. When goodwill exists in the books



**A) When the goodwill does not exist in the books**

- Only the retiring partner's share is brought into the books.
- Total goodwill of the firm is brought into books.
- Goodwill is written off.
- Goodwill does not exist but goodwill is debited to the continuing partner's capital accounts.

**Example:**

Mitu, Udit and Sunny are partners sharing profit equally. Sunny retires and the goodwill of the firm is valued at ₹54,000. No goodwill account appears in the books of the firm. Mitu and Udit share future profit in the ratio of 3 : 2. Make necessary journal entry for goodwill.

**Answer:**

**Journal**

| Date | Particulars   | L.<br>F. | Dr.<br>Amount<br>(₹) | cr.<br>Amount<br>(₹) |
|------|---|----------|----------------------|----------------------|
|      | Mitu's Capital A/c .....Dr  |          | 14,400               |                      |
|      | Udit's Capital A/c .....Dr  |          | 3,600                |                      |
|      | To, Sunny's Capital A/c   |          |                      | 18,000               |
|      | (Sunny's share of goodwill adjusted to remaining partners in their gaining ratio 4:1) |          |                      |                      |

**Note:**

Sunny's share of goodwill = ₹54,000 × 1/3 = ₹18,000

Gaining Ratio = New Ratio – Existing Ratio

Mitu Gains = 3/5 – 1/3 = 9 – 5/15 = 4/15

Udit Gains = 2/5 - 1/3 = 6 – 5/ 15 = 1/15

Gaining Ratio between Mitu and Udit = 4 : 1

**B) When goodwill exists in the books**

- Only the retiring partner's share in the additional goodwill is recorded.
- Full amount of additional goodwill is brought into record.
- Additional value is written off after it is brought into record.
- Total amount of goodwill is written off.



**Example:**

Tanu, Priya and Mayank are partners' sharing profit in the ratio of 3 : 2 : 1. Priya retires and on the date of Priya's retirement goodwill is valued at ₹90,000. Goodwill already appears in the books at a value of ₹48,000. New ratio of Tanu and Mayank is 3 : 2. Make the necessary journal entries.

**Answer:**

| Journal |   |          |                      |                      |
|---------|---|----------|----------------------|----------------------|
| Date    | Particulars   | L.<br>F. | Dr.<br>Amount<br>(₹) | cr.<br>Amount<br>(₹) |
|         | Tanu's Capital A/c .....Dr  |          | 24,000               |                      |
|         | Priya's Capital A/c .....Dr   |          | 16,000               |                      |
|         | Mayank's Capital A/c .....Dr  |          | 8,000                |                      |
|         | To, Goodwill A/c  |          |                      | 48,000               |
|         | (Existing goodwill written - off in the books)  |          |                      |                      |
|         | Tanu's Capital A/c .....Dr  |          | 9,000                |                      |
|         | Mayank's Capital A/c .....Dr  |          | 21,000               |                      |
|         | To, Priya's Capital A/c A/c   |          |                      | 30,000               |
|         | (Priya's share of goodwill adjusted to remaining partners in their gaining ratio 3:7) |          |                      |                      |

**Note:**

Priya's share of goodwill = ₹90,000 × 2/6 = ₹30,000

Gaining Ratio = New Ratio – Existing Ratio,

Tanu Gains = 3/5 – 3/6 = 18 – 15/30 = 3/30

Mayank Gains = 2/5 – 1/6 = 12 – 5/30 = 7/30

Gaining Ratio between Tanu. and Mayank = 3 : 7



## **BUSINESS ETHICS AND ITS RELATION WITH CORPORATE GOVERNANCE AND CSR**

In an organization, the corporate governance practices are greatly influenced by various elements, including business ethics, Corporate Social Responsibility (CSR), and environmental concerns. Business ethics is a branch of philosophy that encompasses the application of ethical code of conduct in business environment. It focuses on the just and unjust business practices and their respective consequences in the organization. CSR helps to establish a mutual relationship of an organization with the society and its stakeholders. An organization gets business and resources from the society and surrounding environment and offers products and services in return. Therefore, the organization and the society are mutually dependent on each other. Environmental concerns deal with a number of problems faced in the modern business scenario, for example, pollution. These concerns are needed to be addressed as they cause a lot of damage to the environment of an organization.

As a manager, you should be well familiarized with the concepts of business ethics, CSR, and environmental concerns, as they help in the effective and successful implementation of the corporate governance practices. A management professional should be able to develop key competitive advantages for organization based on business ethics and CSR.

Now we would learn about various topics that help an organization to take an ethical responsibility towards the society and environment. It explains the concept and importance of business ethics. Further, the chapter discusses the importance of ethics in the Indian corporate culture at length. It also describes the causes, issues, and solutions related to unethical behavior in an organization. The chapter discusses the relationship between corporate governance and ethics in detail. In addition, it elaborates on the concept of CSR, its definition, scope, importance, and role in the Indian scenario. The chapter also explains the responsibility of an organization towards the society. Further, it discusses the concept of environmental concerns in the corporate world. The chapter also deals with the environment management activities in India in the end.

### **Concept of Business Ethics**

Business ethics refers to moral as well as behavioral codes of conduct that every individual working with an organization must follow. It probes moral and ethical principles and problems arising in the business environment. The ethical issues are concerned with various negative aspects, such as corruption and fraud in an organization. The organizations started taking interest in business ethics during 1980s and 1990s. There are many organizations that emphasize the implementation of ethical codes, social responsibility, and environmental concerns.

### **Importance of Business Ethics**

Business ethics comprises various traits, such as trustworthiness and transparency in customer services. Ethical business practices strengthen customer relationship that is of prime importance for long-term organizational success. It deals with retaining and creating a long-lasting impression in the minds of customers. Such impressions help the organization to win the trust of customers and get more business. Business ethics plays a very crucial role in various management functions, which are given as follows:



- **Ethics in Finance:** Deals with various ethical dilemmas and violations in day-to-day financial transactions. An example of ethical violations is data fudging in which organizations present a fabricated statement of accounts and other records, which are open to investigation. Ethics in financial transactions gained importance when due to their insufficiency nations suffered massive economic meltdowns. The following are the ethics in finance:
  - Following truthfulness and authenticity in business transactions
  - Seeking the fulfillment of mutual interests
  - Getting the economies and financial units freed from greed-based methodologies
- **Ethics in Human Resource Management:** Deals with the enforcement of the rights of employees in an organization. Such rights are as follows:
  - Having a right to work and be compensated for the same
  - Possessing a right for free association and participation
  - Enjoying a right for fair treatment in an organization
  - Holding a right to work in a hazard-free environment
  - Blowing whistle (an activity where an employee can raise voice against any wrong practice of anyone in an organization)
- **Ethics in Marketing:** Deals with a number of issues, which are as follows:
  - Misinforming the customers about the products or services
  - Deciding high prices for the products and services
  - Creating false impression on the customers/consumers about the features of products
  - Promoting sexual attitudes through advertising; thus, affecting the young generation and children
- **Ethics in Production:** Deals with the responsibility of an organization to make sure that products and processes of production are not causing harm to the environment. It throws light on the following issues:
  - Avoiding rendering services or producing products that are hazardous to health. For example, tobacco and alcohol
  - Maintaining ethical relations with the environment and avoiding environmental pollution

### **Ethics and the Indian Corporate Culture**

Ethics in India is based on a number of scriptures, thoughts, ideas, and Vedas. In India, the organizational culture is divided into two broad divisions, namely professional culture and community culture. The professional culture helps the employees to maintain a certain acceptable level of discipline in the organization. The community culture of an organization emerges from the varied cultural backgrounds to which its employees belong. One important aspect of organizational community culture is that the beliefs and views of any particular culture or religion should not alienate any individual belonging to another culture. The Indian corporate culture has borrowed many ethical values that have been taught by Indian scriptures. Some of these ethical values are as follows:





- **Respect:** Means that every individual should have respect for the beliefs and values of other individuals. In a multiethnic country as India, the people should respect each other's views, beliefs, and ideas to maintain good mutual relationships.
- **Trust:** Means that the employees of an organization should cultivate mutual trust and faith in each other. Doubts may create misunderstandings, problems, and chaos among individuals, and thus need to be avoided. Such doubts can be solved by placing trust in each other to facilitate a better working of an organization.
- **Spirituality:** Emphasizes the positive inner transformation of an individual's life. An individual performs efficiently and feels satisfied at workplace when he/she is in peaceful and contented frame of mind. Now-a-days, the organizations are realizing the importance of spirituality, contemplation, meditation, and yoga practices, which are the essence of the Indian culture. Such practices help people to lead a more sensible life, increase work efficiency, and decrease stress levels.
- **Tolerance:** Helps to maintain cordial relationships among the employees of an organization. Tolerance refers to increase in the level of adaptability of an employee to various organizational changes. The individuals need to be permissible and receptive to the challenges of their work. They should accept people as they are without judging them.
- **Flexibility:** Refers to the degree at which an individual can adapt with the surroundings in the organizational environment. It takes into account the receptive and adaptive nature of an individual towards fellow employees and assigned tasks.
- **Sincerity:** Refers to truthfulness and transparency in the nature and behavior of employees in an organization. It also necessitates an honest code of conduct in an organization.
- **Patience:** Refers to the degree at which the individuals can tolerate any delays in the fulfillment of their wishes or goals. Individuals with high degree of patience are not affected by delays in getting rewards for their accomplished tasks.
- **Perseverance:** Refers to the quality of an individual to not to give up soon and keep on trying for achieving goals. Individuals with perseverance can keep their spirits high to achieve the desired goals.

#### **Causes and Issues of Unethical Behavior**

Unethical behavior refers to the behavior of people that do not confirm with the acceptable standards of social and professional behavior. Such behavior may include making long-distance calls from the office, duplicating the organization's system software to use at home, projecting a false report on the number of worked hours, or falsifying business records.



There can be numerous factors that cause unethical behavior in the employees of an organization. Such factors are as follows:

- **Primary Factors:** Refer to the factors that comprise external stimuli and compel people to move in a particular direction without thinking about ethical parameters. For example, obedience to authority is a primary concept that affects the ethical mindset of an individual. Children tend to obey their parents right from the time when they do not know anything about ethics. This makes their every act conditioned to their parents' teachings and orders. This mindset of children continues right from their school time. As a result, when an authoritative person orders the individual to do an unethical act, he/she tends to obey him/her as well. This happens due to the conditioning of their mind to obey orders right from their childhood.
- **Personality Factors:** Refer to the prominent characteristics of an individual. If these characteristics of an individual are negative then they are reflected in his/her behavior. For example, if a person has a prominent characteristic of being late to the office regularly then indiscipline is he/she personality factor.
- **Defensive Factors:** Refers to the attempts of an individual to find easy ways to escape from an act of violation of a law or a duty. Generally, the defensive factors are the maneuvers caused by two basic internal stimuli, which are guilt and shame. These two stimuli force individuals to lie, or draw a false consensus of others to cover their mistakes.

The aforementioned factors can be dealt with the help of following techniques:

- Appointing a psychologist or consultant to help the employees deal with the strong emotions that force them to indulge in an unethical behavior
- Ensuring that the employees know about common psychological factors of unethical behavior and the ways to deal with them
- Recognizing the factors that cause unethical behavior; thus, finding the ways to tackle the same

### Corporate Governance and Ethics

Numerous Indian organizations have acknowledged the significance of incorporating ethical values, such as integrity, transparency, and mutual and healthy communication in their corporate governance system. The organizations believe that the goodwill generated by implementing business ethics helps to gain monetary and nonmonetary benefits in the long run.

The increasing awareness among stakeholders and consumers leads to the identification of the existence of unethical practices in the organization. Such practices include financial frauds, tax evasion, bad quality products and services, indifference towards environmental concerns, and hazardous working conditions.

Now-a-days, the investors make sure that the organizations in which they invest are managed properly and possess a proper corporate governance structure. The organizations regard corporate governance as an



important control mechanism that makes the optimum use of the human, financial, and physical resources of an organization. Thus, the organizations focus to ingrain ethics into their culture and concentrate on implementing appropriate corporate governance practices.

### Concept of Corporate Social Responsibility

CSR is a form of self-regulation policy that is integrated with the business model of an organization. The CSR policy encompasses various activities, such as monitoring ethical standards and global norms. An organization takes up the responsibility to influence the society, consumers, employees, and stakeholders in a positive manner. The concept of business ethics has given a new dimension to deal with moral or ethical problems arising in the business environment.

### Definition of Corporate Social Responsibility

CSR can be defined as a voluntary approach that probes to integrate various ethical, social, and environmental concerns in an organization. It is defined in a publication, *Making Good Business Sense* by Lord Holme and Richard Watts, as: "Corporate Social Responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large."

### Scope of Corporate Social Responsibility

In an organization, various functions are affected by its CSR initiatives. For example, human resource department focuses on the rights of the employees; whereas, financial department focuses on transparency in the disclosure of account information of the organization. Now, let us discuss the vast scope of CSR in various functions of an organization:

- **CSR in Human Resources:** Helps in retaining employees by improving the image of the organization among its staff. The staff of an organization can participate in the CSR activities by fundraising and helping various nonprofit organizations.
- **CSR in Risk Management:** Helps in preventing the goodwill of an organization from depletion. Many organizational strategies focus on managing various risks. In an organization, the generated goodwill can be ruined by various incidents, such as scandals, corruption, and environmental accidents. Such incidents gain undesirable attention from various legal and regulatory bodies, including courts and media. The role of CSR becomes very crucial at such times.
- **CSR in Brand Differentiation:** Builds a unique image of the organization in the minds of stakeholders. Integrity and the implementation of best practices can help an organization to gain a distinct image in the market and have an edge over its competitors.



### Importance of Corporate Social Responsibility

CSR creates, develops, and sustains values, such as mutual respect, accountability, and economic responsibility of the organizational environment. Recently, CSR is being talked much about in print as well as electronic media. The ultimate goal of CSR is to augment the welfare of the society. CSR takes present situations into account by keeping a track of a long-term vision. As a management student or practitioner, one needs to remain abreast with various CSR initiatives being taken up by organizations.

### Corporate Social Responsibility in the Indian Scenario

CSR has been an important corporate phenomenon in India since a long time. Most of the big organizations of India are engaged in various CSR activities. In India, the private sector organizations are generally more considerate and active in performing CSR activities than the government/public sector organizations.

The CSR initiatives have been taken in India since mid 1990s. Among all the initiatives, the first one was voluntary code of corporate governance- "Desirable Corporate Governance: A Code", which was established in April 1998. This initiative was taken by one of the India's largest industry/business association called Confederation of Indian Industry (CII), which later partnered with National Foundation for Corporate Governance (NFCG); established by Ministry of Corporate Affairs. NFCG encourages the effective implementation of corporate governance practices in the Indian organizations, which in turn helps an organization to acquire stability and growth.

CSR aims at protecting the rights of organizations' employees, including labourers. Let us discuss the role of International Labour Organization (ILO), which protects the labor rights. India is affiliated with ILO and has signed 40 conventions of ILO. India has still not signed four of the ILO core conventions, which are as follows:

- 087 - Freedom of Association and Protection of the Right to Organize (1948)
- 098 - Right to Organize and Collective Bargaining (1949)
- 138 - Minimum Age Convention (1973)
- 182 - Elimination of the Worst Forms of Child Labor (1999)

The domestic law about child labor in India, Child Labour (Prohibition and Regulation) Act (1986), forbids the employment of children below the age of 14 in any hazardous occupations, such as factories and mines. As per UNICEF, India has not given sufficient attention to eradicate the child labor. The child labor law amendment in 1986 does not cover children in all sectors or industries. India has the largest number of child laborers belonging to the age of 14 in the world.

CSR also takes care of appropriate remuneration that must be offered to employees of an organization. Most of the Indian states follow the Minimum Wage Act of 1948; however, some people still breach this act. According to ILO, a laborer under minimum wage is regarded as a form of forced labor.

Protecting the environment is another issue taken care by corporate social responsibility division of an organization. One of the significant laws on environment and production is the Environment (Protection) Act



(1986), which gives authority to the central government for safeguarding and improving the quality of the environment. It also focuses on controlling and reducing pollution from all sources. A lot of Indian organizations have emerged with voluntary guidelines about environment-friendly practices.

In many Indian organizations, one of the biggest problems is organizational politics and governance practices. These problems increase the level of corruption in the organizations; thus, need strict law enforcement.

A law was established in 2005 and called Right to Information (RTI) Act, under which the employees must know about various policies and practices of an organization. The main purpose of this act was to encourage transparency and responsibility in government organizations.

## **GIST OF LANDMARK RULING OF SC/HC U/S 10** **EXEMPTIONS**

### **1. SHARE INCOME FROM FIRM [SECTION 10(2A)]**

**Sub-partnership** - A sub-partnership, which is in receipt of share of profit of a partner in main partnership, has to be deemed to be a partner in main partnership for limited purpose of section 10(2A) and will be entitled to exemption under section 10(2A) - Radha Krishna Jalan v. CIT [2007] 294 ITR 28/165 Taxman 538 (Gauhati).

### **2. INTEREST INCOME OF NON-RESIDENTS [SECTION 10(4)]**

**Interest on deposit of foreign currency not covered by declaration** - The foreign currency, for which no declarations under section 13 of FEMA had been produced by the respondent-assessee but only exchange vouchers issued by the exchange centres outside the country were produced, even if deposited in the NRE account cannot be said to be moneys standing to the credit of the respondent in the NRE account in accordance with the FEMA and the rules made thereunder and the income by way of interest on such moneys would not be exempt from inclusion in the total income of the respondent under section 10(4)(ii) - CIT v. Purshottam Khatri [2006] 155 Taxman 399 (MP).

**Interest on FDR** - Interest earned on FDR made out of money deposited in NR(E) Account is exempt under section 10(4)(ii) - CIT v. Asandas Khatri [2006] 152 Taxman 635/283 ITR 346/201 CTR 160 (MP).

### **3. LEAVE TRAVEL CONCESSION [SECTION 10(5)]**

**Employer must preserve evidence about correctness of leave travel concession availed by employee** - An employer, discharging his statutory obligation under section 192, is not only required to satisfy himself that



payment made by him to his employees in respect of leave travel concession is not taxable, as envisaged under section 10(5), but also has to preserve evidence in relation thereto so as to demonstrate and establish to the satisfaction of officer to whom return prescribed under section 206 has been filed that he has not neglected to discharge his statutory obligation of deducting tax at source - C.E.S.C. Ltd v. ITO[2004] 134 Taxman 511 (Cal).

**Validity of rule 2B** - Provisions of rule 2B(a) making difference between air travel charges and railway first class AC charges exigible to tax under the Act, are not ultra vires provision of section 10(5) - K.P. Harihara Kumar v. Union of India [2004] 270 ITR 194/[2005] 142 Taxman 64 (Ker).

**Employer's duty to preserve evidence about correctness of leave travel concession availed by employee** - Assessee employer is under no statutory obligation to collect evidence to show that its employee(s) had actually utilized amount(s) paid towards leave travel concession(s)/conveyance allowance - CIT v. Larsen & Toubro Ltd [2009] 181 Taxman 71/313 ITR 1 (SC).

#### **4. GRATUITY [SECTION 10(10)]**

In cases not governed by section 10(10)(i) or 10(10)(ii), section 10(10)(iii) applies which excludes the gratuity amount up to rate of 15 days' wages for every year of completed service subject to a maximum in this regard. Therefore, the prescribed limit of gratuity which is to be excluded under section 10(10) is the same irrespective of whether it is paid under the 1972 Act or any other scheme and, therefore, the limit of 15 days wages for completed services, as prescribed under section 10(10)(iii), is not discriminatory and violative of article 14 - Gwalior Rayons Staff Association v. UOI [2006] 152 Taxman 520 (Ker.).

#### **5. PENSION [SECTION 10(10A)]**

**Illustrations** - In SAIL DSP VR Employees Association 1998 v. Union of India [2003] 128 Taxman 704/262 ITR 638 (Cal.), it was held that VRS of SAIL could not be said to be in conflict with the requirement of rule 2BA, inasmuch as clause (8) of the scheme clearly laid down that a retiring employee would not be eligible for employment in any of the plants, subsidiaries or joint ventures of the SAIL. This is in consonance with clause (v) of rule 2BA.

In the case of CIT v. Koodathil Kallyatan Ambujakshan [2008] 175 Taxman 113 (Bom.), the Court held that the amount received by the assessee under the optional early retirement scheme of RBI was eligible for exemption as the scheme impliedly satisfied all the conditions of rule 2BA. The Court held that:

The very object of enacting the provisions of section 10(10C) was to downsize the employees' strength so that unwanted personnel could seek voluntary retirement thereby enabling the public sector to achieve the true object for which it was established. This would indicate that the provisions of the section itself contemplates a scheme whereby there has to be downsizing on account of surplus or the like. The object is to make the public sector undertakings to play their role in national economy by improvement in their functioning in all possible ways. The provision is an incentive for unwanted personnel to seek voluntary retirement. The section therefore speaks of a scheme for voluntary retirement or termination of service. The section does not provide for any predicates. Normally, therefore, the scheme ought to be read as a scheme framed by the company or authority



set out under section 10(10C). Under the rules a scheme framed must be in accordance with the requirements as set out therein. The scheme, therefore, must either expressly or impliedly, comply with the requirements. Merely because the scheme may not expressly set out that the posts will not be filled, it cannot result in the scheme not being a scheme falling under section 10(10C) read with rule 2BA, bearing in mind the procedural nature of the rules. It will have to be read in harmonious construction with the substantive provisions of the Act so as not to render it ultra vires the provisions of the substantive provisions of the Act.

The judgment of Bombay High Court in Koodathil's case (supra) was approved by the Supreme Court in Chandra Ranganathan v. CIT [2010] 326 ITR 49/195 Taxman 418 wherein it was held that amount received by employees of RBI opting for Optional Early Retirement Scheme would qualify for deduction under section 10(10C) [see also Sunil Kumar Ganguly v. ITO [2010] 322 ITR 297 (Cal.)].

#### **6. LEAVE ENCASHMENT [SECTION 10(10AA)]**

**Leave encashment while in service is not exempt** - The words 'or otherwise' in section 10(10AA) must draw the restricted meaning qua the immediately preceding word 'superannuation' which signifies an employee's severance of relationship with his employer in terms of the contract of employment. Therefore, the words 'or otherwise' will not cover cases where the assessee continues to be under the employment of the same employer and receives leave encashment receipt. Such a receipt will not be exempt from tax – CIT v. Ram Rattan Lal Verma [2005] 145 Taxman 256 (All.)/ CIT v. Vijai Pal Singh [2005] 144 Taxman 504 (All.)/CIT v. Ashok Kumar Dixit [2005] 273 ITR 126 (All.).

#### **7. VOLUNTARY RETIREMENT, RECEIPTS ON [SECTION 10(10C)]**

**Terminal benefits** - Terminal benefits cannot be brought within scope of 'amount received' under section 10(10C) - SAIL DSP VR Employees Association 1998 v. Union of India [2003] 128 Taxman 704/262 ITR 638 (Cal.).

**Relief under section 89** - Assessee is eligible to claim simultaneous benefit under section 10(10C) as well as section 89(1) in respect of compensation received under voluntary retirement scheme - CIT v. G. V. Venugopal [2005] 193 CTR (Mad.) 661.

**Emphasis is on amount receivable and not on manner/method/mode of payment-** The emphasis in rule 2BA is on the amount receivable on account of voluntary scheme which should not exceed the limits prescribed therein. It is not the intention of the legislature that every VRS framed by the companies must provide that an employee availing benefit of VRS would be paid an amount either equivalent to (1) three months salary for each completed year of service; or (2) salary at the time of retirement multiplied by the balance months of service left before the date of his retirement on superannuation. On construction of rule 2BA, it is difficult to hold that other manners/methods/modes of payment of amount in the VRS framed by the companies are forbidden.

Rule 2BA does not provide at all that the amount representing the lower of the two limits specified in clause (vi) of rule 2BA should be allowed under the VRS. The words 'does not exceed the amount equivalent to' preceding the two limits specified in rule 2BA(vi) do not suggest at all that the lower of the two limits specified



therein, is allowable. The amount receivable by an employee on account of his voluntary retirement can be either of the aforesaid two amounts. However, the amount which will qualify for exemption under section 10(10C) will be up to ₹ 5,00,000 only - Arunkumar T. Makwana v. ITO [2006] 156 Taxman 429 (Guj.).

#### **8. PERQUISITES NOT PROVIDED BY WAY OF MONETARY PAYMENT [SECTION 10(10CC)]**

**Tax of employee** - Tax paid by employer on salaries/remuneration of employees would constitute non-monetary benefits and, as such, same would be exempted under section 10(10CC) - DIT (International Taxation) v. Sedco Forex International Drilling Inc. [2012] 210 Taxman 25/25 taxmann.com 238 (Uttarakhand). Amounts paid directly by foreign employer to discharge employees' income-tax liability is exempt in hands of employees under section 10(10CC) - Yoshio Kubo v. CIT [2013] 36 taxmann.com 1/218 Taxman 164 (Delhi)

#### **9. LIFE INSURANCE RECEIPTS [SECTION 10(10D)]**

**Keyman insurance policy** - Where a company-employer had taken a Keyman Insurance Policy on one of its employees, and in the very next year assigned the policy in favour of the said employer, the character of the insurance policy changes and it gets converted into an ordinary policy. Contracting parties also change inasmuch as after the assignment which is accepted by the insurance company, the contract is now between the insurance company and the individual and not the company/employer which initially took the policy. Such company/employer no more remains the contracting parties. The law permits such an assignment. Even LIC accepted the assignment and the same is permissible. There is no prohibition as to the assignment or conversion under the Act. Once there is an assignment, it leads to conversion and the character of policy changes. The insurance company has itself clarified that on assignment, it does not remain a Keyman policy and gets converted into an ordinary policy. In these circumstances, it is not open to the revenue to still allege that the policy in question is Keyman policy and when it matures, the advantage drawn therefrom is taxable under section 10(10D)(b). The maturity proceeds will be governed by the provisions of section 10(10D) as applicable to ordinary policies - CIT v. Rajan Nanda [2012] 205 Taxman 138/18 taxmann.com 98 (Delhi).

#### **10. HOUSE RENT ALLOWANCE [SECTION 10(13A)]**

**Allowance paid to employer in occupation of own premises is not exempt** - The house rent allowance paid to an assessee who is not in occupation of rented premises but his own, is not for reimbursing or meeting any amount paid or paid away or any amount that has gone out of his coffer as rent and, therefore, is not exempt from tax liability under section 10(13A) - Patil Vijaykumar v. Union of India [1985] 151 ITR 48(Ker.), All India Lakshmi Commercial Bank Officers' Union v. Union of India [1984] 150 ITR 1 (Delhi), M. Krishna Murthy v. CIT [1985] 152 ITR 163 (AP), CIT v. P.D. Singhania [2006] 156 Taxman 504 (All.).





**11. INTEREST INCOME [SECTION 10(15)]**

**Approval granted by RBI under FERA cannot be equated with approval by Government of India** - To claim tax exemption under section 10(15)(iv), the applicant must have in its possession, either the approval granted by the ECD Division, Department of Economic Affairs, Ministry of Finance, on the basis of which he is required to approach the RBI for approval under the FERA or the approval granted by department of revenue depending upon the applicability of particular item of section 10(15)(iv). The approval granted by the RBI cannot be equated with the approval by the Government of India - Yu Bo Investment Co. (P.) Ltd., In re [2004] 139 Taxman 277/267 ITR 734 (AAR - New Delhi).

**Interest on terminal benefits** - Under the Income-tax Act, if any income is liable to be taxed, it is not open for High Court to issue a direction to employer (Government of India)/income-tax department not to levy income-tax on interest earned by assesseees (employees) on their retirement/terminal benefits - R.K. Srivastava v. Union of India [2004] 141 Taxman 84 (Delhi).

**12. AIRCRAFT, PAYMENT TO ACQUIRE AIRCRAFT ON LEASE [SECTION 10(15A)]**

Application for approval of lease agreement - Rejection of application for approval of agreement by Central Government without a speaking order is not justified - AFT Trust-Sub 1 v. Chairman, CBDT [2004] 192 CTR (Delhi) 406.

**Conditions precedent** - An agreement to acquire an aircraft on lease in future after 1-4-2007 would not meet requirement of section 10(15A) - GO Airlines (P.) Ltd. v. Union of India [2012] 24 taxmann.com 306/209 Taxman 329 (Delhi).

**13. SCHOLARSHIP [SECTION 10(16)]**

Scholarship granted by employer to son of employee could not be treated as perquisite but would be exempt under section 10(16) - CIT v. B.L. Garg [2006] 155 Taxman 189 (All).

**14. RULERS' PALACE [SECTION 10(19A)]**

**Let out palace** - Where Ruler continues to occupy palace, whether by actually utilizing it or by keeping it vacant, it shall be, for purpose of section 10(19A), deemed to be in his occupation; however, he will not be entitled to exemption under section 10(19A) in respect of annual value of part of palace, possession of which he has parted with in favour of tenants - CIT v. Maharao Bhim Singh [2014] 45 taxmann.com 350 (Raj.).

**15. Local Authority [Section 10(20)]**

The status of the U.P. State Road Transport Corporation is not 'local authority' and as such the income derived by it from house property, capital gains, the business of supply of goods and services was not exempt to the extent provided in section 10(20) - U.P. State Road Transport Corpn. v. CIT [2006] 156 Taxman 501 (All.).



Agricultural Produce Marketing Committee is not a local authority for purposes of section 10(20) -Agricultural Produce Marketing Committee v. CIT [2006] 156 Taxman 286 (Delhi).

**Industrial Area Development Authority** - Income of assessee-Industrial Area Development Authority constituted under Bihar Industrial Area Development Authority Act, 1974 to provide for planned development of industrial area, for promotion of industries and matters appurtenant thereto, is not exempt under section 10(20) - Adityapur Industrial Area Development Authority v. UOI [2006] 153 Taxman 107 (SC)

**H.P. Marketing Board** - H.P. Marketing Board is not a local authority within meaning of section 10(20) - CIT v. H.P. Marketing Board[2011] 203 Taxman 159/15 taxmann.com 211 (HP).

**U.P. Jal Nigam** - U.P. Jal Nigam created under section 3 of U.P. Water Supply and Sewerage Act, 1975 is a local authority for purpose of section 10(20) - U.P. Jal Nigam v. CIT [2011] 338 ITR 248 (All.).

**Capitation fees** - Amount received as capitation fee by educational institution is not exempt - P.S. Govindasamy Naidu & Sons v. Asstt. CIT [2010] 324 ITR 44 (Mad.).

#### **16. CHARITABLE TRUSTS/INSTITUTIONS [SECTION 10(23C)]**

**Income must be applied only in India** - Application of the income is required to be applied in India for the purposes of section 10(23C)(vi) read with the third proviso thereof. The words 'in India' have necessarily to be read into the third proviso to make it workable and to keep it in conformity with the application of the Act. The revenue had rightly noted that the Act applies to the whole of India. It is not extra-territorial in operation. If a contrary view is taken, the revenue would be given powers to apply the provisions of the Act even outside India - something that is not even postulated by the Parliament. - American Hotel & Lodging Association Educational Institute v. CBDT [2007] 158 Taxman 146 (Delhi).

**Foundation set up by ICAI** - Where assessee-foundation was set up by Institute of Chartered Accountants of India (ICAI) with main objective to make it an academy for imparting, spreading and promoting knowledge, learning, education and understanding in various fields related to profession of accountancy, it was entitled to grant of exemption, and merely because it undertook research projects at instance of Government/local bodies and received remuneration for such projects, essential character of assessee-foundation could not be said to have been converted into one which carried on commerce or business activity or rendered any service in relation to trade, commerce or business, so as to reject assessee's claim for exemption - ICAI Accounting Research Foundation v. DGIT [2009] 183 Taxman 462 (Delhi).

**Activity of holding classes by ICAI** - Activity of Institute of Chartered Accountants of India in holding classes for students and members and charging fees for classes and materials supplied, cannot be said to be business activity and not a charitable activity - DIT (Exemptions) v. Institute of Chartered Accountants of India [2011] 202 Taxman 138/14 taxmann.com 5 (Delhi).

**Illustrations** - Where a registered society which is imparting formal education by running an institute of information technology is conferred the status of a deemed university by UGC, and, in order to comply with guidelines issued by UGC as a pre-condition for granting deemed university status introduces courses with objectives of 'greater interface with society through extra-mural extension and field action related



programmes', these are not objectives independent of education but are an aid to education and hence such institute is to be treated as fulfilling all requirements of section 10(23C)(vi) - Jaypee Institute of Information Technology Society v. Director General of Income-tax (Exemptions) [2009] 185 Taxman 110 (Delhi).

Where it was not disputed that the petitioner-society ran educational institutions and it was not for the purpose of making profit, merely because the object of the society was also to serve the church and the nation would not mean that the educational institution was not existing solely for educational purpose - Ewing Christian College Society v. Chief CIT [2009] 318 ITR 160 (All.).

Where assessee was not only providing traditional education but also preparing students by providing guidelines to get admission in professional institutions to pursue their higher studies, assessee was to be held as a charitable institution which was engaged wholly for purposes of education, especially when no material had been brought to prove that there was any element of personal profit - City Montessori School (Regd.) v. Union of India [2009] 315 ITR 48 (All.).

**Consolidated application covering three years cannot be rejected outright** - Where the assessee which was granted exemption under section 10(23C)(vi) prior to the assessment year 2004-05 applied for exemption for the assessment years 2004-05, 2005-06 and 2006-07 by filing a consolidated application, and the Commissioner rejected claim of assessee holding that it had filed a consolidated application for exemption in respect of three assessment years which had to be decided as a whole and if application was allowed, it would amount to granting approval from assessment year 2005-06 onwards including assessment year 2007-08, for which application under section 10(23C)(vi) was beyond period of limitation as prescribed by proviso (XIV) added to section 10(23C) by the Finance Act, 2006 with effect from 1-6-2006, it was held that the order of the Commissioner was liable to be set aside 'since it was passed in a mechanical manner without application of judicious mind which is expected from a quasi-judicial authority', and was also not in conformity with the CBDT Circular 14 of 2006 (which was binding on the Commissioner) and the guidelines prescribed in rule 2CA. The Commissioner was directed to consider the case of the assessee afresh, since 'no bar has ever been created either by the statute or by the instructions/circulars that such type of consolidated applications could not have been dealt with in parts in respect of each assessment year/financial year while adjudicating' -Ajanta Educational Centre v. Chief CIT [2010] 187 Taxman 75 (Punj. & Har.).

**Condonation of delay in late filing of application** - The Act nowhere provides any provisions for condonation of delay in presenting application under section 10(23C)(vi) for grant of exemption. In absence of such a provision any application made under section 10(23C)(vi) beyond the statutory period of limitation cannot be entertained by the appropriate authority by condoning the delay in presenting such application - Roland Educational & Charitable Trust v. Chief CIT [2009] 309 ITR 50 (Ori.).

Even if application for grant of approval for exemption has been filed by an educational institution belatedly it should be considered on merits; there is no clear statutory bar preventing such condonation - Padmashree Krutarth Acharya Institute of Engineering & Technology v. Chief CIT [2009] 309 ITR 13 (Ori.).

**Wholly or substantially financed by Government, connotation of** - Words 'wholly or substantially financed by Government' cannot be confined only to annual grants as apart from providing annual grant, if Government



grants land, invests money in building and infrastructure and also runs educational institutions all these factors have to be taken into consideration to decide whether institution is wholly or substantially financed by Government in order to become eligible to claim exemption under section 10(23C)(iiiab). Thus, the contention of the revenue that the grant which was given by Government in a particular year was to be taken into consideration to decide whether the institution was wholly or substantially financed by the Government was without any substance – CIT v. Indian Institute of Management [2014] 49 taxmann.com 136/ 226 Taxman 301 (Kar.)

### **17. EDUCATIONAL INSTITUTIONS [SECTION 10(23C)(vi)]**

**Conditions precedent** - To decide entitlement of an institution for exemption under section 10(23C)(vi), test of predominant object of its activity has to be applied by posing question whether it exists solely for education and not to earn profit and merely because profits have resulted from activity of imparting education would not result in change of character of an institution that it exists solely for educational purpose - Pinegrove International Charitable Trust v. Union of India [2010] 188 Taxman 402/327 ITR 73 (Punj. & Har.).

If after meeting expenditure, a surplus results incidentally from an activity lawfully carried on by educational institution, institution would not cease to be one which is existing solely for educational purposes where object is not to make profit; if trust exists solely for educational purposes and conducts an educational institution, fact that it has other objects would not disentitle it to exemption so long as activity carried out by it in that assessment year was that of running an educational institution and not for profit - Vanita Vishram Trust v. Chief CIT [2010] 192 Taxman 389/327 ITR 121 (Bom.).

In case of an educational institution, capital expenditure incurred wholly and exclusively for achieving its objects is entitled to exemption and would not constitute part of total income - Pinegrove International Charitable Trust v. Union of India [2010] 188 Taxman 402/327 ITR 73 (Punj. & Har.).

Merely because an educational institution accumulates income, it does not go out of consideration of section 10(23C)(vi); it goes out only if application of income is for purposes other than education - Maa Saraswati Educational Trust v. Union of India [2010] 194 Taxman 84 (HP).

It is obligatory on part of prescribed authority, while considering application for grant of exemption, to decide whether expenditure incurred as capital investment is on object of education or not; advancement of loans to employees of institution cannot be regarded as mis-application of funds; likewise, it would be a relevant factor if any institution had enjoyed exemption for last  $2\frac{1}{2}$  decades - Kashatriya Sabha Maharana Partap Bhawan v. Union of India [2010] 194 Taxman 442 (Punj. & Har.).

While granting approval under section 10(23C)(vi), CBDT can impose condition like assessee must apply seventy five per cent of its total income for educational purposes in India; however, where an institute applies for initial approval for first time, authority must provide an opportunity to institute to comply with monitoring conditions which have been stipulated for first time by third proviso to section 10(23C) and must allow a



reasonable period to do so in event of Assessing Officer coming to conclusion that there is any shortfall in compliance - American Hotel & Lodging Educational Institute v. CBDT[2010] 192 Taxman 275 (Bom.).

Application for exemption filed after prescribed period is not maintainable - Sant Baba Sunder Singh Canadian Charitable Trust v. CBDT [2010] 195 Taxman 88 (Punj. & Har.).

In view of the twelfth proviso to section 10(23C)(vi), money advanced to another educational institution cannot be treated as application of income to the objects for which the assessee-society was established; such a transaction would only mean that the funds of the assessee-society had not been utilized solely for the purposes of education; and the society would, therefore, be disentitled from being granted approval by the prescribed authority under section 10(23C)(vi) - New Noble Educational Society v. Chief CIT [2011] 201 Taxman 33/12 taxmann.com 267 (AP).

**Computation of prescribed limit** - For purposes of exemption of income under section 10(23C)(iiiad), limit of aggregate annual receipts of ₹ 1 crore should be computed for each educational institution of assessee-trust - CIT v. Children's Education Society [2013] 34 taxmann.com 285 (Kar.)

Sale proceeds of land and bonds was not an annual receipt therefore, same had to be excluded while considering monetary limit prescribed under section 10(23C)(iiiad). - CIT v. Madrasa E-Bakhiyath-Us-Salihath Arabic College [2014] 50 taxmann.com 81/226 Taxman 372 (Mad.).

**Application for approval** - Where subsequent to rejection of application for grant of certificate under section 10(23C)(vi), assessee-society amended its objects, assessee should make a fresh application before authorities along with amended objects of society - Om Prakash Shiksha Prasar Samiti v. Chief CIT [2014] 42 taxmann.com 574 (SC).

Where assessee, a society, was running a degree college and it made an application for approval under section 10(23C)(vi), said application could not be rejected merely on ground that it was not filed by educational institution itself - Neeraj Janhitkari Gramin Sewa Sansthan v. Chief CIT [2013] 36 taxmann.com 105/218 Taxman 61 (All.)

Where for assessment year 2012-13, assessee's application for approval as charitable institution was filed on 28-3-2012 though it should have been filed only after 30-4-2012, in view of fact that, said application reached competent authority for consideration in May 2012, it could not be rejected as premature - Lokmanya Shiksha Samiti v. ITO [2013] 39 taxmann.com 15/219 Taxman 109 (MP).

Where subsequent to rejection of application for grant of certificate under section 10(23C)(vi), assessee-society amended its objects, assessee should make a fresh application before authorities along with amended objects of society. - Om Prakash Shiksha Prasar Samiti v. Chief CIT [2014] 42 taxmann.com 574/222 Taxman 40 (Mag.) (SC).

**Education/educational institution, connotation of** - There is nothing to indicate that section W(23Q)(iiiad) requires the educational institutions referred to therein to impart education in any particular subject or in any manner whatsoever. So much so, the term 'education' should enjoy a wide connotation covering all kinds of coaching and training carried on in a systematic manner leading to personality development of an individual. In the case of seminary, students on completion of their studies are made priests who head the churches as



religious leaders practising and propagating religion as a profession. So much so, religious teaching in the seminary is also education and seminary is, therefore an 'educational institution' entitled to exemption under section 10(23C)(iiiad) – CIT v. St. Mary's Malankara Seminary[2012] 19 taxmann.com 175/ 206 Taxman 429 (Ker.).

Holding of classes is not mandatory for an institution to qualify and to be treated as an educational institution under section 10(23C)(vi) - Council for the Indian School Certificate Examinations v. DGIT [2012] 20 taxmann.com 505/206 Taxman 466 (Delhi).

**Illustrations** - Where a registered society which is imparting formal education by running an institute of information technology is conferred the status of a deemed university by UGC, and, in order to comply with guidelines issued by UGC as a pre-condition for granting deemed university status introduces courses with objectives of 'greater interface with society through extra-mural extension and field action related programmes', these are not objectives independent of education but are an aid to education and hence such institute is to be treated as fulfilling all requirements of section 10(23C)(vi) - Jaypee Institute of Information Technology Society v. Director General of Income-tax (Exemptions) [2009] 185 Taxman 110 (Delhi).

Where it was not disputed that the petitioner-society ran educational institutions and it was not for the purpose of making profit, merely because the object of the society was also to serve the church and the nation would not mean that the educational institution was not existing solely for educational purpose - Ewing Christian College Society v. Chief CIT [2009] 318 ITR 160 (All.)

Where assessee was not only providing traditional education but also preparing students by providing guidelines to get admission in professional institutions to pursue their higher studies, assessee was to be held as a charitable institution which was engaged wholly for purposes of education, especially when no material had been brought to prove that there was any element of personal profit - City Montessori School (Regd) v. Union of India [2009] 315 ITR 48 (All.).

## **18. HOSPITALS [SECTION 10(23C)(via)]**

**Conditions precedent** - Philanthropy is not restricted to give free treatment only to extremely poor, but it would also be philanthropy to give treatment at a concessional rate to those who though not extremely poor cannot afford to pay full and normal charges - Breach Candy Hospital Trust v. Chief CIT [2010] 192 Taxman 98/322 ITR 246 (Bom.).

**Maternity hospital** - Maternity hospital is entitled to exemption under section 10(23C)(iii ae) - Nehru Prasutika Aspatal Samiti v. CIT [2014] 41 taxmann.com 283 (All.).

**Hospital running a chemist shop** - Application for approval under section 10(23C)(via) cannot be rejected merely on ground that a chemist shop was being run in hospital premises - Baun Foundation Trust v. Chief CIT [2012] 251 CTR (Bom.) 237.

## **19. SCHEDULED TRIBES [SECTION 10(26)]**



**'Residing' does not mean permanent residence relatable to concept of 'domicile'** - Crucial expression 'residing in any area specified' occurring under section 10(26), cannot be given a narrow and restricted meaning to imply that members of a scheduled tribe migrating from their place of origin, which happens to fall in one of areas specified in that clause, to another area although once again falling within areas specified in that clause, would not get benefit of exemption under section 10(26). The expression 'residing in any area specified', occurring under section 10(26) is used by the Parliament synonymously with the expression 'in relation to any area specified' under the said clause. The expression 'residing in any area specified' is not meant to be restrictive of the benefit provided under the said clause in the case of members of the scheduled tribes, who otherwise fall within the scope of the said section but migrating to one of the places specified in the said sub-section but only descriptive of the limited number of scheduled tribes, which are residents of the areas specified under section 10(26). Therefore, it cannot be said that a Government servant or employee of a State loses benefit of section 10(26) on mere accident of his being posted out of his place of origin, though within areas specified under section 10(26). -Pradip Kr. Taye v. Union of India [2010] 189 Taxman 483/320 ITR 29 (Gau.) (FB).

**'Residing' does not mean permanent residence relatable to concept of 'domicile'** - The word 'residing' occurring in section 10(26) cannot be given restricted interpretation confining the benefit to exemption only to the local members of the Scheduled Tribes. It cannot be held that the word 'residing' connotes permanent residence relatable to the concept of 'domicile'. The benefit of exemption is given to the members of the Scheduled Tribe for economic advancement of the tribal areas vis-a-vis financial benefit to the individuals. Therefore, a very casual or passing presence of a person would be incompatible with the legislative intent.

A member of a Scheduled Tribe notified in any tribal areas as mentioned in the Table to paragraph 20 of the Sixth Schedule will be entitled to the benefit of exemption under section 10(26) provided - (a) he is residing in any other tribal area as described in the Table to paragraph 20; (b) the income which accrues to him must arise from any source in such area; (c) the tribe to which he belongs is also recognised as a Scheduled tribe in the other tribal area where he is residing in connection with his avocation - Smt. Dipti Doley Basumatary v. Union of India [2007] 163 Taxman 246/290 ITR 498 (Gauhati).

Benefit of clause (26) of section 10 will be available to the members of scheduled tribe only residing 'in any areas' specified in the said section. The members of the scheduled tribe residing in other part of the country other than the one and specified under section 10(26) are not entitled to the benefit of section 10(26). - Amal Shyam v. Union of India [2013] 359 ITR 440 (Tripura).

## **20. SCHEDULED TRIBES/CASTES, CENTRAL/STATE FINANCIAL BODIES [SECTION 10(26B)]**

Income of assessee, State Forest Corporation, which was primarily formed with object to ameliorate suffering of tribal population of State of Arunachal Pradesh and for ushering concept of developmental activities in State, was entitled to exemption under section 10(26B)- Arunachal Pradesh Forest Corporation Ltd v. Asstt. CIT (2007) 162 Taxman 277 (Gau.).



**21. WHERE INCOME OF FIRM IS EXEMPT UNDER SECTION 10(34), (35) AND (38)**

A partner of firm is entitled to claim exemption under clause (2A) of section 10 on share of profit of firm which even includes income exempted under clauses (34), (35) and (38) of section 10- Vidya Investment & Trading Co. (P.) Ltd v. Union of India [2014] 43 taxmann.com 1 /223 Taxman 199 (Kar.)

**Compliance of section 11(5)** - Any institution, which obtains sanction under section 10(23C)(vi) as an institution established for charitable purposes, is also required to comply with section 11(5) as per third proviso to section 10(23C) - Little Angels Educational Society v. ITO [2011] 336 ITR 413 (AP).

Fact that petitioner-society was not recognized by any university or Board or fact that it was not awarding its own degrees or certificates was of no relevance for deciding an application under section 10(23C)(vi) -Delhi Music Society v. Director General of Income-tax [2012] 204 Taxman 231/17 taxmann.com 49 (Delhi).

Exemption under section 10(23C) does not depend upon books of account but it depends upon relevant provisions of Act – CIT v. Sweta Kalyan Samiti [2013] 39 taxmann.com 21/219 Taxman 115 (Mag.) (All.).

Mere possibility that society in future might pursue non-charitable activities, would not constitute grounds to reject approval under section 10(23C)(vi) - C.P. Vidya Niketan Inter College Shikshan Society v. UOI [2013] 40 taxmann.com 76 (All.)

For purpose of section 10(23C)(vi), failure of assessee-educational institution to provide admissions strictly in accordance with prescribed rules, regulations and statute could not lead to its losing character as an entity existing solely for purpose of education - Chief CIT v. Geetanjali University Trust [2013] 31 taxmann.com 304/ 214 Taxman 11 (Raj.).

**22. COMPENSATION ON COMPULSORY ACQUISITION OF AGRICULTURAL LAND [SECTION 10(37)]**

**Where land was cultivated through labourers** - Assessee could be allowed exemption under section 10(37), even if agricultural land was not cultivated by assessee himself but through hired labourer or other family member – CIT v. Jasubhai Somabhai Patel [2014] 47 taxmann.com 406/225 Taxman 158 (Guj.).

**Where assessee was staying away from agricultural land** - Merely because assessee was staying away from agricultural land or was pursuing some other business, it would not be sufficient to hold that land was not used for agricultural purposes – CIT v. Amrutbhai S. Patel [2014] 41 taxmann.com 430/221 Taxman 69 (Mag.)(Guj.).

**23. INCOME ARISING FROM TRANSFER OF EQUITY SHARES/UNITS [SECTION 10(38)]**

**Set off of loss** - Loss arising on sale of capital asset covered under section 10(38) would not be available for set off – Kishorebhai Bhikhabhai Virani v. Asstt. CIT [2014] 367 ITR 261 (Guj.).





## **RULES REGARDING CENVAT CREDIT**

**Cenvat:** Under Cenvat (Central Value Added Tax) scheme, the credit of the excise duty/ additional duty of customs paid on the inputs and capital goods and service tax paid on input services is allowed to be utilised for the payment of excise duty on the final products or service tax on output services in order to avoid the cascading effect of the duty/ tax.

**Eligible Credits:** Manufacturer/ service provider can take credit for the following duties and taxes paid by him:

- (i) Basic Excise Duty (BED) levied on excisable goods, and Additional Duty equivalent to BED levied on imported goods;
- (ii) Special Excise Duty (SED) levied on excisable goods and Additional Duty equal to SED levied on imported goods;
- (iii) The additional duty of excise levied on goods of special importance like sugar and tobacco. Duty in respect of imported goods is also eligible for credit;
- (iv) The National Calamity Contingent duty leviable on certain excisable goods and imported goods;
- (v) The Education Cess on excisable and imported goods;
- (vi) The additional duty of excise levied on Pan Masala and certain tobacco products;
- (vii) Service tax leviable on taxable service;
- (viii) The Education Cess on taxable service;
- (ix) The additional duty leviable on specified goods under section 3 of the Customs Tariff Act;
- (x) The Secondary and Higher Education Cess leviable on excisable goods;
- (xi) The Secondary and Higher Education Cess on taxable service;
- (xii) Duty paid by job worker.

**Utilisation of Cenvat Credit:** The CENVAT credit may be utilized for payment of-

- a) any duty of excise on any final product; or
- b) an amount equal to CENVAT credit taken on inputs if such inputs are removed as such or after being partially processed; or
- c) an amount equal to the CENVAT credit taken on capital goods if such capital goods are removed as such; or
- d) an amount under sub rule (2) of rule 16 of Central Excise Rules, 2002; or
- e) Service tax on any output service. Cenvat cannot be used for the service tax payable under reverse charge.

**Conditions for allowing CENVAT credit:**

- (1) The CENVAT credit in respect of inputs may be taken immediately on receipt of the inputs in the factory of the manufacturer or in the premises of the provider of output service. The manufacturer or the output



service provider cannot take Cenvat credit after six months of the date of issue of any documents specified in Rule 9(1) of Cenvat Credit Rules.

- (2) The CENVAT credit in respect of capital goods received in a factory or in the premises of the provider of output service at any point of time in a given financial year shall be taken only for an amount not exceeding fifty per cent. of the duty paid on such capital goods in the same financial year. The balance of CENVAT credit may be taken in any financial year subsequent to the financial year in which the capital goods were received in the factory of the manufacturer, or in the premises of the provider of output service, if the capital goods, other than components, spares and accessories, refractories and refractory materials, moulds and dies and goods falling under heading 6805, grinding wheels and the like, and parts thereof falling under heading 6804 of the First Schedule to the Excise Tariff Act, are in the possession of the manufacturer of final products, or provider of output service in such subsequent years.
- (3) The CENVAT credit in respect of the capital goods shall be allowed to a manufacturer, provider of output service even if the capital goods are acquired by him on lease, hire purchase or loan agreement, from a financing company.
- (4) The CENVAT credit in respect of capital goods shall not be allowed in respect of that part of the value of capital goods which represents the amount of duty on such capital goods, which the manufacturer or provider of output service claims as depreciation under section 32 of the Income-tax Act, 1961.

**Example:** If capital goods are purchased for ₹ 22,47,200 (inclusive of excise duty ₹ 2,47,200) and depreciation is claimed on entire ₹ 22,47,200, then no credit is available. However, if the manufacturer claim depreciation on ₹ 20,00,000 (net cost), cenvat credit of ₹ 2,47,200 shall be admissible.

- (5) (a) The CENVAT credit shall be allowed even if any inputs or capital goods as such or after being partially processed are sent to a job worker for further processing, testing, repair, re-conditioning, or for the manufacture of intermediate goods necessary for the manufacture of final products or any other purpose, and it is established from the records, challans or memos or any other document produced by the manufacturer or provider of output service taking the CENVAT credit that the goods are received back in the factory within one hundred and eighty days of their being sent to a job worker and if the inputs or the capital goods are not received back within one hundred eighty days, the manufacturer or provider of output service shall pay an amount equivalent to the CENVAT credit attributable to the inputs or capital goods by debiting the CENVAT credit or otherwise, but the manufacturer or provider of output service can take the CENVAT credit again when the inputs or capital goods are received back in his factory or in the premises of the provider of output service.



- (b) The CENVAT credit shall also be allowed in respect of jigs, fixtures, moulds and dies sent by a manufacturer of final products to,-
- (i) another manufacturer for the production of goods; or
  - (ii) a job worker for the production of goods on his behalf, according to his specifications.
- (6) The Deputy Commissioner of Central Excise or the Assistant Commissioner of Central Excise, as the case may be, having jurisdiction over the factory of the manufacturer of the final products who has sent the input or partially processed inputs outside his factory to a job-worker may, by an order, which shall be valid for a financial year, in respect of removal of such input or partially processed input, and subject to such conditions as he may impose in the interest of revenue including the manner in which duty, if leviable, is to be paid, allow final products to be cleared from the premises of the job-worker.
- (7) The CENVAT credit in respect of input service shall be allowed, on or after the day which payment is made of the value of input service and the service tax paid or payable as is indicated in invoice, bill or, as the case may be, challan referred to in rule 9. The manufacturer or the output service provider cannot take Cenvat credit after six months of the date of issue of any documents specified in Rule 9(1) of Cenvat Credit Rules.

## ACCOUNTING FOR GOVERNMENT GRANT (ACCOUNTING STANDARD - 12)



### Some Important Points Relating to Methods of Accounting

#### Fixed Assets

- Grants related to fixed assets should be presented in the balance sheet by showing the grant as a deduction from the gross value of the assets concerned in arriving at their book value.
- Where the grant related to a specific fixed asset equals the whole, or virtually the whole, of the cost of the asset, the asset should be written at their nominal value.

#### Example:

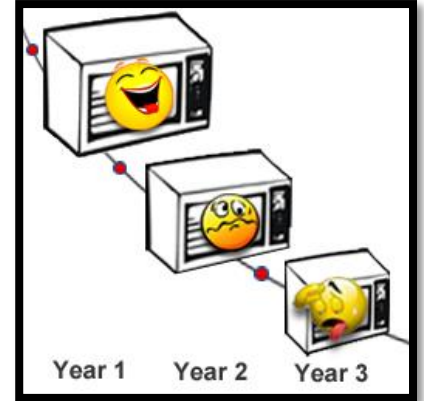
An asset with ₹ 20 lakhs fair value is supplied by Govt. at —

- Concessional rate of ₹6 lakhs, or
- Free of cost

| Particulars |  | Debit<br>₹ in lakhs | Credit<br>₹ in lakhs |
|-------------|--|---------------------|----------------------|
| (i)         | Fixed Asset A/c Dr.<br>To, Bank A/c<br>(If it is depreciable fixed asset depreciation will be charged on ₹6 lakhs)   | 6                   | 6                    |
| (ii)        | Fixed Asset A/c Dr.<br>To, Profit and Loss A/c<br>(Asset will be shown at this nominal value in the books till remains with the organization. When it is scrapped/ disposed it will be written off to profit and loss account) | 20                  | 20                   |

**Depreciable Fixed Assets**

- A. Grant is shown as deduction from the gross value of asset in arriving at its book value. When the grant is equal to the cost of assets, the asset should be shown in balance sheet at nominal value.
- B. If grants are treated as deferred income. The deferred income is recognised in profit and loss account on a systematic and rational basis over the useful life of assets. Such allocation to income is made over the periods and in proportions in which depreciation on related assets is charged.



**Non-Depreciable Fixed Assets**

- Grant is shown as deduction from the gross value of asset in arriving at its book value. When the grant is equal to the cost of assets, the assets should be shown in balance sheet at nominal value;
- If the conditions attached to grants are fulfilled ( i.e. grants received after fulfillment of the conditions attached to grants). Grants are credited to capital reserve account; or
- If condition attached to grants is yet to be fulfilled
  - Grants are credited to income over the same period over which the cost of meeting such conditions is charged to income.
  - Unapportioned deferred income is disclosed in the balance sheet as "Deferred Govt. Grants".



**Example:**

A fixed asset purchased for ₹45 lakhs. Government grant received towards it ₹18 lakhs. Show the accounting if it is non-depreciable asset or if it is a depreciable asset with ₹9 lakhs residual value and 4 years life. Assume Straight Line Method of depreciation.

**Answer:**

| Particulars   | Debit<br>₹ in lakhs | Credit<br>₹ in lakhs |
|---|---------------------|----------------------|
| <b>Non-depreciable Fixed Assets</b>   |                     |                      |
| <b>If there is no obligation attached which requires expenditures to be incurred then</b> |                     |                      |
| Bank A/c <span style="float: right;">Dr.</span>   | 18                  |                      |



|   |     |     |     |
|---|-----|-----|-----|
| To, Fixed Assets A/c or, Capital Reserve A/c  |     |     | 18  |
| <b>If there is an obligation to incur expenses says over 4 years</b>  |     |     |     |
| Bank A/c  | Dr. | 18  |     |
| To, Deferred Govt. Grant A/c  |     |     | 18  |
| ( then this deferred Government Grant will be written off to Profit & Loss A/c in 4 years i.e. ₹4.5 lakhs every year)   |     |     |     |
| <b>Depreciable Fixed Assets:</b>  |     |     |     |
| <b>(i) Credit the grant to fixed assets</b>   |     |     |     |
| Bank A/c  | Dr. | 18  |     |
| To, Fixed Assets A/c  |     |     | 18  |
| (the book value is reduced to ₹27 lakhs; the estimated scrap value is ₹9 lakhs and life is 4 years hence, depreciation to be charged on this asset every year will be ₹4.5 lakhs)   |     |     |     |
| <b>(ii) Credit the grant as deferred income</b>   |     |     |     |
| Bank A/c  | Dr. | 18  |     |
| To, Deferred Govt. Grant A/c  |     |     | 18  |
| (The book value of asset is ₹45 lakhs, residual value is ₹9 lakhs and life is 4 years, hence depreciation to be charged on ₹9 lakhs per annum for 4 years)  |     |     |     |
| <b>The grant has to be recognised in profit and loss account over the life of asset in proportion to depreciation. Depreciation is ₹9 lakhs per annum for 4 years hence grant to be written off will be ₹4.5 lakhs per annum for a year. It comes to 25% per annum of grant amount by straight line method.</b> |     |     |     |
| Deferred Govt. Grant A/c  | Dr. | 4.5 |     |
| To, Profit and Loss A/c   |     |     | 4.5 |
| (The amount of grant has to be fully allocated over the life of asset in proportion to the amount of depreciation charged)  |     |     |     |

## Which items are to be considered for computing Cash flow from Operating, Investing and Financing Activities (AS – 3)?



Cash flows are inflows and outflows of cash and cash equivalents.

- Cash comprises cash on hand and demand deposits with banks.
- Cash equivalents are short-term, highly liquid, investments that are readily convertible into known amounts of cash and which are subject to insignificant risk of changes in value.

The Standard prescribes presentation of information under three main segments, namely, operating, investing and financing activities.

### Cash flow from Operating Activities

Cash flows from Operating activities are the principal revenue producing activities of the enterprise and other activities that are not investing or financing activities. It is a key indicator to judge the ability of the entity, to maintain its operating capability, to pay dividends, to repay loans, and to make new investments without recourse to external source of financing.

### How to determine Operating Cash flow?

First we have to reckon the nature of business of the entity, as also the nature of underlying transactions if any. In the case of an entity, whose primary business relates to money lending and investments, cash flows attributable to receipt of interest or dividends, and payment of interest, would be classified under operating activities.

|                   | Classification for                        |  |
|-------------------|---|--|
|                   | Entities whose main activity is financing | Others (trading, manufacturing entities) |
| Interest received | Operating activity                        | Investing activity                       |
| Interest Paid     | Operating activity                        | Financing activity                       |
| Dividend received | Operating activity                        | Investing activity                       |
| Dividends paid    | Financing Activity                        | Financing activity                       |



**Examples of cash flow from operating activities are:**

|   |
|---|
| • Cash receipts from sale of goods and services   |
| • Cash receipts in the form of royalty, fees, commissions and other revenue   |
| • Cash payments to suppliers for goods & services   |
| • Cash payments to and on behalf of employees   |
| • Refund of, or payments towards, taxes will form part of operating activities, unless they can be specifically identified with financing and investing activities. |

**In case of Operating Activities there are two methods of presentation —**

- Direct Method or
- Indirect Method.

**Direct Method —** It is a method, wherein major classes of gross cash receipts and gross cash payments are disclosed.

Under this method, information may be obtained either

- from accounting records
- or by adjusting sales, cost of sales, and other items in the statements of profit and loss.

**Indirect Method —** In this, the reported amount of net profit or loss is adjusted for the following:

- Effects of transactions of a non-cash nature
- Any deferrals or accruals of past or future operating cash receipts or payments
- Changes in current assets and liabilities (other than cash & cash equivalents)
- Items of income or expense associated with investing or financing cash flows.

**Presentation of direct and indirect method is illustrated in the following table:**

| Direct method                                | ₹     | Indirect method                                    | ₹     |
|--|-------|--|-------|
| <b>Cash flows from operating activities:</b> |       | <b>Cash flows from operating activities:</b>       |       |
| Cash sales                                   | XXX   | Net profit before taxation and extraordinary items | XXX   |
| Collection from customers                    | XXX   | Adjustments (non-cash and non- operating items)    |       |
| Cash payments to suppliers                   | (XXX) | Depreciation                                       | XXX   |
| To employees                                 | (XXX) | Foreign exchange loss                              | XXX   |
| Cash from operations                         | XXX   | Interest income                                    | (XXX) |
| Income taxes paid                            | (XXX) | Dividend income                                    | (XXX) |
| Cash-flow before extraordinary items         | XXX   | Interest expense                                   | XXX   |
| Extraordinary item                           | XXX   | Operating profit before working capital changes    | XXX   |
| Net cash from operating activities           | XXX   | Increase in sundry debtors                         | (XXX) |
|  |       | Decrease in inventories                            | XXX   |
|  |       | Decrease in sundry creditors                       | (XXX) |
|  |       | Cash generated from operations                     | XXX   |
|  |       | Income taxes paid                                  | (XXX) |





|  |  |                                      |     |
|--|--|--------------------------------------|-----|
|  |  | Cash flow before extraordinary items | XXX |
|  |  | Extraordinary item                   | XXX |
|  |  | Net cash from operating activities   | XXX |

**Cash flow from Investing Activities**

Investing activities are acquisition and disposal of long term assets and other investments not included in cash equivalents. A separate disclosure of cash flows arising from investing activities is important because it reflects the extent to which an entity incurs expenditure towards - or realises cash by disposal of - such resources, which are intended to generate future income and cash flows.

**Examples of cash flows arising from investing activities are:**

|  |
|--|
| <b>Cash receipts</b>   |
| <ul style="list-style-type: none"> <li>• from disposal of fixed assets including intangibles (related accounting entries in P&amp;L does not affect this classification)</li> <li>• from sale of investments, interest in JV, etc</li> <li>• from repayment of "loans and advances" made to third parties (for entities whose primary business is other than financing)</li> </ul> |
| <b>Cash payments</b>   |
| <ul style="list-style-type: none"> <li>• for acquisition of fixed assets including intangibles, or towards self constructed assets</li> <li>• towards acquisition of shares, debt instruments and interest in JV, etc</li> <li>• towards advances or loans to third parties</li> </ul>   |

**Cash flow from Financing Activities**

Financing activities are activities that result in changes in the size and composition of owners' capital (including preference share capital) and borrowings of the enterprise. A separate disclosure of cash flows arising from financing activities is important because it is useful in predicting the claims on future cash flows by those who provide capital or loan funds to the reporting entity.

**Examples of cash flows arising from financing activities are:**

|  |
|--|
| <b>Cash receipts</b>   |
| <ul style="list-style-type: none"> <li>• from issue of shares or other equity instruments</li> <li>• from issue of debentures, loans, notes, bonds, mortgages and other short or long term borrowings</li> </ul> |
| <b>Cash payments</b>   |
| <ul style="list-style-type: none"> <li>• to owners of equity, to acquire or redeem equity, namely, buy back</li> <li>• repayments of amounts borrowed</li> <li>• towards dividends distributed</li> </ul>        |

**Treatment of some selected items**

**(i) Foreign Currency cash flows**



Cash flows arising from transaction in a foreign currency should be recorded in an enterprise's reporting currency and by applying to the foreign currency amount, the exchange rate between the reporting currency and foreign currency at the date of cash flow (or an average rate that closely approximates to the actual rate).

"Unrealised gains or losses arising from changes in foreign exchange rates are not cash flows.

**(ii) Extraordinary items**

Cash flows associated with the extraordinary items should be classified as arising from operating, investing or financing activities as appropriate and separately disclosed.

**(iii) Taxes on income**

Cash flows arising from taxes on income should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.

**(iv) Non- cash transactions**

Investing and financing transactions that do not require the use of cash or cash equivalents should be excluded from a cash flow statement. Such transactions should be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

Examples of noncash transactions are:

- Acquisition of assets by assuming directly related liabilities;
- Acquisition of an enterprise by means of Issuing of shares; and
- Conversion of debt into equity.

