INDIRECT AND DIRECT-TAX MANAGEMENT

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Paper 14

INDIRECT AND DIRECT TAX MANAGEMENT

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STUDY NOTE - 1

OVERVIEW OF CENTRAL EXCISE ACT, 1944

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1.1 CONSTITUTIONAL BACKGROUND

Central Excise is a duty on excisable goods manufactured or produced in India, other than alcoholic liquor. Duty liability is principally on 'manufacturer', except in a few cases. In majority of cases, duty rate w.e.f. 24.2.09 is 10% plus education cess of 2% and Secondary and Higher Education Cess of 1%. Thus, generally, duty is 10.30%. There are some exclusions, partial or full exemptions and higher duties in some cases. As per Appendix IV of CETA, the rate of additional duty on Goods of special Importance is 8% in majority of the cases. (Section 3(1) of The Additional Duties of Excise (Goods of Special Importance) Act, 1957.

Power of Taxation under Constitution of India is as follows :

(a) The Central Government gets tax revenue form Income-tax (except on Agricultural Income), Excise (except on alcoholic drinks) and Customs.

(b) The State Governments get tax revenue from sales tax, excise from liquor and alcoholic drinks, tax on agricultural income.

(c) The Local Self Governments e.g. municipalities, etc. get tax revenue from entry tax and house property tax.

Article 265 provides that no tax shall be levied or collected except by authority of Law. The authority for levy of various taxes, as discussed above, has been provided for under Article 246 and the subject matters enumerated under the three lists set out in the Schedule-VII to the Constitution.

List I : Union List

Item No. 82	Tax on income other than agricultural income
Item No. 83	Duties of customs including export duties
Item No. 84	Duties of excise on tobacco and other goods manufactured or produced in India except alcoholic liquors for human consumption, opium narcotics, but including medical and toilet preparations containing alcohol, opium or narcotics
Item No. 85	Corporation Tax
Item No. 92A	Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of interstate trade or commerce.
Item No. 92B	Taxes on consignment of goods, where such consignment takes place during interstate trade or commerce
Item No. 92C	Taxation of Services
Item No. 97	Any other matter not included in the List II, List III and any tax not mentioned in List II or List III

List-II i.e. the State List, in respect of which the State Government has exclusive powers to levy taxes, are as follows :

Item No. 46	Taxes on agricultural income
Item No. 51	Excise duty on alcoholic liquors, opium and narcotics
Item No. 52	Tax on entry of goods into a local area for consumption, use or sale therein (usually called as Octroi)
Item No. 54	Tax on sale and purchase of goods other than newspapers except tax on interstate sale or purchase

List-III : Concurrent List — List III of Seventh Schedule, called "concurrent list", includes matters where both Central Government and State Government can make laws.

1.1.1 Laws Relating to Central Excise

Central Excise Act, 1944(CEA) : The basic Act which provides the constitutional power for charging of duty,valuation, powers of officers, provisions of arrests, penalty, etc.

Central Excise Tariff Act, 1985 (CETA) : This classifies the goods under 96 chapters with specific codes assigned.

Central Excise Rules, 2002 : The procedural aspects are laid herein. The rules are implemented after issue of notification.

Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 : The provisions regarding the valuation of excisable goods are laid down in this rule.

Cenvat Credit Rules, 2004 : The provisions relating to Cenvat Credit available and its utilisation is mentioned.

1.1.2 Central Excise Act, 1944

The duty of Central Excise is levied if the following conditions are satisfied :

(1) The duty is on goods.

(2) The goods must be excisable.

(3) The goods must be manufactured or produced

(4) Such manufacture or production must be in India.

In other words, Unless all of these conditions are satisfied, Central Excise Duty cannot be levied.Ownership of raw material is not relevant for duty liability — Ownership of raw material is not relevant for duty liability – *Hindustan General Industries* v. *CCE* 2003 (155) ELT 65 (CEGAT)

* *CCE* v. *Mahindra & Mahindra* 2001(132) ELT 632 (CEGAT).

1.1.3 Duties Leviable

- **Basic Excise Duty** is levied u/s 3(1) of Central Excise Act. The section is termed as 'charging section'. General rate of duty of central excise on non-petroleum products is 10% w.e.f. 27-02-2010. (The duty rate was 14% during 1-3-2008 to 6-12-2008, which was reduced to 10% w.e.f. 7-12-2008 and to 8% w.e.f. 24-02-2009). This duty is applicable to majority of excisable goods. There is partial exemption to a few products.
- **Education Cess** @ 2% of excise duty under section 93 of Finance (No. 2) Act (w.e.f. 9-7-2004).
- **Secondary and Higher Education Cess** (S&H Education Cess) @ 1% of the total duties of excise vide section 136 read with section 138 of Finance Act, 2007 w.e.f. 1-3-2007.

  Thus, total excise duty is 10.30% in majority of the cases.

National Calamity Contingent Duty – A 'National Calamity Contingent Duty' (NCCD) has been imposed vide section 136 of Finance Act, 2001 on some products. NCCD of 1% has been imposed on mobile phones w.e.f. 1-3-2008.

In addition, cesses and duties have been imposed on some specified products.

1.1.4 Goods

It is obvious from section 3(1) that, to attract excise duty, the following conditions must be fulfilled :

- There should be goods;
- The goods must be excisable;
- The goods must be manufactured or produced; and
- The manufacture or production must be in India.

Goods manufactured or produced in SEZ are "excluded excisable goods". This means, that the goods manufactured or produced in SEZ are "excisable goods" but no duty is leviable, as charging section 3(1) excludes these goods. Thus, the goods manufactured in SEZ are not "Exempted goods". They can be termed as "excluded excisable goods".

As per explanation to section 2(d), 'goods' includes any article, material or substance which is capable of being bought and sold for a consideration and such goods shall be deemed to be marketable'.

Basic Ingredients

From the above definitions of 'goods', the two essential elements of goods are emanated:

(i) They should be movable, and
(ii) They should be marketable.

1.1.4.1 *Goods must be moveable*

In order to be movable, an article must fulfill two conditions:

(i) It should come into existence (as a result of manufacture); and
(ii) It should be capable of being moved to market to be bought and sold.

Thus, goods must exist. Where goods have not come into existence, they can not be moved as well. So long as the goods have not come into existence, no question of levy of excise duty would arise. It has been observed that the word 'manufacture' or 'production' are associated with movables.

- Marketability is to be decided on the basis of condition in which goods are manufactured or produced.
- Everything that is sold is not necessarily 'marketable'.
- Waste and Scrap can be 'goods' but dutiable only if 'manufactured' and are mentioned in Tariff.
- The marketability test requires that the goods *as such* should be in a position to be taken to market and sold. If they have to be separated, the test is not satisfied. Thus, if machinery has to be dismantled before removal,

it will not be goods -*Triveni Engineering* v. *CCE* AIR 2000 SC 2896 = 2000 AIR SCW 3144 = 40 RLT 1 = 120 ELT 273 (SC).

- Branded Software is goods. However, service tax will be payable on tailor made software after Finance Bill, 2008 is passed.

In *Municipal Corporation of Greater Mumbai v. Union of India,* a petrol pump of huge storage capacity which was not embedded to earth but which could not be removed without dismantling was held to be immovable in nature.

In *Sirpur Papers Mills Ltd. V. CCE* the machinery embedded to a concrete base to ensure its wobble free operation was held to be a movable property.

CBEC has clarified that whatever is attached to earth, unless it is like a tree/building/similar thing, shall not necessarily be regarded as immovable property if the whole purpose behind such attaching to the concrete base is to secure maximum operational efficiency and safety.

Thus, excise duty cannot be levied on immovable property.

1.1.4.2 *Marketability of Article*

Marketability denotes the capability of a product, of being put into the market for sale. Where goods are not marketable, excise duty cannot be charged on them. Marketability is the decisive test for durability. The article must be capable of being sold to consumer without any additional thing.

The test of marketability will depend on the facts and circumstances of each case. It is a question of fact. The vendibility or marketability test includes the following three essential components :-

(a) the goods should be capable of being sold in the market,

(b) the goods should be capable of being sold ordinarily, and

(c) the goods should be capable of being sold as such.

Case Laws

(1) In *Cipla Ltd. V Union of India*, it was held by the Karntaka High Court that for dutiability, a product must pass the test of marketability, even if it is a transient item captively consumed in the manufacture of other finished goods and that it is the onus is on the Department to produce evidence of marketability.

(2) In *UOI v Indian Aluminium Co. Ltd. v CCE*, the Supreme Court held that marketability of a product must be for its dutiability. Mere manufacture or specification of an article in Tarrif is not enough.

(3) In *Bhor Industries Ltd. v CCE*, the Supreme Court held that the mere inclusion of a particular article in the Tariff Schedule will not render it liable to excise duty. The marketability of that article is of primary importance. The decision given in this case was a turning point because prior to this decision, it was normal to treat all goods in the Tariff Schedule, as chargeable to duty regardless of the test of marketability.

(4) In *Union Carbide India Ltd. v UOI & Geep Industrial Syndicate Ltd. v Central Government*, the Supreme Court held that intermediate products, which were in a crude form, would not constitute goods. In this case, aluminium cans produced by the extrusion process were not to be goods, as they were neither capable of being sold nor were marketable.

1.1.5 Excisable Goods

- Section 2(*d*) of Central Excise Act defines Excisable Goods as 'Goods specified in the Schedule to Central Excise Tariff Act, 1985 as being subject to a duty of excise and includes salt. As per explanation to section 2(d), 'goods' includes any article, material or substance which is capable of being bought and sold for a consideration and such goods shall be deemed to be marketable'. Thus, unless the item is specified in the Central Excise Tariff Act as subject to duty, no duty is leviable.

In terms of the above definition of 'Excisable Goods, it may be held that all those goods, which are specified in the Tariff Schedule are 'excisable goods'. However, question arises as to whether those goods, which are exempted from duty by a notification, but find a place in the tariff schedule are excisable goods.

By analyzing the definition, the following two important ingredients of excisable goods are found :

(a) Goods must be specified in the Schedule to the Central Excise Tariff Act, 1985;

(b) The goods so specified must be subject to duty.

1.1.5.1 ***Excisability of Plant & Machinery***

In view of Entry N. 84 of List-I Seventh Schedule to the Constitution of India, duty of excise could be levied only on goods and not on immovable property. The goods are classified and charged to duty according to the state and condition in which they are removed from the factory.

Assembly of Plant & Machinery at Site

Mere bringing together of parts of a plant and machinery at site cannot be termed to be manufacture and hence, assembled plant cannot be treated to be goods.

Where assembly of parts and components brings out a different recognizable marketable product, before its installation or erection or attachment to the earth, it would be goods and hence chargeable to duty.

In *Sirpur Paper Mills Ltd. v CCE*, the Supreme Court held that machinery assembled and erected at site from bought out component was held to be goods and hence chargeable to duty, as it was attached to earth for operational efficiency and could be removed and sold.

However, in Triveni Engineering v CCE the Supreme Court overruled its decision given in Sirpur case and held that the marketability test, essentially, requires that goods should be in such condition, as could be brought as such to the market and sold, but if machinery requires dismantling before removal, it cannot be goods and hence, not chargeable to duty.

1.1.5.2 ***Excisability of Waste & Scrap***

Section 3 imposes duty on manufacture of goods. Waste and scrap are not manufactured, but arise as a result of manufacture of the final product. Therefore, generally, there should not be levied any tax on the waste and scrap. Thus, waste and scrap can be 'goods' but duitable only if 'manufactured' and are mentioned in Tariff.

Case Laws

In 1987 in the case of Modi Rubber Ltd., it was held that even though the waste was capable of fetching some amount of sale, it would not be chargeable to excise duty. Similar decision was given in the case of Captainganj Distilleries.

Later in 1989, the criteria for determining, whether waste generated would be excisable or not was laid down in the case of Asiatic Oxygen Limited *v* CCE. The Tribunal held that the question as to whether waste would be charged to duty or not would depend on :

(a) whether a process of manufacture has taken place, and

(b) whether the waste generated is marketable.

1.1.6 Manufacture

Any Taxable event for central excise duty is manufacture or production in India. The word 'produced' is broader than 'manufacture' and covers articles produced naturally, live products, waste, scrap etc. Manufacture means to make, to inset, to fabricate, or to produce an article by hand, by machinery or by other agency. To manufacture is to produce something new, out of existing materials.

- 'Manufacture' means :
  - (a) Manufacture as specified in various Court decisions i.e. new and identifiable product having a *distinctive name, character or use* must emerge *or*
  - (b) Deemed Manufacture.
- Deemed manufacture is of two types –
  - (a) CETA specifies some processes as 'amounting to manufacture'. If any of these processes are carried out, goods will be said to be manufactured, even if as per Court decisions, the process may not amount to 'manufacture', [Section 2(f)(ii)].

(b) In respect of goods specified in Third Schedule to Central Excise Act, repacking, re-labelling, putting or altering retail sale price etc. will be 'manufacture'. The goods included in Third Schedule of Central Excise Act are same as those on which excise duty is payable u/s 4A on basis of MRP printed on the package. [Section 2(f)(iii) w.e.f. 14-5-2003].

1.1.6.1 ***Definition***

Section 2(f) defines the term 'Manufacture' to include any process :-

(i) incidental or ancillary to the completion of a manufactured product; and

(ii) which is specified in relation to any goods in the Section or Chapter Notes of the Schedule to the Central Excise Tariff Act, 1985, as amounting to manufacture or,

(iii) which, in relation to the goods specified in the Third Schedule, involves packing or repacking of such goods in a unit container or labeling or re-labelling of containers including the declaration or alteration of retail sale price on it or adoption of any other treatment on the goods to render the product marketable to the consumer. And the word "manufacturer" shall be constued accordingly and shall include not only a person who employs hired labour in the production or manufacture of excisable goods, but also any person who engages in their production or manufacture on his own account.
[Clauses (ii) and (iii) are called deemed manufacture]

Case Laws

It was decided in the case of *"Union of India v Delhi Cloth & General Mills Ltd" that.*, the manufacturer of vanaspati used to purchase oil from market and *vanaspati* was manufactured after subjecting the oil with various processes. The excise was paid on *vanaspati*. The Excise Department contended that during the process of manufacture of *vanaspati,* vegetable non-essential oil was produced, which is a separate dutiable product. The court decided that :

Manufacture implies a change, but every change is not manufacture and yet every change of an article is the result of treatment, labour and manipulations. But something more is necessary and there must be transformation; a new and different article must emerge having a distinctive name and character or use."

Based on the above definition, the Court held that mere processing of basic oils did not amount to manufacture, because it is not marketable product. The refined oil requires deodorization before marketing.

In *South Bihar Sugar Mills Ltd. v UOI* the Supreme Court held that there must be such a transformation that a new and different article must emerge having a distinctive name.

In *Ujagar Prints v UOI*, the Supreme Court held that the generally accepted test to ascertain whether there was a manufacture, is whether the change or the series of changes brought about by the application of processes should take the commodity to the point, where commercially can no longer be regarded as the original commodity, but instead is recognized as a distinct and new article that has emerged out of and because of the result of processes.

1.1.6.2 ***Assembly or repair or production- whether the same is manufacture***

Assembly involves use of certain duty paid components to bring into existence an operational or functional product. As per the cardinal list laid down by the Supreme Court in *Emperor Industries* case, "any process would amount to manufacture if as a result of the said process the object has been transferred into a commercially known new and different product".

Thus, where assembly brings into existence of a new commercially known different product, however minor the consequent change be, it would amount to manufacture.

However, in *Enfield India Ltd*. case the tribunal held that an assembly, repair or reconditioning only improves the quality of performance of something which is not otherwise useful or fit to use, it would be manufacture.

1.1.6.3 ***Explanation as to what is not Manufacture***

Any activity shall not be deemed to be manufacture, only because it has been so written in the licence granted. The following are not manufacture :

(a) Natural activity, even if carried otherwise, e.g. drying yarn in natural sun;

(b) Processing of duty paid goods;

(c) Purchasing various item and putting into a container and selling them;

(d) Obtaining of natural products;
(e) Testing/quality control of items manufactured by others;
(f) Cutting and polishing of diamond;
(g) Upgradation of computer system;
(h) Printing on glass bottles;
(i) Affixing brand name;
(j) Crushing of boulders into smaller stones.

1.1.6.4 *Explanation about incidental & Ancillary Process*

'Incidental' means anything that occurs incidentally. It refers to occasional or casual process.

'Ancillary' means auxiliary process, which unless pursued, shall not result into manufacture of the product. The definition of 'manufacture' under section 2(f), includes the processes which are 'incidental or ancillary to the completion of a manufactured product'. A process can be regarded as incidental or ancillary to the completion of the manufactured product, if it comes in relation to the finished product. It is immaterial whether the process is significant or inessential. On the other hand, where a process is not connected to the manufacture of the final product, it cannot be termed as incidental or ancillary.

1.1.6.5 *Intermediate Products & Captive Consumption*

The definition of manufacture under section 2*(f)* implies that manufacture would take place even at an intermediate stage, so long as the intermediate product is commercially and distinctly identifiable.

Intermediate products are such products, which are produced in a process naturally in the course of manufacture of a finished product, which involves more than one process. Thus, such products are output of one process and input for the subsequent process. Captive consumption means consumption of such output of one process in the subsequent process. Generally, the intermediate products do not have any marketable identity and can hardly be sold in the market.

In the case of *JK Spinning & Weaving Mills v UOI* the Supreme Court held that the captive consumption would amount to removal, hence would amount to removal, hence chargeable to duty. However, in *Union Carbide v UOI,* the Supreme Court held that an intermediate product would be chargeable to excise duty, only if it is a complete product and can be sold in the market to a consumer. This decision was affirmed in *Bhor Industries v UOI.*

1.1.7 Manufacturer

Manufacturer is the person who actually brings new and identifiable product into existence.

- Duty liability is on manufacturer in most of the cases.
- Mere supplier of raw material or brand name owner is not 'manufacturer'.
- Loan licensee is not 'manufacturer'.

Loan licensee can be treated as manufacturer only if the manufacture is carried out by use of his own raw material under his own supervision by hiring the premises and equipment shift-wise or otherwise.

1.1.7.1 Definition of Manufacturer

Section 2*(f)* defines the term 'manufacture' to "include any process –

(i) incidental or ancillary to the completion of a manufactured product; and

(ii) which is specified in relation to any goods in the Section or Chapter notes of the Schedule to the Central Excise Tariff Act, 1985, as amounting to manufacture;

(iii) which, in relation to the goods specified in the Third Schedule, involves packing or repacking of such goods in a unit container or labeling or re-labelling of containers including the declaration or alteration of retails sale price on it or adoption of any other treatment on the goods to render the product marketable to the consumer.

And the word "manufacturer" shall be construed accordingly and shall include not only a person who employs hired labour in the production or manufacture of excisable goods, but also any person who engages in their production or manufacture on his own account".

Thus, according to the above definition, the manufacturer is a person :

(a) who manufactures or produces any excisable goods, or

(b) carries on any process incidental or ancillary to the completion of the manufactured products.

1.1.7.2 Who is a Manufacturer as per statute

The following are held to be manufacturer :

(a) Person manufacturing for own consumption,

(b) Person hiring labour or employees for manufacturing,

(c) A job-order worker,

(d) A contractor.

1.1.7.3 Who is not a Manufacturer

The following have been held as not to be a manufacturer :

(a) Where an activity is not a manufacture;

(b) Brand Owners, where goods are manufacture under his control;

(c) Labour Contractors, who supply labor;

(d) Loan licensee.

(e) Raw material supplier is not manufacturer

1.1.7.4 Dutiability of Packing, Labelling and Repacking Activities

Section 2*(f)*, defines 'Manufacture' to include any process, which is specified in relation to any goods in the Section or Chapter notes of the Schedule to the Central Excise Tariff Act, 1985 (CETA) as amounting to manufacture. Thus, the process may not amount to manufacture as per principles evolved by Courts, but the same may be liable to excise duty, if it is defined as amounting to manufacture under CETA.

This provision seemingly includes the process like packing, labeling, re-labelling, re-packing into manufacture, though otherwise these processes are not 'manufacture' as no new product emerges. In fact, these processes are adjunct to manufacture. The manufacture shall be complete only when the product is rendered marketable and movable and for this purpose packing is an inevitable process. Therefore, packing and associated with that the labeling is a part of the manufacturing process.

In *CCE v Prabhat Packging Ltd.,* the Tribunal has held that repacking of an already manufactured product would not amount to manufacture in excise law, since repacking does not result into a new commercially distinct product.

Labelling on packaged products is also not manufacture, since in the common market parlance a labeled and unlabelled product is treated as the same product and the distinction as such is made. The principle was affirmed in the case of *Pioneer Tools and Appliances Ltd. v UOI* by the Bombay High Court.

1.2 CLASSIFICATION OF GOODS

Central Excise Duty is chargeable at the rates, which are manufactured in India and are subject to excise duty. However, all goods cannot be charged with the same rate of duty. Therefore, the goods need to be grouped into separate categories and sub-categories, for which the rate of excise duty may be determined. This identification of goods through groups and sub-groups is called classification of goods.

The rate of duty is found out by classifying the product in its appropriate heading under Central Excise Tariff. The Central Excise Tariff Act, 1985 (CETA) classifies all the goods under 96 chapters and specific code is assigned to each item. CETA is based on International convention of Harmonised System of Nomenclature (HSN), which is developed by World Customs Organisation (WCO) (That time called as Customs Cooperation Council). This is an

International Nomenclature standard adopted by most of the Countries to ensure uniformity in classification in International Trade. HSN is a multi purpose 6 digit nomenclature classifying goods in various groups. Central Excise Tariff is divided in 20 broad sections. Section Notes are given at the beginning of each Section, which govern entries in that Section. Each of the sections is divided into various Chapters and each Chapter contains goods of one class. Chapter Notes are given at the beginning of each Chapter, which govern entries in that Chapter. There are 96 chapters in Central Excise Tariff. Each chapter and sub-chapter is further divided into various headings and sub-headings depending on different types of goods belonging to same class of products.

The Central Excise Tariff Act, 1985 (CETA) came into force w.e.f. 28th February, 1986.

The main features of the Excise Tariff are :

(a) The Central Excise Tariff has been made very detailed and comprehensive as all the technical and legal aspects in relation to goods have been incorporated in it.

(b) The Excise Tariff is based on the Harmonised System of Nomenclature, which is an internationally accepted product coding system formulated under the GATT.

(c) The goods of the same class have been grouped together to bring about parity in treatment and restrict the dispute in classification matter.

(d) The Central Excise Tariff provided detailed clarificatory notes under each section/chapter.

(e) The interpretation of the Tariff have been provided for at the beginning of the Schedule. All the section notes, chapter notes and rules for interpretation are legal notes and/therefore serve as statutory guidelines in classification of goods.

(f) The Tariff is designed to group all the goods relating to one industry under one chapter from one raw material in a progressive manner.

1.2.1 Harmonised System of Nomenclature

All goods are classified using 4 digit system. These are called 'headings'. Further 2 digits are added for sub-classification, which are termed as 'sub-headings'. Further 2 digits are added for sub-sub-classification, which is termed as 'tariff item'. Rate of duty is indicated against each 'tariff item' and not against heading or sub-heading.

Harmonised System of Nomenclature (HSN) is an internationally accepted product coding system, formulated to facilitate trade flow and analysis of trade statistics. The system was developed by World Customs Organisation (WCO), which was earlier known as Customs Cooperative Council. HSN was adopted by International Convention of Harmonised System of Nomeclature.

The CETA is also based on the HSN pattern, of course, with some deviation. HSN has got commercial as well as judicial recognition.

1.2.2 Interpretative Rules of CETA

The Central Excise Tariff Act, 1985 incorporates FIVE Rules of interpretation, which together provide necessary guidelines for classification of various products under the schedule. Rules for Interpretation of Schedule to Tariff are given in the Tariff itself. These are termed as 'General Interpretative Rules' (GIR). GIR (General Interpretative Rules) are to be applied for interpretation of Tariff, if classification is not possible on the basis of tariff entry and relevant chapter notes and section notes. Following are the steps of classification of a product.

(1) Refer the heading and sub-heading. Read corresponding Section Notes and Chapter Notes. If there is no ambiguity or confusion, the classification is final (Rule 1 of GIR). You do not have to look to classification rules or trade practice or dictionary meaning. If classification is not possible, then only to GIR. The rules are to be applied sequentially.

(2) If meaning of word is not clear, refer to trade practice. If trade understanding of a product cannot be established, find technical or dictionary meaning of the term used in the tariff. You may also refer to BIS or other standards, but *trade parlance* is most important.

(3) If goods are incomplete or un-finished, but classification of finished product is known, find if the un-finished item has *essential characteristics* of finished goods. If so, classify in same heading - Rule 2(a).

(4) If ambiguity persists, find out which heading is specific and which heading is more general. Prefer specific heading.- Rule 3(a).

(5) If problem is not resolved by Rule 3(a), find which material or component is giving ' *essential character* ' to the goods in question - Rule 3(b).

(6) If both are equally specific, find which comes last in the Tariff and take it - Rule 3(c).

(7) If you are unable to find any entry which matches the goods in question, find goods which are most akin - Rule 4.

(8) Packing material is to be classified in the heading in which the goods packed are classified – Rule 5.

(9) In case of mixtures or sets too, the procedure is more or less same, except that each ingredient of the mixture or set has to be seen in above sequence. As per rule 2(b), any reference to a material or substance includes a reference to mixtures or combinations of that material or substance with other material or substance.

As regards the Interpretative Rules, the classification is to be first tested in the light of Rule 1. Only when it is not possible to resolve the issue by applying this Rule, recourse is taken to rules 2,3 and 4 in seriatim.

1.2.3 Steps in Classification

The following steps are involved in classification :

1. First reference is made to the heading and sub-heading, together with corresponding section notes and chapter notes. In case of no ambiguity, as per Rule 1, the classification would be final.
2. Where the product name is not clear, reference is made to the common trade practice, Further reference may be made to dictionary meaning or technical terminology, if the product name is not understood in common trade practice or, it is a new product.
3. In case of incomplete or un-finished goods, the essential characteristics of the product must be matched with the known finished product. In case of similarity, it should be classified, as per Rule 2, under the same heading.
4. In case of ambiguity Rule 3(a) should be applied and specific heading should be preferred over general heading.
5. If Rule 3(a) does not apply, goods should be classified, as per rule 3(b) as if they consist of material or components which gives them their essential character.
6. When goods cannot be classified with reference to rules 3(a) and 3(b), they should be classified, as per Rule 3(c) under the heading, which occurs last in numerical order.
7. In case of residuary items classification should be made as per Rule 4 under heading, which is most akin to the goods in question.

1.3 VALUATION OF GOODS

Excise duty is payable on *one of the following basis* :

- *Duty based on production capacity* - Some products (e.g. pan masala, rolled steel products) are perceived to be prone to duty evasion. In case of such products, Central Government, by notification, can issue notification specifying that duty on such notified products will be levied and collected on the basis of production capacity of the factory [section 3A(1) of Central Act inserted w.e.f. 10th May 2008]. When such notification is issued, annual capacity will be determined by Assistant Commissioner [section 3A(2)(a) of CEA]. Factors relevant to determine production capacity will be specified by rules issued by Central Government [section 3A(2)(b)(i)].
- *Specific Duty* - It is the duty payable on the basis of certain unit like weight, length, volume, thickness etc. For example, duty on Cigarette is payable on the basis of length of the Cigarette, duty on sugar is based on per Kg basis etc.
- *Tariff value* - In some cases, tariff value is fixed by Government from time to time. This is a " *Notional Value* " for purpose of calculating the duty payable. Once 'tariff value' for a commodity is fixed, duty is payable as percentage

of this 'tariff value' and not the Assessable Value fixed u/s 4.

- Duty based on basis of Maximum Retail Price printed on carton after allowing deductions - section 4A of CEA.
- *Compounded Levy Scheme* - Normal excise procedures and controls are not practicable when there are numerous small manufacturers. Rule 15 of Central Excise Rules provides that Central Government may, by notification, specify the goods in respect of which an assessee shall have option to pay duty of excise on the basis of specified factors relevant to production of such goods and at specified rates. The scheme is presently applicable only to stainless steel pattas/pattis and Aluminium circles. These articles are not eligible for SSI exemption.
- Duty as % based on *Assessable Value* fixed under section 4 (*ad valorem duty*) (If not covered in any of above)

1.3.1 Methods & Techniques of Valuation

Proper valuation of goods manufactured is an integral part towards levy of Excise Duty accurately. Accordingly, goods manufactured should be valued strictly in the manner as prescribed in the Central Excise Act, 1944 and Rules framed there-under. Details of the provisions relating to valuation has been discussed herein below :

1.3.2 Value under the Central Excise Act, 1944

Value of the excisable goods has to be necessarily determined when the rate of duty *is* on ad-valorem basis. Accordingly, under the Central Excise Act, 1944. the following values are relevant for assessment of duty. Transaction value is the most commonly adopted method.

(i) Transaction value under Section 4 of the Central Excise Act

(ii) Value determined on basis of maximum Retail Sale Price as per Section 4A of the Act, if applicable to a given commodity.

(iii) Tariff value under Section 3, if applicable.

Details of all the methods of valuation are discussed below :

1. *Transaction Value*

Section 4(3)(d) of the Central Excise Act, as substituted by section 94 of the Finance Act, 2000 (No. 10 of 2000), came into force from the 1st day of July, 2000. This section contains the provision for determining the Transaction value of the goods for purpose of assessment of duty.

For applicability of transaction value in a given case, for assessment purposes, certain essential requirements should be satisfied. If anyone of the said requirements is not satisfied, then the transaction value shall not be the assessable value and value in such case has to be arrived at under the valuation rules notified for the purpose. The essential *conditions for application* of a Transaction value are :

(a) The goods are sold at the time of removal from the factory or warehouse.

(b) The transaction is between unrelated parties, i.e, the assessee and the buyer are not related parties

(c) The price the sole consideration for the sale

 (i) The goods are sold by an assessee for delivery at the time of place of removal. The term "place of removal" has been defined basically to mean a factory or a warehouse, and will iltclude a depot, premises of a consignment agent or any other place or premises from where the excisable goods are to be sold after their clearances from the factory.

 (ii) The assessee and the buyer of the goods are not related; and

 (iii) The price is the sale consideration for the sale.

Transaction value would include any amount which is paid or payable by the buyer to or on behalf of the assessee, on account of the factum of sale of goods. In other words, if, for example, an assessee recovers advertising charges or publicity charges from his buyers, either at the time of sale of goods or even subsequently, the assessee cannot claim that such charges are not to be included in the transaction value. The law recognizes such payment to be part of the transaction value, that is assessable value for those particular transactions.

(1) As per the new Sec.4, transaction value shall include the following receipts/recoveries or charges, incurred or provided for in connection with the manufacturing, marketing, selling of the excisable goods :

(a) Advertising or publicity;
(b) Marketing and selling organization expenses;
(c) Storage;
(d) Outward handling;
(e) Servicing, warranty;
(f) Commission or
(g) Any other matter.

The above list is not exhaustive and whatever elements which enrich the value of the goods before their marketing and were held by Hon'ble Supreme Court to be includible in "value" under the erstwhile section 4 would continue to form part of section 4 value even under new section 4 definition.

(2) Thus if in addition to the amount charged as price from the buyer, the assessee recovers any other amount by reason of sale or in connection with sale, then such amount shall also form part of the transaction value. Where the assessee includes all their costs incurred in relation to manufacture and marketing while fixing price payable for the goods and bills and collects an all inclusive price -as happens in most cases where sales are to independent customers on commercial consideration - the transaction price will generally be the assessable value.

However, where the amount charged by an assessee does not reflect the true intrinsic value of goods marketed and total value split up into various elements like special packing charges, warranty charges, service charges ete. it has to be ensured that duty is paid on correct value.

1.3.3 Inclusions in Assessable Value :

(i) Packing charges : Packing charges shall form part of the assessable value as it is a charge in connection with production and sale of the goods, recovered from the buyer. Under the erstwhile See. 4, inclusion of cost of packing in the value was related to the nature of packing such as preliminary or secondary ete. Such issues are .not relevant in the new See. 4 and any charges recovered for packing, whether ordinary or special is includible in the transaction value if the same is not included in the price of the goods.

In the case of reusable containers (glass bottles, crates etc.), normally the cost is amortized and included in the cost of the product itself. Therefore, the same is not required to be included in the value or the product unless it is found that the cost of reusable container has not been amortised and included in the value of the product.

However, rental charges or cost of maintenance of reusable metal containers like gas cylinders etc. are to be included in the value since the amount has been charged by reason of, or in connection with the sale of goods.

Similarly, cost or containers supplied by the buyer will be included in the transaction value of the goods, as the price will not be the sole consideration of the sale and the valuation would be governed by Rule 6 of the Valuation Rules, 2000.

Durable and returnable packing — In case of durable/returnable containers, all that would be necessary, as per the Board's Circular No. 643/34/2002-CX dated 1-7-2002 [2002 (143) E.L.T. T39], is to include the amortised cost of the container in the price of the product itself; the returnable deposit taken from the buyer or deposit of the empty container by him would not then be treated as additional consideration.

(ii) Design and Engineering charges being an essential process/activity for the purpose of manufacture shall be included in the Assessable value.

(iii) Consultancy charges relating to manufacturing/production is included as such payment is 'by reason of sale".

(iv) Loading and handling charges within the factory are included in Assessable Value.

(v) Royalty charged in franchise agreement for permission to use the brand name is included in Assessable value as such payment is 'by reason of sale' or 'in connection with sale'.

(vi) Advance authorisation surrendered in favour of seller is additional consideration and includible. It is considered as an Additional consideration. It shall be included if it is paid by or on behalf of buyer to manufacturer-assessee and not when it is given by third party.

(vii) Price increase, variation, escalation subsequent to removal of goods cleared from the factory is not relevant, *provided the price is final at the time of removal.*

(viii) Free After Sales Service/Warranty charges will form part of the transaction value irrespective of whether the warranty is optional or mandatory.

(ix) Advertisement and sales promotion expenses incurred by the buyer : Manufacturer incurs advertisement expenditure. These are obviously built in the selling & distribution cost for determining the selling price. In addition, often dealers also advertise for the product at their own cost.

Definition of "Transaction value" includes charges for "advertisement, publicity and marketing expenses". However, these are includible only if the buyer is liable to pay the amount to assessee or on behalf of the assessee.

Thus, advertisement and sales promotion expenses incurred by dealer/distributor, if done on his own, are not to be included, if transaction between buyer and seller is on principle to principle basis. This is because the buyer is not incurring these expenses "on behalf of the assessee".

(x) After sales service and pre delivery inspection (PDI) charges : After sales service and pre delivery inspection (PDI) are services provided free by the dealer on behalf of the assessee and the cost towards this is included in the dealer's margin (or reimbursed to him).

The value of goods which are consumed by the assessee or on his behalf in the manufacture of other articles will be on cost construction method only (Rule 8). The assessable value of captivity consumed goods will be taken at 110% (substituted by 60/2003 (NT.) 5-10-2003 - prior to that it was 115%) of the cost of manufacture of goods even if identical or comparable goods are manufactured and sold by the same assessee as there have been disputes in adopting values of comparable goods. The concept of deemed profit for notional purposes has also been done away with and a margin of 10% by way of profit etc. is prescribed in the rule itself for ease of assessment of goods used for captive consumption. The cost of production of captively consumed goods will be done strictly in accordance with CAS- 4.

(xi) "**Transaction Value**" includes receipts/recoveries or charges incurred or expenses provided for in connection with the manufacturing, marketing, selling of the excisable goods to be part of the price payable for the goods sold. In other words, whatever elements which enrich the value of the goods before their marketing and were held by Hon'ble Supreme Court to be includible in "value" under the erstwhile Section 4 would continue to form part of Section 4 value even under new Section 4 definition. Where the assessee charges an amount as price for his goods, the amount so charged and paid or payable for the goods will form the assessable value. If however, in addi-tion to the amount charged as price from the buyer, the assessee also recovers any other amount "by reason of sale" or "in connection with sale", then such amount shall also form part of the transaction value for valuation and as-sessment purposes. Thus if assessee splits up his pricing system and charges a price for the goods and separately charges for packaging, the packaging charges will also form part of assessable value as it is a charge in connection with production and sale of the goods recovered from the buyer.

1.3.4 Exclusions from Assessable Value :

(i) Taxes and duties : The definition of transaction value mentions that whatever amount is actually paid or actually payable to the Government or the relevant statutory authority by way of excise, sales tax and other taxes, such amount shall be excluded from the transaction value. If any excise duty or other tax is paid at a concessional rate for a particular transaction, the amount of *excise* duty or tax actually paid at the concessional rate shall only be allowed to be deducted from price.

(ii) Erection, installation and commissioning charges : If the final product is not excisable, the question of including these charges in the assessable value of the product does not arise. As for example, since a thermal power, as a whole, is an immovable property and therefore not excisable, no duty would be payable on the cost of erection, instigations and commissioning of the steel plant. Similarly, if a machine is cleared from a factory on payment of appropriate duty and later on taken to the premises of the buyer for installation/ erection and commissioning into an immovable property, no further duty would be payable. On the other hand if parts/components of a generator are brought to a site and the generator erected/installed and commissioned at the site then, the generator being an excisable commodity, the cost of erection, installation and commissioning charges would be included in its assessable value. In other words if the expenditure on erection, installation and commissioning has been incurred to bring into existence any excisable goods, these charges would be included in the Assessable Value of the goods. If these costs are incurred to bring into existence some immovable property, they will not be included in the assessable value of such resultant property.

However, 'time of removal' in case of excisable goods removed from the place of removal is deemed to be the time of clearance of such goods from the 'factory'. therefore, the assessable value is with reference to delivery at the 'time and place of removal, transaction value will be the assessable value.

(iii) **Freight :** It follows from the Valuation Rules that in such categories of cases also if the price charged is with reference to delivery at a place other than the depot, etc. then the actual or average cost of transportation (average freight being calculated according to generally accepted principles of costing - CAS - 5 beyond the depot/place of sale will not be taken to be a part of the transaction value and exclusion of such cost allowed on similar lines as discussed earlier, when sales are effected from factory gate/warehouse. There is no question of including the freight etc. right upto the buyer's premises even though delivery may be effected at that place. Delivery to the carrier at factory gate/depot is delivery to the buyer and element of freight and transit insurance are not includible in assessable value. Moreover, the ownership of the goods has no relevance so far as their transit insurance is concerned. - *Escorts JCB Ltd.* v. CCE., *Delhi-II* - 2002 (146) E.L.T. 31 (S.C) and *Prabhat Zarda Factory Ltd.* v. CCE. -2002 (146) E.L.T. 497 (S.C). Freight (actual or average) upto the point of depot etc. will, however, continue to be included.

(iv) **Advertising/Publicity expenditure by brand name/copyright owner** — the expenditure incurred by brand name/copyright owner on advertisement and publicity charges, in respect of goods will not be added to assessable value, as such expenditure is not incurred on behalf of the manufacturer-assessee.

(v) **Notional interest on security deposit/advances** — The notional interest on advances may not be includible if relation between advance and selling price is only casual. There is 'relation' but 'no connection in relation to manufacture'.

(vi) **Interest on Receivables:** As regards interest for delayed payments it is the normal practice in industry to allow the buyers some credit period for which no interest is charged. That is to say, the assessee allows the buyers some time (normally 30 days, which could be less or even more depending upon industry) to make the payment for the goods supplied. Interest is charged by him from the buyer only if the payments are made beyond this period. A question has been raised whether such interest on receivables (for delayed payments) should form part of the transaction value or not. As per the earlier practice under Section 4 such amount of interest is not included in "value". Also, similar is the practice followed in this regard on the Customs side, where duties are collected on transaction value basis, and the importers are given certain "free" period for payment or to pay up interest for delayed payments. As the intention is not to disturb the existing trade practice in this regard, charges for interest under a financing arrangement entered between the assessee and the buyer relating to the purchase of excisable goods shall not be regarded as part of the assessable value provided that :

(a) the interest charges are clearly distinguished from the price actually paid or payable for the goods;

(b) the financing arrangement is made in writing; and

(c) where required, assessee demonstrates that such goods are actually sold at the price declared as the price actually paid or payable.

(vii) **Discounts —** As regards discounts, the definition of transaction value does not make any direct refer-ence. In fact, it is not needed by virtue of the fact that the duty is chargeable on the net price paid or payable. Thus if in any transaction a discount is allowed on declared price of any goods and actually passed on to the buyer of goods as per common practice, the question of including the amount of discount in the transaction value does not arise. Discount of any type or description given on any normal price payable for any transaction will, therefore, not form part of the transaction value for the goods, e.g. quantity discount for goods purchased or cash discount for the prompt payment etc. will therefore not form part of the transaction value.

(i) cash discount for prompt payment and

(ii) interest or cost of finance for delayed payment, when not exorbitant, is to be granted abatement whether availed or not even under new Section 4 - 2006 (204) E.L.T. 570 (Tri - L.B.) - *CCE* v. *Arvind Mills Ltd.*

The differential discounts extended as per commercial considerations on different transactions to unrelated buyers if extended can not be objected to and different actual prices paid or payable for various transactions are to be accepted for working assessable value. Where the assessee claims that the discount of any description for a transaction is not readily known but would be known only subsequently - as for example, year end discount - the assessment for such transactions may be made on a provisional basis. However,. the assessee has to disclose the intention of allowing such discount to the department and make a request for provisional assessment. Trade discount not paid to dealers at the time of in-voice preparation but paid later on net sale value was held as deductable for valuation purpose by Hon'ble Supreme Court in the case of *Commissioner* v. *DCM Textiles* - 2006 (195) E.L.T. 129 (S.C). Liquidated damages (as for example price reduction for delay in delivery of goods) is acceptable - 2006 (204) E.L.T. 626 (Tri.) - *United Telecom Ltd.* v. *CCE.*

(viii) Deemed export incentives earned on goods supplied : Duty drawback cannot be added to assessable value, especially if there is no evidence of drawback with depression of prices.

(ix) Subsidy/rebate obtained by assessee : A general subsidy/rebate is not to be included as it has no connection with individual clearances of goods. In case of rebate/subsidy which is directly relatable to individual clerances, it should not be includible.

(x) Price of accessories and optional bought out items is not includible in Assessable value.

1.3.5 Value based on Retail Sale Price

Section 4A of CEA empowers Central Government to specify goods on which duty will be payable based on 'retail sale price'.

The provisions for valuation on MRP basis are as follows :

(a) The goods should be covered under provisions of Standards of Weights and Measures Act or Rules [section 4A(1)].

(b) Central Government has to issue a notification in Official Gazette specifying the commodities to which the provision is applicable and the abatements permissible. Central Government can permit reasonable abatement (deductions) from the 'retail sale price'[section 4A(2)].

(c) While allowing such abatement, Central Government shall take into account excise duty,sales tax and other taxes payable on the goods [section 4A(3)].

(d) The 'retail sale price' should be the maximum price at which excisable goods in packaged forms are sold to ultimate consumer. It includes all taxes, freight, transport charges, commission payable to dealers and all charges towards advertisement, delivery, packing, forwarding charges etc. If under certain law, MRP is required to be without taxes and duties, that price can be the 'retail sale price' [*Explanation* 1 section 4A].

(e) If more than one 'retail sale price' is printed on the same packing, the maximum of such retail price will be considered [Explanation 2(a) to section 4A]. If different MRP are printed on different packages for different areas, each such price will be 'retail sale price' for purpose of valuation [*Explanation* 2(c) to section 4A].

(f) Removing excisable goods without MRP or wrong MRP or tampering, altering or removing MRP declared on a package is an offence and goods are liable to confiscation [section 4A(4)] If price is altered, such increased price will be the 'retail sale price' for purpose of valuation [*Explanation* 2(b) to section 4A].

For example, Government had issued a notification to the effect that excise duty on 'cosmetics and toilet preparations' will be payable on the basis of MRP printed on retail carton after allowing abatement of 40%. In such case, if MRP printed on carton is ₹ 200 and if the duty on 'cosmetics & toilet preparations' is 10% plus education cess of 2% plus SAH education cess of 1%, the duty @ 10% will be payable on ₹ 120 (i.e. after allowing 40% abatement on MRP of ₹ 200). Thus duty payable per pack will be ₹ 12.00, plus education cess ₹ 0.24 plus SAH education cess of ₹ 0.12.

MRP provisions are overriding provisions – Section 4A(2) of Central Excise Act uses the words 'notwithstanding section 4'. Hence, when section 4A is applicable, provisions of section 4 for determination of assessable value are not applicable.

Provision of MRP based valuation are applicable only when product is statutorily covered both under Weights and Measures Act and notification issued under CEA - reiterated in *Swan Sweets* v. *CCE* 2006 (198) ELT 565 (CESTAT).

Same product sold in wholesale and under MRP - CBE&C has clarified in circular No. 737/53/2003-CX dated 19-8-2003 that when goods covered u/s 4A are supplied in bulk to large buyer (and not in retail), valuation is required to be done u/s 4. Provisions of section 4A apply only where manufacturer is legally obliged to print MRP on the packages of goods. Thus, there can be instances where the same commodity would be partly assessed on basis of section 4A and partly on basis of transaction value u/s 4.

Products covered under the MRP valuation scheme - So far, 96 articles have been covered under this scheme [Notification No. 2/2006-CE(NT) dated 1-3-2006.

Non-applicability of provisions of MRP - If an article is not covered under provisions in respect of marking MRP, provisions of duty payable on basis of MRP do not apply and in those cases, duty will be payable on *ad valorem* basis as per section 4. As per rules 2A and 34 of Standards of Weights and Measures (Packaged Commodities) Rules, 1977 (as amended w.e.f. 14-1-2007), the provisions of marking MRP are not applicable to following commodities – Packages above 25Kg (50 Kg in case of cement) * Packaged commodities for industrial or institutional consumers * Small packages of 10gm/10 ml or less * Fast food items * Scheduled drugs and formulations * Agricultural farm produce * Bidis for retail sale * Domestic LPG gas.

Deemed Manufacture of products covered under MRP - In respect of goods specified in third schedule to Central Excise Act, any process which involves packing or repacking of such goods in a unit container or labelling or re-labelling of containers including the declaration or alteration of retail sale price on the container or adoption of any other treatment on the goods to render the product marketable to consumer will be 'manufacture'. [section 2(f)(iii) effective from 14-5-2003].

1.3.6 Valuation rules to determine assessable value

As per Section 4(1)(b) of the Central Excise Act, if 'Assessable Value' cannot be determined u/s 4(1)(a), it shall be determined in such manner as may be prescribed by rules. Under these powers, Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 have been made effective from 1-7-2000.

In Ispat Industries Ltd. *v* CCE 2006, it was observed that Excise Valuation Rules should be applied serially. The rules are as below :

(i) **Value nearest to time of removal if goods not sold —** If goods are not sold at the time of removal, then value will be based on the value of *such goods* sold by assessee at any other time nearest to the time of removal, subject to reasonable adjustments. [Rule 4].

The rule applies when price at the time of removal is not available as the goods are not sold by the assessee at the time of removal. Thus, this rule should apply in case of removal of free samples or supply under warranty claims.

In case of new or improved products or new variety of products, price of similar goods may not be available. In such case, valuation should be on basis of cost of production plus 10%, in absence of any other mode available for valuation.

(ii) **Goods sold at different place —** Sometimes, goods may be sold at place other than the place of removal e.g. in case of FOR delivery contract. In such cases, actual cost of transportation from place of removal upto place of delivery of the excisable goods will be allowable as deduction. Cost of transportation can be either on actual basis or on equalized basis. [Rule 5]

"Cost of transportation" includes – (i) the actual cost of transportation; and (ii) in case where freight is averaged, the cost of transportation calculated in accordance with generally accepted principles of costing.

(iii) **Valuation when the price is not the sole consideration —** Where the price is not the sole consideration for sale, the value of such goods shall be deemed to be the aggregate of —

(a) such transaction value, and

(b) the amount of money value of any additional consideration flowing directly or indirectly from the buyer to the assessee. [Rule 6]

In case any of the goods and services (*listed below*) is provided **by the buyer free of change or at reduced cost** in connection with production and sale of such goods, then, the value of such goods and services, apportioned as appropriate, shall be deemed to be the money value of the additional consideration.

Only the value of the following goods and services are to be added in the transaction value –

(a) materials, components, parts and similar items relatable to such goods;

(b) tools, dies, moulds, drawings, blue prints, technical maps and charts and similar items used in the production of such goods;

(c) material consumed, including packaging materials, in the production of such goods;

(d) engineering, development, artwork, design work and plans and sketches undertaken elsewhere than in the factory of production and necessary for the production of such goods.

(iv) **Sale at depot/consignment agent —** Section 4(3)(c)(iii) provides that in case of sale at depot/consignment agent, the depot/place of consignment agent will be the 'place of removal'. As per section 4(3)(cc), in case of sale from depot/place of consignment agent, 'time of removal' shall be deemed to be the time at which the goods are cleared from factory.

In other words, in case of sale from depot/place of consignment agent, duty will be payable on the price prevailing at the depot as on date of removal from factory. Price at which such goods are subsequently sold from the depot is not relevant for purpose of excise valuation.

When goods are sold through depot, there is no 'sale' at the time of removal from factory. In such cases, price prevailing at depot (but at the time of removal from factory) shall be the basis of Assessable Value. The value should be 'normal transaction value' of such goods sold from the depot at the time of removal or at the nearest time of removal from factory. [rule 7 of Valuation Rules].

As per Valuation Rule 2(b), "normal transaction value" means the transaction value at which the greatest aggregate quantity of goods are sold.

For example, if an assessee transfers a consignment of paper to his depot from Delhi to Agra on 5-7-2000, and that variety and quality of paper is normally being sold at the Agra depot on 5-7-2000 at transaction value of ₹ 15,000 per tonne to unrelated buyers, where price is the sole consideration for sale, the consignment cleared from the factory at Delhi on 5-7-2000 shall be assessed to duty on the basis of ₹ 15,000 per tonne as the assessable value. If assuming that on 5-7-2000 there were no sales of that variety from Agra depot but the sales were effected on 1-7-2000, then the normal transaction value on 1-7-2000 from the Agra depot to unrealated buyers, where price is the sole consideration shall be the basis of assessment. [Illustration given in the departmental circular dated 30-6-2000].

(v) **Captive consumption —** Since excise duty is on manufacture of goods, duty is payable as soon as goods are manufactured within the factory. Such goods are called 'intermediate products' and its use within the factory is termed as 'captive consumption'. Duty is payable even when goods are despatched from one factory to another factory of the same manufacturer.

Duty payable on intermediated products – In A S Processors *v.* CCE 1999(112) ELT 706 (CEGAT), it was held that once a new marketable intermediate product comes into existence, it is to be charged to duty if not exempted by a notification – same view in CCE *v.* Citric India 2001(127) ELT 539 (CEGAT).

Captive consumption for dutiable final products – The intermediate product manufactured within the factory is exempt from duty, if it is consumed captively for manufacture of (*a*) Capital goods as defined in Cenvat Credit Rules i.e. those which are eligible for Cenvat credit *or* (*b*) Used for is or in relation to manufacture of final products eligible for Cenvat, made from inputs which are eligible for Cenvat. [Notification No. 67/1995 dated 16-3-1995].

Duty payable on captive consumption if intermediate product under compounded levy scheme – In *Gaya Aluminium Industries v. CCE* (2004) 170 ELT 98 (CESTAT), it was held that even if Aluminium Circles are captively consumed, duty will be payable under compounded levy scheme [However, assessee claimed that compounded levy scheme is optional and assessee can opt to pay normal duty. Hence, the matter was remanded to adjudicating authority for consideration].

In *Gouri Shankar Industries v. CCE* 2004 (173) ELT 247 (CESTAT) also, it was held that duty is payable if Aluminium circles are consumed captively.

Valuation in case of captive consumption – In case of captive consumption, valuation shall be done on basis of cost of production plus 10% [The percentage was 15% upto 5-8-2003]. (Rule 8 of Valuation Rules). Cost of production is required to be calculated as per CAS – 4.

Captive consumption means goods are not sold but consumed within the same factory or another factory of same manufacturer (i.e. inter-unit transfers).

The rule may also be helpful if goods are to be transferred to job worker for job work and then brought back for further processing. If job worker is utilizing some of his own material, it may be advisable to clear processed inputs on payment of duty to job worker. The job worker can avail Cenvat credit and then send back the goods manufactured by him on payment of duty.

Rule 8. Where the excisable goods are not sold by the assessee but are used for consumption by him or on his behalf in the production or manufacture of other articles, the value shall be one hundred and ten per cent of the cost of production or manufacture of such goods.

Captive consumption by related person – In case goods are supplied to a 'related person' but consumed by the related person and not sold, valuation will be done on the basis of cost of production plus 10% [*Proviso* to rule 9]. – CBE&C, vide its circular No. 643/34/2002-CX dated 1-7-2002, ahs clarified that this proviso applies when goods are transferred to a sister unit or another unit of the same factory for captive consumption in their factory.

(vi) **Sale to a related person —** 'Transaction Value' can be accepted as 'Assessable Value' only when buyer is not related to seller. *In other words, price to an independent buyer has to be considered for excise valuation.*

As per section 4(3)(b) of Central Excise Act, persons shall be deemed to be 'related' if –

(a) They are inter-connected undertakings

(b) They are relatives

(c) Amongst them, buyer is a relative and a distributor of assessee, or a sub-distributor of such distributor or

(d) They are so associated that they interest, directly or indirectly, in the business of each other.

Interconnected Undertakings – Buyer and seller are 'related' if they are inter-connected undertakings, as defined in section 2(g) of Monopolies and Restrictive Trade Practices Act, 1969 (MRTP). – *Explanation* (i) to section 4(3)(b) of Central Excise Act.

The essence of the definition under MRTP is that the inter-connection could be through ownership, control or management. Just 25% of total controlling power in both undertakings is enough to establish inter-connection.

Since only 25% control is enough to make to buyer and assessee as inter connected undertakings, many assessees would come under the definition. This would have affected many assessees.

However, the provisions in respect of 'inter connected undertaking' have been made almost ineffective in valuation reules. Now, the 'inter connected undertakings' will be treated as 'realated person' only if they are holding and subsidiary or they are 'related person' under any other clause. In other cases, they will not be treated as 'related person'. If they are not treated as related person, price charged by assessee to buyer will be accepted as 'transaction value' – confirmed in *South Asia Tyres* v. *CCE* (2003) 152 ELT 434 (CEGAT)

Interest in business of 'each other' – As per section 4(3)(b)(iv), buyer and seller are 'related' if they are associated that they have interest, directly or indirectly, in the business of each other. It is not enough if only buyer has interest in seller or seller has interest in buyer. Both must have interest, directly or indirectly, in each other - *Atic Industries Ltd.* v. *UOI* (1984) 3 SCR 930 = 1984 (17) ELT 323 (SC) = AIR 1984 SC 1495 = (1984) 3 SCC 575. The term 'relative and distributor' should be 'read down' and understood to means as '*distributor who is a Relative*' of assessee.

The word 'relative' is defined in section 6 of Companies Act, 1956 as follows : - A person shall be deemed to be a relative of another if, and only if, - *(a)* they are members of a Hindu undivided family; or *(b)* they are husbad and wife; or *(c)* the one is related to the other in the manner indicated in Schedule I-A of Companies Act. This Schedule contains following relatives : (1) Father (2) Mother (including step-mother) (3) Son (including step-son)(4) Son's wife (5) Daughter (including step-daughter) (6) Father's father (7) Father's mother (8) Mother's mother (9) Mother's father (10) Son's son (11) Son's son's wife (12) Son's daughter (13) Son's daugher's husband (14) Daughter's husband (15) Daughter's son (16) Daughter's son's wife (17) Daughter's daughter (18) Daughter's daughter's husband (19) Brother (including step-brother) (20) Brother's wife (21) Sister (including step-sister) (22) Sister's husband.

It is obvious that only a living i.e. natural person can be 'relative' of other. Thus, a company, partnership firm, body corporate, HUF, trust cannot be 'relative' of other.

Valuation when sale is through related person – If entire sale is made through 'related person', price relevant for valuation will be 'normal transaction value' at which the related buyer sales to unrealated buyer, as per rules 9 and 10 of Valueation Rules.

As per Valueation Rule 2(b), 'normal transaction value' means the transaction value at which the greatest aggregate quantity of goods are sold. The term 'GREATEST AGGREGATE QUANTITY' is used in Rule 7 of Customs Valuation Rules.

Provision when sale is only partly through related person – Rules 9 and 10 of Central Excise Valuation Rules make it clear that these rules apply only in cases where assessee sales goods *exclusively* to or through 'related person'.

Thus, there is no provision in rules when assessee partly sale to related person and partly to unrelated persons. As the wroding stands, even if negligible quantity is sold to unrelated buyer, rules 9 and 10 become inapplicable. Valuation cannot be done on the basis of 'transaction value' of assesee to buyer as that is prohibited u/s 4(1)(a).

In such case, the only alternative seems to be residual method i.e. rule 11 of Valuation Rules, which states that if value cannot be determined under any of the foregoing rules, value shall be determined using reasonable means consistent with the principles and general provisions of section 4 and Valuation Rules.

(vii) **Best judgement assessment —** If assessment is not possible under any of the foregoing rules, assessment will be done by 'best judgement'. If the value of any excisable goods cannot be determined under the foregoing rules, the value shall be determined using reasonable means consistent with the principles and general provisions of these rules and sub-section (1) of section 4 of the Act. [Rule 11]

As the Valuation Rules stand today, there is no provision for calculating 'Value' in following cases- (a) If assessee makes sale partly to related person and partly to others. (b) Free samples. In these cases, valuation may be done under rule 11.

1.3.7 VALUATION IN CASE OF JOB WORK – RULE 10A

Meaning of job worker

Job-worker means a person engaged in the manufacture or production of goods on behalf of a principal manufacturer, from any inputs or goods supplied by the said principal manufacturer or by any other person authorised by him.

According to **Rule 10A**, the value of goods manufactured on job work shall be determined as under :

(i) When the goods are sold by the principal manufacturer from the premises of jobworker : In a case where the goods are sold by the principal manufacturer for delivery at the time of removal of goods from the factory of job-worker, where the principal manufacturer and the buyer of the goods are not related and the price is the sole consideration for the sale, the value of the excisable goods shall be the transaction value of the said goods sold by the principal manufacturer;

(ii) When the goods are sold by the principal manufacturer from a place other than the premises of jobworker : In a case where the goods are not sold by the principal manufacturer at the time of removal of goods from the factory of the job-worker, but are transferred to some other place from where the said goods are to be sold after their clearance from the factory of job-worker and where the principal manufacturer and buyer of the goods are not related and the price is the sole consideration for the sale, the value of the excisable goods shall be the normal transaction value of such goods sold from such other place at or about the same time and, where such goods are not sold at or about the same time, at the time nearest to the time of removal of said goods from the factory of job-worker;

(iii) In any other case : In a case not covered under (i) or (ii), the provisions of foregoing rules, wherever applicable, shall *mutatis mutandis* apply for determination of the value of the excisable goods.

1.3.8 VALUATION OF GOODS IN CASE OF JOB CONTRACT

Job work Valuation. — For goods manufactured on job work basis on behalf of a person (commonly known as principal manufacturer), the newly inserted Rule 10-A prescribes that value for payment of excise duty would be based on the sale value at which the principal manufacturer sells the goods as against the provision hith-erto where the value was taken as cost of raw material plus the job charges. There are also usual conditions of the buyer and seller being unrelated and the price being the sole consideration for sale. The new Rule 10-A seems to be open to challenge because there cannot be two manufacturers for the same goods.

Additional consideration. — In the case where price is not the sole consideration for the sale, but the other requirements of clause (a) of sub-section (1) of Section 4 of the Central Excise Act are satisfied, the value shall be determined in accordance with the provisions of Rule 6 of the valuation rules. This provides for adding to the transaction value the money value or any additional consideration flowing directly or indirectly from the buyer to the assessee. Additional consideration is the difference in prices between the price at which goods actually sold and the offer price [C.CE. v. *IFGL Refractories Ltd.* - 2005 (186) E.L.T. 529 ·(S.C.)]. Such additional consideration would include the money value of goods and services provided free or at reduced cost by or on behalf of the buyer to the assessee.

An Explanation has been added in the rule to remove any doubts with respect to its scope. A subsidy re-ceived from the Government (and not from buyer of the goods) is not addable in value - C.CE. v. *Kashmir Handloom Industries* - 2005 (190) E.L.T. *A43* (S.c.); *C.C.E.* v. *Mazagaon Dock Ltd.* - 2005 (187) E.L.T. 3 (S.c.). Statutory benefits allowed by statutory authorities under different schemes cannot be treated as additional consideration flowing to manufacturer from buyer - 2001 (134) E.L.T. 230 (Tri.) - *FGL Refractory Ltd.* v. *Commissioner.* In the case of no-tional interest on advance payments received from the buyer by the assessee, it has now been statutorily provided that such interest shall not be added to the value unless the authority has evidence to the effect that the advance re-ceived has influenced the price to the said buyer. Burden to prove so will be on the department.

1.3.9 VALUATION IN CASE OF TRANSACTION BETWEEN RELATED PARTIES

Related person. —Where goods are sold through related persons, the transaction value is not applicable. However, there is some change in the definition of 'related persons' vis-a-vis the old definition. It includes "inter-connected undertakings" as defined in the Monopolies and Restrictive Trade Practices Act 1969. The definition of inter-connected undertaking in the said Act reads as follows :

"Inter-connected undertakings" means two or more undertakings which are inter-connected with each other in any of the following manner, namely :

(i) if one owns or controls the other,

(ii) where the undertakings are owned by firm, if such firms have one or more common partners,

(iii) where the undertakings are owned by bodies corporate, -

- (a) if one body corporate manages the other body corporate, or
- (b) if one body corporate is a subsidiary of the other body corporate, or
- (c) if the bodies corporate are under the same management, or (ii) if one body corporate exercises control over the other body corporate in any other manner;

(iv) Where one undertaking is owned by a body corporate and the other is owned by a firm, if one or more partners of the firm, -

- (a) hold, directly or indirectly, not less than fifty per cent of the shares, whether preference or equity, of the body corporate, or
- (b) exercise control, directly or indirectly, whether as director or otherwise, over the body corporate, (v) if one is owned by a body corporate and the other is owned by firm having bodies corporate as its part-ners, if such bodies corporate are under the same management,

(v) if the undertakings are owned or controlled by the same person or (by the same group),

(vi) if one is connected with the other either directly or through any number of undertakings which are inter-connected undertakings within the meaning of one or more foregoing sub-clauses.

Explanation I. - For the purpose of this Act, (two bodies corporate,) shall be deemed to be under the same management, -

(i) if one such body corporate exercises control over the other or both are under the control of the same group or any of the constituents of the same group; or

(ii) if the managing director or manager of one such body corporate is the managing director or manager of the other; or

(iii) if on such body corporate holds not less than (one fourth) of the equity shares in the other or controls the composition of not less than (one fourth) of the total membership of the Board of Directors of the other; or

(iv) if one or more directors of one such body corporate constitute, or at any time within a period of six months immediately preceding the day when the question arises as to whether such bodies corporate are under the same management, constituted (whether independently or together with relatives of such di-rectors or the employees of the first mentioned body corporate) one-fourth of the directors of the other; or

(v) if the same individual or individuals belonging to a group, while holding (whether by themselves or together with their relatives) not less than (one-fourth) of the equity shares in one such body corporate also hold (whether by themselves or together with their relatives) not less than (one-fourth) of the equity shares in the other; or

(vi) if the (same body corporate or bodies corporate belonging to a group, holding, whether independently or along with its or their subsidiary or subsidiaries, not less than one-fourth of the equity shares) on one body corporate, also hold not less than (one-fourth) of the equity shares in the other; or

(vii) if not less than (one-fourth) of the total voting power (in relation to) each of the two bodies corporate is exercised or controlled by the same individual (whether independently or together with his relatives) or the same body corporate (whether independently or together with its subsidiaries);

(viii) if not less than (one-fourth) of the total voting power (in relation to) each of the, two bodies corporate is exercised or controlled by the same individuals belonging to a group or by the same bodies corporate belonging to a group, or jointly by such individual or individuals and one or more of such bodies corporate; or

(ix) if the directors of the one such body corporate are accustomed to act in accordance with the directions or instructions of one or more of the directors of the other, or if the directors of both the bodies corporate are accustomed to act in accordance with the directions or instructions of an individual, whether belong-ing to a group or not.

Explanation II. – If a group exercises control over a body corporate, that body corporate and every other body corporate, which is a constituent of or controlled by, the group shall be deemed to be under the same man-agement

Explanation III. – If two or more bodies corporate under the same management hold, in the aggregate, not less than (one-fourth) equity share in any other body corporate, such other body corporate shall be deemed to be under the same management as the first mentioned bodies corporate.

***Explanation* IV. –** In determining whether or not two or more bodies corporate are under the same manage-ment, the shares held by (financial institutions) in such bodies corporate shall not be taken into account.

Sale both to related person and independent buyer.

In case of sales partly to related buyers and partly to independent buyers, the latter will be assessed on transaction value and the former under the residuary Rule 11 read with Rule 9 (or 10). [Rule 9 cannot be applied in such cases directly since it covers only those cases where all the sales are made to related buyers only]. But the Tribunal does not agree with this view of the Board.

1.3.10 Captive Consumption

1.3.10.1 ***Duty payable on intermediate products*** – In *A.S. Processors v. CCE 1999(112)* ELT 706 (CEGAT), it was held that once a new marketable intermediate product comes into existence, it is to be charged to duty if not exempted by a notifications – same view in *CCE v. Cirtric India* 2001(127) ELT 539(CEGAT).

1.3.10.2 ***Intermediate product should be marketable*** – Intermediate product should be marketable. Similarly, Aluminium cans or torch bodies manufactured (for final manufacture of torches) are in elementary and unfinished condition and are not marketable. Hence, 'Aluminium cans' are not goods and no duty is payable on those intermediate products – *Union Carbide India Ltd. v. UOI* 24 ELT 169 = 1986(2) SCR 162 = AIR 1986 SC 1097 = 64 STC 444 = (1986) 2 SCC 547 [confirming *Union Carbide v. UOI* 126 ELT 383 (All)] – quoted with approval in *Porritts and Spencer (Asia) Ltd. v. CCE* – AIR 1995 SC 2344 = 106 ELT 18 = 1995 (Suppl) SCC 219 (SC 3 member bench), where it was held that an intermediate product must be capable of being sold, if duty is to be levied. It should be a distinct article having identity in commercial world.

1.3.10.3 ***Duty payable on captive consumption if intermediate product under compounded levy scheme*** – In *Gaya Aluminium Industries v. CCE* (2004) 170 ELT 98 (CESTAT), it was held that even if Aluminium Circles are captively consumed, duty will be payable under compounded levy scheme [However, assessee claimed that compounded levy scheme is optional and assessee can opt to pay normal duty. Hence, the matter was remanded to adjudicating authority for consideration].

In *Gouri Shankar Industries v. CCE* 2004 (173) ELT 247 (CESTAT) also, it was held that duty is payable if Aluminium circles are consumed captively.

1.3.10.4 ***Inputs eligible for Cenvat credit even if intermediate product exempt*** **–** CBE&C had clarified vide para 5 of circular No. B4/7/2000- TRU dated 3.4.2000, that Cenvat credit should not be denied if the inputs are used in any intermediate of final product, even if such intermediate product is exempt from payment of duty. The idea is that Cenvat credit is available so long as the inputs are used in or in relation to manufacture of final product, and whether directly or indirectly – view reiterated in *Chapter 5 Para 3.9 of CBE&C's CE Manual, 2001* – same view in *CCE v. Hindustan Sanitaryware* 2002 AIR SCW 3652 = AIR 2002 SC 3162 = 145 ELT 3 (SC), in respect of earlier notification 217/86-same view in *Ecorts Ltd. v CCE* (2004) 171 ELT 145 = 2004 AIR SCW 4826(SC).

1.3.10.5 ***Capital goods manufactured and used within factory*** – As per notification No. 67/95-CE dated 16-3-1995, capital goods (as defined in Cenvat Credit Rules) manufactured in a factory and used within the factory of production are exempt from excise duty. Further, as per explanation 2 to rule 2*(g)* of Cenvat Credit Rules, inputs include goods used in manufacture of capital goods which are further used in the factory of manufacturer. Thus, if capital goods are manufactured and used within the factory, Cenvat Credit can be availed of goods which are used to manufacture such capital goods. Moreover, no duty will be payable on such capital goods.

In *Kinetic Honda Motors Ltd. v CCE* 2000 (119) ELT 372 (CEGAT), it was held that steel trollies manufactured and used within the factory for storage/carrying of parts is 'use in relation to manufacture of final products' and hence the trollies will be exempt from duty.

1.3.10.6 ***Valuation in case of captive consumption*** – In case of captive consumption, valuation shall be done on basis of cost of production plus 10% [The percentage was 15% upto 5-8-2003]. (Rule 8 of Valuation Rules). Cost of production is required to be calculated as per CAS – 4.

Captive consumption means goods are not sold but consumed within the same factory or another factory of same manufacturer (i.e. inter-unit transfers).

The rule may also be helpful if goods are to be transferred to job worker for job work and then brought back for further processing. If job worker is utilizing some of his own material, it may be advisable to clear processed inputs on payment of duty to job worker. The job worker can avail Cenvat credit and then send back the goods manufactured by him on payment of duty.

Rule 8. Where the excisable goods are not sold by the assessee but are used for consumption by him or on his behalf in the production or manufacture of other articles, the value shall be one hundred and ten per cent of the cost of production or manufacture of such goods.

Captive consumption by related person - In case goods are supplied to a 'related person' but consumed by the related person and not sold, valuation will be done on the basis of cost of production plus 10% [*Proviso* to rule 9]. – CBE&C, vide its circular No. 643/34/2002-CX dated 1-7-2002, ahs clarified that this proviso applies when goods are transferred to a sister unit or another unit of the same factory for captive consumption in their factory.

Valuation of free samples – CBE&C, vide circular No. 813/10/2005-CX dated 25-4-2005 has clarified that in case of samples distributed free, valuation should be done on basis of rule 4 [Earlier, as per CBE&C circular dated 1-7-2002, valuation of free samples was required to be done on basis of 11 along with rule 8 *i.e.* cost of production plus 10%].

The revised circular seems to be legally correct, *i.e.* valuation should be on basis of value of identical goods cleared at or around the same. However, in case of new or improved products or new variety of products, price of similar goods may not be available. In such cae, valuation should be on basis of cost of production plus 10%, in absence of any other mode available mode for valuation.

1.3.10.7 Principles of cost analysis

Institute of Cost and Works Accountants of India (ICWAI) has issued Cost Accounting Standard CAS-4 titled 'Cost of Production for Captive Consumption'. The standard deals with determination of cost of production for captive consumption. CBE&C, vide circular No. 692/8/2003 dated 13-2-2003, has clarified that in case of captive consumption, cost calculation should be as per CAS-4 standard only.

Following details are based on those prescribed in CAS – 1 to CAS – 4.

Formula of costs – Cost of Production will include various cost components as defined in Cost Accounting Standard – 1 (Classification of Cost – CAS-1). As per CAS-1, the cost is classified as follows –

Direct material Cost + Direct labour Cost + Direct Expenses = Prime Cost

Prime Cost + Production Overheads + Administration Overheads + R&D Cost (Apportioned) = Cost of Production

Cost of Production + Selling Cost + Distribution Cost = Cost of Sales

(Note that Cost of Sales + Profit will be equal to Selling Price).

Elements of cost of Production – As per CAS-4, Cost of Production shall consist of material consumed, direct wages and salaries, direct expenses, works overheads, quality control cost, research and development cost, packing cost, administrative overheads relating to production. To arrive at cost of production of goods dispatched/used for captive consumption, adjustment for stock of Work-in-Process, finished goods, recoveries of sales of scrap, wastage etc. shall be made.

Material cost shall be net of discounts, Cenvat credit, sales tax VAT (if any) etc. (refer case law under job work).

The research and development cost incurred for development and improvement of the process of existing product shall be included in the cost of production. Administrative overheads in relation to activities other than manufacturing activities e.g. marketing, projects management, corporate office expenses etc. shall be excluded form cost of production. – If product is transferred/dispatched duly packed for captive consumption, cost of such packing shall be included. – Packing cost includes both cost of primary and secondary packing required for transfer/ dispatch of the goods used for captive consumption.

Analysis of overheads for cost of production – Overheads shall be analysed into variable overheads and fixed overheads. The variable production overheads shall be absorbed in production cost based on actual capacity utilization. The fixed production overheads and other similar items of fixed costs such as quality control test, research and development costs, administrative overheads relating to manufacturing shall be absorbed in the production cost on the basis of the normal capacity or actual capacity utilization of the plant, whichever is higher. – Normal capacity is the production achieved or achievable on an average over a period or a season under normal circumstances taking into account the loss of capacity resulting from planned maintenance. (Cost Accounting Standard for Capacity Determination – CAS – 2).

In *Phamasia v. CCE* 2004 (173) ELT 481 (CESTAT), it was held that other works overheads as shown in cost audit report are includible in assessable value.

1.4 DUTY ON AD VALOREM BASIS

If a product Central Excise is payable on the basis of value. This is called " ad valorem duty ". The 'assessable value' is arrived at on the basis of Section 4 of the Central Excise Act and duty is payable on the basis of such value. Assessable Value (AV) is the ''V*alue* ' on which duty is payable as a percentage.

- When duty is payable on *ad valorem* basis, it is payable on assessable value as defined in section 4 of CEA.

- 'Transaction Value' is taken as Assessable Value if goods are sold at the time and place of removal, buyer is unrelated and price is sole consideration.
- Transaction value is the price paid or payable for the goods 'by reason of, or in connection with sale'.
- Transaction value does not include duty of excise, sales tax and any other taxes on goods.
- If goods are cleared without payment of duty, the price is taken as 'cum duty' price and tax payable should be calculated by back calculations.

  The basic provisions of new Section 4(1)(a) state that 'assessable value' when duty of excise is chargeable on excisable goods with reference to value will be 'transaction value' on each removal of goods, if following conditions are satisfied -
- The goods should be sold at the time and place of removal.
- Buyer and assessee should not be related.
- Price should be the *sole consideration* for the sale.
- Each removal will be treated as a separate transaction and 'value' for each removal will be separately fixed.

1.5 OTHER IMPORTANT PROVISIONS

Other important provisions are summarized below.

1.5.1 Refund of excise duty

- Assessee can claim refund of duty within one year from relevant date u/s 11B, in form R.
- Refund is subject to doctrine of unjust enrichment, i.e. refund will be available only if the amount was not recovered from buyer. These are overriding provisions.
- Doctrine of unjust enrichment applies to captive consumption, provisional assessment and also when duty was paid under protest.
- If refund is delayed beyond three months, interest is payable @ 6% p.a.

1.5.2 Exemption from Duty

Goods exported under bond are not 'exempted goods'

Rule 19(1) of Central Excise Ruloes states that any material may be exported wiothout payment of duty from factory of producer or manufacturer by removing under bond. Thus, the goods are cleared 'without payment of duty'. They are not 'exempt' goods. Ministry of Law Advice dated 29.10.1974 – confirmed and circulated vide CBE&C circular No. 278/112/96-CX dated 11.12.1996, states as follows, 'Under Central Excise, 'exemption' means exemption by notification under section 5A of CEA [earlier rule 8]. Thus, goods exported under bond are not 'exempt' from duty. These goods also cannot be termed as 'chargeable to Nil rate of duty', as in fact, the goods are dutiable.

- Section 5A(1) of Central Excise Act and section 25(1) of Customs Act empower Central government to exempt any excisable goods from duty, by issuing notification in Official Gazette.
- Such exemption may be partial or full, conditional or unconditional.
- Absolute i.e. unconditional exemption is compulsory, while conditional notification is at option of assessee.
- Central Government can also grant exemptions in exceptional cases u/s 5A(2).
- An exemption notification should be strictly construed, but purposeful construction is permissible.
- Principle of promissory estoppel can apply to an exemption notification.

1.5.3 EA 2000 Excise Audit

An Audit section is attached to each Commissionerate. Audit of assessee's factory is carried out by visit by 'audit party'. The Audit Party usually consist of 2/3 inspectors and a Deputy Office Superintendent, headed by a Excise Superintendent. The audit system is termed as 'EA-2000' [Excise Audit 2000]

The frequency of audit will be on basis of excise duty paid annually. The 'duty paid' means paid by cash plus through Cenvat credit. The frequency is as follows, as per CBE&C letter No. 381/145/2005 dated 6-6-2006 –

- Units paying duty more than ₹ three crores – every year.
- Units paying duty between ₹ one crore and ₹ 3 crores – once every two years.
- Units paying duty between ₹ 50 lakhs and ₹ one crore – once every five years.
- Units paying duty below ₹ 50 lakhs – 10% of units every year.

CERA audit - In addition to departmental audit, C&AG carries out selective audits, which is termed as 'CERA' (Central Revenue Audit').

1.6 PROCEDURES IN CENTRAL EXCISE

Some procedures are basic, which every assessee is required to follow. Besides, some procedures are required to be followed as and when required.

Basic Procedures

(1) Every person who produces or manufactures excisable goods, is required to get registered, unless exempted. [Rule 9 of Central Excise Rules]. If there is any change in information supplied in Form A-1, the same should be supplied in Form A-1.

(2) Manufacturer is required to maintain Daily Stock Account (DSA) of goods manufactured, cleared and in stock. [Rule 10 of Central Excise Rules]

(3) Goods must be cleared under Invoice of assessee , duly authenticated by the owner or his authorised agent. In case of cigarettes, invoice should be countersigned by Excise officer. [Rule 11 of Central Excise Rules]

(4) Duty is payable on monthly basis through GAR-7 challan / Cenvat credit by 5th/6th of following month, except in March. SSI units have to pay duty on monthly basis by 15th/ 16th of following month. Assessee paying duty through PLA more than ₹ 50 lakhs per annum is required to make e-payment only [Rule 8].

(5) Monthly return in form ER-1 should be filed by 10th of following month. SSI units have to file quarterly return in form ER-3. [Rule 12 of Central Excise Rules] — EOU/STP units to file monthly return in form ER-2 – see rule 17(3) of CE Rules.

(6) Assessees paying duty of ₹ one crore or more per annum through PLA are required to submit Annual Financial Information Statement for each financial year by 30th November of succeeding year in prescribed form ER-4 [rule 12(2) of Central Excise Rules].

(7) Specified assessees are required to submit Information relating to Principal Inputs every year before 30th April in form ER-5, to Superintendent of Central Excise. Return for 2004-05 was required to be submitted by 31-12-2004 [rule 9A(1) to Cenvat Credit rules inserted w.e.f. 25-11-2004]. Any alteration in principal inputs is also required to be submitted to Superintendent of Central Excise in form ER-5 within 15 days [rule 9A(2) to Cenvat Credit Rules inserted w.e.f. 25-11-2004]. Only assessees manufacturing goods under specified tariff heading are required to submit the return. The specified tariff headings are – 22, 28 to 30, 32, 34, 38 to 40, 48, 72 to 74, 76, 84, 85, 87, 90 and 94; 54.02, 54.03, 55.01, 55.02, 55.03, 55.04. Even in case of assessees manufacturing those products, only assessees paying duty of ₹ one crore or more through PLA (current account) are required to submit the return.

(8) Assessee who is required to submit ER-5 is also required to submit monthly return of receipt and consumption of each of Principal Inputs in form ER-6 to Superintendent of Central Excise by tenth of following month [rule 9A(3) to Cenvat Credit rules inserted w.e.f. 25-11-2004]. *Only those assessees who are required to submit ER-5 return are required to submit ER-6 return.*

(9) Every assessee is required to submit a list in duplicate of records maintained in respect of transactions of receipt, purchase, sales or delivery of goods including inputs and capital goods, input services and financial records and statements including trial balance [Rule 22(2)].

(10) Inform change in boundary of premises, address, name of authorised person, change in name of partners, directors or Managing Director in form A-1.

These are core procedures which each assessee has to follow. There are other procedures which are not routine.

Non-core procedures - The non-core procedures are as follows : -

(a) Export without payment of duty or under claim of rebate [Rules 18 and 19 of Central Excise Rules]
(b) Receipt of goods for repairs / reconditioning [Rule 16 of Central Excise Rules]
(c) Receipt of Goods at concessional rate of duty for manufacture of Excisable Goods.
(d) Payment of duty under Compounded Levy Scheme
(e) Provisional Assessment [Rule 7 of Central Excise Rules]
(f) Warehousing of goods.
(g) Appeals and settlement.

1.6.1 Invoice for removal of final products

Rule 11(1) of Central Excise Rules provides that excisable goods can be removed from factory or warehouse only under an 'Invoice' signed by owner or his authorised agent. In case of cigarettes, invoice shall be counter-signed by Inspector. Invoice should bear serial number and should be in triplicate. As per Rule 11(2) of Central Excise Rules, Invoice shall contain –

(a) Registration Number
(b) Address of jurisdictional Central Excise Division.
(c) Name of consignee
(d) Description and classification of goods
(e) Time and date of removal
(f) Mode of transport and vehicle registration number
(g) Rate of duty
(h) Quantity and Value of goods
(i) Duty payable on the goods.

1.6.2 Export Procedures

Exports are free from taxes and duties.

- Goods can be exported without payment of excise duty under bond under rule 19 or under claim of rebate of duty under rule 18.
- Excisable Goods should be exported under cover of Invoice and ARE-1 form.
- Merchant exporter has to execute a bond and issue CT-1 so that goods can be cleared without payment of duty. Manufacturer has to issue Letter of Undertaking.
- Export to Nepal/Bhutan are required to be made on payment of excise duty.
- EOU has to issue CT-3 certificate for obtaining inputs without payment of excise duty.

Bringing goods for repairs, re-making etc.

- Duty paid goods can be brought in factory for being re-made, refined, reconditioned or for any other reason under rule 16.

- The goods need not have been manufactured by assessee himself.
- Cenvat credit of duty paid on such goods can be taken, on basis of duty paying documents of such goods.
- After processing/repairs, if the process amounts to 'manufacture', excise duty based on assessable value is payable.
- If process does not amount to manufacture, an 'amount' equal to Cenvat credit availed should be paid [rule 16(2)].
- If some self manufactured components are used, duty will have to be paid on such components.
- Buyer/recipient of such goods can avail Cenvat credit of such amount/duty.
- If the above procedure cannot be followed, permission of Commissioner is required [rule 16(3)].

1.6.3 Receipt of Goods at concessional rate of duty

Some users of excisable goods can obtain goods at nil or lower rate of duty, subject to certain conditions. In other words, the exemption is based on end use. If the buyer is entitled to obtain excisable goods at nil or concessional rate of duty, he is required to follow prescribed proceure. The provisions are contained in Central Excise (Removal of Goods at Concessional Rate for Manufacture of Excisable Goods) Rules, 2001.

1.6.4 Returns to be filed

Form of Return Description Who is required to fil

Form of Return	Description	Who is required to file	Time Limit
ER-1 [Rule 12(1) of Central Excise Rules]	Monthly Return by large units	Manufacturers not eligible for SSI concession	10th of following month
ER- 2 [Rule 12(1) of Central Excise Rules]	Return by EOU	EOU units	10th of following month
ER-3 [Proviso to Rule 12(1) of Central Excise Rules]	Quarterly Return by SSI	Assessees availing SSI concession	20th of next month of the quarter
R-4 [Rule 12(1) of Central Excise Rules]	Annual Financial Information Statement	Assesses paying duty of ₹ One crore or more per annuam through PLA	Annually by 30th November of succeeding year
ER-5 [Rule 9A(1) and 9A(2) of Cenvat Credit Rules]	Information relating to Principal Inputs	Assessees paying duty of ₹ one crore or more per annum thorugh PLA and manufactureing goods under specified tariff headings	Annually, by 30th April for the current year (e.g. return for 2005-06 is to be filled by 30.4.2005].
ER-6 [Rule 9A(3) of Cenvat Credit Rules]	Monthly return of receipt and consumption of each of Principal Inputs	Assessees required to submit ER-5 return	10th of following month

1.7 DEMANDS, PENALTIES AND APPEALS

1.7.1 Demands of Excise Duty

- If duty is short paid or not paid or erroneously refunded, show cause notice can be issued u/s 11A(1) of CEA within one year from 'relevant date'.
- In case of allegation of suppression of facts, willful misstatement, fraud or collusion, the show cause notice can be issued within five years.
- Show cause notice is to be issued by authority who is empowered to adjudicate the case.
- Adjudicating authority is required to follow principles of natural justice. He has to pass orders with reasons

- In case of delay in payment of duty, interest @ 13% is payable u/s 11AB(1) of CEA.
- Property of person to whom show cause notice has been issued can be attached provisionally during adjudication, to protect interest of revenue.

1.7.2 Adjudication powers the adjudication powers are as follows :-

Authority	Issue of SCN And Demand of duty	Remission of duty for loss of goods	Other powers
Commissioner	Without limit	Without limit	
Additional Commissioner	Between ₹ 20 lakhs to 50 lakhs	₹ 5,00,000	Cases relating matters under *proviso* to section 35B(1) i.e. export under bond or under claim of rebate, loss of goods during transit to warehouse - without upper monetary limit
Joint Commissioner	Between ₹ 5 lakhs to 50 lakhs	₹ 5,00,000	Cases relating matters under *proviso* to section 35B(1) i.e. export under bond or under claim of rebate, loss of goods during transit t0 ware-house-wit without upper monetary limit
Deputy/Assistant Commissioner	Upto ₹ 5 lakhs	₹ 1,00,000	(1) Issue registration certificate (2) Refund claim without limit
Superintendent	No powers	Upto ₹ 10,000	

Note : (1) Demand of duty or differential duty may be relating to * determination of valuation and / or classification or * Cenvat credit cases or * duty short paid or not paid or erroneously refunded for any reason. Such demand may or may not contain for allegation of fraud, suppression of facts etc. (in other words, whether or not there is allegation of fraud/suppression of facts etc., the monetary limit of adjudication remains same.

Note : (2) As per CBE&C circular No. 809/6/2005-CX dated 1-3-2005, in case of refund claim, AC/DC can pass order without any monetary limit. However, claims of ₹ 5 lakhs and above will be subject to pre-audit at level of jurisdictional Commissioner

Note : (3) It has been clarified that value of goods/conveyance, plants, machinery, land, building etc. liable to confiscation will not alter the powers of adjudication as the powers solely depend upon the amount of duty/Cenvat credit involved on the offending goods.

Who can issue show cause notice - Show cause notice should be approved and signed by officer empowered to adjudicate the case.

1.7.3 Appeals

Excise and Customs Law empower excise/customs officers to pass adjudication orders demanding duty and interest and imposing penalty and confiscation of goods.

Excise and Customs Act have made elaborate provisions for appeals against adjudication orders passed by excise/ customs authorities. There is only one appeal in case of orders of Commissioner, while in case of other orders (i.e. orders of Superintendent, Assistant Commissioner, Dy. Commissioner, Jt. Commissioner, and Additional Commissioner), first appeal is with Commissioner (Appeals) and other with Tribunal. In some matters, revision application lies with Government against order of Commissioner and Commissioner (Appeals). Tribunal is final fact finding authority and no further appeal lies against facts as found by Tribunal (CESTAT). In case of order of Tribunal relating to classification or valuation, appeal lies with Supreme Court. In other matters, appeal can be made to High Court only if substan-tial question of law is involved.

Pre-deposit for filing appeal - Section 35F of Central Excise Act (similar section 129E of Customs Act) provides that person desirous of appealing against the order shall, *pending the appeal*, deposit the duty demanded or penalty levied. In case of customs, pre-deposit of duty, interest and penalty is required. However, the appellate authority [Commissioner (Appeals) or Appellate Tribunal] is empowered to dispense with such deposit if it is of the opinion that the deposit of duty or penalty will cause undue hardship to the person. Such waiver may be subject to such conditions as may be imposed to safeguard interests of revenue.

Meaning of 'duty demanded' - As per *explanation* to section 35F of CEA (inserted w.e.f. 11-5-2007), 'duty demanded' shall include following – (i) amount determined u/s 11D (ii) amountof erroneous Cenvat credit taken (iii) amount payable under earlier Central Excise Rule 57cc (iv) amount payable under rule 6 of Cenvat Credit Rules (v) Interest payable under provisions of Central Excise Act and Rules.

1.8 IMPORTANT PROVISIONS OF CENTRAL EXCISE ACT, 1944

Section No.	Brief Contents
2(d)	'Excisable Goods' means goods specified in the Schedule to Central Excise Tariff Act, 1985 as being subject to a duty of excise and includessalt. *Explanation* - 'goods' includes any article, material or substance which is capable of being bought and sold for a consideration and such goods shall be deemed to be marketable
2(e)	'Factory' means any premises, including the precincts thereof, wherein or in any part of which, excisable goods other than salt are manufactured; or wherein or in any part of which any manufacturing process connected with production of these goods is being carried on or is *ordinarily* carried on.
2(f)	*"Manufacture"* includes any process - (*i*) incidental or ancillary to the completion of manufactured product; (*ii*) which is specified in relation to any goods in the Section or Chapter notes of the First Schedule to the Central Excise Tariff Act, 1985 as amounting to manufacture; *or (iii)* which, in relation to goods specified in Third Schedule to the CEA,involves packing or repacking of such goods in a unit container or labelling or re-labelling of containers or declaration or alteration of retail sale price or any other treatment to render the product marketable to consumer; — and the word 'manufacturer' shall be construed accordingly and shall include not only a person who employs hired labour in the production or manufacture of excisable goods, but also any person who engages in their production or manufacture on his own account. *[Clauses (ii) and (iii) are called deemed manufacture]*. The definition of 'manufacture' is inclusive and not exhaustive.
2 (h)	'Sale' and 'purchase' with their grammatical variations and cognate expressions, means any transfer of possession of goods by one person to another in the ordinary course of trade or business for cash or deferred payment or other valuation consideration.
3 (1) (a)	This section is the 'charging section' of 'basic excise duty' and Reads as follows - There shall be levied and collected in such manner as may be prescribed duties on all excisable goods (*excluding goods produced or manufactured in special economic zones*) which are produced or manufactured in India as, and at the rates, set forth in the First Schedule to the Central Excise Tariff Act, 1985.
3 (2)	Central Government can fix tariff values for puose of levying excise duty. Once tariff value is fixed, valuation section 4 will not apply, as made clear in section 4(2).
3A	On goods to be notified by Central Government, duty will be payable onthe basis of annual capacity of production. The production capacity will be determined by Assistant/Deputy Commissioner on the basis of rules.The provision will not apply to goods manufactured by EOU.
4(1)	Where under this Act,the duty of exciseis chargeable on any excisable goods with reference to their value, then, on each removal of the goods, such value shall—(*a*) in a case where the goods are sold by the assessee, for delivery at the time and place of the removal, the assessee and the buyer of the goods are not related and the price is the sole consideration for the sale, be the transaction value; (*b*) in any other case, including the case where the goods are not sold, be the value determined in such manner as may be prescribed.
Explanation to section 4(1)	Price actually paid to assessee (less sales tax and other taxes) will be price-cum-duty and shall be deemed to include the duty payable on such goods.

Section No.	Brief Contents
4 (3) (b)	Persons shall be deemed to be 'related' if – (i) They are inter-connected undertakings (ii) They are relatives (iii) Amongst them, buyer is a relative and a distributor of assessee, or a sub-distributor of such distributor or (iv)They are so associated that they have interest, directly or indirectly, in the business of each other. *Explanation* (i) inter-connected undertakings shall have meaning assigned to it in section 2(g) of Monopolies and Restrictive Trade Practices Act, 1969 (MRTP) (ii) 'relative' shall have meaning assigned to it in section 2(41) of the Companies Act.
4(3)(c)	'Place of removal' means - (i) a factory or any other place or premises of production or manufacture of the excisable goods from where such goods are removed (ii) A warehouse or any other place or premises wherein the excisable goods have been permitted to be deposited without payment of duty from where such goods are removed (iii) A depot, premises of a consignment agent or any other place or premises from where excisable goods are to be sold after their clearance from factory; from where such goods are removed.
4(3)(cc)	"Time of removal", in respect of the excisable goods removed from the place of removal referred to in sub-clause (iii) of clause (c), shall be deemed to be the time at which such goods are cleared from the factory.
4(3)(d)	'Transaction value' means the price actually paid or payable for the goods, when sold, and includes in addition to the amount charged as price, any amount that the buyer is liable to pay to, or on behalf of, the assessee, by reason of, or in connection with the sale, whether payable at the time of sale or at any other time, including, but not limited to, any amount charged for, or to make provision for, advertising or publicity, marketing and selling organization expenses, storage, outward handling, servicing, warranty, commission or any other matter; but does not include the amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods.
4A	Section 4A of CEA empowers Central Government to specify goods on which duty will be payable based on 'retail sale price'. The provisions for valuation on MRP basis are as follows - (a) The goods should be covered under provisions of Standards of Weights and Measures Act or Rules [section 4A(1)]. (b) Central Government has to issue a notification in Official Gazette specifying the commodities to which the provision is applicable and the abatements permissible. Central Government can permit reasonable abatement (deductions) from the 'retail sale price' [section 4A(2)]. (c) While allowing such abatement, Central Government shall take into account excise duty, sales tax and other taxes payable on the goods [section 4A(3)]. (d) The 'retail sale price' should be the maximum price at which excisable goods in packaged forms are sold to ultimate consumer. It includes all taxes, freight, transport charges, commission payable to dealers and all charges towards advertisement, delivery, packing, forwarding charges etc. If under certain law, MRP is required to be without taxes and duties, that price can be the 'retail sale price' [Explanation 1 section 4A]. (e) If more than one 'retail sale price' is printed on the same packing, the maximum of such retail price will be considered [Explanation 2(a) to section 4A]. If different MRP are printed on different packages for different areas, each such price will be 'retail sale price' for purpose of valuation [Explanation 2(c) to section 4A]. (f) Removing excisable goods without MRP or wrong MRP or tampering, altering or removing MRP declared on a package is an offence and goods are liable to confiscation [section 4A(4)] If price is altered, such increased price will be the 'retail sale price' for purpose of valuation [Explanation 2(b) to section 4A].
5	Government can provide for remission of duty of excise payable on excisable goods, which due to any natural cause, are found to be deficient in quantity, by making rules in that behalf (Rule 21 provides for remission of duty)

Section No.	Brief Contents
5A(1)	Central Government can exempt any excisable goods, (*a*) generally (*b*) either absolutely or subject to such conditions (to be fulfilled before or after removal), (*c*) from whole or any part of excise duty leviable. Such exemption should be in public interest and it should be by way of a notification published in Official Gazette.
Proviso to section 5A(1)	The exemption notification issued u/s 5A is not applicable in respect of DTA clearances by EOU unit, unless specifically provided in the notification.
5A(1A)	Absolute i.e. unconditional exemption is compulsory.
5A(2)	Central Government can grant exemption, in public interest, in exceptional circumstances by a special order (This is *ad hoc* exemption and can be granted even retrospectively)
5A(2A)	Central Government, for the purpose of clarifying the scope or applicability of exemption notification or exemption order, may insert an explanation to the exemption notification or order within one year of such notification or order. Such Explanation to an exemption Notification will have retrospective effect from date of exemption notification.
5A(3)	Partial exemption under section 5A(1) or 5A(2) can be granted by providing exemption from duty at a rate expressed in form or method different from which statutory duty is leviable. However, the duty prescribed by an exemption notification can never exceed the *Statutory Duty.*
6	Registration is required to be obtained by any prescribed person who is engaged in (*a*) every manufacturer or producer of excisable goods i.e. goods specified in First or Second Schedule to Central Excise Tariff Act and (*b*) wholesale purchase or sale (whether on his own account or as broker or commission agent) or storage of any specified goods included in First or Second Schedule to Central Excise Tariff Act – Rule 9 makes provisions in respect of registration.
9(1)	Following are offences punishable with imprisonment and fine - (i) Contravening provisions of restrictions of possession of goods in excess of prescribed quantity as prescribed under section 8. (a) Evading payment of duty payable under CEA. (b) Removing excisable goods or concerning himself with such removal, in contravention of provisions of Central Excise Act and Rules. (c) Acquiring or in any way concerning himself with transporting, depositing, concealing, selling, purchasing or otherwise dealing with excisable goods where he knows or has reason to believe that the goods are liable to confiscation under Central Excise Act or Rules. (d) Contravening any provision of Central Excise Act or rules in relation to Cenvat credit. (e) Failure to supply information or knowingly supplying false information. (f) Attempting to commit or abetting commission of an offence regarding evasion of duty or transit of goods or restriction on storage of goods or non-registration of a unit. Punishment imposable is imprisonment upto seven years and fine (without limit) if (a) the duty leviable on the excisable goods exceeds one lakh of rupees [section 9(1) or (b) a person already convicted for offence under Central Excise Act is convicted again [section 9(2)]
9C	Mens rea (culpable mental state) shall be presumed by Court. Accused can prove that he had no culpable mental state.
11	Excise authorities can recover excise duty by any of the following means – • Adjusting against money payable to the person (e.g. if refund is due to him) • By attachment and sale of excisable goods belonging to the assessee. • As Arrears of Land Revenue, by issuing certificate to District Collector of Revenue, who is empowered to recover the amount as arrears of land revenue.
Proviso to section 11	If a person transfers his business or trade or disposes of his business to a third person, any duty or any other sum due from predecessor can be recovered from successor in trade or business, by attaching all goods, materials, preparations, plants, machineries, vessels, utensils, implements and articles which was transferred to the successor.

Section No.	Brief Contents
11A(1)	Central Excise Officer can, within one year from relevant date, serve show cause notice on person chargeable to duty, if – (a) duty of excise has not been levied or paid or (b) short levied or paid or (c) erroneously refunded. The show cause notice should ask the person why he should not pay the amount specified in the notice.
Proviso to section 11A (1)].	In case of fraud, collusion, wilful mis-statement and suppression of facts, or contravention of any provision of Central Excise Act or rules with intent to evade payment of duty, demand for duty can be raised within 5 years
11A(1A)	Where notice has been served on assessee under proviso to section 11A (1) of Central Excise Act (CEA), for short payment or non-payment of duty on account of fraud, collusion or wilful misstatement or suppression, the person to whom notice is service can pay full duty or in part as accepted to him within 30 days. In addition, he should pay interest payable under section 11AB of Central Excise Act and penalty equal to 25% of excise duty specified in the notice or 25% of duty as acceptable to him. In such cases, other persons to whom notices have been sent shall be deemed to be concluded, as per proviso to section 11A (2) of Central Excise Act.
11A(2)	After considering representation of the person on whom notice is served, the central excise officer will determine the duty payable and then the person shall pay the duty so determined
11A(2B)	If assessee pays duty due on his own, the officer shall not issue any show cause notice. However, if the officer is of the opinion that there is short payment in respect of the amount, he can issue notice for payment of balance amount. In such case, the time limit for issue of show cause notice will be counted from the receipt of information of payment. Further, the provision does not apply if the short payment or non- payment or erroneous refund was due to collusion, wilful mis-statement or suppression of facts.
11A(3)(ii)	The prescribed period for service of show cause notice cum demand is one year or 5 years from "relevant date". The relevant date will be one of the following : • If Return is to be filed as per provision of law, the actual date of filing of return [section 11A(3)(ii)(a)(A)]. • If the return was required to be filed but was not filed, then the date on which return should have been filed [section 11A(3)(ii)(a)(B)]. • If no return is required to be filed under the relevant provisions of Excise law, then date of payment of duty [section 11A(3)(ii)(a)(C)]. • In case of provisional assessment, date of adjustment of duty after final adjustment [section 11A(3)(ii)(b)]. • In case of demand on account of erroneous refund, dare of such refund [section 11A(3)(ii)(c)].
11AB(1)	If duty is not paid when it ought to have been paid, interest is payable at the rates specified by Central Government by notification in Official Gazette (present rate is 13% w.e.f. 12-9-2003). The interest is payable from the first day of the month following the month in which the duty ought to have been paid, till the date of payment.
11AC	A mandatory penalty equal to the duty short paid or not paid or erroneously refunded is payable if such non-payment or short payment or erroneous refund was due to fraud, collusion, wilful mis-statement or suppression of facts etc. If duty and interest along with penalty is paid within 30 days, penalty will be 25% [There is dispute whether the penalty is mandatory or can be reduced in deserving cases].
11B(1)	Person claiming refund of excise duty and interest, if any, paid on such duty, to make application within one year of 'relevant date' to AC/DC. The limitation of one year shall not apply if duty was paid under protest.

Section No.	Brief Contents
11B(2)	Doctrine of unjust enrichment – Refund, after sanction, to be credited to Consumer Welfare Fund.
Proviso to section 11B(2)	Refund will be paid to assessee only in following cases – • Rebate of excisable goods exported out of India (if he had exported on section 11B(2) payment of duty) • Rebate of excise on excisable materials used in manufacture of goods exported out of India (if he has not availed Cenvat credit) • Refund of duty paid on inputs (if payable according to any rule or notification) • To Manufacturer, if he has not passed on incidence of the duty to another person • To Buyer, if he has borne the duty and if he has not passed on incidence of the duty to another person • To any other class of applicant if borne by any such class of applicants, as may be notified by Government of India, if the incidence of duty has not been passed on to any other person (not specified so far)
11B(3) Explanation B to section 11B	Section 11B(2) to have overriding effect over any judgment or rule Relevant date for purpose calculation of period of one year for filing refund claim is as under : (a) In case of exports (i) when the ships or aircraft leaves India (ii) if the goods are exported by land, the date on which the goods leave Indian frontier (iii) if export is by post, date of despatch of goods by post office to a place outside India. (b) If Compound levy scheme is applicable, if assessee pays the full duty and if rate is subsequently reduced by Government, then date on which notification regarding reduction of rate is published. (c) In case of refund claim filed by purchaser, date of purchase of the goods (d) If duty is exempted by a special order under section 5A(2), the date of issue of such order (e) If duty was paid on provisional basis, the date of adjustment of duty after final assessment of duty. (f) Where duty becomes refundable as a consequence of judgment, decree, order or direction of appellate authority, CESTAT or any Court, date of such judgment, decree, order or direction (This clause inserted by Finance Act, 2007 w.e.f. 11-5-2007) (g) In other cases, date of payment of duty
11BB	Interest on delayed refund if not paid within three months from date of receipt of application u/s 11B(1), at rate notified (Presently, 6% w.e.f. 12-9-2003). As per explanation, order for refund by Commissioner (Appeals), Tribunal or Court, refund is also deemed to be an order passed u/s 11B(2).
11C	***Exemption if duty not paid as per past general practice*** - If (a) there was a generally prevalent practice of levy or non-levy of any excisable goods and (b) such goods were actually liable for duty at higher rates; Central Government may, by notification in Official Gazette, direct that such excess duty payable, need not be paid.
11D(1)	Duty collected from buyer must be paid - Every person, who is liable to pay duty under Central Excise Act and Rules and has collected from buyer any amount in excess of the duty assessed or determined and paid on any excisable goods under CE Act or rules, representing as duty of excise; must pay the amount immediately (forthwith) to the credit of Central Government
11D(1A)	Every person who has collected from buyer any amount in excess of the duty assessed or determined and paid on any excisable goods under CE Act or rules, representing as duty of excise; must pay the amount immediately (forthwith) to the credit of Central Government.

Section No.	Brief Contents
11DD	Interest on amount payable under section 11D
11DDA	Provisional attachment of property of a person to whom show cause notice has been serviced under sections 11A or 11D of Central Excise Act, if the Central Excise Officer (or customs officer as the case may be) is of the opinion that it is necessary to do so, to protect interests of revenue.
12	Central Government can apply provisions of Customs Act regarding levy, exemption, drawback, warehousing, offences, penalties, confiscation and procedure relating to offences and appeal to Central Excise, making suitable modifications and alterations to adapt them to circumstances.
12A	Every person liable to pay duty of excise, shall prominently indicate in all documents relating to assessment, sales invoice and other like documents, the amount of duty, which forms part of the price at which such goods are sold. (This is also required under rule 11(2) of Central Excise Rules).
12B	Every person who had paid duty shall be deemed to have passed on the burden to buyer of the goods.
12C	Constitution of Consumer Welfare Fund. Section 12D provides that the fund should be utilised for welfare of consumers.
12E(1)	Central Excise Officer can exercise powers and discharge duties conferred on CE officer subordinate to him.
13	Powers of arrest with prior approval of Commissioner
14(1)	Powers to issue summons to a person to attend and give evidence or produce document.
14A and 14AA	Special audit by Cost Accountant of Value u/s 14AA and of Cenvat credit u/s 14AA
18	Search and arrest under the Act to be made in accordance with Code of Criminal Procedure.
22	Vexatious search and seizure by Central Excise Officer
23A to 23H	Advance ruling
31 and 32 to 32PA	Settlement of Cases
33	Powers of adjudication of confiscation and penalty – Unlimited to Commissioner and limited to lower officers as per limits prescribed by CBE&C
34	Option to pay fine in lieu of confiscation
34A	Even if goods re confiscated or penalty is imposed, other punishment can be imposed.
35(1)	Appeal to Commissioner (Appeals) within 60 days from order of officer lower in rank than Commissioner.
35(1A)	Commissioner (Appeals) can adjourn the hearing but not more than three adjournments can be given.
35A(3)	Commissioner (Appeals) can pass order confirming, modifying or annulling the decision or order appealed against.
35B(1)	Appeal to Tribunal (CESTAT) against order of Commissioner or Commissioner (Appeals).
35B(2)	Committee of Commissioners can direct any Central Excise Officer to file appeal against order passed by Commissioner (Appeals). If there is difference of opinion between two Commissioners, the matter will be referred to jurisdictional Chief Commissioner who will decide whether to file appeal

Section No.	Brief Contents
35B(3)	Appeal to be filed within three months from date of communication of order to Commissioner or other party, as the case may be. As per section 35B(5), Tribunal can condone delay in filing appeal if sufficient cause is shown.
35B(4)	Other party can file cross-objection within 45 days from receipt of copy of appeal filed by other party.
35B(6)	Appeal to be filed in prescribed form with prescribed fees.
35C(1A)	Tribunal can give maximum three adjournments.
35C(2)	Tribunal can correct a mistake apparent from record, within six months from date of order, if mistake brought to notice by Commissioner or other party.
35D(3)	Single member bench can determine issue if duty involved or amount of fine/penalty involved is less than ₹ 10 lakhs. However, issue relating to rate of duty or value cannot be determined by a single member bench.
35E(1)	Committee of two Chief Commissioners can direct any Commissioner to apply to Tribunal for the determination of points arising out of order of Commissioner of Central Excise (This will be treated as departmental appeal). If there is difference of opinion between two Chief Commissioners, the matter will be referred to CBE&C (Board) who will decide whether to file appeal As per section 35E(3), order directing to file appeal shall be made within three months from date of communication of order. After that, as per section 35E(4), authorised officer should file appeal with Tribunal within one month.
35E(2)	Commissioner can direct any excise officer subordinate to him to apply to Commissioner (Appeals) for the determination of points arising out of order of an adjudicating authority subordinate to him (This will be treated as departmental appeal). As per section 35E(3), order directing to file appeal shall be made within three months from date of communication of order. After that, as per section 35E(4), authorised officer should file appeal with Commissioner (Appeals) within one month.
35EE(1)	In case of following order of Commissioner or Commissioner (Appeals), appeal does not lie with Tribunal, but revision application can be made to Central Government - (a) loss of goods occurring in transit from factory to warehouse or to another factory (b) rebate of duty on goods exported outside India or excisable goods used in manufacture of goods which are exported and (c) goods exported without payment of duty.
35EE(2)	Revision application should be filed within three months from date of communication of order. Delay upto three months can be condoned by Central Government.
35F	Duty, penalty, interest, erroneous Cenvat credit or 'amount' to be deposited pending appeal. Pre-deposit can be dispensed with if it may cause undue hardship to assessee.
35FF	If the amount deposited u/s 35F becomes refundable pursuance to order passed by Commissioner (Appeals) or Tribunal, the amount should be refunded within three months from date of communication of the order to adjudicating authority. If not so refunded, interest is payable at the rate specified in section 11BB of the Act
35G(1)	Appeal to High Court on substantial question of law. Appeal to High Court can be made if the order of CESTAT does not relate, among other things, to the determination of any question having a relation to rate of duty or to value of goods. Appeal to be filed within 180 days. Appeal against judgment of High Court lies with SC u/s 35L(a)(i).

Section No.	Brief Contents
35L(b)	Appeal to Supreme Court, if the order of CESTAT relates, among other things, to the determination of any question having a relation to rate of duty or to value of goods.
35Q	Appearance of authorised representative before Central Excise Officer or Tribunal.
36A	Documents produced by a person or seized from him shall be presumed to be true. Document will be admissible as evidence even if not duly stamped.
36B	Microfilms, fax copies and computer print puts will be admissible as evidence.
37B	Board empowered to issue orders, instructions and directions to Central Excise Officers for purposes of uniformity in the classification of excisable goods or with respect to levy of excise duties on such goods. However, such order cannot require central excise officer to make assessment in a particular way or interfere with discretion of Commissioner (Appeals).
37C	Any decision or order passed or any summons or notice under the Act shall be served (a) by tendering the same or by sending it with registered post with acknowledgement due to the person for whom it is intended or his authorised agent (b) If it cannot be served as aforesaid, then by affixing a copy at a conspicuous space in factory or warehouse. (c) If this is also not possible, then affixing a copy on the notice board of the office or authority which issued the notice, order, summons or decision.
37D	Duty, interest, penalty or fine to be rounded off to nearest rupee
Third Schedule	List of goods where packing, repacking, labelling etc. will amount to manufacture u/s 2(f)(iii) [These are same goods which are covered under MRP provisions under section 4A].

1.9 IMPORTANT PROVISIONS OF CENTRAL EXCISE RULES, 2002

Rule No.	Brief Contents
2(b)	'Assessment' includes self-assessment of duty made by the assessee and provisional assessment made under rule 7.
2(c)	'Assessee' means any person who is liable for payment of duty assessed or a producer or manufacturer of excisable goods or a registered person of a private warehouse in which excisable goods are stored, and includes an authorized agent of such person.
2(ea)	A taxpayer who is registered under Central Excise or Service tax provisions and is an assessee under Income Tax Act and has PAN number, and who fulfils prescribed conditions is 'Large Tax payer'.
5	Duty will be payable at rate and valuation as applicable at the time of actual removal from factory or warehouse, except in case of khandsari molasses [rule 5(1)]. Rate of duty applicable in case of khandsari molasses shall be the rate in force on date of receipt of such molasses in the factory of the procurer of such molasses [Rule 5(2)].
6	Assessee shall himself assess the duty payable on excisable goods, except that that in case of cigarettes, the Superintendent or Inspector of Central Excise shall assess the duty payable before removal of goods.
7	Provisional assessment can be requested by the assessee. Department cannot itself order provisional assessment. Final assessment will be made later by Assistant / Deputy Commissioner after getting the required details.
8	Duty is payable by 5th of following month (6th in case of e-payment). SSI units availing SSI exemption have to pay duty by 15th of following month (16th in case of e-payment). For the month of March, duty is payable by 31st March, both by large units as well as SSI
8(2)	Duty is deemed to have been paid for purpose of availment of Cenvat credit by the buyer
8(3)	If duty is not paid fully on due date, assessee is liable to pay the outstanding amount along with interest on unpaid amount at the rate specified under section 11AB. If part of duty is paid, the provision of interest will apply to that part of duty which is not paid [present rate of interest is 13%]
8(3A)	If duty and interest is not paid within 30 days after due date, assessee will forfeit the facility to pay duty in monthly instalments. He will have to pay duty through PLA before clearance of goods. He cannot utilise Cenvat credit for payment of duty during that period. This forfeiture of facility is automatic and mandatory. If despite such restrictions, assessee clears goods without payment of duty and consequences and penalties as applicable for removal of goods without payment of duty will follow.
9(1)	Every person who produces, manufactures, carries on trade, holds private store-room or warehouse or otherwise uses excisable goods shall get registered.
9(2)	Board is authorised to issue notifications (a) specifying conditions and procedures for registration and (b) granting exemption to person or class of persons from provisions of registration.
10(1)	Daily Stock Account of manufactured goods - A daily stock of goods manufactured or produced has to be maintained by every assessee.
10(2) and 10(3)	The first page and last page of such account book shall be duly authenticated by the producer or manufacturer or his authorised agent [rule 10(2)]. All such records shall be preserved for 5 years [rule 10(3)].
11(1)	Goods should be removed from a factory or warehouse only under an invoice signed by owner or his authorised agent. In case of cigarettes, invoice shall be counter-signed by Inspector.
11(2)	Invoice shall contain Registration Number, Address of jurisdictional Central Excise Division (added w.e.f. 1-4-2007), Name of consignee, Description and classification of goods, Time and date of removal, Mode of transport and vehicle registration number, Rate of duty, Quantity and Value of goods and Duty payable on the goods.

Rule No.	Brief Contents
11(3)	Invoice should be in triplicate and should be marked as follows (i) Original shall be marked 'ORIGINAL FOR BUYER' (ii) Duplicate copy shall be marked 'DUPLICATE FOR TRANSPORTER' (iii) Triplicate shall be marked 'TRIPLICATE FOR ASSESSEE'.
11(4)	Only one copy of invoice book at a time, unless otherwise allowed by AC/DC.
11(5)	Each foil of the Invoice shall be pre-authenticated by the assessee - by owner, working partner, Managing Director or Secretary or any person duly authorised for this purpose, before being brought into use.
11(6)	Before making use of the invoice book, serial numbers shall be intimated to Range Superintendent.
11(7)	Provisions of rule 11 (which is applicable to manufacturers) shall apply mutatis mutandis to goods supplied by a first stage dealer or a second stage dealer.
Proviso to rule 11(7)	If a first stage or second stage dealer receives goods under an invoice which mentions that Cenvat credit of the special CVD paid u/s 3(5) of Customs Tariff Act is not admissible, he should make similar endorsement in his invoice to buyer.
12(1)	A monthly return is to be submitted by every assessee to Superintendent of Central Excise, of production and removal of goods, and Cenvat credit availed, by 10th of the following month in form ER-1. SSI unit availing concession on basis of annual turnover have to file return on quarterly basis within 20 days from close of quarter in form ER-3.
12(2)	Assessees paying duty of Rupees One crore or more per annum through PLA are required to submit Annual Financial Information Statement for each financial year by 30th November of succeeding year in prescribed form ER-4.
12(3)	The Range Officer will scrutinise the monthly/quarterly return. He can call for documents from the assessee as he considers necessary.
12(4)	It will be responsibility of assessee to provide necessary records as and when required by excise officer.
12AA	Procedure for job work in articles of jewellery.
12BB	Procedures by LTU [Large Taxpayer Unit]
15	Central Government can notify scheme for payment of duty under 'Compounded Levy Scheme'.
16	Duty paid goods can be brought in factory for being re-made, refined, reconditioned or for any other reason under rule 16(1). After processing/repairs, if the process amounts to 'manufacture', excise duty based on assessable value is payable. If process does not amount to manufacture, an 'amount' equal to Cenvat credit availed should be paid. [rule 16(2)]. If the above procedure cannot be followed, permission of Commissioner is required [rule 16(3)].
16C	A manufacturer can, with specific permission of Commissioner, remove excisable goods manufactured in his factory for carrying out tests or any other process not amounting to manufacture, to some other premises, without payment of duty. The provision does not apply to prototype which are sent out for trial or development test. Conditions as specified in permission of Commissioner of CE will have to be followed [The rule is useful in cases where Cenvat provisions do not apply].
17	EOU to clear goods under invoice and duty is payable at the time of removal (not on monthly basis).
18	Duties can be paid on final product and subsequently rebate (refund) is claimed after exportation of such goods. Alternatively, rebate can be granted of duty paid on inputs used in the exported final product and final product is exported without payment of excise duty.
19	Excisable goods can be removed for export without payment of duty [Rule 19(1)]. Inputs to be used for manufacture of final product to be exported can be obtained without payment of excise duty [Rule 19(2)].

Rule No.	Brief Contents
20	Facility of warehousing for removal of excisable goods from factory of production to a warehouse or from one warehouse to another warehouse without payment of duty. CBE&C can prescribe conditions, limitations and safeguards.
21	Remission of duty can be granted in following cases – Remission of duty can be granted in following cases – (a) Goods have been lost or destroyed by natural causes (b) Goods have been lost or destroyed by unavoidable accident (c) Goods are claimed by manufacturer as unfit for consumption or for marketing.
22(2)	Every assessee and first stage dealer and second stage dealer should submit a list in duplicate, of specified records prepared or maintained by him.
23	Power to stop and search conveyance
24	Power to detain or seize goods
25	Following are offences for which goods can be confiscated and penalty upto duty on contravening excisable goods or ₹ 2,000, whichever is higher, can be imposed. (i) Removing excisable goods in contravention of Excise Rules or notifications issued under the rules [rule 25(1)(a)]. (ii) Not accounting for excisable goods manufactured, produced or stored [rule 25(1)(b)]. (iii) Engaging in manufacture, production or storage of excisable goods without applying for registration certificate u/s 6 of CE Act [rule 25(1)(c)]. (iv) Contravening any provision of Central Excise Rules or notifications issued under these rules with intent to evade payment of duty [rule 25(1)(d)].
26(1)	Personal penalty for knowingly dealing in goods liable to confiscation - Any person who acquires possession of, or is in any way concerned in transporting, removing, depositing, keeping, concealing, selling or purchasing, or in any other manner deals with any excisable goods which he knows or has reason to believe are liable to confiscation under the Act or rules, shall be liable to a penalty upto the duty payable on such goods or ₹ 2,000 whichever is greater.
26(2)	Penalty for issuing false invoice or document for availing ineligible Cenvat credit, upto amount of benefit or ₹ 5,000 whichever is higher.
27	Residual penalty - for breach of any excise rule, if no penalty has been prescribed, the penalty would be ₹ 5,000 plus confiscation of goods in respect of which offence has been committed.

1.10 IMPORTANT PROVISIONS OF CENTRAL EXCISE VALUATION RULES, 2000

Rule No.	Brief Contents
2(b)	"Normal transaction value" means the transaction value at which the greatest aggregate quantity of goods are sold.
	If goods are not sold at the time of removal, then value will be based on the value of such goods sold by assessee at any other time nearest to the time of removal, subject to reasonable adjustments.
5	Some times, goods may be sold at place other than the place of removal e.g. in case of FOR delivery contract. In such cases, actual cost of transportation from place of removal upto place of delivery of the excisable goods will be allowable as deduction. Cost of transportation can be either on actual basis or on equalized basis.
6	If price is not the sole consideration for sale, the 'Assessable Value' will be the price charged by assessee, plus money value of the additional consideration received. The buyer may supply any of the following directly or indirectly, free or at reduced cost. (a) Materials, components, parts and similar items (b) Tools, dies, moulds, drawings, blue prints, technical maps and charts and similar items used (c) Material consumed, including packaging materials (d) Engineering, development, art work, design work and plans and sketches undertaken elsewhere than in the factory of production and necessary for the production of the goods In such cases, value of such additional consideration will be added to the price charged by assessee to arrive at the 'transaction value'. [explanation 1 to Rule 6].
Explanation 2 to Rule 6	Where an assessee receives any advance payment from the buyer against delivery of any excisable goods, no notional interest on such advance shall be added to the value unless the Central Excise Officer has evidence to the effect that the advance received has influenced the fixation of the price of the goods.
7	When goods are sold through depot, there is no 'sale' at the time of removal from factory. In such cases, price prevailing at depot (but at the time of removal from factory) shall be the basis of Assessable Value. The value should be 'normal transaction value' of such goods sold from the depot at the time of removal or at the nearest time of removal from factory.
8	In case of captive consumption, valuation shall be done on basis of cost of production plus 10% (Cost of production is required to be calculated as per CAS-4)
9	If entire production is sold to 'related person' other than inter-connected undertakings, the assessable value will be 'normal transaction value' at which the related person sells the goods to unrelated buyers.
Proviso to rule 9	If assessee sales goods to 'related person', but related person uses them in captive consumption (and not sell them), valuation will be done on basis of cost of production plus 10%, as per rule 8.
10	If entire production is sold to 'related person' who are inter- connected undertakings, the assessable value will be as follows – (a) If they are 'related person' as defined in other clauses or is a holding or subsidiary company of assessee, 'normal transaction value' at which the related person sells the goods to unrelated buyers (b) In other cases, the value will be as if they are not 'related person'
10A	In case of job worker manufacturing goods on behalf of Principal Manufacturer, value will be the value at which the Principal Manufacturer sales goods to unrelated buyer. 'Job worker' means a person engaged in manufacture or production of goods on behalf of a principal manufacturer, from any inputs or capital goods supplied by the said principal manufacturer or by any other person authorised by him.
11	Residuary method - If value cannot be determined under any of the foregoing rules, value shall be determined using reasonable means consistent with the principles and general provisions of section 4 and Valuation Rules.

1.11 RULES OF CLASSIFICATION

General Rules for Interpretation of Schedule to Central Excise Tariff and Customs Tariff are given in First Schedule to the Tariff. The rules are same for excise and customs. The highlights of rules are given below.

Rule	Brief contents
1	Classification shall be determined according to the terms of the headings and any relative section or chapter notes and, provided such headings or Notes do not otherwise require, according to other provisions of the rules
First part of rule 2(a)	Any reference to complete goods also includes incomplete or un-finished goods, if such incomplete or un-finished goods have the essential characteristic of finished goods.
Second part of rule 2(a)	Heading will also include finished goods removed un-assembled or disassembled i.e. in SKD or CKD packs.
2(b)	Any reference in heading to material or substance will also include the reference to mixture or combination of that material or substance with other materials or substance. The classification of goods consisting of more than one material or substance shall be according to the principles contained in rule 3.
3	When by application of sub-rule (b) of rule 2 or for any other reason, goods are, *prima facie*, classifiable under two or more headings, classification shall be effected as given in rule 3(a), 3(b) or 3(c).
3(a)	The heading which provides most specific description shall be preferred to heading providing a general description.
3(b)	If Mixture and Composite goods consisting of different materials or different components cannot be classified based on above rule i.e. rule 3(a), it should be classified as if they consisted of the material or component which gives it their *essential character.*
3(c)	If two or more headings seem equally possible and the dispute cannot be resolved by any of the aforesaid rules, if both the headings appear equally specific, the heading which occurs last in numerical order is to be preferred (*i.e. latter the better*).
4	If the classification is not possible by any of the aforesaid rules 1, 2 and 3, then it should be classified under the heading appropriate to goods to which they are most akin. [This is only a last resort and a desperate remedy to resolve the classification issue]
5	cases for camera, musical instruments, drawing instruments, necklaces etc. specially shaped for that article, suitable for long term use will be classified along with that article, if such articles are normally sold along with such cases. Further, packing materials and containers are also to be classified with the goods *except when the packing is for repetitive use* (This provision is obviously made to ensure that the packing and the goods are charged at same rate of duty).
6	Classification of goods in sub-headings shall be determined in terms of those sub-headings. Only sub-headings at the same level are comparable

1.12 SOME CRITICAL ISSUES IN CENTRAL EXCISE

1.12.1 Software is 'goods', but unbranded software is service

In *Tata Consultancy Services* v. *State of Andhra Pradesh* (2005) 1 SCC 308 = 141 Taxman 132 = 271 ITR 401 = AIR 2005 SC 371 = 2004 AIR SCW 6583 = 137 STC 620 = 178 ELT 22 (SC 5 member Constitution bench), it has been held that canned software (i.e. computer software packages sold off the shelf) like Oracle, Lotus, Master-Key etc. are 'goods'. The copyright in the programme may remain with originator of programme, but the moment copies are made and marketed, they become 'goods'. It was held that test to determine whether a property is 'goods' for purpose of sales tax, is not whether the property is tangible or intangible or incorporal. The test is whether the concerned item is capable of abstraction, consumption and use, and whether it can be transmitted, transferred, delivered, stored, possessed etc. Even intellectual property, once it is put on a media, whether it be in form of books or canvas (in case of painting) or computer discs or cassettes and marketed would become goods. In all such cases, intellectual property has been incorporated on a media for purpose of transfer. The buyer is purchasing the intellec- tual property and not the media, i.e. the paper or cassette or discs or CD. - - There is no distinction between 'branded' and 'unbranded' software. In both cases, the software is capable of being abstracted, consumed and used. In both the cases, the software can be transmitted, transferred, delivered, stores, possessed etc. Unbranded software when marketed/sold may be goods.

However, Supreme Court did not express any opinion because in case of unbranded software, other questions like *situs* of contract of sale and/or whether the contract is a service contract may arise. Hence, in case of unbranded software, the issue is not yet fully settled. [SC upheld decision of AP High Court reported in *Tata Consultancy Services* v. *State of AP* (1997) 105 STC 421 (AP HC DB)].

In *Bharat Sanchar Nigam Ltd*. v. *UOI* (2006) 3 SCC 1 = 152 Taxman 135 = 3 STT 245 = 145 STC 91 = 282 ITR 273 (SC 3 member bench), following extract from decision in case of *Tata Consultancy Services* v. *State of Andhra Pradesh* was quoted with approval and adopted, 'A 'goods' may be a tangible property or an intangible one. It would become goods provided it has the attributes thereof having regard to (a) its utility; (b) capable of being bought and sold and (c) capable of being transferred, delivered, stored and possessed. If a software, whether customised or non-customised satisfies these attributes, the same would be goods'.

Earlier also, in *Associated Cement Companies Ltd.* v. *CC* 2001(4) SCC 593 = 2001 AIR SCW 559 =128 ELT 21 = AIR 2001 SC 862 = 124 STC 59 (SC 3 member bench), it was held that computer software is 'goods' even if it is copyrightable as intellectual property.

In *State Bank of India* v. *Municipal Corporation* 1997(3) Mh LJ 718 = AIR 1997 Bom 220, it was held that 'computer software' is 'appliance' of computer. It was held that it is 'goods' and octroi can be levied on full value and not on only value of empty floppy. [In this case, it was held that octroi cannot be levied on license fee for duplicating the software for distribution outside the corporation limits].

Excise duty on software - All software, except canned software i.e. software that can be sold off the shelf, is 'exempt' under notification No. 6/2006-CE dated 1-3-2006.

Para 138 of Finance Minister's speech dated 28-2-2006 reads as follows, 'I propose to impose an 8 per cent excise duty on packaged software sold over the counter. Customized software and software packages downloaded from the internet will be exempt from this levy'.

Meaning of 'software' - 'Information Technology Software' is defined in Supplementary Note of chapter 85 of Central Excise Tariff (and also Customs Tariff) as follows - 'For the purpose of heading 8523, 'Information Technology Software' means any representation of instructions, data, sound or image, including source code and object code, recorded in a machine readable form, and capable of being manipulated or providing interactivity to a user, by means of an automatic data processing machine'.

In *CCE* v. *Pentamedia Graphics* (2006) 198 ELT 164 (SC), it was held that 'motion picture animation file' recorded in a machine readable format and capable of being manipulated by automatic data processing machine is software – referred in *Padmini Polymers* v. *CCE* (2007) 215 ELT 392 (CESTAT), where it was held that multimedia application software on CD ROM is exempt. In this case, Cook Books and games which were interactive were held as 'software'. Reference was made to CBE&C circular No. 7/98-Cus dated 10-2-1998 where it was clarified that encyclopedia, games, books will be 'software' if these satisfy the interactivity criterion.

The SC decision was also followed in *Gayatri Impex* v. *CC* (2007) 215 ELT 397 (CESTAT) and *Adani Exports* v. *CCE* (2007) 210 ELT 443 (CESTAT). However, from the decision, it is not clear what was exactly imported. There is no requirement that to qualify as software, it must work without any operating system preloaded on computer. Any programme which requires anther programme like operating system will also be treated as software – *Contessa Commercial Co. P Ltd.* v. *CC* (2007) 208 ELT 299 (CESTAT). In this case, the importer had imported educational programmes and games.

Classification of encyclopedia, books on CD - In case of encyclopedia and books, there is hardly any 'interactivity', except that search engine helps in locating particular information. Further, search engine, which can be termed as 'software' forms insignificant part of the whole goods.

Applying the criteria of 'essential character' in case of mixture of goods, in my view, these cannot be termed as 'software'. These have to be classified as books.

Chapter 49, Note no 2 reads as follows, 'For the purpose of Chapter 49, the term 'printed' also means reproduced by means of a duplicating machine, produced under the control of an automatic data processing machine, embossed, photographed, photocopies, thermocopied or type-written. Hence, it can be argued that a book can be 'printed' on CD since it is produced under the control of an automatic data processing machine.

As per item Sr. No. 26 of Notification No. 6/2006-CE dated 1-3-2006, CD-ROMs containing books of an educational nature, journal, periodicals (magazines) or newspaper are fully exempt from excise duty. Thus, a book can be on CD has been recognised in law.

Unbranded software is service

Though Supreme Court has held that tailor made software is also goods, Finance Bill, 2008 has imposed service tax on tailor made i.e. unbranded software. "Information technology software" means any representation of instructions, data, sound or image, including source code and object code, recorded in a machine readable form, and capable of being manipulated or providing interactivity to a user, by means of a computer or an automatic data processing machine or any other device or equipment [proposed section 65(53a) of Finance Bill, 2008]. Any service provided or to be provided to any person, by any other person in relation to information technology software for use in the course, or furtherance, of business or commerce, including :—

(*i*) development of information technology software,

(*ii*) study, analysis, design and programming of information technology software,

(*iii*) adaptation, upgradation, enhancement, implementation and other similar services related to information technology software,

(*iv*) providing advice, consultancy and assistance on matters related to information technology software, including conducting feasibility studies on implementation of a system, specifications for a database design, guidance and assistance during the startup phase of a new system, specifications to secure a database, advice on proprietary information technology software

(*v*) acquiring the right to use information technology software for commercial exploitation including right to reproduce, distribute and sell information technology software and right to use software components for the creation of and inclusion in other information technology software products

(*vi*) acquiring the right to use information technology software supplied electronically, is a taxable service [proposed section 65(105)(zzzze) of Finance Bill, 2008].

Departmental clarification – CBE & C TRU letter F. No.334/1/2008-TRU dated 29-1-2008 clarifies as follows -

Software consists of carrier medium such as CD, Floppy and coded data. Softwares are categorized as "normal software" and "specific software". Normalised software is mass market product generally available in packaged form off the shelf in retail outlets. Specific software is tailored to the specific requirement of the customer and is known as customized soft-ware.

Packaged software sold off the shelf, being treated as goods, is leviable to excise duty @ 8%. In this budget, it has been increased from 8% to 12% vide notification No. 12/2008-CE dated 01.03.2008. Number of IT services and IT enabled services (ITeS) are already leviable to service tax under various taxable services :

- Consulting engineer's service - advice, consultancy or technical assistance in the discipline of hardware engineering [section 65(105)(g)].
- Management or business consultant's service - procurement and management of information technology resources [section 65(65)].
- Management, maintenance or repair service - maintenance of software, both packaged and customized and hardware [section 65(64)].
- Banking and other financial services - 'provision and transfer of information and data processing' [section 65(12)].
- Business support service - various outsourced IT and IT enabled services [section 65(105)(zzzq)].
- Business auxiliary service - services provided on behalf of the client such as call centres [section 65(19)].

IT software services provided for use in business or commerce are covered under the scope of the proposed service. Said services provided for use, other than in business or commerce, such as services provided to individuals for personal use, continue to be outside the scope of service tax levy. Service tax paid shall be available as input credit under Cenvat credit Scheme.

Software and upgrades of software are also supplied electronically, known as digital delivery. Taxation is to be neutral and should not depend on forms of delivery. Such supply of IT software electronically shall be covered within the scope of the proposed service.

With the proposed levy on IT software services, information technology related services will get covered comprehensively.

1.12.2 Plant and Machinery assembled at site

Plant and Machinery assembled and erected at site cannot be treated as 'goods' for the purpose of Excise duty, if it is not marketable and movable. [It may be noted that even if goods are held as 'excisable', they will be exempt if manufactured within factory of production. See case law under 'Captive Consumption' in earlier chapter].

The word 'goods' applies to those which can be brought to market for being bought and sold, and it is implied that it applies to such goods as are movable. Goods erected and installed in the premises and embedded to earth cease to be goods and cannot be held to be excisable goods. - *Quality Steel Tubes (P.) Ltd.* v. *CCE* 75 ELT 17 (SC) = (1995) 2 SCC 372 = 6 RLT 131 = 1995 AIR SCW 11 - in this case, it was held that tube mill and welding head erected and installed in the premises and embedded in the earth for manufacture of steel tubes and pipes are not 'goods'. followed in *Mittal Works* v. *CCE* (1997) 1 SCC 203 = 1996 (88) ELT 622 (SC) = 106 STC 201 -quoted with approval in *Thermax Ltd.* v. *CCE* 1998(99) ELT 481 (SC) - same view in *TriveniEngineering* v. *CCE* AIR 2000 SC 2896 = 2000 AIR SCW 3144 = 40 RLT 1 = 120 ELT 273 (SC) * *CCE* v. *Damodar Ropeways* 2003(151) ELT 3 = 54 RLT 125 (SC 3 member bench).

In *Municipal Corporation of Greater Bombay* v. *Indian Oil Corporation* AIR 1991 SC 686 = 1991 Supp (2) SCC 18, it was held that if the chattel is movable to another place in the same position (condition?), it is movable property. If it has to be dismantled and re-erected at later place, it is attached to earth and is immovable property.

Assembly at site is not manufacture, if immovable product emerges - In *Mittal Engg Works* v. *CCE* 1996 (88) ELT 622 = 17 RLT 612 = 106 STC 201 = (1997) 1 SCC 203, it was held that if an article has to be assembled, erected and attached to the earth at site and if it is not capable of being sold as it is, without anything more, it is not 'goods'. Erection and installation of a plant is not excisable - followed in *CCE* v. *Hyderabad Race Club* 1996 (88) ELT 633 (SC), where it was held that an article embedded in the earth was not 'goods' and hence excise duty is not leviable – followed in *TTG Industries* v. *CCE* 2004 AIR SCW 3329 = 167 ELT 501 (SC) – same view in case of storage cabinets, kitchen counters etc. erected at site in *Craft Interiors P Ltd.* v. *CCE* 2006 (203) ELT 529 (SC) – same view in respect of refrigeration plant, air conditioning plant and caustic soda plant in *CCE* v. *Virdi Brothers* 2007 (207) ELT 321 (SC).

Capital Goods manufactured within factory of production are exempt even if manufactured by third party - It may be noted that capital goods manufactured within the factory and used within the factory are exempt from excise duty *vide* notification No. 67/1995-CE dated 16.3.1995.

The exemption is available even when the capital goods are manufactured in the factory of production by third party. [refer case law under 'Captive Consumption'].

Assembly is manufacture only if machinery can be removed without dis-assembly – In *Triveni Engineering* v. *CCE* AIR 2000 SC 2896 = 2000 AIR SCW 3144 = 40 RLT 1 = 120 ELT 273 (SC), it was observed, 'The marketability test requires that the goods as such should be in a position to be taken to market and sold. If they have to be separated, the test is not satisfied'. [Thus, if machine has to be dis-assembled for removal, it is not 'goods' and duty cannot be levied].

If machine (generating set in this case) is only bolted on a frame and is capable of being shifted from that place, it is capable of being sold. It is goods and not immovable property – *Mallur Siddeswara Spinning Mills* v. *CCE* 2004 (166) ELT 154 (SC).

Present legal position in respect of machinery erected at site – The latest judgment on the issue is of *Triveni Engineering* judgment dated 8-8-2000, which has been practically accepted by Board *vide* its circular dated 15-1-2002. Hence, the present legal provision is, as decided in *Triveni Engineering* , i.e. 'The marketability test requires that the goods ***as such*** should be in a position to be taken to market and sold. If they have to be separated, the test is not satisfied'. Thus, if machinery has to be dismantled before removal, it will not be goods. Following is also clear (a) Duty cannot be levied on immovable property (b) If plant is so embedded to earth that it is not possible to move it without dismantling, no duty can be levied (c) If machinery is superficially attached to earth for operational efficiency, and can be easily removed without dismantling, duty is leviable (d) Turnkey projects are not dutiable, but individual component/ma chinery will be dutiable, if marketable.

Article can be 'goods' if marketable before erection - An article will be liable to duty if its manufacture is complete before it is fastened to earth. Similarly, if 'machinery' is in marketable condition at the time of removal from factory of manufacture, duty will be leviable, even if subsequently, it is to be fastened to earth.

1.12.3 Dutiability of Steel and Concrete Structures

Following are covered in 'iron and steel structure' as defined in tariff heading 7308 – (i) big structures like bridges, transmission towers, and lattice masts, lock-gates, roofs etc. of iron and steel (ii) parts of structures e.g. doors, windows and their frames, shutters, balustrades, pillars and columns etc. of iron and steel (iii) Plates, rods, angles, shapes, sections, tubes and the like prepared for use in structures of iron and steel.

In *Mahindra & Mahindra Ltd.* v. *CCE* 2005 (190) ELT 301 (CESTAT 3 member LB), it has been held as follows –

(i) Immovable iron and steel structures are not goods.

(ii) Structures and parts mentioned in parenthesis of 7308 like bridges, lock-gates, towers, trusses, columns frames etc., *in their movable state* will be subject to excise duty, even if latter they get permanently fixed in the structures. (iii) Plates, rods, angles, sections, tubes and the like, prepared for use in the structures will also be excisable goods subject to duty *in their pre-assembled or disassembled state.*

Fabrication of steel structurals like columns, crane, grinders, trusses amounts to 'manufacture'- *R S Avtar Singh* v. *CCE* (2007) 213 ELT 105 (CESTAT).

Structure for pre-fabricated building is dutiable – Steel structure for prefabricated building is dutiable. – *Mittal Pipe Mfg. Co*. v. *CCE* 2002(146) ELT 624 (CEGAT).

Fabrication of steel structure at site is exempt - As per Sr. No. 64 of notification No. 3/2005-CE dated 24-2-2005, (earlier it was in tariff entry 7308.50), structures fabricated at site of work for use in construction at site are exempt from duty. In *Delhi Tourism* v. *CCE* 1999(114) ELT 421 (CEGAT), it was held that the term 'site' should be given wider meaning and not narrow meaning. Even if structure is cast at different place and brought to site of construction, it will be eligible for exemption.

1.12.4 Goods with Blank Duty Rate in Central Excise Tariff are 'Excisable Goods'

Some goods are mentioned in Central Excise Tariff but column of rate of duty is blank (e.g. live animals in Chapter 1, Electrical Energy in chapter 27, Newspaper and maps in Chapter 49).

As per additional note No. 1(c) to Central Excise Tariff, 'tariff item' means description of goods in the list of tariff provisions accompanying either eight-digit number and the rate of duty or eight-digit number with blank in the columns of the rate of duty. Hence, goods where duty rate is blank is excisable goods – para 22 of *Geetanjali Woolens* v. *CCE* (2007) 218 ELT 152 (CESTAT) [Interestingly, in case of Customs Tariff, the note 1(c) does not make mention of 'blank' rate in the column of rate of duty].

However, in *CCE* v. *Solaris Chemtech* (2007) 9 STT 412 = 214 ELT 481 (SC), it is observed that electricity is not an excisable item. In excise tariff, rate is 'blank' in items like rice, wheat, soya bean, cotton seed etc. These are 'produced'.
In excise tariff, rate is 'blank' in items like rice, wheat, soya bean, cotton seed etc. These are 'produced'.

Goods mentioned as 'free' in Customs Tariff - In *Associated Cement Companies Ltd*. v. *CC* 2001 AIR SCW 559 = AIR 2001 SC 862 = (2001) 4 SCC 593 = 128 ELT 18 = 124 STC 59 = (SC 3 member bench), it was held that if duty rate specified in Customs Tariff Act is 'FREE' (i.e. no duty is payable), no duty is payable on such goods and hence these are not 'dutiable goods'. [In Central Excise Tariff, the duty rate indicated is 'Nil'. Hence, these are 'excisable goods'].

1.12.5 Manufacture – Other Aspects

Cutting of jumbo rolls of typewriter to make ribbon of standard length and winding on spool and blister packed - In *Kores India* v. *CCE* (2003) 152 ELT 395 (CEGAT), it was held that conversion of jumbo reels of ribbons into spool form to suit particular model and make of typewriting/telex machine is 'manufacture' as new and distinct product emerges – view upheld in *Kores India* v. *CCE* (2005) 1 SCC 385 = 174 ELT 7 (SC) – followed in *CCE* v. *Sohum Industries Ltd*.2006 (203) ELT 493 (CESTAT).

This decision was discussed in *Anil Dang* v. *CCE* (2007) 213 ELT 29 (CESTAT 3 member bench). It was held that this was no mere cutting and slitting but the roll was spooled on metal spools, plaster packed and sealed with aluminium foils. Hence, this decision will not apply where only slitting and cutting is involved.

Betel Nut to supari powder is not manufacture – Crushing betel nuts into smaller pieces and sweetening them does not result in a distinct product, as 'betel nut remains a betel nut' – *Crane Betel Nut Powder Works* v. *CCE* 2007 (210) ELT 171 = 6 VST 532 (SC) – decision of Tribunal in *CCE* v. *Crane Betel Nut Powder Works* 2005 (187) ELT 106 (CESTAT) is now not valid.

Upgradation of computer system is not manufacture - Upgradation of computer system by increasing its storage / processing capacity by increasing hard disk capacity, RAM or changing processor chip is not manufacture as new goods with different name, character and use do not come into existence. - CBE&C circular No. 454/20/99-CX dated 12-4-1999 – view confirmed in *Maxim Information Tech* v. *CCE* 2005 (184) ELT 78 (CESTAT) * *CCS Infotech* v. *CCE* (2007) 216 ELT 107 (CESTAT).

1.12.6 MRP Based Valutation

1.12.6.1 ***Same product partly sold in retail and partly in wholesale*** - CBE&C has further clarified in circular No. 737/53/2003-CX dated 19-8-2003 that when goods covered u/s 4A are supplied in bulk to large buyer (and not in retail), valuation is required to be done u/s 4. Provisions of section 4A apply only where manufacturer is legally obliged to print MRP on the packages of goods. Thus, there can be instances where the same commodity would be partly assessed on basis of section 4A and partly on basis of transaction value u/s 4 – view noted and approved in *Jayanti Food Processing* v. *CCE* (2007) 10 STT 375 = 215 ELT 327 (SC).

1.12.6.2 ***Valuation on MRP basis even if package is not really intended for retail sale*** - In *Jayanti Food Processing* v. *CCE* (2007) 10 STT 375 = 215 ELT 327 (SC), it was observed that nature if sale is not the relevant factor for application of section 4A but application would depend on five factors i.e. (i) goods should be excisable goods (ii) They should be such as are sold in the package (iii) There should be requirement of SWM Act or rules or any other law to declare price of such goods relating to their retail price on package (iv) The Central Government must have specified such goods by notification of Official gazette and (v) Valuation of such goods would be as per the declared retail price on the package less the amount of abatement.

In *ITEL Industries P Ltd.* v. *CCE* 2004 (163) ELT 219 (CESTAT 2 v. 1 decision), telephone instruments were supplied to DOT/MTNL in bulk with MRP duly marked. DOT/MTNL lent these to subscribers retaining their ownership. It was held that since goods were packed, the valuation is required to be done u/s 4A on basis of MRP, even if goods were not sold to customers – followed in *BPL Telecom* v. *CCE* (2004) 168 ELT 251 = 60 RLT 664 (CESTAT), where it was held that there is no requirement under Packaged Commodities Rules that goods covered by those provisions must be actually sold in retail – view confirmed in *Jayanti Food Processing* v. *CCE* (2007) 10 STT 375 = 215 ELT 327 (SC).

This was followed in *CCE* v. *Liberty Shoes* (2007) 216 ELT 692 (CESTAT), where it was held that MRP provisions apply even when sale is in bulk to institutional buyers.

1.12.6.3 ***Provision does not apply to ice cream sold in bulk*** - In *Monsanto Manufacturers* v. *CCE* 2006 (193) ELT 495 (CESTAT), it was held that if ice cream is sold in bulk to hotels and not intended for retail sale, valuation will be as per section 4 and not on MRP basis – view confirmed in *Jayanti Food Processing* v. *CCE* (2007) 10 STT 375 = 215 ELT 327 (SC).

1.12.6.4 ***Two items in combi-pack with one item free*** - In *Icon Household Products* v. *CCE* (2007) 216 ELT 579 (CESTAT), assessee was selling Mosquito Repellant Liquid (MRL) and Liquid Vapourising Device (LVD) as combi-pack. MRP was contained only on plastic container of MRL and not on LVD. It was held that this MRP will be taken for valuation of multipack. LVD supplied free in the multipack is not liable to assessment separately – relying on *Himalaya Drug Company* v. *CCE* (2006) 195 ELT 109 (CESTAT) - same view in *CCE* v. *J L Morison* (2008) 223 ELT 655 (CESTAT SMB).

1.12.6.5 ***No MRP on free gifts/samples, hence valuation as per section 4*** – In *Jayanti Food Processing* v. *CCE* (2007) 10 STT 375 = 215 ELT 327 (SC), assessee as selling Kitkat chocolates to Pepsi. These were distributed as free gift along with Pepsi bottle as a marketing strategy. It was held that even if product (chocolate) is covered under MRP provisions, since the product was not to be sold in retail, MRP is not required. Hence, valuation should be on basis of section 4.

1.12.6.6 Provision when more than one retail price declared

MRP printed on package is required to be inclusive of taxes. Rate of taxes vary from State to State. Hence, in some cases, a manufacturer may print different prices for different States. In some cases, manufacturer earmarks different packages for different areas and marks different prices for different areas.

If a package bears more than one retail sale price, maximum out of these will be deemed to be retail price for purpose of section 4A [*Explanation* 2(a) to section 4A(4)]. If retail price declared on the package at the time of removal is subsequently altered to increase the price, such increased retail price will be retail price for purpose of section 4A [*Explanation* 2(b) to section 4A(4)]. Where different retail sale prices are declared on different packages, each such retail price shall be the 'retail sale price' for purposes of valuation of excisable goods intended to be sold in area to which the retail price relates. [*Explanation* 2(c) to section 4A(4)]. Thus, if different prices are printed on different packages, each such price will be 'retail price'.

There is no stipulation in the Act that all packages should bear same MRP. Different MRPs for different buyers can be fixed. Even if MRP is different for each packet, such MRP is required to be adopted for assessable value– *CCE* v. *Bell Granito Ceramics* (209) 235 ELT 171 (CESTAT).

1.12.7 Assessable value under Section 4

1.12.7.1 ***Factory can be place of removal even if insurance taken by assessee as service to customers*** – In *Blue Star Ltd* . v. *CCE* (2008) 224 ELT 258 (CESTAT), transport was arranged by assessee since individual customer cannot arrange for transportation. Insurance was taken for safe transport of goods, as a service to customers. It was held that insurance cover cannot be taken as criteria for determining ownership of goods. It was held that there was sale at factory gate and freight is not includible in assessable value.

1.12.7.2 Minimum charges if assured quantity not purchased, are not part of excise assessable value - In *Jindal Praxair Oxygen* v. *CCE* (2007) 208 ELT 181 (CESTAT), MTOP charges were payable to assessee if buyer fails to purchase minimum quantity assured, as in such cases, assessee is not in position to operate his plant at optimum capacity. It was held that these are not includible in assessable value - followed in *CCE* v. *Praxair India* (2008) 223 ELT 596 (CESTAT).

1.12.7.3 ***Place of removal in case of exports*** – In case of exports, the place of removal is port where export documents are presented to customs office – *Kuntal Granites* v. *CCE* (2007) 215 ELT 515 = 2007 TIOL 930 (CESTAT) – quoted and followed in *Rajasthan Spinning & Weaving Mills* v. *CCE* (2007) 8 STR 575 (CESTAT).

1.12.7.4 ***Cash discount admissible whether availed or not*** - In *CCE* v. *Arvind Mills Ltd.* (2006) 204 ELT 570 (CESTAT 3 member bench), it has been very clearly held that cash discount and finance cost are admissible under new section 4 of CEA also. Differential price represents interest for delayed payment. Cost of finance and cash discount whether availed or not are to be granted as abatement even after 1-7-2000.

1.12.7.5 ***Self insurance charges addible*** - In *Gujarat Borosil* v. *CCE* (2007) 217 ELT 367 (CESTAT), assessee was collecting 7% amount was 'insurance charges'. Actual insurance premium paid was much less. The charge was to cover breakage of goods in transit. It was held that this cannot be permitted as deduction since assessee was not an insurance company.

1.12.7.6 ***Valuation of free samples*** – CBE&C, *vide* circular No. 813/10/2005-CX dated 25-4-2005 has clarified that in case of samples distributed free, valuation should be done on basis of rule 4 i.e. value of similar goods. The revised circular dated 25-4-2005 stating that valuation of samples should be on basis of rule 4, has been upheld as valid in *Indian Drugs Manufacturers' Assn* v. *UOI* (2008) 222 ELT 22 (Bom HC DB).

1.12.7.7 ***Valuation in case of stock transfer*** - In case of stock transfer, value to be adopted is the price prevailing in depot at the time of clearance from factory. Once goods are cleared from factory to depot on payment of duty (on basis of price prevailing at the time of removal from factory), it is not necessary to chase the goods and see at what price the goods were subsequently sold -*CCE* v. *Carborandum Universal Ltd.* (2008) 224 ELT 290 (CESTAT).

1.12.7.8 ***Sale to parent company both as spares as well as for maintenance*** – In *CCE* v. *Aquamall Water Solutions* (2008) 223 ELT 385 (CESTAT), assessee sold its water purifying equipment to its parent company (Eureka Forbes Ltd.). Assessee also supplied parts of the water purifying equipment to its parent company, both for sale as spares and also for maintenance purposes. In case of spares for sale, duty was paid on the basis of selling price of spares of parent company. In case of parts supplied for use in maintenance, duty was paid on the basis of cost of production plus 10%. Department contended that in case of parts supplied for maintenance also, duty should be paid on basis of selling price of parent company. However, Tribunal held that when parts are not sold by parent company, duty should be paid under rule 8 on basis of cost of production plus 10% since no other specific rule to cover this (The decision is based on a Board circular which has since been withdrawn).

Part sale and part consumption – in *Ispat Industries Ltd.* v. *CCE* 2006 (201) ELT 65 (CESTAT), it was held that if goods are partially sold to unrelated buyers and partially supplied to sister concern, valuation should be under rule 4 i.e. on the basis of price at which goods are sold to other independent buyers – relying on *Aquamall Water Solutions* v. *CCE* 2003 (153) ELT 428 (CEGAT).- view upheld in *Ispat Industries* v. *CCE* 2007 (209) ELT 185 (CESTAT 3 member bench).

1.12.7.9 Valuation in case of job work

Excise duty will not be payable if raw material/semi-finished components are sent for job work under Cenvat provisions or under notification No. 214/86-CE. However, in other cases, if job work results in 'manufacture' of a product, duty will become payable by job worker. Rule 10A of Valuation Rules, as inserted w.e.f. 1-4-2007 provides that in such cases, excise duty will be payable on the basis of price at which the raw material supplier (termed as 'principal manufacturer' in valuation rules) sales the goods. Rule 10A has been inserted in the Central Excise Valuation (Determination of Price of ExcisableGoods) Rules, 2000 to provide that where goods are manufactured by a job-worker on behalf of a person (commonly known as principal manufacturer), the value for payment of excise duty would be based on the sale value at which the principal manufacturer sells the goods, as against the present provision where the value is taken as cost of raw material plus the job charges - *Para 32.1 of DO letter F. No. 334/1/2007-TRU dated 28-2-2007.*

1.12.7.10 ***Provisions relating to valuation*** - The liability to pay duty will rest with the job-worker as per the present practice - *Para 32.2 of DO letter F. No. 334/1/2007-TRU dated 28-2-2007.* The value in such cases shall be as follows, w.e.f. 1-4-2007 :

1.12.7.11 ***When goods are sold at the factory of job worker by Principal Manufacturer*** – If the goods are sold by 'Principal Manufacturer' (raw material supplier) from factory of job worker, the value will be the 'transaction value of the goods at which the goods are sold' by the principal manufacturer for delivery at the time of removal of goods from the factory of job-worker. This would be so if the principal manufacturer and the buyer of the goods are not related and the price is the sole consideration for the sale [rule 10A(i) of Valuation Rules]. *Proviso* to rule 10A of Valuation Rules clarifies that cost of transport from premises from which goods are sold to place of delivery will not be included in the assessable value.

1.12.7.12 ***When goods are sold by Principal Manufacturer from some other place*** – If goods manufactured by job worker are delivered at other place (e.g. depot, branch, godown etc. of Principal Manufacturer) and sold from there, the valuation will be on the basis of 'normal transaction value of goods sold at or about the same time' by the Principal Manufacturer from such place.

This would be so if the principal manufacturer and the buyer of the goods are not related and the price is the sole consideration for the sale [rule 10A(ii) of Valuation Rules]. *Proviso* to rule 10A clarifies that cost of transport from premises from which goods are sold to place of delivery will not be included in the assessable value. This methodology is similar to valuation in case of sale through depot.

1.12.7.13 ***When valuation as per rule 10A(i) or 10A(ii) of Valuation Rules is not possible*** – If valuation is not possible as per rule 10A(i) or 10A(2) of Valuation Rules, 'value' will be determined in accordance with the principles enunciated in the Valuation Rules on a case-to-case basis [rule 10A(iii) of Valuation Rules]. For example, if the excisable goods manufactured on job-work are sold by the principal manufacturer where the price is not the sole consideration for sale, the value of such goods shall be determined in terms of principles laid down in rule 6. If goods are captively consumed by Principal Manufacturer, valuation can be on basis of rule 8.

1.12.7.14 ***Meaning of job worker*** – As per *Explanation* to rule 10A, for the purposes of rule 10A, 'job worker' means a person engaged in manufacture or production of goods on behalf of a principal manufacturer, from any inputs or capital goods supplied by the said principal manufacturer or by any other person authorised by him.

Question : A Trader supplies raw material of ₹ 1,150 to processor. Processor processes the raw material and supplies finished product to the trader. The processor charges ₹ 450, which include ₹ 350 as processing expenses and ₹ 100 as his (processor's) profit. Transport cost for sending the raw material to the factory of processor is ₹ 50. Transport charges for returning the finished product to the trader from the premises of the processor is ₹ 60. The finished product is sold by the trader at ₹ 2,100 from his premises. He charges Vat separately in his invoice at applicable rates. The rate of duty is 16% plus education cess as applicable. What is the AV, and what is total duty payable?

Answer on and after 1-4-2007 : Assessable Value is to be calculated on basis of selling price of trader which is ₹ 2,100. This price is to be treated as inclusive of excise duty. Hence, assessable value will be (2,100 x 100)/110.30 i.e. ₹ 1,903.89. Basic excise duty @ 10% will be 190.40. Education Cess (2%) is ₹ 3.80 and Secondary and Higher Education Cess is ₹ 1.90. Total duty payable will be ₹ 196.10.

Answer upto 31-3-2007 - Assessable Value (AV) is ₹ 1,650 (1,150+350+100+50). Duty is not payable on ₹ 1,800, which includes Traders' profit. Since place of the processor is the place of removal of goods, no duty is payable on outward freight of ₹ 60. Material cost is not required to be added if parent manufacturer had sent material under Cenvat, as per decision of Supreme Court in *International Auto Ltd* . v. *CCE* 2005 (183) ELT 239 = 68 RLT 341 (SC 3 member bench).

1.12.8 Other Issues

1.12.8.1 When two exemption notifications are available, assessee can select either - If applicant is entitled to claim benefit under two different notifications, he can claim more (i.e. better) benefit and it is the *duty* of authorities to grant such benefit to applicant – *Share Medical Care* v. *UOI* 2007 (209) ELT 321 (SC).

1.12.8.2 Benefit of exemption can be claimed at any stage - Even if an applicant does not claim benefit under a particular exemption notification at initial stage, he is not debarred, prohibited or estopped from claiming such benefit at a later stage - *Share Medical Care* v. *UOI* 2007 (209) ELT 321 (SC) – quoted and followed in *Cipla Ltd* . v. *CC* (2007) 218 ELT 547 (CESTAT), where it was held that benefit of exemption notification can be claimed at appellate stage also.

1.12.8.3 Manufacturer not liable for duty liability of scrap / waste generated at end of job worker

Earlier rule 57F provided that waste and scrap arising during job work is required to be returned to raw material supplier. New Cenvat Credit Rules make no such provision. Hence, in *Rocket Engineering Corporation* v. *CCE* 2006 (193) ELT 33 (CESTAT), it has been held that the scrap is not required to be returned to raw material supplier and the raw material supplier is not required to pay any duty on the scrap, since Cenvat Credit Rules after 1-4-2000 do not make any such provision – view confirmed in *CCE* v. *Rocket Engineering Corporation* (2008) 223 ELT 347 (Bom HC DB) - followed in *Emco Ltd.* v. *CCE* (2008) 223 ELT 613 (CESTAT). In *Preetam Enterprises* v. *CCE* 2004 (173) ELT 26 (CESTAT), it was held that even in respect of inputs sent under Cenvat Credit Rules, job worker is manufacturer of scrap and he is liable to pay duty on scrap. Duty on scrap cannot be demanded from raw material supplier after 1-4- 2000 – same view in *Rocket Engineering* v. *CCE* 2006 (193) ELT 33 (CESTAT) [Scrap is treated as a final product if mentioned in the Tariff. However, it is 'final product' of job worker and not of raw material supplier].

In *Silicon Cortec* v. CCE (2004) 166 ELT 473 (CESTAT SMB), it has been held that waste and scrap is final product of job worker and he can clear the same on payment of duty. In *Timken India* v. *CCE* (2007) 215 ELT 182 (CESTAT), it was held that duty liability on scrap is of the job worker. If he is under SSI exemption, no duty is payable by him. In *GKN Sinter Metals* v. *CCE* 2007 (210) ELT 222 (CESTAT), it was held that if waste and scarp is only in nature of floor sweeping, and if there is invisible loss, no duty is required to be paid on such scrap.

1.12.8.4 Service tax on job work

Job work falls under 'Business Auxiliary Service', if the job work is not 'manufacture'. Service tax will be payable. Job work done under Cenvat provisions is exempt from service tax. If the job worker is not availing any Cenvat credit of any common input or input services, question does not arise. However, if the job worker is availing Cenvat credit on inputs or input services, he will be liable to pay 8% 'amount' on job charges under rule 6(3) of Cenvat Credit Rules, or he may have to go in for proportionate reversal of Cenvat Credit as per rule 6(3A) of Cenvat Credit

Rules effective from 1-4-2008. If the job worker thinks that the rule 6(3A) is cumbersome, it may be advisable to pay service tax @ 12.36% on job charges, since the customer will be in a position to avail Cenvat credit. If job worker charges 8% 'amount', customer cannot avail Cenvat credit, but if job worker charges regular service tax, the customer will be eligible to avail Cenvat credit.

1.12.9 Excise on Small Scale Industries

1.12.9.1 Small Scale Industries

The contribution of Small Scale Sector in the industrial growth of the Indian economy and to the Gross Domestic Product is significant, besides the potential for employment generation. Keeping this into consideration, special provisions of Central Excise are applicable to small-scale units.

1.12.9.2 Exemption to SSI

- SSI are eligible for exemption from duty under Notification No. 8/2003-CE dated 1-3- 2003. The SSI unit need not be registered with any authority.
- Broadly, items generally manufactured by SSI (except in tobacco, matches and textile sector) are eligible for SSI exemption. Some items like pan masala, matches, watches, tobacco products, Power driven pumps for water not confirming to BIS, products covered under compounded levy scheme etc. are specifically excluded, even when these can be manufactured by SSI. Some items like automobiles, primary iron and steel etc. are not eligible for SSI exemption, but anyway, these are beyond capacity of SSI unit to manufacture.
- Unit whose turnover was less that ₹ 4 crores in previous year are entitled to full exemption upto ₹ 150 lakhs in current financial year.
- SSI units manufacturing goods with brand name of others are not eligible for exemption, unless the goods are manufactured in rural area.
- Turnover of all units belonging to a manufacturer will be clubbed for calculating SSI exemption limit.
- Clubbing is also possible if two units are sham or bogus or if there is unity of interest and practically they are one.While calculating limit of ₹ 400/150 lakhs -
- Turnover of Exports, deemed exports, turnover of non-excisable goods, goods manufactured with other's brand name and cleared on full payment of duty, job work done under notification No. 214/86-CE, 83/94-CE and 84/94-CE, processing not amounting to manufacture, strips of plastics used within factory is to be excluded.
- Value of intermediate products (when final product is exempt under notification other than SSI exemption notification), branded goods manufactured in rural area and cleared without payment of duty, export to Nepal and Bhutan and goods cleared on payment of duty is to be included.
- Value of turnover of goods exempted under notification (other than SSI exemption notification or job work exemption notification) is to be included for purpose of limit of ₹ 400 lakhs, but excluded for limit of ₹ 150 lakhs.

1.12.9.3 Exemption from registration

The requirement of registration has been exempted for the following persons *vide* Notification No. 22/98-CE(NT), dated 4-6-1998 as amended :

- Manufactures, who are only manufacturing goods, which are exempted from payment of duty of Central Excise.
- For small scale industries, which are manufacturing goods up to an aggregate value of less than ₹ 90 lakhs. After crossing ₹ 90 lakhs turn over the SSI must file declaration.
- In case an SSI is manufacturing goods of more than 30 lakhs it must file a declaration only once in prescribed form.

1.13 ILLUSTRATIONS

Illustration 1.

M/s XYZ. are in the business of supplying "Turbo-alternators" to various customers. They manufacture steam turbines in the factory, which are removed to the customer's site on payment of Central Excise Duty. They purchase duty paid alternators from the market which are delivered at the customer's site. M/s XYZ assemble both the items and fix them permanently on a platform at the site. Department demands central excise duty payable on "@ Turbo-alternator" when it comes into existence after being assembled on the platform embedded to the earth. Is the view taken by the department correct. Discuss with the help of case laws, if any.

Answer :

In the present case two issues are involved

(1) Whether assembly of steam turbines and duty paid alternators amounts to manufacture of turbo alternators, and

(2) Whether such assembly results in manufacture of excisable goods.

The facts of the case are similar to the case of *Triveni Engineering and Industries Ltd. v C. CEX, 2000* (120) El,T 273(SC)

In the present case, the Appellants were, according to specified designs, combining steam turbine and alternator by fixing them on a platform and aligning them. As a result of this activity of the Appellants, an new product, turbo alternator, came into existence, which has a distinctive name and use different from its components. Therefore, the process involved in fixing steam turbine and alternator and in coupling and aligning them in a specified manner to form a turbo alternator, a new commodity, is nothing but a manufacturing process.

Though the process of assembling results into a new commodity and therefore is a process amounting to manufacture, yet the turbo alternator set (known in the market as such) comes into existence only when a steam turbine and alternator with all their accessories are fixed at the site. Further, in order to be brought in the market the turbo would not remain turbo alternator. Thus, its is obvious that without fixing to the ground the turbo alternator does not come into being. The installation or erection of turbo alternator on the platform specially constructed on the land cannot be treated as a common base, therefore, such alternator would be immovable property. Accordingly, such activity could not be considered as 'excisable goods'.

Illustration 2.

Snow White Ltd. Manufactures paper and in the course of such manufacture, "wastepaper" is produced (paper being the main product and dutiable goods). The Central Excise Tariff Act, 1985 (CE7) was amended w.e.f. 1-3-1995, so as to include waste paper. White Ltd. was issued a show cause notice by the Central Excise Officer, demanding duty of ₹ 2 lakhs on waste paper produced during October, 1994 to February, 1995, but cleared during April-May, 1995. A reply is due to be filed immediately to the notice. As Counsel of Snow White Ltd. you we required to advise the company about –

(i) The legality and validity of the proposed levy and collection of duty on waste paper for the period prior to 1-3-1995; and

(ii) State (with the help of decided cases) the reasons for your advice/opinion.

Answer :

The issue involve in the given case is determination of taxable event for the purpose of levy of excise duty.

As per section 3 of the Central Excise Act, 1944, the taxable event for levy of Central Excise is "manufacture of excisable goods". The date for determination for rate of duty and tariff valuation is the date of actual removal of the goods from the factory or warehouse.

However, there must be a levy of duty of excise at the time of manufacture and only then, the duty can be collected at the time of removal as has already been held in *Vazir Sultan Tobacco Industry's* case 1996 (83) ELT 3(SC).

Therefore, the waste paper produced prior to the levy will not be chargeable to duty of excise even though it has been cleared after such levy and the proposed show cause notice demanding ₹ 2 lakhs of excise duty on such waste paper is invalid and illegal and liable to be quashed.

Illustration 3.

Kagaz Karkhana Ltd., manufactures paper In the year 1995, it embarked on a major expansion programme, and for the purpose, fabricated at site, 75% of the portion of papermaking machine and procured (paying excise duty) the remaining parts of the papermaking machine from other suppliers. Having done so, it assembled all the parts together into a paper-making machine at site. The erection and installation was completed during November, 1995. and the machine was firmly fastened to the earth, with the help of bolts, nuts and grouting material on a concrete bed, to prevent rattling and ensure wobble-free operation and presently the machine is functional and operating. During July, 1998, the Central Excise authorities served the company a show cause demanding excise duty of ₹ 5 crores, on the paper-making machine, alleging that the activity resulted in manufacture of excisable goods, failing under chapter 84 of CET. The company engages you as 'counsel' to represent them and desires to contest the case on the grounds :

(i) That the activity of erection and installation was not manufacture,

(ii) That the activity resulted in "immovable property" emanating at site and

(iii) That the demand is time-barred

You are required to discuss the tenability or otherwise of the contentions of the notice client and advise them drawing support form the judicial decision.

Answer :

There are three issues involved in the present case :

(i) Whether the activity of erection and installation was not manufacture,

(ii) Whether the activity resulted in "immovable property" emanating at site and

(iii) Whether the demand is time-barred

In respect of the first issue, it is to be noted that the excise duty is levied on the excisable goods manufactured in India, and hence it will not be attracted where goods are not produced from the manufacturing process.

A commodity is said to be manufactured if by application of the process its identity is changed and it is known in the market as a separate and distinct commodity having separate name, character and use.

The assembly of parts results in paper-making machine which has distinct identity, name and character and use and hence such assembly amounts to manufacture.

The second issue is whether erection and installation of such machine on a concrete bas results in a immovable property. The Supreme Court, in *Sirpur Paper Mills v C.C.Ex., Hyderabad* 1998(97) ELT 3 (SC), has held that papermaking machine if assembled and erected at site and embedded in concrete base to ensure wobble free operation will not become an immovable property. The machine can be dismantled from its base and sold in parts. Hence, the assessee's first two contentions are untenable and incorrect as the activity has resulted in the manufacture of goods and there is no immovable property brought into existence and assembly operations are liable to duty of excise.

The third issue is whether the demand notice is time barred. Under section 11A of the Central Excise Act, 1944, the extended period of limitation can be invoked only when there is a fraud, collusion, willful misstatement, suppression of facts or contravention of the provisions of the Act with an intent to evade the payment of duty of excise. If the manufacturing activity of paper-making machine was known to the department then the department cannot invoke the extended period of limitation. Hence, the contention of the assessee is an arguable pint and the same is legally tenable.

Illustration 4.

Regarding the applicability of excise duty, Computers are covered under Heading no 84.71 of the First schedule to the Central Excise Tariff Act, 1985 which describes computers as automatic data processing machines. XYZ Ltd. has undertaken upgradation of its computers both in terms of storage capacity and processing speed by increasing the hard disc capacity, RAM, changing of processor chip from 386 to 486 and in certain cases from Pentium III to Pentium IV. The Department's contention is that new goods with a different name character and use have come into existence and the upgraded products are chargeable to excise duty. Discuss in the light of provision of section 2*(f)* of the Central Excise Act, 1944 relating to "manufacture" whether this stand of the Department is justified.

Answer :

The computers covered under heading No. 84.71 of the Schedule to the Central Excise Tariff Act, 1985 are described as automatic data processing machines. An automatic data processing machine will be known by this name, irrespective of its capacity of storage and processing, which may be enhanced by increasing the hard disk capacity. RAM or by changing the mother board or the processor chip. However, it cannot be said that new goods with a different name, character and use have come into existence, which can be subjected to duty again.

Accordingly, upgrading of old and used computer systems would not amount to manufacture, in so far as the upgradation does not bring into existence goods with a distinct new name, character and use.

Illustration 5.

Full exemption is granted by exercising Central Excise Notification which explains all products of printing industry including newspapers and printed periodicals." A manufacturer, who is manufacturing cardboard cartons and subsequently doing varied printing on them, claims benefit of the said exemption notification on the ground that every material on which printing is done becomes a product of the printing industry. Is the claim of the manufacturer justified? Give reasons for your view.

Answer :

The cited Central Excise exemption notification grants full exemption to – "all products of printing industry including newspapers and printed periodicals". The products in respect of which exemption is claimed are cardboard, cartons although subsequently varied printing is done on them. These products relate to the packaging industry. The mere fact that printing is done on these products will not render these products as the products of the printing industry.

Accordingly, the products of the packaging industry shall not be entitled to the exemption granted to "all products of printing industry including newspapers and printed periodicals".The case in support is *Rollatainiers Ltd. v UOI* (1994) 72 ELT 793(SC).

Illustration 6.

How would you arrive at the assessable value for the purpose of levy of excise duty from the following particulars-cum-duty selling price exclusive of sales-tax ₹ 10,000 – Rate of excise duty applicable to the product : 10% — Trade discount allowed – ₹ 1,200 – Freight ₹ 750.

Answer :

In computation of assessable value for the purpose of Levy of excise duty, trade discount and freight are allowed as deductions.

Thus, —

Net price = Selling Price – (Trade Discount + Freight)

= ₹ 10,000 – (1,200 + 750)

= ₹ 8,050

Since the price is inclusive of excise duty @ 10%,

Therefore,—

$$\text{Assessable Value} = \frac{\text{Selling Price} \times 100}{100 + \text{Excise Duty}}$$

$$= \frac{8050 \times 100}{100 + 10}$$

= 7,318.18

Excise Duty will be ₹ 8,050 – 7,318.18 = ₹ 731.82

Check : 10% of ₹ 7,318.18 is ₹ 731.82.

Illustration 7.

X Ltd. is engaged in the manufacture of 'paracetamol' tablets that has an MRP of ₹ 9 per strip. The company cleared 1,00,000 tablets and distributed as physician's samples. The goods are not covered by MRP, but the MRP includes 10% Excise Duty and 2% CST. If the cost of production of the tablet is 40 paise per tablet, determine the total duty payable.

Answer :

If the product is not covered under MRP provisions, valuation provisions under section 4A do not apply. In that case, valuation is required to be done as per Central Excise Valuation Rules.

As per the CBEC's circular, any physicians samples or other samples distributed free of cost are to be valued under Rule 11 read with Rule 8 of Central Excise Valuation Rules, 2000.

As per Rule 8, such samples are to be valued at 110% of cost of production or manufacture. The given cost of production is 40 Ps, Assessable Value will be 44 Ps. Therefore, duty payable @ 10% on 46 paise = 10% × 0.46 = 0.046 paise per tablet.

Illustration 8.

M/s. A.U.L. avail of CENVAT credit of the duty paid on the inputs namely, steel sheets. The scrap generated during the manufacture of their final product was cleared by them without payment of duty. Subsequently the Department raised a demand of Excise duty on waste and scrap. M/s. A.U.L. accepted the duty liability, but contended that the price at which waste and scrap had been sold should be considered to be cum-duty price and assessable value should be determined after deducting the element of excise duty. The contention of the Department is that as no central Excise duty was paid by them while clearing the scrap, no deduction on account of excise duty is available to M/s. A.U.L.

Answer :

The facts of the given ease are similar to those decided by the Supreme Court in *C.C.Ex. v Maruti Udyog Ltd.* (2002) 141 ELT 3 (SC) in the said case, the department raised duty demand on waste and scrap and the price realized by the assessee was taken as the assessable value. The assessee contended that the price of such waste and scrap was includive of excise duty. The Supreme Court decided the issue in favour of the assessee. Accordingly, in the given case, as the Department has raised duty demand on waste and scrap, the price collected by M/s. A.U.L. will be considered as the cum-duty price and it shall be deemed that the element of excise duty is already included in such price. The manufacturer will therefore be entitled for deduction on account of such price. Thus the assessable value will be worker out as under –

$$\text{Assessable value} = \frac{\text{Cum - duty price} - \text{Permissible deduction} \times 100}{100 + \text{rate of duty}}$$

Illustration 9.

State whether the following elements are to be included or not as part of the 'Transaction value' under section 4 of the Central Excise Act, 1944.

(i) Erection and commissioning charges

(ii) System software etched in the computer system

(iii) Cylinder holding charges

(iv) After-sales warranty charges –

Answer :

(i) Any payment made by buyer to assessee is includible in assessable value only if it is in 'connection' with sale. In case of erection and commissioning charges for erecting machinery at site, these are incurred after goods are removed from the factory. These may be in 'relation' to sales but are not in 'connection' with sales as there is no 'cause and effect' relationship between the two. Hence these are not includable in assessable value. This is also confirmed *vide* CBE&C Circular No. 643/34/2002-CX, dated 1-7-2002.

(ii) A computer manufacturer loads bought out computer software on computer while selling. Thus, the system software is loaded on computer while computer is cleared from the factory. Computer software as such is exempt from duty. Department had earlier clarified that value of computer software etched or loaded on computer will be includible. However, if computer software is supplied separately on floppy disc or tapes, its value will not be includible. [However, as per CBE&C circular dated 28-2-2003, value of computer software will not be includible in assessable value of computer].

(iii) In case of durable and returnable containers, the container is returnable after the gas or other material inside is used. Often, manufacturing companies take some deposit and charge some rent for the container. These are 'cylinder holding charges'. CBE&C, *vide* its Circular No. 643/34/2002-CX, dated 1-7-2002, has clarified that rental charges or cost of maintenance of reusable metal containers like cylinders etc. are to be included in assessable value. This view is correct as such rental charges and the sale of gas are so intrinsically connected that there can be no sale without such charges.

(iv) Compulsory after sales warranty charges are includible as the sale goods and such charges are inseparable. However, optional service charges are not includable as there is no connection between the sale of goods and the optional service charges.

Illustration 10.

A Ltd., a manufacturer to tyres was extending a warranty discount on any tyres that, were defective. The scheme of warranty discount operated thus: the customers lodged their claim with-regard to any defects in the tyres. Such claims were then scrutinized by a Technical Committee of A Ltd., which would decide the amount of refund due to the customer on the basis of the reduction in the normal life of tyre attributable to the defect. This refund was to be given by the Technical Committee. This practice was being followed by A Ltd. for the last 15 years. A Ltd. claimed the 'warranty discount' as a Trade discount which is deductible in computing the assessable value of the tyres. Is this correct? Discuss in the light of the provisions under Section 4 of the Central Excise Act, 1944.

Answer :

According to section 4 of the Central Excise Act, 1944, regarding discounts, transaction value does not make a direct reference. Now actually the excise duty is paid/payable on the net price of the goods after deduction of discounts. If in any transaction discount is allowed in accordance with normal practice of trade and it is passed on to the buyer, tile inclusion of such discount is not justified. However, the said amount to be allowed as deduction must be in the nature of discount.

From the facts of the above case, the manufacturer was extending warranty discount on any tyres that were defective. Though this was known as discounts, but it was only a compensation for defects in tyres, which was given to the customers. Hence, it will not be allowed as deduction from the transaction value as was held in *GOI v MRF* (1995) 77 ELT 433(SC).

Illustration 11.

How would you arrive at the assessable value for the purpose of levy of excise duty from the following particulars :

- Cum-duty selling price exclusive of sales tax ₹ 20,000
- Rate of excise duty applicable to the product 10%
- Trade discount allowed ₹ 2,400
- Freight ₹ 1,500

Answer :

Trade discount of ₹ 2,400 and freight of ₹ 1,500 are allowed as deductions.

Hence, net price will be ₹ 16,100 [₹ 20,000 – 2,400 – 1,500].

Since the price is inclusive of excise duty of 10%, Excise Duty will be ₹ (16,100 × 10)/110 *i.e.* ₹ 1,463.64 and Assessable Value will be ₹ 14,636.36 [16,100 – 1,463.64]

Illustration 12.

M/s U.T.A. manufacture welding electrodes which are put first in Polythene bags and then packed together ill cardboard cartons. They sell electrodes at the factory gate packed in cardboard cartons whereas such electrodes are also packed in wooden boxes when sold to their customers located at outstations. Is the department justified to include the cost of wooden boxes in the assessable value of the welding electrodes? Discuss with the help of case laws, if any.

Answer :

The new Section 4 of the Central Excise Act, 1944, does not make any specific reference to packing charges. In normal commercial transactions the price of goods charged includes the cost of packing charges. The charges that are recovered on account of packing are obviously the charges in relation to sale of goods under assessment and will form the part of transaction value. Whatever be the nature of packing that is whether the packing is primary or secondary or special or packing for the purpose of transportation, the cost of such packing shall be includible.

In light of the new Section 4, the earlier case laws hold no significance now.

Illustration 13.

X Ltd. manufactures three health drinks viz. Slim, Trim, Prim, Slim was sold only to Y Ltd., a subsidiary company of X Ltd. Trim was sold to Z Ltd., where the Managing Director of X Ltd. is a Manager. Prim is sold to P Ltd. who are sole distributor of X Ltd., and was coming under the same management of X Ltd. Determine the assessable value/ transaction value of the three products in the hands of X Ltd. on the basis of the following information :

Price of X Ltd. to Y Ltd. ₹ 100

Price of X Ltd. to Z Ltd. ₹ 50

Price of X Ltd. to P Ltd. ₹ 20

Price of Y Ltd. to customer ₹ 120

Price of Z Ltd. to customer ₹ 60

Price of P Ltd. to customer ₹ 30

Answer :

As per Central Excise Valuation Rules, if goods are sold exclusively through a related person', the price at which goods are sold to unrelated person by the related person will be the transaction value for purposes of Central Excise. Product 'Slim' was sold exclusively to 'Y' where MD of the manufacturer is Manager. Hence, they are 'inter connected undertakings'. However, as per Rule 10 of Valuation Rules, inter connected undertakings are considered as 'related person' only if there is 'holding subsidiary' relationship. Since there is no such relationship, transaction value will be ₹ 50 only, *i.e.* price at which X sales to Z.

Product 'Prim' was sold to P. Since X and P are under same management, they are 'inter connected undertakings'. However, as per Rule 10 of Valuation Rules, inter connected undertakings are considered as 'related person' only if there is 'holding subsidiary' relationship. Since there is no such relationship, transaction value will be ₹ 20 only, i.e. price at which X sales to P.

Illustration 14.

M/s R.M.T. Industries manufactures cigarettes which are sold in wholesale, exfactory, at cum-duty price to wholesale dealers. The price charged to all the dealers from the cigarettes is the same. However, the dealers who purchase on credit are required to deposit interest free security with M/s R.M.T. The department has demanded duty from M/s R.M.T. contending that they had earned notional interest in the security deposit received from the dealers which should be included in the assessable value of the cigarettes being the additional consideration. Duty on cigarettes is being charged on advalorem basis. Discuss the stand taken by the department with decided case laws, if any.

Answer :

The facts of this case are similar to the case of *VST Industries Ltd. v C.C.Ex.* (1998) 97 ELT 395 (SC).

In the instant case the interest free deposit scheme was introduced by the assessee because of commercial consideration of covering the risk of credit sales, no special consideration flowing form the assessee to the buyer keeping tile deposit, the Supreme Court held that the notional interest cannot be included in the assessable value.

Illustration 15.

Z Ltd. is a small-scale industrial unit manufacturing a product X. The Annual report for the year 2008-09 of the unit shows a gross sale turnover of ₹ 1,91,40,000. The product attracted an excise duty rate of 10% as BED and Sales Tax 10%. Determine the duty liability under Notification Nos. 8/2001 and 9/2001 meant for SSI units.

Answer :

(A) Duty payable under Notification No. 9/2001-CE (Now 9/2002-CE)

Under excise Notification No. 9/2001-CE, an SSI unit is required to pay 60% of normal duty (*i.e.* 6% duty) on first ₹ 100 lakhs and 10% on the balance. The assessee can avail Cenvat credit on all the inputs. Since the example gives gross sale turnover, it is first necessary to find net sales turnover.

In respect of first net turnover of ₹ 100 lakhs (₹ 1,00,00,000), excise duty will be ₹ 6,00,000. Sales tax @ 10% is payable on net turnover *plus* excise duty *i.e.* on ₹ 1,06,00,000, sales tax @ 10% will be 10,60,000.

Therefore, balance gross sale turnover will be ₹ 74,80,000 [₹ 1,91,400,00 – 1,16,60,000]. This includes excise duty at 10% and sales tax @ 10%.

Sales tax is payable on cum duty price. If Net turnover for excise purposes is 'Z', the gross sale turnover will be as follows :

Net Turnover	= Z
Duty @ 10%	= 0.10 × Z
Sub-Total	= 1.10 × Z
Add : Sales Tax @ 10%	= 0.11 × Z
Total price (*i.e.* inclusive of duty and sales tax)	= 1.21 × Z

Now :

1.21 × Z = ₹ 74,80,000.00

Hence, Z = ₹ 61,81,818.18

This can be checked as follows:

Net turnover = ₹ 61,81,818.18

Excise duty @ 10% = ₹ 6,18,181.82

Sub-Total = ₹ 68,00,000.00

Add: Sales Tax @ 10% = ₹ 6,80,000.00

Gross Selling Price = ₹ 74,80,000.00

Therefore, —

Excise duty paid on first net turnover of ₹ 1,00,00,000	= ₹ 6,00,000
Excise duty on subsequent Turnover of ₹ 6,18,181.18	= ₹ 6,18,181.82
Total excise duty paid	= ₹ 12,18,181.82
This can be checked as follows :	
Total Net turnover	= ₹ 1,61,81,818.18
Total Excise Duty	= ₹ 12,18,181.82
Sales tax @ 10% on Net turnover plus Excise duty (*i.e.* on ₹ 1,74,00,000) [1,61,81,818.18 + 12,18,181.82]	= ₹ 17,40,000
Therefore, Gross sales turnover	= ₹ 1,91,40,000

(B) Duty payable under Notification No. 8/2001-CE (Now 8/2002-CE)

Under excise Notification No. 8/2001-CE, an SSI unit is exempt from duty on first ₹ 100 lakhs and duty payable on balance amount is 10%. The assessee can avail Cenvat credit on inputs after it crosses turnover of ₹ 100 lakhs. Since the example gives gross sale turnover, it is first necessary to find net sales turnover.

In respect of first net turnover of ₹ 100 lakhs (₹ 1,00,00,000), excise duty will be Nil. Sales tax @ 10% will be payable on net turnover on ₹ 1,10,00,000. Sales tax @ 10% will be 10,00,000.

Accordingly, gross sale turnover in respect of first net turnover of 100 lakhs (where excise duty is not paid) will be ₹ 1,10,00,000.

Therefore, balance gross sale turnover will be ₹ 81,40,000 [₹ 1,91,40,000 – 1,10,00,000]. This includes excise duty at 10% and sales tax @ 10%.

Sales tax is payable on cum duty price. If Net turnover for excise purposes is 'Z', the gross sale turnover will be as follows :

Net Turnover	=	Z
Duty @ 10%	=	0.10 × Z
Sub-Total	=	1.10 × Z
Add: Sales Tax @10%	=	0.11 × Z
Total price (*i.e.* inclusive of duty and sales tax)	=	1.21 × Z

Now :

1.21 × Z = ₹ 81,40,000.00

Hence, Z = ₹ 67,27,272.73

This can be checked as follows:

Net turnover = ₹ 67,27,272.73

Excise duty @ 10% = ₹ 6,72,727.27

Sub-Total = ₹ 74,00,000.00

Add: Sales Tax @ 10% = ₹ 7,40,000.00

Gross Selling Price = ₹ 81,40,000.00

Hence,—

Excise duty paid on first net turnover of ₹ 1,00,00,000	=	Nil
Excise duty on subsequent of ₹ 67,27,272.73	=	₹ 6,72,727.27
Total excise duty paid	=	₹ 6,72,727.27

This can be checked as follows:

Total Net turnover	=	₹ 1,67,27,272.73
Total Excise Duty	=	₹ 6,72,727.27
Sales tax @ 10% on Net turnover *plus* Excise duty *i.e.* on ₹ 1,74,00,000 (1,67,27,272.73 + 6,72,727.27)	=	₹ 17,40,000.
Hence, Gross sales turnover [1,74,00,000 + 17,40,000].	=	₹ 1,91,40,000

Illustration 16.

B Ltd. manufactures two products namely, Eye Ointment and Skin Ointment. Skin Ointment is a specified product under section 4A of Central Excise Act, 1944. The sales prices of both the products are at ₹ 43/unit and ₹ 33/unit respectively. The sales price of both products included 10% excise duty as BED and 8% excise duty as SED. It also includes CST of 2%. Additional information is as follows –

Units cleared: Eye Ointment: 1,00,000 units

Skin Ointment: 1,50,000 units

Deduction permissible under section 4A: 40%

Calculate the total excise duty liability of B Ltd., on both the products.—

Answer :

Duty on eye ointment and skin ointment is required to be calculated separately.

Duty on Eye ointment :

Let us assume that Assessable Value of Eye Ointment is Z.

Assessable Value	=	Z
Duty @ 18% [Basic 10% + Special 8%]	=	0.18 × Z
Sub-Total	=	1.18 × Z
Add: Central Sales Tax @ 2%	=	0.0236 × Z
Total price (*i.e.,* inclusive of duty and sales tax)	=	1.2036 × Z

Now:

1.2036 × Z = ₹ 43.00

Hence, Z = ₹ 35.73

This may be checked as follows:

Assessable Value per unit	=	₹	35.73
Excise duty @ 18%	=	₹	6.43
Sub-Total	=	₹	42.16
Add: Sales Tax @ 2%	=	₹	0.84
Total price	=	₹	43.00

Excise duty payable per unit of eye ointment is ₹ 6.43

Total quantity cleared is 1,00,000.

Hence, total excise duty on eye ointment will be ₹ 6,43,000.

Duty on skin ointment

Since the product is covered under section 4A, Assessable Value is required to be calculated after deducting abatement @ 40%.

The MRP is ₹ 33 and abatement is 40%.

Therefore, Assessable Value (after allowing deduction @40%) will be ₹ 19.80

Excise duty payable per unit @ 18% will be ₹ 3.56.

Total quantity cleared is 1,50,000 units.

Accordingly, total duty payable on skin ointment (basic plus special) will be ₹ 5,34,000

Illustration 17.

Determine the value on which Excise duty is payable in the following instances. Quote the relevant section/rules of Central Excise Law.

(a) A. Ltd. sold goods to B Ltd., at a value of ₹ 100 per unit, In turn, B Ltd. sold the same to C Ltd. at a value of ₹ 110 per unit. A Ltd. and B Ltd. are related, whereas B Ltd. and C Ltd. are unrelated.

(b) A Ltd. and B. Ltd. are inter-connected undertakings, under section 2(g) of MRTP Act. A Ltd. sells goods to B Ltd. at a value of ₹ 100 per unit and to C Ltd. at ₹ 110 per unit, who is an independent buyer.

(c) A Ltd. sells goods to B Ltd. at a value of ₹ 100 per unit. The said goods are captively consumed by B Ltd. in its factory. A Ltd. and B Ltd. are unrelated. The cost of production of the goods to A Ltd. is ₹ 120 per unit.

(d) A Ltd. sells motor spirit to B Ltd. at a value of ₹ 31 per litre. But motor spirit has administered price of ₹ 30 per litre, fixed by the Central Government.

(e) A Ltd. sells to B Ltd. at a value of ₹ 100 per unit. B Ltd. sells the goods in retail market at a value of ₹ 120 per unit. The sale price of ₹ 100 per unit is wholesale price of A Ltd. Also, A Ltd. and b Ltd. are related.

(f) Depot price of a company are –

Place of removal	**Price at depot on 1-1-2009**	**Price at depot on 31-1-2009**	**Actual sale price at depot on 1-2-2009**
Amritsar Depot	₹ 100 per unit	₹ 105 per unit	₹ 115 per unit
Bhopal Depot	₹ 120 per unit	₹ 115 per unit	₹ 125 per unit
Cuttack Depot	₹ 130 per unit	₹ 125 per unit	₹ 135 per unit

Additional information : (i) Quantity cleared to Amritsar Depot – 100 units (ii) Quantity cleared to Bhopal Depot – 200 units (iii) Quantity cleared to Cuttack Depot – 200 units (iv) The goods were cleared to respective depots on 1-1-2009 and actually sold at the depots on 1-2-2009.

Answer :

(a) Transaction value ₹ 110 per unit (Rule 9 of Transaction value Rules). [Sale to unrelated party].

(b) Transaction value ₹ 100 per unit for sale to B and ₹ 110 for sale to C – Rule 10 read with Rule 4 [Note that inter connected undertaking will be treated as 'related persons' for purpose of excise valuation only if they are 'holding and subsidiary' or are 'related person' as per any other part of the definition of 'related person'. Note that A is selling directly to C as per the question, and not through B Ltd].

(c) Transaction value will be ₹ 100. – section 4(1)—Incase of sale to unrelated person, question of cost of production does not arise.

(d) Transaction value ₹ 31. – section 4. – Since the goods are actually sold at this price, administered price is not considered.

(e) Transaction value ₹ 120 per unit – Rule 9 read with section 4 of Central Excise Act. Sale to an unrelated buyer. [Under new rules, there is no concept of 'wholesale price and retail price']

(f) Under Rule 7, the price prevailing at the Depot on the date of clearance from the factory will be the relevant value to pay Excise duty.

Therefore –

(i) Clearance to Amritsar depot will attract duty based on the price as on 1-1-2009. Transaction value ₹ 110 × 100 units = ₹ 11,000

(ii) Clearance to Bhopal depot. Depot price on 1-1-2009 Transaction value ₹ 120 × 200 units = 24,000

(iii) Clearance to Cuttack Depot. Depot price on 1-1-2009. Transaction value ₹ 130 × 200 units = ₹ 26,000. Note The relevant date is 1-1-2009, since the goods were cleared to the depots on that date. No additional duty is payable even if goods are later sold from depot at higher price.

Illustration 18.

Determine the transaction value and the Excise duty payable from the following information : (i) Total Invoice Price ₹ 18,000; (ii) The Invoice Price includes the following :

(a)	Sales-tax	₹ 1000
(b)	Surcharge on ST	₹ 100
(c)	Octroi	₹ 100
(d)	Insurance from Factory to depot	₹ 100
(e)	Freight from factory to depot	₹ 700
(f)	Rate of Basic Excise duty	10% ad valorem
(g)	Rate of Special excise duty	24% ad valorem

Answer :

Let us assume that the Invoice Price of ₹ 18,000 is depot price. Thus, deduction of insurance and transport charges from factory to depot will not be available.

The deductions available will be :

- Sales Tax ₹ 1,000.
- Surcharge on Sales Tax ₹ 100 and
- Octroi ₹ 100

Thus, net price excluding taxes on final product (but inclusive of excise duty) will be ₹ 16,800.

The rate of excise duty is 34% [10% basic plus 24% special].

Hence, duty payable is as follows –

$$\frac{16{,}800 \times 34}{134} = 4{,}263$$

Assessable Value = 16,800 – 4,263 = ₹ 12,537

Check : Excise duty payable (basic plus special) is 34% of ₹ 12,537 i.e. ₹ 4,263.

Illustration 19.

Having regard to the provisions of section 4 of the Central Excise Act, 1944, compute/derive the assessable value of excisable goods, for levy of duty of excise, given the following information :

	₹
Cum-duty wholesale price including sales tax of ₹ 2,500	15,000
Normal secondary packing cost	1,000
Cost of special secondary packing	1,500
Cost of durable and returnable packing	1,500
Freight	1,250
Insurance on freight	200
Trade discount (normal practice)	1,500
Rate of C.E. duty as per C.E. Tariff	10% Advalorem

State in the footnote to your answer, reasons for the admissibility or otherwise of the Deductions.

Answer :

The assessable value from cum-duty price can be worked out by the under-mentioned formula.

$$\text{Assessable value} = \frac{\text{Cum - duty price} - \text{Permissible deduction} \times 100}{100 + \text{rate of duty}}$$

Computation of Assessable value

		₹	₹
	Cum-duty price		15,000
Less :	Deductions (See Notes)		
	Sales tax	2,500	
	Durable & returnable-packing	1,500	
	Freight	1,250	
	Insurance	200	
	Trade-Discount	1,500	6,950
			8,050
	Less: Central Excise Duty thereon @ 10% Advalorem 8,050 × 10/110		732
	Assessable value		7,318

Notes :

1. The transaction value does not include Excise duty, Sales tax and other taxes.
2. The Excise duty is to be charged on the net price, hence trade discount is allowed as deduction.
3. With regards to packing, all kinds of packing except durable and returnable packing is included in the assessable value. The durable and returnable packing is not included as the such packing is not sold and is durable in nature.
4. Freight and insurance on freight will be allowed as deduction only if the amount charged is actual and it is shown separately in the invoice as per Rule 5 of the Central Excise Valuation Rules, 2000.

Illustration 20.

Explain whether the following items can be included in/excluded from the transaction value under section 4 of the Central Excise Act, 1944.

(1) Collection expenses incurred in respect of empty bottles for filling aerated waters from the premises of buyers to the manufacturers.

(2) Delivery and collection charges of gas cylinders and collection of empty cylinders.

(3) Interest notional or real accruing on deposits for sale/return of gas cylinders as well as rentals.

(4) Cash discount known at the time of clearance of goods but not availed by the customer.

(5) Value of system software in case of computers.

Answer :

(1) Transaction value includes any amount charged in addition to the price of the goods by reason of or in connection with the sale. Since collection expenses are incurred by reason of or in connection with the sale, it would be included in the transaction value.

(2) CBEC has vide Circular No. 643/34/2002, dated 1-7-2002 clarified that delivery and collection charges of gas cylinders are by reason of or in connection with the sale of goods and therefore, the same would be included in the transaction value.

(3) The interest on advances taken from the customers would not be included in the assessable value, unless the receipt of such advance had no effect of depressing the wholesale price.

In *VST Industries Ltd. v C.C.Ex, Hyderabad* 1998 (97) ELT 395(SC), where interest free deposits were taken because of commercial consideration of covering the risk of credit sales, no special consideration flowing from the assessee to the buyer keeping the deposit was found and the Supreme Court held that notional interest cannot be included in the assessable value.

(4) However, in such case, the burden of proof lies on the Department to prove a nuxus between the fact of advance taken and the depression in the value.

(5) The transaction value is the price actually paid or payable for the goods. In the given situation, as the case of cash discount has not been passed on to tile customer, it will not be allowed as deduction.

As per tile CBEC & Circular No. 644/35/2002-CX, dated 12-7-2002 the Software can

be of the following types –

Systems software/Operating software – which is designed to control the operation of the computer system.

Application software – Which is developed for specific applications only.

Valuation of goods is done in the form in which it is cleared. Therefore, computer *systems* will be valued by including the value of the software loaded on the hard disc. No distinction is to be made between an ‘operating software’ and an ‘application software’.

Illustration 21.

Thunder TV Ltd is engaged in the manufacture of colour television sets having its factories at Bangalore and Pune. At Bangalore the company manufactures picture tube; which are stock transferred to Pune factory where it is consumed to produce television sets. Determine the Excise duty liability of the captively consumed picture tubes from the following information :

Direct material cost (per unit)	₹ 600
Indirect material	₹ 50
Direct Labour	₹ 100
Indirect Labour	₹ 50
Direct Expenses	₹ 100
Indirect Expenses	₹ 50
Administrative overheads	₹ 50
Selling and Distribution overheads	₹ 100

Additional Information :

1. Profit margin as per the Annual Report for the company for 2008-2009 was 15% before income tax.
2. Material cost includes Excise duty paid ₹ 100.
3. Excise duty rate applicable is 10%.

Answer :

As per Rule 8 of The Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, the valuation of captively consumed goods is 110% of the cost of production. The cost of production of goods would include cost of material, labour cost and overheads including administration cost and depreciation etc.

The cost of material would be net of excise duty if CENVAT credit is availed in respect of such inputs.

Accordingly, the assessable value will be determined as follows :

Raw materials Cost (net of excise duty)	₹	500
Indirect material	₹	50
Direct Labour	₹	100
Indirect Labour	₹	50
Direct Expenses	₹	100
Indirect Expenses	₹	50
Administrative overheads	₹	50
Total cost of production	₹	900
Assessable value	₹	990
(*i.e.* 110% of the cost of production)		
Excise duty @ 10%	₹	99
Education Cess @ 2%	₹	1.98
SHEC @ 1%	Re.	0.99

∴ Total Duty Liability = ₹ (99 + 1.98 + 0.99) = ₹ 101.97

The raw material cost has been taken at ₹ 500 after deducting the duty element assuming that the CENVAT credit has been availed.

Illustration 22.

Mrs. E fails to pay Excise Duty of ₹ 60,000 on the goods cleared in February by 5th March of 2009. The assessee, Mrs. E, is owner of a SSI unit. What is the interest payable under Rule 8 of Central excise Rules, 2002 if the duty was actually paid on 10th May of 2009?

Answer :

The default period is 2 months and 5 days. It is for 64 days (26 days of March, 30 days of April and 10 days of May 2009). The interest payable is 2% for every month or ₹ 1,000 per day, whichever is more, subject to maximum of duty payable.

(A) Interest @ 2% per month on ₹ 60,000 will be ₹ 1,200. Since default is for 2 months and 5 days, *i.e.* 2.161 months [2 + 5/31], interest will be ₹ 2,593.20.

(B) Minimum interest @ ₹ 1000 per day of default will be ₹ 64,000.

Greater of (A) & (B) = ₹ 64,000

However this is subject to maximum of duty which is ₹ 60,000.

Hence interest payable will be ₹ 60,000.

Illustration 23.

From the following data, determine the CENVAT allowable if the goods are produced or manufactured in a FTZ or by a 100% EOU and used in any other place in India.

Assessable value : ₹ 770 per unit,
Quantity cleared 77,770 units,
BCD— 30%,
CVD – 16%

Answer :

As per Rule 3 of CENVAT Credit Rules, 2002 the following formula is to be used if a unit in DTA purchases goods from EOU –

CENVAT = 50% of Assessable value × {[1 + BCD/100] × CVD/100}

Hence, CENVAT Available per unit is as follows –

CENVAT = 0.50 × 770 x {[1 + 30/100] × 16/100}
= 385 {1.30 × .16}
= 385 × 0.208 = ₹ 80.08 per unit

Hence, CENVAT allowable on 77,770 units = 77,770 × 80.08 = ₹ 62,27,821.60

Illustration 24.

H Ltd. purchased a Boring-Drilling machine at a cum-duty price of ₹ 32,14,476. The Excise duty rate charged on the said machine was @ 10%. The machine was purchased on 1-4-2007 and disposed of on 30-9-2008 for a price of ₹ 12 lakhs. The company was claiming depreciation @ 25% following Straight Line Method.

Using the said information, answer the following questions :

(i) What is the Excise duty paid on the machine?
(ii) What is the Cenvat credit allowable under Cenvat Rules?
(iii) What is the amount of Cenvat credit reversible or duty payable at the time of clearance of the said machinery?

Answer :

Cum-duty price ₹ 32,14,476

Hence, Basic Price *i.e.* Assessable value = 32,14,476 × 100/110 = ₹ 29,22,250

Excise duty paid = ₹ 2,92,225, *i.e.* 10% of ₹ 29,22,250.

As per Cenvat Rules, 50% Cenvat credit can be availed in current financial year an balance 50% of Cenvat is allowable only in following financial year, if the capital Goods are in possession and use.

Since the Capital goods were in use for six months in the year 2007-08, Cenvat of balance 50% is allowable. Cenvat allowable in the year 2006-07 ₹ 1,46,112.50 and Cenvat allowable in the year 2007-08 ₹ 1,46,112.50.

As per Cenvat Credit Rules (as applicable upto 28-2-2003), an 'amount' equal to duty payable at the rate and value as applicable on the date of removal is payable.

Hence, 'amount' payable at the time of disposal on 30-9-2008 is ₹ 12,00,000 × 10/100 *i.e.* ₹ 1,20,000.

It may be noted that w.e.f. 1-3-2003, the Cenvat Credit Rules had been amended, and an 'amount' equal to Cenvat credit availed on goods is payable. Hence, in this case, an amount of ₹ 2,92,225 would have been payable, if clearance was after 1-3-2003.

Illustration 25.

Prepare a Cenvat account in the books of A Ltd., and determine the balance as on 30-9-2009 from the following data :-

Opening balance as on 1-4-2009 ₹ 47,000.

Inputs received on 04-04-2009 involving excise duty paid ₹ 14,747

Purchased a lathe for ₹ 1,16,000-cum duty price @ excise duty rate of 10% on 5-4-2009 and received the lathe into the factory on 5-12-2009.

On 6-4-2009 paid excise duty on final products @ 10% through Cenvat A/c (cum duty price of the goods ₹ 2,32,000).

Inputs cleared as such to a job worker on 1-4-2009 not returned in 180 days, quantity 1,000 Kgs; Asssessable value ₹ 2 lacs; ED @ 10% of the above, 50% of the inputs were received on 1-10-2009.

Common inputs were used in a product, which was exempted from payment of duty cleared at a price of ₹ 100/unit, which included taxes of ₹ 20/unit ; quantity cleared 1,000 units.

On 7-4-2009 duty paid on inputs amounting to ₹ 17,867 was taken credit for in the Cenvat A/c as ₹ 17,687.

Answer :.

CENVAT Credit Receivable Account in the Books of A Ltd., as on 30-9-2009

Date	Particulars	Debit (₹)	Credit (₹)
1-4-2009	To Opening Balance	47,000	
4-4-2009	To Sundry Creditors	14,747	
6-4-2009	By Excise duty paid on Final product		21,091
7-4-2009	To Sundry Creditors	17,687	
30-9-2009	To Sundry Creditors (Credit short taken on 7-4-2002)	180	
30-9-2009	By Reversal of Cenvat Account (8% Amount on Exempted goods)		6,400
30-9-2009	By Reversal of Cenvat Account (Amount equal to duty on inputs not returned within 180 days)		20,000
	By Balance Carry Forward		32,123

Notes :

(i) Since capital goods (lathe) was received only on 5-12-2009, the credit is permissible only on 5-12-2009 and not before that date.

(ii) When 50% of inputs are received on 1-10-2009 (sent on job work), the credit is allowable for 50% only on 1-10-2009.

(iii) Where goods are exempted, an 'amount' is payable @ 8% on sale price less taxes.

(iv) For wrong amount of credit, rectification entry is passed.

(v) The 'amount' paid on 30-9-2009 is reversal of Cenvat credit. It is not 'excise duty'. Hence, a separate account 'Reversal of Cenvat Account' or "Payment of 'Amount' under Central Excise Rules" may be opened. At the year end, the balance may be transferred to expenses account. Strictly legally, it is not 'excise duty' paid.

Illustration 26.

M/s Tips and Toes Ltd., manufactures four types of "Nail Polishes", namely Sweetly, Pretty, Beauty, Tweety. The company has availed CENVAT credit of ₹ 4,00,000 on the common inputs used in the manufacture of 'Nail Polishes'. During the financial year 1999-2000, the company manufactured 1000 litres of each type of 'Nail Polishes". The CENVAT availed input was used in equal proportion in all the four types of the products. Calculate the CENVAT credit amount not available or amount payable under CENVAT Rules 57AA read with 57AD of CENVAT Rules of Central Excise, using the following additional data :

Product	Nature of Sale	Sale price excluding Sales Tax & other local taxes
Sweety	Sale to Home Consumption	₹ 30 per 20 ml bottle
Pretty	Sold to a 100% EOU	₹ 40 per 20 ml bottle
Beauty	Fully exported	₹ 50 per 20 ml bottle
Tweety	Supplied to Defence Canteen under exemption	₹ 60 per 20 ml bottle

Answer :

Cenvat credit is available in respect of the products Sweety (Home Consumption), Pretty (sale to EOU) and Beauty (Goods exported). However, Cenvat credit is not available in respect of goods cleared for home consumption under exemption notification. Thus, Cenvat credit is not available in respect to 'Tweety' *i.e.* goods supplied to defence canteen under exemption.

Assessee has two options –

(a) Maintain separate records right from receipt stage in respect of inputs used in 'Tweety'.

(b) If this is not possible, pay an amount of 8% on the exempted goods.

In this case, since the inputs are common, it is assumed that assessee was not in a

position to maintain separate records. The price of goods is ₹ 60 per 20 ml bottle *i.e.*₹ 300 per 100 ml, *i.e.* ₹ 3,000 per 1000 ml, *i.e.* ₹ 3,000 per litre. Thus, total value of goods is 1,000 liters x 3,000 *i.e.* ₹ 30,00,000.

Therefore, he is required to pay 8% of ₹ 30,00,000 *i.e.* ₹ 2,40,000.

Illustration 27.

A manufacturer brings some inputs valued at ₹ 25,000 on which duty of ₹ 5,000 has been paid @ 20%. Subsequently, the manufacturer sold the input as such, which goods he sold for ₹ 30,000. What is the duty payable by the manufacturer if –

1. Rate of duty on the date of clearance on inputs was 25%.
2. Rate of duty on the date of clearance on input was 10%.

Answer :

CENVAT Credit Rules, 2002, provide that in case the inputs are removed as such then the removal of such goods will be under cover of Invoice and the manufacturer will have to pay duty as if the inputs are manufactured in his premises.

Hence, in –

Case 1 : The duty payable by the manufacturer will be 25% of ₹ 30,000 = ₹ 7,500

Case 2 : The duty payable by the manufacturer will be 10% of ₹ 30,000 = ₹ 3,000

However, the Finance Bill, 2003 has amended CENVAT credit Rules, 2002. As per the amended Rule 3(4), now if the inputs are removed as such, the manufacturer will have to pay excise duty equal to the credit availed in respect of such inputs.

Therefore, as per the amendment the duty payable in both the above cases will be ₹ 5,000.

Illustration 28.

ABC and Co. are manufacturing the products specified below from excise duty paid high density polyethylene granules. Part of the goods are captively consumed and other part of the goods cleared for home consumption in India and for export to Bhutan and United Kingdom. The effective rate of duty, and the value of clearances during the preceding year 2007-08, and the current assessment period 2008-2009 are as follows –

1. Rate of duty —

   Product 'A' – 10%. Product 'B' – 10%. Product 'C' (Waste & Scrap) – Exempt from duty.

2. Value clearances in 2007-08 –

   Product 'A' –

   (a) Clearance for home consumption – ₹ 130 Lakhs.
   (b) For captive consumption in the manufacture of excisable goods – ₹ 135 lakhs.
   (c) Exports to Bhutan – ₹ 35 lakhs
   (d) Exports to UK under bond – ₹ 100 lakhs

   Product 'B' —

   (a) Clearance for home consumption – ₹ 80 lakhs
   (b) For captive consumption in the manufacture of excisable goods – Nil
   (c) Exports to Bhutan – ₹ 50 lakhs.
   (d) Exports to UK under bond – ₹ 200 lakhs.

   Product 'C' –

   (a) Clearance for home consumption – ₹ 40 lakhs
   (b) For captive consumption in the manufacture of excisable goods – ₹ 20 lakhs.
   (c) Exports to Bhutan – Nil
   (d) Exports to UK – Nil

3. Value of clearances during current year *i.e.* 2008-09 —

   Product 'A' –

   (a) Clearance for home consumption – ₹ 50 lakhs.
   (b) For captive consumption in the manufacture of excisable goods – ₹ 40 laksh
   (c) exports to Bhutan – Nil
   (d) Exports to UK under bond – ₹ 50 lakhs.

   Product 'B' –

   (a) Clearance for home consumption – ₹ 80 lakhs
   (b) For captive consumption in the manufacture of excisable goods – Nil
   (c) Exports to Bhutan – ₹ 50 lakhs.
   (d) Exports to UK under bond – ₹ 100 lakhs.

Product 'C' –

(a) Clearance for home consumption – ₹ 50 lakhs.

(b) For captive consumption in the manufacture of excisable goods – Nil

(c) Exports to Bhutan – ₹ 50 lakhs.

(d) Exports to UK under bond – ₹ 100 lakhs.

Advise the manufacturers as to whether they are entitled to small scale exemption and the amount of excise duty payable for their clearances during 2008-09, if the assessee intends to avail Cenvat credit.

Answer :

Turnover in 2007-08 for purpose of considering SSI exemption limit is as follows –

Product A – ₹ 165 lakhs [130 + 35]

Product B – ₹ 130 lakhs [80 + 50]

Product C – ₹ 20 lakhs.

If final product is exempt from duty, the goods used for captive consumption are liable to duty.

Therefore, total turnover during 2007-08 is ₹ 315 lakhs.

Since total turnover exceeds ₹ 300 lakhs, the assessee is not entitled to any exemption in 2008-09 and has to pay full normal duty @ 10%.

Whether assessee avails or does not avail Cenvat credit does not affect the turnover limit of ₹ 300 lakhs.

Illustration 29.

The value of excisable goods viz. Iron and Steel articles manufactured by M/s. Alpha Ltd., was ₹ 120 lakhs during the financial year 2008-09. The goods attract 10% ad valorem duty. Determine the excise duty liability when the assessee opts for 'CENVAT' and 'opts for not to avail CENVAT' under SSI exemption notifications respectively.

Answer :

If the assessee does not avail Cenvat, duty will payable will be ₹ 3.2 lakhs. [Nil for first 100 lakhs and ₹ 2.00 lakhs for subsequent ₹ 20 lakhs]. If assessee avails Cenvat credit, duty payable will be ₹ 11.8 lakhs (₹ 6.00 lakhs on first ₹ 100 lakhs and ₹ 2.00 lakhs on balance ₹ 20 lakhs)

Illustration 30.

M/s NML, a unit registered as a small scale unit, manufactures coloured television sets under the brand name "SONY" in India, which brand name is owned by a Foreign Company. M/s NML has the exclusive right to use the Brand name "SONY" in India.

Explain briefly with reference to Notifications governing Small Scale Industrial Undertakings under the Central Excise Act, 1944 and the Rules, whether the manufacturer in this case M/s NML is entitled to the benefit of the exemption as applicable to small scale industrial undertakings.

Answer :

The benefit of SSI exemption is not applicable incase an SSI unit is manufacturing under the brand name or trade name of another person whether registered or not.

In the present case, since NML is manufacturing the TV sets under the brand name of "Sony", it will not be entitled for the benefit of SSI exemption.

Case in support is *Namtech Systems Ltd. v C.C.Ex, (Tribunal).*

Illustration 31.

M/S RPL has three units situated in Bangalore, Delhi and Pune. The total clearances from all these three Small Scale units of excisable goods was ₹ 350 lakhs during the financial year, 2007-2008. However, the value of individual clearances of excisable goods from each of the said units was Bangalore Unit ₹ 150 lakhs; Delhi Unit ₹ 100 lakhs; and Pune Unit ₹ 1000 lakhs.

Discuss briefly with reference to the Notifications governing small scale industrial undertakings under the Central Excise Act, 1944 whether the benefit of exemption would be available to M/s RPL for the financial year, 2008-2009.

Answer :

Any SSI unit whose turnover was less than ₹ 3 crore in the previous year is entitled for exemption irrespective of their investment in plant & machinery or number of employees.

Where the manufacturer has more than one factory, the turnover of all factories will have to be clubbed together for the purpose of calculating the SSI exemption limit of ₹ 300 lakhs.

Since in the above case, the total value of clearances during the preceding financial year 2007-2008 is 350 lakhs, hence it will not be entitled for the SSI benefit.

Illustration 32.

An assessee has factory in Kolkata. As a sales policy, he has fixed uniform price of ₹ 2,000 per piece (excluding taxes) for sale anywhere in India. Freight is not shown separately in his invoice. During F.Y. 2008-09, he made following sales – (i) Sale at factory gate in Kolkata – 1,200 pieces – no transport charges (ii) Sale to buyers in Gujarat – 600 pieces –actual transport charges incurred – ₹ 28,000 (iii) Sale to buyers in Bihar – 400 pieces – actual transport charges incurred – ₹ 18,000 (iv) Sale to buyers in Kerala – 1,000 pieces – Actual transport charges – ₹ 54,800. Find assessable value.

Answer :

The total pieces sold are 3,200 (1,200 + 600 + 400 + 1000). The actual total transport charges incurred are ₹ 1,00,800 (Nil + 28,000 + 18,000 + 54,800). Thus, equalized (averaged) transport charges per piece are ₹ 31.50. Hence assessable value will be ₹ 1968.50 (₹ 2,000 – ₹ 31.50). This will apply to all 3,200 pieces sold by the manufacturer.

Illustration 33.

1,500 pieces of a product 'A' were manufactured during the financial year. Its list price (i.e. retail price) is ₹ 250 per piece, exclusive of taxes. The manufacturer offers 20% discount to wholesalers on the list price. During the year, 840 pieces were sold in wholesale, 510 pieces were sold in retail, 35 pieces were distributed as free samples. Balance quantity of 115 pieces was in stock at the end of the year. The rate of duty is 10% plus education cess and SAH education cesses as applicable. What is the total duty paid during the financial year?

Answer :

Assume that the manufacture is not eligible for SSI concession.

The total selling price is as follows –

Qty	Price	Total
510	250	1,27,500
840	200	1,68,000
35	200	7,000
Total		3,02,500

Duty payable is 10% of ₹ 3,02,500 i.e. ₹ 30,250, plus education cess @ 2% i.e. ₹ 605.00 plus SAH education cess @ 1% is ₹ 302.50.

***Note* :**

(a) Since 115 pieces were in stock at year end, no duty will be payable. Duty will be payable only when goods are cleared from factory.

(b) In case of samples, as per rule 4 of Valuation Rules, value nearest to the time of removal, subject to reasonable adjustments is required to be taken. However, since prices are varying, value nearest to the time of removal may not be ascertainable and will not be acceptable for valuation as the prices are changing. In such case, recourse will be taken to rule 11 of Valuation Rules, i.e. best judgment assessment. We can take recourse to rule 7 and 9 where principle of 'normal transaction value' is accepted, when prices are varying. As per rule 2(b) of Valuation Rules, 'normal transaction value' means the transaction value at which the greatest aggregate quantity of goods are sold. Since greatest quantity of 840 pieces are sold at ₹ 200, that will be 'normal transaction value', which can be taken for valuation of free samples. A manufacturer has appointed brokers for obtaining orders from wholesalers. The brokers procure orders for which they get brokerage of 5% on selling price. Manufacturer sells goods to buyers at ₹ 250 per piece. The price is inclusive of State Vat and Central excise duty. State Vat rate is 4% and excise duty rate is 10% plus education cess and SAH education cess as applicable. What is the AV, and what is duty payable per piece?

Assume that Assessable Value = x. No deduction is available in respect of brokerage paid to third parties from Assessable Value.

Since Excise duty is 10%, education cess is 2%, SAH education cess is 1% and State Vat rate is 4%, price including excise will be 1.103x.

State Vat @ 4% of 1.103x is 0.04412x. Hence, price inclusive of sales tax and excise duty will be 1.14712x.

Now,	1.14712x	= ₹ 250.00
Hence,	x	= ₹ 217.94
Check the answer as follows –		
Assessable Value		= ₹ 217.94
Add duty @ 10.30% of ₹ 206.37		= ₹ 22.45
Add State Vat @ 4% on ₹ 240.39 (217.94+22.45)		= ₹ 9.62
Total Price (Including duty and tax) (217.94+22.45+9.62)		= ₹ 250.00

Illustration 34.

Find Assessable Value and duty payable. The product is not covered under section 4A. Maximum Retail Trade Price : ₹ 1,100/- per unit. - State Vat, Octroi and other Local Taxes : 10% of net price- Cash Discount : 2% - Trade Discount: 10% - Primary and Secondary packing cost included in the above MRP : ₹ 100 - Excise duty rate : 8% ad valorem plus education cesses as applicable.

Answer :

Cash discount ₹ 22 (2% of ₹ 1,100) and trade discount 88 [8% of ₹ 1,100] are available as deduction. Packing cost is not allowable as deduction. Hence, price of excise purposes is ₹ 990. [₹ 1,100 – 22 – 88]. — Now, if X is the assessable value, excise duty is 0.103x and price including Excise duty is 1.103x. State Vat and local taxes @ 10 % of 1.103x will be 0.1103x. Thus, price inclusive of excise duty and sales tax will be 1.2133x.

Now,	1.2133x	= ₹ 990.00
Hence,	x	= ₹ 815.96
Excise Duty @ 10.30% of	x	= ₹ 84.04
Check the answer as follows –		
Assessable Value		= ₹ 815.96
Add duty @ 10.30% of ₹ 206.37		= ₹ 84.04
Add State Vat @ 4% on ₹ 900 (815.96+84.04)		= ₹ 90.00
Total Price (After allowable deductions)		= ₹ 990.00

Illustration 35.

A manufacturer has to supply a machinery on following terms and conditions : (a) Price of machinery : 3,40,000 (net of taxes and duties) (b) Machinery erection expenses : 26,000 (c) Packing (normally done by him for all machinery) : 4,000 (d) Design and drawing charges relating to manufacture of machinery : 30,000 (Net of taxes and duties) (e) Central Sales Tax @ 4% (f) Central Excise Duty @ 10% plus education cess of 2% plus SAH education cess of 1% (g) Cash discount of ₹ 5,000 will be offered if full payment is received before dispatch of goods. (h) the machine will The buyer made all payment before delivery. (b) The manufacturer incurred cost of ₹ 1,200 in loading the machinery in the truck in his factory. These are not charged separately to buyer. Find the 'Assessable Value' and the duty payable.

Answer :

Erection expenses are not includible in AV. Cash discount is allowable as deduction. Duty is not payable on optional bought out accessories supplied along with the machinery. The cost of ₹ 1,200 is already included in the selling price of machinery (as it is not charged separately) and hence is not to be added again. Hence, AV is ₹ 3,69,000 [₹ 3,40,000 + 4,000 + 30,000 – 5,000]. Duty @ 10% will be ₹ 36,900, plus education cess @ 2% i.e. ₹ 738.00 and SAH education cess @ 1% i.e. ₹ 369.00.

Illustration 36.

An SSI unit (manufacturing goods eligible for benefits of SSI exemption notification) has cleared goods of the value of ₹ 60 lakhs during the financial year 2008-09. The effective rate of Central Excise Duty on the goods manufactured by it is 10% Ad valorem. Education cesses are payable at applicable rates. What is the correct amount of duty which the unit should have paid on the above clearances for 2008-09?

Answer :

(a) If unit intends to avail Cenvat credit on inputs, duty payable is normal duty i.e. 10% of ₹ 60 lakhs, i.e. ₹ 6,00,000, plus education cess of ₹ 12,000 (2% of ₹ 6.00 lakhs), plus SAH education cess of ₹ 6,000 (1% of ₹ 6.00 lakhs).

(b) If unit does not intend to avail Cenvat credit on inputs, duty payable is Nil.

Illustration 37.

The value of excisable goods viz. Iron and Steel articles manufactured by M/s. Alpha Ltd., was ₹ 120 lakhs during the financial year 2008-09, net of taxes and duties. The goods attract 10% ad valorem basic duty plus education cess of 2% plus SAH education cess as applicable. Determine the excise duty liability when the assessee opts for 'CENVAT' and 'opts for not to avail CENVAT' under SSI exemption notifications respectively.

Answer :

If the assessee does not avail Cenvat, duty payable is Nil. If assessee avails Cenvat credit, duty payable will be - Basic - ₹ 12.00 lakhs, Education Cess - ₹ 24,000 and SAH education Cess - ₹ 12,000.

Illustration 38.

A small scale manufacturer had achieved sales of ₹ 73 lakhs in 2007-08. Turnover achieved during 2008-09 was ₹ 1.52 crores. Normal duty payable on the product is 10% plus education cesses as applicable. Find the total excise duty paid by the manufacturer during 2008-09 (a) If the unit has availed Cenvat credit (b) If the unit has not availed Cenvat credit. [The turnover is without taxes and duties]

Answer :

(a) If the unit has availed Cenvat credit, it has to pay full duty on entire turnover. Hence, duty payable is 10% of ₹ 1.52 crores i.e. ₹ 15.20 lakhs, plus education cess @ 2% of ₹ 15.20 lakhs i.e. 30,400, plus SAH education cess @ 1% of ₹ 15.20 lakhs i.e. ₹ 15,200. Total – ₹ 15,65,600.

(b) If the SSI unit has not availed Cenvat, the duty payable is as follows: (i) On first ₹ 150 lakhs : Nil (ii) On subsequent sales : Normal duty of 10% plus education cesses as applicable. Thus, duty on remaining ₹ 2 lakhs will be ₹ 20,000. Thus, excise duty paid is ₹ 20,000, plus education cess of ₹ 400 plus SAH education cess of ₹ 200 Total – ₹ 20,600.

Illustration 39.

An SSI manufacturer may like to pay full duty even when he is eligible for SSI exemption. (a) Can he do so? (b) Why he would like to pay full duty ? (c) What is the duty payable?

Answer :

(*a*) Yes, he can do so. He can avail Cenvat on inputs. (*b*) He would like to do so if his customer wants to avail Cenvat and if duty paid on his inputs is high. In such case, effective cost of the buyer is reduced, if the manufacturer pays duty. (*c*) Duty payable will be normal rate, less concession available, if any, under any exemption notification.

Illustration 40.

A small scale manufacturer produces a product 'P'. Some of the production bears his own brand name, while some production bears brand name of his customer. The customer purchases the goods from the small scale unit and sales himself by adding 20% margin over his purchase cost. Clearances of the SSI unit in 2007-08 was ₹ 3,53,00,000. He achieved clearances of ₹ 445 lakhs in 2008-09 as per following break up. [These clearances are without considering excise duty and sales tax]

(a) Clearances with his own brand name : ₹ 80 lakhs. (b) Clearances of product bearing his customer's brand name : ₹ 365 lakhs. Normal excise duty of his product is 10% plus education cesses as applicable. The SSI unit intends to avail Cenvat benefit on inputs on goods supplied to the brand name owner but intends to avail SSI exemption on his own clearances.

(A) Find the total duty paid by the manufacturer in 2008-09, if (i) Inputs are common but SSI unit is able to maintain separate records of inputs in respect of final products under his brand name and those with other's brand name (ii) The inputs are common and SSI unit is not able to maintain separate records on inputs used in final products manufactured under his brand name and with other's brand name.

(B) What will be the rate of excise duty payable by him in April 2009 (i) on product bearing his own brand name and (ii) on product bearing his customer's brand name.

(C) Will there be any difference in duty payable in April 2009 if all his clearances of ₹ 445 lakhs in 2008-09 were of product under his own brand name ?

Answer :

(*A*) SSI unit can avail Cenvat on final products cleared under other's brand name and avail SSI exemption in respect of his own production. (i) In the first case, he has to pay duty @ 10% on ₹ 365 lakhs, i.e. ₹ 36.50 lakhs plus education cess of ₹ 73,000 plus SAH education cess of ₹ 36,500. He cannot avail Cenvat credit in respect of inputs used to manufacture product under his own brand name.

(ii) In the second case, since he is unable to maintain separate record of inputs, he will have to pay 10% 'amount' on ₹ 80 lakhs as per rule 6(3)(b) of Cenvat Credit Rules. Thus, he has to pay duty of ₹ 36.50 lakhs, plus education cess of ₹ 73,000 plus SAH education cess of ₹ 36,500, plus an 'amount' of ₹ 8.00 lakhs. He can avail Cenvat of all the inputs. — Note that in respect of goods bearing customer's brand name, duty is payable on his selling price to the customer even if customer sells them subsequently at higher price.

The assessee has to carefully do his costing and decide (i) whether to avail Cenvat on all inputs, pay full duty on all final products and 10% 'amount' on final products cleared under his own brand name or (ii) Not avail Cenvat at all and avail exemption from duty on his own production with his brand name.

(*B*) The turnover of SSI during 2008-09 was over ₹ 4 crores. However, for purposes of calculating the upper limit of ₹ 4 crores, clearances with other's brand name are not to be considered. Hence, from 1st April 2009, he can clear goods bearing his own brand name upto ₹ 150 lakhs without payment of duty, if he does not avail Cenvat credit on inputs used in such products. If he is unable to maintain separate records, he will have to pay 10% 'amount' on goods manufactured under his own brand name.

(*C*) If total turnover of ₹ 4.45 crores in 2008-09 was under his own brand name, the manufacturer is not eligible for any Small industry concession in April 2007, and he will have to pay duty at normal rates on his total clearances in April 2009.

STUDY NOTE - 2

CENVAT CREDIT

This Study Note includes

- Background
- Overview of Cenvat Credit Rules, 2004
- Significant Issues relating to Cenvat Credit
- Input Service for Cenvat
- Capital Goods for Cenvat
- Input Service Distributor
- Reversal of Cenvat
- Documents for Availing Cenvat Credit
- Exempted Goods/Output Services
- Removal of Input, Capital Goods and Waste
- Other Provisions of Cenvat
- Accounting Treatment of Inputs in Cenvat
- Documents and Accounts
- Other Provisions
- Illustrations

2.1 BACKGROUND OF CENVAT CREDIT

Excise and Service tax are central taxes, expected to be consumption based taxes to the extent practicable. Till the goods or service is finally consumed, the burden of excise duty and service tax is passed on to next buyer, who gets credit of the tax and excise duty paid by the supplier/ service provider. Thus, effectively, tax is paid on value added at each stage, as illustrated in following example.

	Transaction without VAT		**Transaction With VAT**	
Details	A	B	A	B
Purchases	—	110	—	100
Value Added	100	40	100	40
Sub–Total	100	150	100	140
Add Tax 10%	10	15	10	14
Total	110	165	110	154

'B' is purchasing goods from 'A'. In second case i.e. under Vat, his purchase price is ₹ 100/- as he is entitled to Cenvat credit of ₹ 10/- i.e. tax paid on purchases. His invoice shows tax paid as ₹ 14. However, since he has got credit of ₹ 10/-, effectively he is paying only ₹ 4/- as tax, which is 10% of ₹ 40/-, i.e. 10% of 'value added' by him. Cenvat (Central Value Added Tax) scheme is used to achieve the aim of levying tax only on 'value added' at each stage.

2.1.1 HIGHLIGHTS OF CENVAT CREDIT SCHEME

General highlights of the scheme are as follows :

2.1.1.1 Credit of duty paid on input and input services

The Cenvat scheme is principally based on system of granting credit of duty paid on inputs and input services. A manufacturer or service provider has to pay excise duty and service tax as per normal procedure on the basis of

'Assessable Value' (which is mainly based on selling price). However, he gets credit of duty paid on inputs and service tax paid on input services. Thus, he actually pays amount equal to duty/ service tax as shown in invoice less the Cenvat credit available to him.

2.1.1.2 Input goods eligible for Cenvat to manufacturer

Credit will be available of excise duty paid on (*a*) raw materials *(excluding few items)* (*b*) material used in or in relation to manufacture like consumables etc. (*c*) Paints, packing materials, fuel etc. used for any purpose. The input may be used directly or indirectly in or in relation to manufacture. The input need not be present in the final product. Inputs need not be used within the factory. However, duty paid on high speed diesel oil (HSD), Light Diesel Oil (LDO) and motor spirit (petrol) is not available as Cenvat credit, *even if these are used as raw materials or as fuel.* [rule 2(k)(i) of Cenvat Credit Rules]

2.1.1.3 Input goods eligible for Cenvat to service provider

In case of service providers, only inputs used directly for providing output service are eligible for Cenvat credit. However, high speed diesel oil (HSD), Light Diesel Oil (LDO) and motor spirit (petrol) are not eligible as 'inputs'. [rule 2(k)(ii) of Cenvat Credit Rules]

As per notification No. 12/2003-ST dated 20-6-2003, a service provider is not required to pay service tax on goods and materials used by him for providing output services. Normally, service tax is not payable on goods where property is transferred to buyer. Hence, Cenvat credit will be available mainly in respect of consumables.

2.1.1.4 Inputs can be sent to job worker

Inputs can be sent to job worker for processing. These should be returned within 180 days [rule 4(5)(a)]. Final product can be cleared directly from premises of job worker on obtaining permission of AC/DC [rule 4(6) of Cenvat Credit Rules]

2.1.1.5 Wide definition of 'input service'

A manufacturer/service provider will be entitled to credit of service tax paid by him which are used by him directly or indirectly in or in relation to manufacture of final product/provision of output services. This would include even services which are received prior to commencement of manufacture/provision of output services. Even input services relating to setting up a factory will be eligible. In addition to this, services like advertising, activities relating to business like accounting, auditing, storage, transport etc., which are not directly related to manufacture/provision of out put services but are related to the sale of manufactured goods/provision of output services would also be permitted for credit. *In fact, all input services relating to all activities relating to business are eligible for Cenvat credit.* [rule 2(l) of Cenvat Credit Rules]

2.1.1.6 Services Billed/received at Head Office/Regional Offices

In some cases, the bill/invoice is raised in the name of head office/regional office etc., but services are actually received in the factory (or factories) or premises of service provider. In addition, the Head Office/Regional Offices receive services which are not specific for any factory/premises or service provider, such as advertising, market research, management consultancy etc. Bills in respect of such services would be received only in these offices. To enable the manufacturer/service provider to avail credit of such input services, a concept of "input service distributor" has been introduced [rule 2(m) of Cenvat Credit Rules]

The HO/Regional Office will have to register as 'Input Service Distributor' with Excise department. The HO/Regional Office will have to issue Invoice to the factory/office providing service. The factory/service provider can avail credit on basis of such invoice. It would be left to the assessee to decide as to how he distributes the credit among various factories or service providing units. He has to ensure that the total credit allowed does not exceed the eligible credit amount. Such offices which distribute the credit would have to obtain service tax registration [rule 7 of Cenvat Credit Rules].

2.1.1.7 Credit of duty paid on capital goods

Capital goods (machinery, plant, spare parts of machinery, tools, dies, etc.) as defined in rule 2(a), used for manufacture of final product and/or used for providing taxable output service will be available. Capital goods should be used in the factory. 50% credit is available in current year and balance in subsequent financial year or years [rule 4(2)(a) of Cenvat Credit Rules]. Assessee should not claim depreciation on duty portion on which he has availed Cenvat credit [rule 4(4) of Cenvat Credit Rules]. A service provider can take out capital goods from his premises, provided that he brings them back within 180 days. This period can be extended [second *proviso* to Rule 3(5) of Cenvat Credit Rules].

2.1.1.8 Removal of used capital goods as scrap

If capital goods are cleared after use as scrap, an 'amount' equal to duty on scrap value of capital goods is payable [rule 4(5A)]. If capital goods are removed after use (not as scarp), an 'amount' is payable equal to Cenvat credit taken on the capital goods, reduced by 2.5% for each quarter of a year or part thereof, from date of taking credit.

2.1.1.9 Credit on motor vehicles used to provide output service

Motor vehicles are not 'capital goods' for purpose of 'manufacture', but credit on motor vehicles would be allowed as 'capital goods' only to the service providers of courier, tour operator, rent-a-cab scheme operator, cargo handling agency, outdoor caterer, pandal and shamiana operator and goods transport agency [rule 2(a)(B) of Cenvat Credit Rules]. Motor vehicle will not be treated as 'capital goods' for manufacturers or other service providers.

2.1.1.10 Credit on basis of specified documents

Credit is to be availed only on the basis of specified documents as proof of payment of duty on inputs or tax on input services. These include Invoice of manufacturer or registered dealer, Bill of Entry, Supplementary Invoice etc. [rule 9(1) of Cenvat Credit Rules]. If there is any defect in duty paying document, specific permission of AC/DC is required [rule 9(2) of Cenvat Credit Rules]

2.1.1.11 Credit available instantly in case of inputs

Credit of duty on inputs can be taken up instantly, i.e. as soon as inputs reach the factory or premises of service provider [rule 4(1) of Cenvat Credit Rules].

2.2.12 Cenvat credit of service tax only after bill amount plus service tax paid - In case of input services, credit is available only after the amount of Bill value with service tax is paid to the service provider [rule 4(7) of Cenvat Credit Rules].

2.1.1.13 Cenvat to manufacturer available only if there is 'manufacture' - Cenvat on inputs or input services is available only if the process is 'manufacture'. Otherwise, Cenvat is not available [rule 3(1) of Cenvat Credit Rules]. [In fact, in such cases, no duty is payable on the final product and question of Cenvat does not arise at all].

2.1.1.14 Utilisation of Cenvat Credit - All taxes and duties specified in rule 3(1) of Cenvat Credit Rules form a 'pool'. This credit can be utilised by manufacturer of excisable goods or provider of taxable service, for payment of any tax or duty as specified in rule 3(4) of Cenvat Credit Rules.

One-to-one correlation not required - Cenvat Credit Rules do not require input-output correlation to be established.

2.1.1.15 No input credit if final product/output service exempt from duty/ service tax

No credit is available if final product is exempt from duty or final service is exempt from service tax [rule 6(1) of Cenvat Credit Rules]. If a manufacturer manufactures more than one product, it may happen that some of the products are exempt from duty. Similarly, in case of service provider, some services may be taxable while some services may not be covered. In such cases, duty paid on inputs and service tax paid on input services used for manufacture of exempted products/services cannot be used for payment of duty or tax on other final products/ services which are not exempt from duty/tax. If the manufacturer/service provider uses common inputs and input services both for exempted as well as un-exempted goods/services, he should maintain separate records for inputs/ input services used for manufacture of exempted final products and should not avail Cenvat on such inputs/input services [rule 6(2) of Cenvat Credit Rules].

2.1.1.16 Partial manufacture/provision of exempted products/services

Cenvat credit of inputs and input services is not available if final product/output service is exempt from excise duty/ service tax. In case of manufacturer manufacturing both exempt and dutiable goods (or service provider providing taxable as well as exempt services), it may happen that same inputs/input services are used partly for manufacture of dutiable goods/taxable services and partly for exempted goods/services.

In such cases, the manufacturer/service provider has following three options (w.e.f. 1-4-2008)

(a) Maintain separate inventory and accounts of receipt and use of inputs and input services used for exempted goods/exempted output services – Rule 6(2) of Cenvat Credit Rules.

(b) Pay amount equal to 5% of value of exempted goods (if he is 'manufacturer) and/or 6% of value of exempted services (if he is service provider) if he does not maintain separate inventory and records, if he is a manufacturer – Rule 6(3)(i) w.e.f. 1-4-2008.

(c) Pay an 'amount' equal to proportionate Cenvat credit attributable to exempted final product/ exempted output services – Rule 6(3)(ii) w.e.f. 1-4-2008.

2.1.1.17 Full credit in case of specified input services

In case of specified services such as construction, erection/ commissioning/ installation etc. credit would be disallowed only when they are used *exclusively* in relation to manufacture of exempted goods/ services. Otherwise full credit would be allowed [rule 6(5) of Cenvat Credit Rules]

2.1.1.18 No cash Refund, except in case of export

In some cases, it may happen that duty paid on inputs and service tax paid on input services may be more than duty payable on final products. In such cases, though the Cenvat credit will be available to the manufacturer/service provider, he cannot use the same and the same will lapse. There is no provision for refund of the excess Cenvat credit. *However, the only exception is in case of exports where duty paid on input material or services used for exported goods is refundable* . [rule 5 of Cenvat Credit Rules].

Other exception is Tribunal can order refund when Cenvat credit could not be availed due to fault / wrong action of the department. Refund may also be granted if assessee could not utilise credit for some other reason.

2.1.2 REVERSAL OF CENVAT IF FINAL PRODUCT OR OUTPUT SERVICE SUBSEQUENTLY EXEMPT

Cenvat Credit is availed as soon as inputs are received. If subsequently the final product or output service is exempt, there might be some inputs lying in stock on date of exemption. Such inputs will then be used for manufacture of exempted final products. In such case, Cenvat credit on such inputs will have to be reversed or equivalent amount paid, if Cenvat credit was already utilised [rules 11(3) and 11(4) of Cenvat Credit Rules of Cenvat Credit Rules].

2.1.3 CENVAT CREDIT IS INDEFEASIBLE

In *CCE* v. *Dai Ichi Karkaria Ltd.* 1999(112) ELT 353 = 1999 AIR SCW 3205 = (1999) 7 SCC 448 = AIR 1999 SC 3234 (SC 3 member bench), it was held that Cenvat credit validly taken is indefeasible. It was also observed that co-relation between final product and raw materials is not required in Cenvat scheme. — However, Cenvat credit balance at the year end is not income of assessee – *CIT* v. *Indo Nippon Chemicals* (2003) 130 Taxman 179 = 155 ELT 452 = 261 ITR 275 (SC).

2.2 OVERVIEW OF CENVAT CREDIT RULES, 2004

Rule No.	Brief Contents
Proviso to rule 1(2)	Provisions relating to availment and utilisation of credit of service tax shall not apply to State of J&K.
2(a)	**'Capital goods' means – (A) The following goods, namely:- (i) all goods falling under chapter 82, chapter 84, chapter 85, chapter 90, heading No.6805, grinding wheels and the like, and parts thereof falling under heading 6804 of the First Schedule to Excise Tariff Act (ii) Pollution control equipment.(iii) Components, spares and accessories of the goods specified at (i) and (ii) above (iv) Moulds and dies, jigs and fixtures. (v) Refractories and refractory material. (vi) Tubes, pipes and fittings thereof and (vii) Storage Tank. Used – (1) in the factory of the manufacturer of the final products, but does not include any equipment or appliance used in an office; or (2) for providing output service** (B) motor vehicle registered in the name of provider of output service for providing taxable service as specified in sub-clauses (f), (n), (o), (zr), (zzp), (zzt) and (zzw) of clause (105) of section 65 of the Finance Act, 1994
2(d)	**'Exempted goods' means goods which are exempt from whole of duty of excise leviable thereon and includes goods which are chargeable to 'Nil' rate of duty.**
2(e)	"Exempted services" means taxable services which are exempt from the whole of the service tax leviable thereon, and includes services on which no service tax is leviable under section 66 of Finance Act.
2(h)	'Final Product' means excisable goods manufactured or produced from inputs, or using input service.

Rule No.	Brief Contents
2(k)	"Input" means – (i) all goods, except light diesel oil, high speed diesel oil and motor spirit, commonly known as petrol, used in or in relation to the manufacture of final products whether directly or indirectly and whether contained in the final product or not ***and includes*** lubricating oils, greases, cutting oils, coolants, accessories of the final products cleared along with the final product, goods used as paint, or as packing material, or as fuel, or for generation of electricity or steam used in or in relation to manufacture of final products or for any other purpose, within the factory of production; (ii) all goods, except light diesel oil, high speed diesel oil, motor spirit, commonly known as petrol and motor vehicles, used for providing any output service. *Explanation 1.* The light diesel oil, high speed diesel oil or motor spirit, commonly known as petrol, shall not be treated as an input for any purpose whatsoever. *Explanation 2* . Input include goods used in the manufacture of capital goods which are further used in the factory of the manufacturer
2(l)	"Input service" means any service – (i) used by a provider of taxable service for providing an output service; or (ii) used by the manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products *upto* the place of removal (The words were 'from the place of removal' upto 31-3-2008) ***and includes*** services used in relation to setting up, modernization, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises, advertisement or sales promotion, market research, storage upto the place of removal, procurement of inputs, ***activities relating to business, such as*** accounting, auditing, financing, recruitment and quality control, coaching and training, computer networking, credit rating, share registry and security, inward transportation of inputs or capital goods and outward transportation upto the place of removal
2(n)	Job Work means processing or working upon of raw materials or semi-finished goods supplied to job worker, so as to complete a part or whole of the process resulting in the manufacture or finishing of an article or any operation which is essential for the aforesaid process.
2(p)	"Output service" means any taxable service provided by the provider of taxable service, to a customer, client, subscriber, policy holder or any other person, as the case may be, and the expressions 'provider' and 'provided' shall be construed accordingly.
3(1)	Cenvat Credit is a 'pool' consisting of following duties and taxes, paid on input or capital goods or input service • Basic excise duty on indigenous inputs [Paid on goods specified in First Schedule to CETA]. Corresponding CVD on imported goods is allowable. • Education cess on manufactured excisable goods and CVD equal to education cess on imported goods. This credit can be utilised only for payment of education cess on final product or output services • SAH (Secondary and Higher Education) Cess manufactured excisable goods and CVD equal to SAH education cess on imported goods. This credit can be utilized only for payment of SAH education cess on final product or output services. • Service tax on input services paid u/s 66 of Finance Act. • Education cess paid on service tax. This credit can be utilised only for payment of education cess on final product or output services. • SAH Education cess paid on service tax. This credit can be utilised only for payment of SAH education cess on final product or output services. • Additional Customs Duty paid u/s 3(5) of Customs Tariff Act w.e.f. 1-3-2005 (SAD or Special CVD). This credit will not be available to service providers [This duty is perceived as in lieu of sales tax. It is payable @ 4%. on most of the products, with few exceptions.]

Rule No.	Brief Contents
	• National Calamity Contingent Duty (NCCD) leviable under section 136 of Finance Act, 2001 and corresponding CVD paid on imported goods. This credit can be used for payment of NCCD on outputs only and not for any other duty. • Additional Excise Duty paid under section 85 of Finance Act, 2005. This duty is payable w.e.f. 1-3-2005 on pan masala and certain tobacco products, as specified in Seventh Schedule to Finance Act, 2005 [Credit of Additional Excise Duty paid under section 85 of Finance Act can be used for payment of this duty. Any other credit cannot be utilised and balance amount is required to be paid in cash only].
3(2)	Manufacturer can take Cenvat credit of goods in stock on day when the final product ceases to be exempted goods or becomes excisa ble.
3(4)	Pool of 'Cenvat Credit' [as defined in rule 3(1)] can be utilised for any of the following – • ***Any*** duty on *any* final product manufactured by manufacturer [Rule 3(4)(a)] • Payment of 'amount' if inputs are removed as such or after partial processing [Rule 3(4)(b)] • Payment of 'amount' on capital goods if they are removed as such [Rule 3(4)(c)] • Payment of 'amount', if goods are cleared after repairs under rule 16(2) of Central Excise Rules [Rule 3(4)(d)] • Service tax on output service [Rule 3(4)(e)] • Payment under Cenvat Credit Rule 6 of 10% 'amount' on exempted goods or reversal of credit on inputs when common inputs or common input services are used for exempted as well as dutiable final products – *Explanation 1.* to Cenvat Credit Rule 6(3) • Reversal of Cenvat credit, if assessee opts out of Cenvat – Rule 11(2) • Payment of 'amount' if goods sent for job work are not returned within 180 days – Rule 4(5)(a).
First proviso to rule 3(4)	Even if duty/tax is payable by 5th /6th /15th /16th of following month, credit can be taken only as available on last day of the current month
Second proviso to rule 3(4)	Restrictions on some credits [summarised above under rule 3(1)]
3(5)	'Amount' equal to Cenvat credit a vailed to be paid if capital goods or inputs removed 'as such' from the factory.
First proviso to Rule 3(5)]	A service provider cannot avail Cenvat credit of special CVD of 4% paid u/s 3(5) of Customs tariff Act.
Second proviso to Rule 3(5)].	If capital goods are removed after use (but not as waste and scrap), an 'amount' equal to Cenvat credit taken on the capital goods, reduced by 2.5% for each quarter of a year or part thereof, from date of taking credit.
3(5A)	'Amount' equal to duty on scrap va lue payable if capital goods are cleared as wa ste and scrap. This 'amount' is eligible as Cenvat Credit, as per rule 3(6)
3(5B)	If (i) inputs or (ii) capital goods before being put to use, are written off in boks or provision made in books, 'amount' to be paid equal to Cenvat availed
3(5C)	If duty on final products is remitted under rule 21 of Central Excise, Cenvat credit of duty paid on inputs used in manufacture or such goods shall be reversed.
3(6)	'Amount' paid under rule 3(5) and 3(5A) is eligible as Cenvat credit to the buyer
3(7)(a)	Cenvat credit of duty paid by EOU as per formula

Rule No.	Brief Contents
3(7)(b)	NCCD, Education cess, SAH cess and additional duty under section 157 of FA 2003 or 85 of FA 2005 can be used for respective duties only. Education cess of excise and service tax inter-changeable. Similarly, SAH Education cess of excise
4(1)	Cenvat credit can be taken immediately on receipt of goods in factory or premises of service provider
4(2)	Capital goods – Cenvat Credit Upto 50% in first financial year and balance in subsequent years, if they are in possession of manufacturer.
4(3)	Cenvat credit available if capital goods taken on leas, hire or loan agreement
4(4)	Depreciation on capital goods should not be availed on the excise duty portion of value of capital goods
4(5)(a)	Inputs and capital goods can be sent to job worker and should be brought back in 180 days
4(5)(b)	Restriction of 180 days does not apply to tools, dies, jigs and fixtures can be sent to job worker
4(6)	Final product can be cleared directly from place of job worker on obtaining permission from AC/DC, valid for a financial year
4(7)	Credit of input services can be availed only after the output service provider makes payment of value of input services and the service tax payable on it, as shown in invoice of input service provider.
5	Refund if final product is exported.
5A	Refund in case of Exports by exempted units in North-East Region and Sikkim
6(1)	Cenvat credit is not admissible on such quantity of input or input service which is used in manufacture of exempted goods or exempted services, except as provided in rule 6(2)
6(2)	Manufacturer manufacturing both exempt and dutiable goods (or service provider providing taxable as well as exempt services), may maintain separate inventory and accounts of receipt and use of inputs and input services used for exempted goods/exempted output services. In such cases, he should not avail Cenvat credit of the inputs and input services which are used in exempted final services at all.
6(3)(i)	If the manufacturer/service provider opts not to maintain such separate accounts, he has to pay an amount equal to 10% of the value of such exempted goods/ 8% of value of exempted services. Such payment can be made by debit to Cenvat credit account or PLA [*Explanation* II to rule 6(3A) [amendment w.e.f. 1-4-2008. Earlier, in few cases as specified in rule 6(3)(a), the manufacturer had to reverse Cenvat credit. Earlier, a service provider of exempted and non-exempted services not maintaining separate accounts was eligible to utilise Cenvat credit only to the extent of 20% of service tax payable on output services, under erstwhile rule 6(3)(c) existing upto 31-3-2008].
6(3)(ii)	Alternatively, the manufacturer/service provider can opt to pay an 'amount' which is proportional to Cenvat credit availed on exempted final product/exempted output services [amendment w.e.f. 1-4-2008]
Explanation I to Rule	Such option [rule 6(3)(i) or rule 6(3)(ii)] has to be exercised in respect of all exempted goods manufactured and all exempted output services provided.
6(3)	The option once exercised shall not be changed in remaining part of financial year
6(3A)(a)	The assessee exercising option under rule 6(3)(ii) should inform prescribed details to Superintendent, while exercising the option.
6(3A)(b)	The manufacturer of goods or the provider of output service shall determine and pay, provisionally, for every month amount of Cenvat credit attributable to input services used in relation to manufacture of exempted product or provision of exempt services, on the basis of ratios of previous year

Rule No.	Brief Contents
6(3A)(c)	At the year end, the manufacturer of goods or the provider of output service shall determine finally amount of Cenvat attributable to input services used in relation to manufacture of exempted product or provision of exempt services, on basis of finalised accounts.
6(3A)(d)	If amount is found to be short paid, the difference should be paid by 30 th June of succeeding year.
6(3A)(e)	In addition to the amount short-paid, the assessee will be liable to pay interest at the rate of twenty-four per cent per annum from the due date, i.e., 30th June till the date of payment, where the amount short-paid is not paid within the said due date.
6(3A)(f)	If at the year end, it is found that the amount provisionally paid was more than the amount finally determined, the manufacturer of goods or the provider of output service may adjust the excess amount on his own, by taking credit of such amount.
6(3A)(g)	The manufacturer of goods or the provider of output service shall intimate to the jurisdictional Superintendent of Central Excise, within a period of fifteen days from the date of payment or adjustment, the prescribed particulars.
6(3A)(h)	If assessee does not manufacture dutiable final products or taxable output service, he can take credit but is not required to pay proportionate amount on provisional basis as provided in rule 6(3A)(b). However, at year end, he should pay amount on proportionate before 30th June.
Explanation I to rule 6(3A)	"Value" for the purpose of rules 6(3) and 6(3A) shall have the same meaning assigned to it under section 67 of the Finance Act, 1994 read with rules made thereunder or, as the case may be, the value determined under section 4 or 4A of the Central Excise Act, 1944 read with rules made thereunder
Explanation II to rule 63(A)	The amount under rule 6(3) or 6(3A) shall be paid by 5th of following month (except in March, where it is payable by 31st March.
6(4)	Capital goods used exclusively for manufacture of exempted goods or providing exempt service are not eligible for Cenvat credit.
6(5)	In case of 16 specified services, full Cenvat credit available even if service partly used for exempted goods or exempted service.
6(6)	If excisable goods are removed to SEZ, EOU, EHTP, STP, UN agencies or for exports or removal of gold or silver arising in manufacture of copper or zinc by smelting, rules 6(1) to 6(4) do not apply i.e. payment of 10% 'amount' or proportionate reversal is not required.
7	The 'Input Service Distributor' [as defined in rule 2(m)] may distribute Cenvat Credit in respect of service tax, among its manufacturing units or providing output service. The credit distributed should not be more than the service tax paid.
7A	The office of service provider where inputs were received can distribute the credit of duty paid on such inputs and capital goods to the service provider by issuing an invoice. Such office will have to be registered with Central Excise and submit returns etc. similar to first stage dealer andsecond stage dealer.
8	Inputs can be stored outside the factory, with permission of AC/DC
9(1)	Cenvat Credit can be taken on the basis of – • Invoice of manufacturer from factory • Invoice of manufacturer from his depot or premises of consignment agent • Invoice issued by registered importer • Invoice issued by importer from his premises or consignment registered with Central Excise

Rule No.	Brief Contents
	• Invoice issued by registered first stage or second stage dealer • Supplementary Invoice by manufacturer • Bill of Entry • Certificate issued by an appraiser of customs in respect of goods imported through foreign post office • TR-6 or GAR-7 Challan of payment of tax where service tax is payable by other than input service provider • Invoice, bill or challan issued by provider of input service on or after 10-9-2004 • Invoice, Bill or Challan issued by input service provider under rule 4A of Service Tax Rules.
Proviso to rule 9(1)	**If a first stage or second stage dealer mentions in his invoice that Cenvat credit of the special CVD paid u/s 3(5) of Customs Tariff Act is not admissible, buyer cannot avail the Cenvat credit.**
9(2)	**Cenvat credit can be taken only if *all* the particulars as prescribed in Central Excise Rules, 2002 or Service Tax Rules, 1994 are contained in the eligible duty paying document. Otherwise, permission of AC/DC is required.**
9(4)	First stage dealer and second stage dealer to maintain proper records and pass on duty on '*pro rata*' basis.
9(5)	Manufacturer and provider of output service to maintain proper records. Burden of proof of admissibility of Cenvat credit is on him.
9(8)	First stage dealer and second stage dealer to submit quarterly returnwithin 15 days from end of quarter.
9(10)	Input service distributor to submit half yearly return within one month
9(11)	Revised return of Cenvat credit by provider of output service within 60 days.
9A(1)	Information relating to Principal Inputs to be submitted annually by 30th April of each Financial Year by specified manufacturers other than SSI, in form ER-5. Change also to be informed within 15 days
9A(3)	Monthly return of receipts and consumption of Principal Inputs by specified manufacturers of excisable goods in form ER-6
10	transfer of unutilised Cenvat credit, if a manufacturer shifts his factory orprovider of output services shifts his business or a manufacturer/service provider transfers his factory/business on account of change in ownership or on account of sale, merger, amalgamation, lease or transfer of factory to a joint venture.
11(2)	Reversal of credit at the time of opting out by SSI unit by paying an 'amount' equivalent to Cenvat credit on such inputs lying in stock orinputs contained in final products. Balance Cenvat credit, if any, will lapse.
11(3)	If final product is exempt subsequent to receipt of inputs, Cenvat credit on inputs lying in stock as on date of such exemption to be reversed by payment of 'amount'.
12	Full credit available in case of goods obtained from North Eastern States, J&K, Sikkim and Kutch district, even if the manufacturer is exempt from duty
12A	Procedures applicable to LTU14 Recovery of Cenvat wrongly availed with interest
15	Confiscation and penalty for contravention of provisions
15A	General penalty of ₹ 5,000 for contravention of rules when no penalty is provided in rules.

2.3 SIGNIFICANT ISSUES RELATING TO CENVAT CREDIT

2.3.1 ***Inputs must be used in the factory*** – The words 'within the factory of production' appear at the end of the definition. The question is whether those words apply only to second part of the definition or both parts of the definition. These words appear much after the words 'and includes' which separate first part from second part of definition. Moreover, these words are preceded by ',' and not ';'. Thus, these words form part of only second part of the definition.

However, in CCE v. JK Udaipur Udyog Ltd. 171 ELT 289 = 2004 AIR SCW 4986, Supreme Court has held that Cenvat is available only if the inputs are used within the factory. Mine situated at a distance from factory cannot be considered as part of factory merely because it is connected with a ropeway, when no manufacturing process is carried on in the mine. Hence, explosives used in mine will not be eligible for Cenvat credit, even if limestone extracted from the mine is used for manufacture of cement in the factory. [The aspect whether 'within factory of production' applies to second part or both the parts of definition was not argued at all. However, now, the judgment is binding, unless someone is able to convince Supreme Court to review the decision.]

Department has expressed an opinion that in view of specific definition of 'input' in new Cenvat Credit Rules, Cenvat credit will be available only if inputs/capital goods are used within the factory. CBE&C circular No. 637/28/2002-CX dated 8=5=2002.

Factory has been defined in section 2(e) of CEA and it covers any premises, including precincts thereof, where manufacturing process is ordinarily carried out.

2.3.2 ***Capital goods must be used within the factory*** – Definition of 'capital goods' in Rule 2(a) of Cenvat Credit Rules specifies that the inputs/capital goods must be used within the factory of production. Even in that case, a view is possible that capital goods can be sent outside to job worker for any purpose.

Cenvat credit on electric cables used for feeder line from electricity sub-station to factory is not allowable as the assessee is not owner of land between the plant and electricity sub-station – National Organic Chemicals v. CCE (2004) 172 ELT 366 (CESTAT).

Fuel used in the factory – Definition of 'input' covers fuel used in factory in or in relation to manufacture of final products or for any other purpose. Thus, 'fuel' will be eligible for Cenvat credit even if electricity/steam generated is utilized/sold outside the factory. As explained above, the words used are 'for any other purpose'.

However, HSD, LDO and petrol have been specifically excluded from definition of 'input', even if used in or in relation to manufacture. In Vam Organics v. State of UP(2003) 132 STC 8 (All HC DB), it has been held that diesel oil used in generating set is 'used in manufacture' followed in Goraya Straw Board v. State of UP(2005) 139 STC 156 (Uttaranchal HC DB). Thus, HSD, LDO and petrol is 'used in relation to manufacture', but Cenvat is not available in view of specific exclusion.

Inputs eligible for Cenvat under first part of definition

The definition of 'input' covers following –

- All goods [except High Speed Diesel Oil (HSD), Light Diesel Oil (LDO) and petrol] used, in or in relation to, the manufacture of the final products. The input may be used directly or indirectly in or in relation to manufacture of final product. The input need not be present in the final product (first part of the definition)
- Input includes lubricating oils, greases, cutting oils and coolants accessories of final products cleared along with the final product. Goods used as paint, Packing material, Fuel, Goods used for generation of electricity or steam used in or in relation to manufacture of final products or for any purpose. These can be used 'for any purpose'. (Second part of the definition)
- Input also includes goods used in manufacture of capital goods which are further used in the factory of manufacturer (Explanation 2 to the definition).

2.3.3 INPUTS SHOULD BE 'USED' – Mere intention to use is not sufficient – Rule 2(k)(i) which defines 'inputs' for manufacturer states that these should be 'used in the factory'. Thus, mere intention to use is not sufficient to avail Cenvat credit.

2.3.4 ***No time limit for utilization of inputs*** – In Bharat Heavy Electricals v. CCE(2002) 50 RLT 208 (CEGAT), it was held that there is no time limit for consumption of inputs. [In this case, it was held that when goods are lying in stock in factory premises, Cenvat credit is not to be reversed even though value has been written off in accounts.]

2.3.5 ***Cenvat credit of capital goods used/manufactured in factory*** – Cenvat credit is available in respect of duty paid in 'capital goods' also. It may be noted that 'capital goods' can also be covered in definition of 'inputs' as these are obviously used 'in or in relation to manufacture'. Some provisions are common in respect of Cenvat on inputs and capital goods. However, there are some differences too. These are discussed later.

2.3.6 CAPTIAL GOODS MANUFACTURED WITHIN THE FACTORY– As per Explanation 2 to rule 2(k), 'input' includes goods used in manufacture of capital goods which are further used in the factory of manufacturer. Thus, if a manufacturer manufactures some capital goods within the factory, goods used to manufacture such capital goods will be eligible as 'inputs'. [i.e. 100% Cenvat credit will be available in the same financial year].

2.3.7 ***In or in relation to manufacture of final product*** – The input must be used in or in relation to the manufacture of final product, in respect of inputs which are not covered in second part of the definition of 'inputs'. Thus, if an input is used 'in the manufacture' or 'in relation to the manufacture', it is eligible for claiming Cenvat credit.

'In the manufacture' means the input is actually used in the manufacture of finished product, either directly or indirectly. It may be present in the 'final product' in same or similar or identifiable form or it might have got converted during process and may not be seen or identified in the final product. 'In relation to the manufacture' means, the input has been used during a process while manufacturing the product like consumable. The input need not form part of final product. Thus, the term 'in relation to manufacture' is a very wide term and covers all inputs which have direct nexus with the manufacturing process. 'Manufacture' includes all processes incidental or ancillary to manufacture. Thus, the term 'inputs' is much more wider than mere 'raw materials'.

2.3.8 ***Input relating to integrally connected processes eligible*** – In J K Cotton Spining and Weaving Mills v. STO, Kanpur 1965(16) STC 563 = (1965)] 1 SCR 900 = AIR 1965 SC 1310 = 1997(91) ELT 34 (SC), Supreme Court has held that if the process is integrally connected with the ultimate such process, all inputs for such process will fall within the expression 'in the manufacture of goods'. [In this case, it was held that 'designing' is a part of process of manufacture. However, building material cannot be said to be used 'in the manufacture of goods]. In CCE v. Rajasthan State Chemical Works – 1991(55) ELT 444 (SC) = AIRE 1991 SC 2222 = 1991 AIR SCW 2548 = (1991) 4 SCC 473 = 36 ECR 465 (3 member bench), it was held as follows :

"Process in manufacture or in relation to manufacture implies not only production but the various processes through which the raw materials are subjected to change by various operations. Manufacture is the cumulative effect of various processes to which raw material is subjected. Therefore, each step towards such production would be a process in relation to manufacture. Where any process is so integrally connected with ultimate production of goods that but for the process, manufacture or processing of goods would be impossible or commercially inexpedient, the process is one in relation to the manufacture."

2.3.9 Inputs captively produced and used

The absence of a specific provision in the CENVAT Scheme with regard to inputs captively produced and used cannot be construed to mean that such inputs do not fall under the eligible category. After all, even captively produced inputs do not come out of nothing. Some raw materials would be required to produce those inputs, and if such raw materials are duty-paid, there is no reason why input credit should be denied. It may be noted in this context that inputs captively produced (other than light diesel oil, high speed diesel oil and petrol) and used in or in relation to the manufacture of final products (other than matches) are exempt from duty under *Notification No. 67/95—C.E, dated 16-3-1995.*

Where duty-paid textured yarn was used to manufacture exempted polyester dyed yarn, and later on the date of withdrawal of exemption, stock of such dyed yarn was cleared without payment of duty, it was held that Notification No. 67/95 would not apply. Since dyed yarn had already been manufactured before withdrawal of exemption, credit on textured yarn could not be refused on ground of benefit of exemption taken – Recron Synthetics Ltd. v. CCE 2004 (174) ELT 326 (New Delhi – Cestat).

In the case of Dhampur Sugar Mills Ltd. v. CCE 2001 (129) ELT 73 (New Delhi- CEGAT), the Tribunal held that, where the factory premises of the appellants had different plants manufacturing different excisable goods and those plants had been registered as separate units under the central excise law, they should be treated as constituting one factory, and that, under a consequence, the benefit of notification No. 67/95 could not be denied to that factory. A civil appeal filed by the Revenue against this decision has been dismissed by the Supreme Court – 2007 (216) ELT A23. The Supreme Court observed that, apart from the reasons given by the Tribunal in its decision, it was noticed that the show-cause notice issued by the department itself proceeded on the basis that the assessee had only a single factory consisting of separate units, and that there was no allegation in the show-cause notice to the effect that there were three factories as submitted by the department. The Supreme Court therefore held that there was no merit in the appeal filed by the Revenue.

2.3.10 Light Diesel Oil/High Speed Diesel Oil/Petrol

To place the matter beyond any doubt, Explanation1 to rule 2(k) makes it clear that light diesel oil, high speed diesel oil and motor spirit (petrol) will not be deemed to be 'input' for any purpose whatsoever. Thus, even if these items are used as fuel, or for generation of electricity or steam, they will not be treated as eligible inputs. It must however be noted that the prohibition operates only for treating light diesel oil, high speed diesel oil and motor spirit as eligible inputs, which means that, if they are used in or in relation to the manufacture of any final product, no Cenvat credit is admissible. However, inputs used in or in relation to the manufacture of light diesel oil, high speed diesel oil or motor spirit will be eligible inputs for purposes of taking Cenvat credit. In respect of high speed diesel oil, it is immaterial whether its quality is High Flash or Low Flash. Both are not eligible inputs for any purpose - [*Shayona Petrochem Ltd. v. CCE* 2004 (172) ELT 111 (Mum. – CESTAT).

Whether Cixon and SBPS are excluded – In one case, the question arose as to whether Cixon and Special Boiling Point Spirit (SBPS) would be covered under the expression 'motor spirit commonly known as petrol', so as to be ineligible for credit. The Tribunal noted that no material evidence in the form of test report, etc., had been brought on record by Revenue to show that these two inputs were commonly known as petrol in the market and held that, in the absence of any such material/evidence, the two inputs could not be treated as excluded, and that the assessee was eligible to avail credit of duty paid on these inputs – *Tuftween Petrochemicals v. CCE 2005*(185) ELT 203 (New Delhi – CESTAT).

2.3.11 Inputs contained in waste/refuse/by-product, or used in intermediate product

The department has clarified the "CENVAT credit is also admissible in respect of the amount of inputs contained in any of the waste, refuse or by-product. Similarly, CENVAT is not to be denied if the inputs are used in any intermediate of the final product even if such intermediate is exempt from payment of duty. The basic idea is that CENVAT credit is admissible so long as the inputs are used in or in relation to the manufacture of final products, and whether directly or indirectly". See decision of the High Court in the case of Asahi India Safety Class Ltd. v. Union of India 2005 (180) ELT 5 (Delhi), which was later followed by the Tribunal in the case of Foil Pack India (P.) Ltd. v. CCE 2007 (216) (New Delhi – CESTAT).

2.3.12 Inputs used in capital goods which are used captively

Under Explanation 2 rule 2(k), goods used in the manufacture of capital goods which are further used in the factory of the manufacturer have also been brought under the definition of 'input'.

The use must be in the 'manufacture' of capital goods. Inputs used for other purposes, like repair, maintenance, and/ or installation of capital goods are not covered under the Explanation. Upper Ganges Sugar & Inds. Ltd. 2004 (178) ELT 325 (New Delhi – CESTAT).

In the case of Hira Power & Steel Ltd. v. CCE 2008 (229) ELT 408 (New Delhi – Cestat), credit availed by the appellants on inputs used in fabrication of captive power plant was disallowed on the ground that the power plant was located outside the factory of production. The Tribunal held that credit was not disallowable since the power plant was situated at the land adjacent to the said factory, and the plant was meant for captive use only. For arriving at this view, the Tribunal relied upon the Supreme Court decision in the case of Vikram Cement v. CCE 2006 (197) ELT 145, according to which capital goods used in captive mines were held to be eligible for credit.

In Hindalco Industries Ltd. v. CCE 2008 (230) ELT 649 (Bang.- Cestat), it was held that steel plates and strips used for fabrication of tanks will qualify to be treated as inputs used in the manufacture of capital goods for captive use, and were hence eligible for credit.

Items excluded – Explanation II has been amended with effect from 7-7-2009 to provide that cement, angels, channels, Centrally Twisted Deform bar (CTD) or Thermo Mechanically Treated bar (TMT) and other items used for construction of factory shed, building or laying of foundation or making of structures for support of capital goods will not be eligible as 'input'.

2.3.13 Design and development charges

Where the assessee, a manufacturer of moulds, had sub-contracted designing to another unit and had also included the design and development charges in the assessable value, it was held that, since the design and development charges are not 'excisable goods' and since the said unit was not required to pay any duty thereon, the credit availed by the assessee on such charges was disallowable – CCE v. NTTE Industries Ltd. 2004 (169) ELT 92 (Beng. – CESTAT).

2.3.14 Inputs used for effluent treatment of plant

In the case of *Indian Farmers & Fertilizers Co-op. Ltd. v. CCE* 1996 (86) ELT 177, the Supreme Court had inter alia observed that "it is too late in the day to take the view that the treatment of effluents from a plant is not an essential and integral part of the process of manufacture in the plant". Relying on these observations, the Tribunal held in one case that hydrochloric acid used for effluent treatment of plant was an eligible input on which credit was allowable – *Fertilizers & Chemicals Travancore Ltd. v. CCE* 2002 (148) ELT 896 (Beng. – CESTAT). Similarly, in another case, hydrocholoric acid and aquachem used in effluent treatment of plant were held as eligible inputs – *Chemplsat Sanmar Ltd. v. CCE* 2004 (176) ELT 412 (Chennai – CESTAT). In yet another case, it was held that urea used in the manufacture of oxalic acid was eligible for credit, since it was a technical necessity, especially where the manufacturer had no separate effluent treatment, and the use of urea in the absorption column for pollution control of absorption of unwanted gases was necessary for the emergence of oxalic acid as a commercially feasible product – *Star Oxochem (P.) Ltd. v. CCE* 2004 (167) ELT 74 (Mum. – CESTAT).

2.3.15 Inputs issued for research

Inputs used for research do not result in the emergence of any article and are hence not eligible for credit. In one case, a manufacturer of three wheeler vehicles claimed credit on components of three wheeler vehicles utilized in the R&D department, and contended that goods used for research today would one day resulting the emergence of some goods which would ultimately be used in the manufacture of final products. The Tribunal dismissed the contention as 'verges on the absurb', and held that credit on the said components was not admissible – Bajaj Auto Ltd. v. CCE 2004 (176) ELT 162 (Mum. – Cestat). In the case of Krebs Biochemicals and Industries Ltd. v. CCE 2007 (220) ELT 170 (Bang. – CESTAT), the Tribunal held that the finding of the lower authorities that credit on inputs used in R&D could not be extended was correct and proper, as it was held that inputs used for testing the quality of inputs prior to putting them in the manufacturing stream was held as eligible inputs, since testing of inputs was a standard practice in manufacture, and that the fact that the testing took place in the R&D Wing would make no difference- ITI Ltd. v. CCE 2005(179) ELT 321 (New Delhi – Cestat).

2.3.16 Inputs sent for job work and then exported

In the case of Brakes India Ltd. v. CCE 2007 (214) ELT 380 (Chennai –CESTAT), the appellants received various inputs such as steel scrap, pig iron, chemicals, etc., and manufactured casting out of them. These castings were sent to a job worker for machining them into automotive parts. Thereafter, they were sent to another job worker for painting. The appellants paid duty for the clearance of these goods by the job workers, and availed credit. Thereafter, the appellants conducted certain tests on the product, packed them, and exported them under bond. The department disallowed credit availed by the appellants, on the ground that the product was exported in the same form in which they were received from the job workers, without any further process which amounted to 'manufacture'. The Tribunal observed that the appellants did not procure the inputs and then exported them as such, but had actually undertaken major part of the manufacturing activity of casting as well as the finishing process, and that the arguments of the appellants that the processes undertaken by them after receipt from the job workers amounted to 'manufacture' carried considerable force. The Tribunal therefore held that the impugned goods became fully manufactured goods only in the premises of the appellants before they were exported, and that hence credit availed by them was not disallowable.

2.3.17 Inputs used for repairs

Where the appellants undertook repair of the goods using cenvatted inputs, and then cleared them on payment of duty, they would not be eligible for credit on the inputs used, since repair cannot be treated as a manufacturing activity – *Markfed HDPE Sacks Plant v. CCE* 2007 (217) ELT 32 (New Delhi – CESTAT).

2.3.18 Inputs used in combination packs

In the case of *Lottee India Corporation Ltd. v. CCE* 2008 (224) ELT 102 (Chennai-Cestat), the appellants manufactured 'Coffee Bite', and sold them in a combination pack along with butter scotch purchased by them. They paid duty on the MRP indicated in the combination pack. The department took the view that butter scotch could not be treated as an 'input', and disallowed credit availed on it. The Tribunal observed that, in view of section 2(f)(iii) of the Central Excise Act, there could not be any doubt that the combipack was a manufactured product, and held that the appellants were eligible for input credit on the butter scotch purchased.

2.3.19 *Inputs used indirectly or got consumed in process also eligible* -

In Eastern Electro Chemical Industries v. CCE 2005 (181) ELT 295 (SC 3 member bench), it was held that there were four kinds of inputs which could be said to be ingredients – (i) those which retain their dominant individual identity and character throughout the process and also in the end-product (ii) those which, as a result of interaction with other chemicals or ingredients, might themselves undergo chemical or qualitative changes and in such altered form find themselves in the end-product (iii) those which like catalytic agents, while influencing and accelerating the chemical reactions, themselves remain uninfluenced and unaltered and remain independent of and outside the end products and (iv) those which might be burnt up or consumed in the chemical reactions – relying on CCE v. Ballarpur Industries Ltd. 43 ELT 804=1989 (1) SCR 323=AIR 1990 SC 196=1989(4) SCC 566=77 STC 282.

2.3.20 One to one correlation not necessary

Rule 3(4)(a) states that Cenvat credit may be utilized for payment of any duty of excise on any final product. Thus, there is no requirement of establishing relation between inputs/input service and final product.

There is no correlation of the raw material and the final product; that is to say, it is not as if credit can be taken only on a final product that is manufactured out of the particular raw material to which the credit is related – CCE v. Dai Ichi Karkaria Ltd. 112 ELT 353=AIR 1999 SC 3234=1994 AIR SCW 3205=(1999) 7 SCC 448 (SC 3 member bench).

2.3.21 Credit on any input can be used for any final product –

Credit of input can be used in any of the final product. An illustration will clarify. Assume that there are two inputs I-1 and I-2, used in two final products F-1 and F-2 respectively. Excise duty paid on inputs is ₹ 350 on I-1 and ₹ 150 on I-2. Manufacturer can avail credit of this duty paid. Duty payable on final product is ₹ 200 on F-1, and ₹ 400 on F-2. Thus, Cenvat credit on I-1 is ₹ 350 while duty payable on F-1 is only ₹ 200. Thus, even after utilizing the full Cenvat credit, a balance of ₹ 150 is left to the credit of manufacturer. Normally, this credit would lapse as there is no provision in Cenvat to grant refund of such excess credit. However, Rule 3(3) of Cenvat Credit Rules provides that Cenvat credit can be utilized for payment of duty of excise on any final product manufactured by the manufacturer. Thus, the balance left on payment of duty on F-1 can be used while paying duty of F – 2, on F-2, duty payable is ₹ 400, while credit available on I-2 is only ₹ 150. Thus, normally, the manufacturer will have to pay balance amount of ₹ 250 by cash (through PLA). However, since the manufacturer has credit balance of ₹ 150, he can utilize the same and pay only ₹ 100 by cash (i.e. through PLA), - confirmed in Mahindra & Mahindra v. CCE 2001(127) ELT 247 (CEGAT).

2.3.22 Inputs used in exempted final products not eligible –

If a manufacturer manufactures more than one products, it may happen that some of the products are exempt from duty. In such cases, duty paid on inputs used for manufacture of exempted products cannot be used for payment of duty on other products which are not exempt from duty. – Rule 6(1) of Cenvat Credit Rules. Thus, this is an exception to above rule.

As per Rule 6 of Cenvat Credit Rules, if the manufacturer is engaged in manufacture of both dutiable and exempt final products, he should maintain separate accounts of these inputs. However, if this is not possible, an 'amount' equal to specified % of 'price' of such exempted products' should be paid.

2.3.23 ***Process losses and handling loss are allowable*** – There will be some loss of inputs during manufacturing process. Cenvat is available on entire quantity of input even if part of input goes in process loss, since all inputs are 'used' in the manufacture of final product, even if it is not reflected in final product – Multimetals Ltd. v. ACCE 57 ELT 209(SC)=1992 (1) SCC 715= AIR 1992 SC 1532=1992 AIR SCW 1644 – quoted with approval in UOI v. Indian Aluminium Co. Ltd. – 1995(77) ELT 268 (SC – 3 member bench order). Where it was held that exact mathematical equation between quantity of raw material purchased and the raw material found in finished product is not possible, and should not be looked for. [This judgment is in respect of Proforma Credit, but its ratio is fully applicable to Cenvat.]

2.3.24 ***Defective final product is 'input' for purpose of availing Cenvat credit*** –

Often goods are dispatched to customer by paying duty. The customer may reject the same if these are found defective. These are then returned to manufacturer. The manufacturer may like to rectify or recondition them. In such case, as per Rule 16 of Central Excise Rules, assessee can avail Cenvat credit of duty paid on such returned goods. While returning the goods after repairs/rectification/refining, if the process carried out was manufacture, duty will be payable at rate and value as on date of removal. If the process did not amount to manufacture, an 'amount' equal to Cenvat credit availed will be paid at the time of removal.

2.3.25 ***Credit if goods lost/destroyed in process but no credit inputs are lost or destroyed in store room or pilfered*** –

Since credit on inputs is available only for inputs used in or in relation to manufacture of final products, if the inputs are lost or destroyed in the store room, credit to duty paid on such inputs will not be available, as it cannot be said that they are used 'in or in relation to manufacture'.

If waste is before actual manufacturing starts, such waste is not 'during manufacture' and in such case, Cenvat will have to be reversed .- Monica Electronics Ltd. v. CCE – 1995(75) ELT 440 (CEGAT) (e.g. waste when inputs are in stores, or while issuing components to shop floor).

2.3.26 Loss due to leakage during process –

Cenvat credit is available even if there is loss of input due to leakage in storage tank during process – Doaba Alco Chemicals v. CCE 2005(179) ELT 434 (CESTAT SMB).

2.3.27 Fire During Process –

If the goods are damaged during production, Cenvat will be available. – eligible if inputs are destroyed by fire during the process.

2.3.28 Damage By Flood –

In CCE v. Colour Chmicals Ltd. 9(113) ELT 132 (CEGAT), it was held that Cenvat credit availed on inputs is eligible even if semi-finished goods and finished goods made out of inputs were washed away by flood water and lost.

2.3.29 Shortages In Stock Of Inputs –

If inputs are found short in stock taking, they are not used in or in relation to manufacture of finished goods. Hence, Cenvat credit is not admissible – K-Three Electronics Pvt. Ltd. v. CCE 2004(173) ELT 432 (CESTAT).

Obsolete goods written off - CBE&C in its circular No. 645/36/2002-CX dated 16-7-2002 has clarified that if unused inputs or unused capital goods are written off in the books of account, Cenvat credit should be reversed. However, if value of inputs is partially written off/reduced in accounts but the inputs are capable and available for use, there would be no question of payment of Cenvat credit availed.In Bharat Heavy Electricals v. CCE (2002) 50 RLT 208 (CEGAT), it was held that when goods are lying in stock in factory premises, Cenvat credit is not to be reversed even though value has been written off in accounts, as there is no time limit for consumption of inputs.

In RPG Cables v. CCE 2003 (157) ELT 273 (CEGAT), it was held that if obsolete stock of inputs is written off and is not physically available, Cenvat credit is required to be written off.

2.3.30 Loss/shortage in transit during receipt of goods –

There may be short receipt of goods. In such cases, no credit is available in case of shortages. However, if such shortage is due to natural causes, full Cenvat is available.

2.3.31 Capital goods not defined as 'capital goods' will be eligible as 'inputs' -

In CCE v. Tata Engineering & Locomotives Co. Ltd. 2003 (158) ELT 130 (SC), it has been held that fork lift trucks, lifting tackles, trolleys, conveyors and measuring instruments are 'inputs' used in or in relation to manufacture of final products. Thus, unless they are excluded by an exclusion clause, they will be eligible as 'inputs' [Decision under different notification, but principle is fully applicable here, as wording is similar].

If certain capital goods are not covered under definition of 'capital goods' as per rule 57AA(a) [Now rule 2(b) of Cenvat Credit Rules], these may be eligible as 'input' if used in or in relation to manufacture, as per ratio of decision of Union Carbide of India v. CCE – 1996(86) ELT 613=66 ECR 172=1996(15) RLT 144 (CEGAT – 3 member bench 2 v. 1 order).

2.3.32 Inputs eligible for Cenvat credit even if intermediate product exempt -

CBE&C had clarified vide para 5 of circular No B4/7/2000- TRU dated 3-4-2000, that Cenvat credit should not be denied if the inputs are used in any intermediate of final product, even if such intermediate product is exempt from payment of duty. The idea is that Cenvat credit is available so long as the inputs are used in or in relation to manufacture of final product, and whether directly or indirectly – view reiterated in Chapter 5 Para 3.9 of CBE&C's Manual, 2001.

2.3.33 Accessories eligible for Cenvat -

Accessories are eligible for Cenvat if these are cleared along with the final product. – Rule 2(k)(i) of Cenvat Credit Rules.Note that the rules do not require that value of accessories should be included in assessable value of final product. Dropper supplied paediatric drops is an attachable component of the bottle. Its value is included in Maximum Retail price of the drug. Hence, Cenvat credit on duty paid on dropper is admissible – Heal well Pharmaceuticals v. CCE 1994(72) ELT 446 (CEGAT).

2.3.34 Cenvat on Paints — Paints used in factory are eligible. As explained above, the extended definition of input says that paints can be used 'for any purpose'. Thus, all paints used in the factory are eligible, for whatever purpose they are used.

2.3.35 Cenvat available on packaging material – Cenvat is available on packing material as per definition of input contained in Rule 2(k)(i) of Cenvat Credit Rules.

2.4 INPUT SERVICE FOR CENVAT

2.4.1 Input Service

Manufacturer as well as service provider will be eligible to get Cenvat credit of 'input services'. Rule 2(1) of Cenvat Credit Rules reads as follows –

(i) Insofar as a service provider is concerned, the term 'input service' means any service used by a provider of taxable service for providing an output service. In other words, if a provider of taxable service avails the services of another service provider, the services provided by such 'other service provider' will fall under the definition of 'input service', provided those services have been availed of by the provider of taxable service exclusively for the purpose of providing output service to the ultimate consumer (client, customer etc.)

(ii) Insofar as a manufacturer is concerned, the term 'input service' means (a) any service used by the manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and (b) clearance of final products from the place of removal (upto 31-3-2008) or clearance of final products upto the place of removal (from 1-4-2008).

    In either case, the service in question can be 'any service' and not necessarily be a 'taxable service' as defined in provisions relating to service tax.

(iii) Certain services are specifically included, both in respect of manufacturer and provider of taxable service.

2.4.2 Wide coverage of input services –

The words used in the definition in relation to manufacturer are 'in relation to'. 'In relation' expands the scope of coverage. It is not restrictive. Service need not be received in factory or premises from where output service provided – In case of inputs and capital goods, Cenvat credit is eligible to manufacturer only if these are received in the factory. However, in case of input service, there is no such requirement. Input service need not be received in factory or premises of service provider. In case of service provider, even there is no requirement that inputs and capital goods should be received in premises of service provider, Input service should have relation to 'manufacture'. Definition of 'input service' is very wide. Any service in relation to business is input service. So far, there was no resistance from industry for service tax, since they had a feeling that they will be able to avail Cenvat credit of service tax paid by them on all their input services. However, in recent Tribunal decisions, a restrictive view is being taken that 'input service' should have relation with manufacture. In Colgate Palmolive P Ltd. v. CCE (2008) 12 STT 269 = 7 STR 294 (CESTAT), a prima facie view was expressed that credit of input services which are common to manufactured as well as exempted/traded goods is not available. A prima facie view was also expressed that even services in the inclusive part of definition should be in relation to manufacture. In Coca Cola India v. CCE (2007) 7 STR 529 (CESTAT), assessee was manufacturing concentrate for cold drinks. He was incurring expenditure for advertisement of aerated water and not concentrate. It was held that advertisement expenses is not his 'input service' since it is not related to manufacture of 'concentrate' but related to sale of aerated waters. The reason given was that such advertisement expenses are not includible in assessable value of base essence [Really, the issue is highly arguable. Aspect of valuation is independent of aspect of eligibility of Cenvat credit]. In Gujarat Ambuja Cement Ltd. v. CCE (2007) 8 STT 122 = 212 ELT 410 = 6 STR 249 (CESTAT). Hon. Tribunal in para 12 of the decision has observed, 'Crucial point to be noted in regard to Cenvat Credit is that credit availability is in regard to 'inputs'. The credit covers duty paid on input materials as well as tax paid on services, used in or in relation to the manufacture of the 'final product'. Therefore, extending the credit beyond the point of duty paid removal of the final product, would be contrary to the Scheme of Cenvat Credit Rules'.

2.4.3 Clearance –

This word has specific meaning in Central Excise, where 'clearance' means removal from the factory. Thus, expenses incurred for removal of final product from factory like loading final products in vehicles will get covered. Place of removal – The words are not defined in Cenvat Credit Rules, but are defined in section 4(3)(c) of Central Excise Act as follows –

2.4.4 "Place of removal" means—

(i) a factory or any other place or premises of production or manufacture of the excisable goods;

(ii) a warehouse or any other place or premises wherein the excisable goods have been permitted to be deposited without payment of duty;

(iii) a depot, premises of a consignment agent or any other place or premises from where the excisable goods are to be sold after their clearance from the factory from where such goods are removed. In Mangalam Cement v. CCE (2007) 8 STR 639 (CESTAT), strong prima facie view was held that if services relate upto the depot, service tax credit will be available. Port/airport is place of removal in case of export - In case of exports, the place of removal isport where export documents are presented to customs office – Kuntal Granites v. CCE (2007)

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215 ELT 515 = 2007 TIOL 930 (CESTAT) – quoted and followed in Rajasthan Spinning & Weaving Mills v. CCE (2007) 8 STR 575 (CESTAT).

2.4.5 Hence, all expenses upto that place should be considered as 'input service'. Activities relating to business All services relating to business will be eligible for service tax credit. The words used are 'activities relating to business, such as - - - - - '. The activities specifically mentioned are as follows –

- Accounting, auditing, financing
- Recruitment and quality control
- Coaching and training

- Computer networking
- Credit rating
- Share registry
- Security
- Inward transportation of inputs or capital goods and
- Outward transportation upto the place of removal.

However, these are only illustrations, as the words used are 'such as'. The illustrations do not mean that only these services are covered under 'activities relating to business'. For example, the words used are 'outward transportation upto the place of removal'. It does not mean out-ward freight after place of removal is excluded.

Meaning of 'such as' - The words 'such as' are used only to illustrate the scope. It is not restrictive.

2.4.6 The input services relating to business can be used for any purpose whatsoever - As per inclusive definition of 'input service' [rule 2(l)], all services used for activities relating to business' are 'input services'. The definition does not say 'activities relating to business pertaining to manufacture or provision of output services'. Thus, all input services used in activities relating to business are 'input services', whatever may be its purpose.

Any expenditure incurred on ground of commercial expediency is for purpose of business – In SA Builders Ltd. v. CIT (Appeals) (2007) 158 Taxman 74 = 288 ITR 1 (SC), it was held that any expenditure incurred on ground of commercial expediency is allowable as business expenditure. 'For the purpose of business' is wider in scope than the expression 'for the purpose of earning income, profits or gains'. 'Commercial expediency' is an expression of wide import and includes such expenditure as a prudent businessman incurs for purpose of business. The expenditure may not have been incurred under legal obligation, yet it is allowable if it was incurred on grounds of commercial expediency – relying on Madhav Prasad Jatin v. CIT AIR 1979 SC 1291.

2.4.7 Mobile phones eligible for Cenvat Credit –

Earlier Service Tax Rules required 'installation' of telephones in the business premises. Hence, CBE&C had clarified vide circular No. 59/8/2003ST dated 20-6-2003 that Cenvat credit will not be available in case of mobile phones. Now there is no such requirement. Hence, service tax paid on mobile phones will be eligible for Cenvat credit w.e.f. 10-9-2004, so long as these are used for 'activity relating to business' – view confirmed in Indian Rayon v. CCE 2007 (6) STT 328 = 4 STR 79 (CESTAT SMB).

2.4.8 Internet services eligible –

Cenvat credit is available in respect of internet services, as it is utilised for information relating to manufacture, sale and despatch – Universal Cables Ltd. v. CCE (2007) 7 STR 310 (CESTAT).

Outward freight after place of removal is not 'input service'?– One of the illustrations given in inclusive part of definition of 'activities relating to business' is 'outward freight upto place of removal'. Hence, a doubt is expressed that freight paid after place of removal is not 'input service'. This is not correct. As already explained, 'such as' means what follows are only illustrations. These are not limitations. It does not mean outward freight after place of removal is excluded from definition of 'input service'. It should be eligible if it is in relation to activities of business. In CCE v. KTMS Engineering (2007) 7 STR 274 (CESTAT), a prima facie view was expressed that service tax paid on outward freight from place of removal is eligible for Cenvat credit – same view in Gujarat Sidhee Cement v. CCE (2007) 7 STR 571 (CESTAT).

However, this view has not been accepted by Tribunal. In Gujarat Ambuja Cement Ltd. v. CCE (2007) 8 STT 122 = 212 ELT 410 = 6 STR 249 (CESTAT), it has been held that outward freight is not an input service. Service tax paid on the cost of transportation from the factory/depots to the buyers' premises, would not be available as credit – followed in India Japan Lighting P Ltd. v. CCE (2007) 11 STT 498 = 8 STR 124 = 218 ELT 103 (CESTAT) – same prima facie view in stay petition in Ultratech Cement v. CCE (2007) 8 STT 152 = 6 STR 364 (CESTAT).

Credit only after payment is made to service provider Credit of input services can be availed only after the output service provider makes payment of value of input services and the service tax payable on it, as shown in invoice of input service provider. [Rule 4(7) of Cenvat Credit Rules]. [In case of excise duty, credit is available as soon as goods are received in the factory. There is no condition that credit can be availed only after payment is made to supplier of goods].

2.4.9 Mere payment of service tax to service provider is not sufficient –

Suppose the invoice is for ₹ 100 and service tax is ₹ 10.30, can you avail Cenvat credit if you pay only ₹ 10.30 to the input service provider? The answer is no, as the words used are 'value of input services *and* the service tax payable on it'.

2.4.10 The specifically included services

The following services are specifically included in the definition of 'input service' :

Services used in relation to :

(i) setting up, modernization, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises,

(ii) advertisement or sales promotion,

(iii) market research,

(iv) storage upto the place of removal,

(v) procurement of inputs,

(vi) activities relating to business, such as accounting, auditing, financing, recruitment and quality control,

(vii) coaching and training,

(viii) computer networking,

(ix) credit rating,

(x) share registry,

(xi) security,

(xii) inward transportation of inputs or capital goods; and

(xiii) outward transportation upto the place of removal.

Scope of 'activities relating of business' –

It is clear that in view of the use of words 'such as', any input service relating to business will be eligible for service tax credit. This is also clear from the fact that service tax paid at head office/regional offices will be available as credit on the basis of invoice/challan/Bill issued by 'input service distributor'.

Some of the input services which may get covered under this head are as follows – (a) Telephone (b) Security Services (c) Travel Agents (d) Audit (e) Banking and financial services (f) Business Auxiliary Services (g) Commercial training (h) consulting Engineer (i) CHA services (j) Management consultant (k) Manpower recruitment (l) Rent-a-cab (m) Storage and warehousing (n) Technical inspection and testing (o) Goods Transport Agency.

2.4.11 Credit only after payment is made to service provider

Credit of input services can be availed only after the output service provider makes payment of value of input services and the service tax payable on it, as shown in invoice of input service provider. [Rule 4(7)]. [In case of excise duty, credit is available as soon as goods are received in the factory. There is no condition that credit can be availed only after payment is made to supplier of goods].

This peculiar provision has a specific purpose. The reason for this provision is that as per Service Tax Rules, the service tax is payable only after the amount is actually received by the service provider. Thus, the service provider of input services will be liable to pay service tax only when the person who has availed the service (output service provider in this case) pays the amount of his invoice.

It may happen that the output service provider may avail credit of service tax on input services on the basis of Invoice raised by provider of input services. However, he may not actually pay the amount of Invoice to the input service provider. If such thing happens, the service provider of output services will avail credit of service tax, while service provider of input services will not be paying the service tax, as he has not received the payment. Hence, it is provided that service provider of output services can avail credit of service tax only when he makes payment of invoice of input service tax provider, including service tax charged by the input service tax provider.

2.4.12 Relevance of CAS-4 Standard –

In the case of CCE v. GTC Industries Ltd. [2008] 17 STT 63 (Mum. – Cestat), a three-member Bench of the Tribunal cited reference to a Press Note dated 12-8-2004 issued at the time of the draft rules in which it was stated that 'in principle, credit of tax on those taxable services would be allowed that to form a part of the assessable value on which excise duty is charged'. Based on this assurance, the Tribunal took the view that CAS-4 Standards in which 'cost of production' is defined will be relevant for determining whether any taxable service will qualify to be treated as an 'input service' or not.

2.4.13 Services used for procurement of imported service –

In the case of CST v. Convergys India (P.) Ltd. (2009) 21 STT 67 (New Delhi – CESTAT), the show-cause notice alleged that the respondent had used imported input services and in connection with procurement of such services, they had also used certain other input services by using telephone, telex, fax, e-mail etc. and that such services used for procuring such input services could not be treated as input services. The Tribunal did not agree. The Tribunal held that using telephone, telex, fax, e-mail etc. could not be treated as output services provided by the respondent and that, therefore, such input services used in connection with procurement of other input services had to be treated necessarily as input services.

2.4.14 Output service

Who is 'input service distributor' - As per rule 2(m), "input service distributor" means an office managing the business of manufacturer or producer of final products or provider of output service, which receives invoices issued under rule 4A of the Service Tax Rules, 1994 towards purchases of input services and issues invoice, bill or, as the case may be, challan for the purposes of distributing the credit of service tax paid on the said services to such manufacturer or producer or provider, as the case may be.

Rule 2(p) defines an 'output service' as a service which satisfies the following requirements :

- It must be a taxable service. Section 65(105) of the Service Tax Act spells out the taxable services. The service in question must fall under the category of one of those specified taxable services.
- With effect from 1-3-2008, it excludes transport of goods by road service.
- It must be rendered by the 'provider of taxable service' to a customer, client, subscriber, policy holder, subscriber or any other person as the case may be. In contrast to an 'input service' which is rendered only to a manufacturer or another service provider; an 'output service' must be one that is rendered to other persons for final consumption.

2.4.15 Document Eligible For Cevat Credit –

As per rule 9(1)(g); 'invoice, bill or challan' issued by an 'input service distributor' under rule 4A of Service Tax Credit Rules is an eligible document for purpose of taking Cenvat credit.

2.5 CAPITAL GOODS FOR CENVAT

2.5.1 Eligible 'Capital Goods'

Cenvat credit is available on inputs as well as capital goods. Some provisions are common while there are some specific provisions in respect of Cenvat on capital goods. General provisions applicable to both inputs and capital goods are discussed in other chapter. The specific provisions in respect of capital goods are discussed here.

Capital Goods eligible to a manufacturer or service provider - Manufacturers and service providers are eligible to avail Cenvat credit of capital goods used by them.

2.5.2 Use of Capital Goods –

The capital goods should be used – (a) in the factory of the manufacturer of the final products, but does not include any equipment or appliance used in an office; or (2) for providing output service.

2.5.3 Installation of capital goods is not required –

Installation/use of capital goods is not a pre-requisite for taking Cenvat credit. First 50%of Cenvat credit taken in respect of capital goods before their installation or use cannot be denied – Goyal MG Gases v. CCE (2004) 168 ELT 369 (CESTAT).

This is correct as rule 3(1) states that Cenvat credit of capital goods can be taken of duty paid on capital goods received in the factory or premises of provider of output service. The rules do not require its installation or commissioning for 'taking' credit.

2.5.4 Capital Goods Eligible even if used for short duration –

Definition of 'capital goods' as per rule 2(b)(a) states that capital goods should be 'used' in the factory/providing output services. Duration is not specified. Hence, even if the capital goods are used for one day, Cenvat eligibility of capital goods is established, as they are 'used'.

2.5.5 Purpose for which Capital Goods used by Manufacturer is immaterial –

The Capital goods can be used within factory for any purpose.

2.5.6 Capital goods used exclusively for exempted final products and output services not eligible –

Capital goods used exclusively for manufacture of exempted goods or providing exempt service are not eligible [rule 6(4)]. [Thus, partial use of capital goods for manufacture of exempted goods or provision of exempt output services is permissible, i.e. in such case, Cenvat credit on capital goods will be allowed].

2.5.7 Capital goods does not cover equipment or appliance used in office for manufacture –

Rule 2(a)(A)(1) clarifies that equipment or appliances used in an office will not be eligible as 'capital goods'. This restriction is only for manufacturer and not for service provider.

2.5.8 Capital goods on hire purchase/lease/loan eligible –

Capital goods obtained on hire purchase, lease or loan agreement from a financing company are eligible for Cenvat – Rule 4(3) of Cenvat Credit Rules. – Though no procedure has been prescribed, it is advisable that the invoice issued by manufacturer of capital goods shows name of the manufacturer as consignee, though the invoice of manufacturer will be in name of the financing company.

2.5.9 Goods imported under project imports –

Goods (mainly machinery) imported under 'project imports' is classified under chapter 98.01 for Customs purposes. Actually, the machinery/goods may be classifiable under differently.

2.5.10 Capital goods manufactured within the factory

As per *Explanation* 2 to rule 2(k) of Cenvat Credit Rules, 'input' includes goods used in manufacture of capital goods which are further used in the factory of manufacturer. Thus, if a manufacturer manufactures some capital goods within the factory, goods used to manufacture such capital goods will be eligible as 'inputs'. [i.e. 100% Cenvat credit will be available in the same financial year]. – It may be noted that capital goods manufactured within the factory and used within the factory are exempt from excise duty vide notification No. 67/95-CE dated 16-3-1995.

2.5.11 Capital goods used by Service provider

A service provider is eligible for Cenvat credit on capital goods, if these are used for providing output service. The definition does not say 'exclusively used'. It also does not specify the period for which the capital goods should be used. Legally, even if they are used for one day, they are 'used', Thus, even if capital goods are used partially for providing output service or they are used only for limited period, Cenvat credit of excise duty paid on capital goods will be available.

2.5.12 Sending out of capital goods by service provider –

Service provider can send out capital goods for providing output service, but these should be brought back within 180 days [second proviso to Rule 3(5)]. Extension can be obtained from Assistant/Deputy Commissioner.

This provision is in conflict with definition of 'capital goods' for service providers, as there is no requirement under rule 2(a) that the capital goods should be brought in the premises of service provider. In case of conflict, basic definition of 'capital goods' should prevail, as rule 3(5) is mainly a procedural provision, while rule 2(a) is a substantive provision.

2.5.13 Depreciation can be taken on 50% of Cenvat credit in first year?

In the first year, the assessee avails credit of only 50% of excise duty. The restriction in rule 4(4) regarding depreciation is only in respect of duty of which Cenvat credit has been taken. Hence, in *Suprajit Engineering Ltd*. v. *CCE* (2007) 6 STR 170 = 212 ELT 394 (CESTAT), it has been held that there is no violation of rule if assessee claims depreciation on the balance 50% of duty, since he has not availed credit of that amount in first year – followed in *Roots Cast* v. *CCE* (2007) 216 ELT 448 (CESTAT SMB).

2.5.14 Sending out of capital goods by service provider –

Service provider can send out capital goods for providing output service. There is no requirement that these should be brought back within 180 days.

Following are the 'capital goods', vide rule 2(a)(i) of Cenvat Credit Rules –

(i) Tools, hand tools, knives etc. failing under chapter 82, Machinery covered under chapter 84, Electrical machinery under chapter 85, Measuring, checking and testing machines etc, falling under chapter 90, Grinding wheels and the like goods falling under sub-heading No. 6801.10, Abrasive powder or grain on a base of textile material, falling under chapter heading 68,02.

(ii) Pollution control equipment.

(iii) Components, spares and accessories of the goods specified above.

(iv) Moulds and dies.

(v) Refractories and refractory material.

(vi) Tubes, pipes and fittings thereof, used in the factory.

(vii) Storage Tank.

2.6 INPUT SERVICE DISTRIBUTOR

A manufacturer or service provider may have head office/regional office at different place/s. The services may be received at head office/regional office, but ultimately, these will be indirectly used for manufacture or providing output service. Provision has been made to avail Cenvat credit of services received and paid for at head office/ regional office. Such head office/ regional office can be registered with Central Excise as 'Input Service Distributor' and it can issue invoice on the anufacturer or producer or service provider.

2.6.1 Who is 'input service distributor' - As per rule 2(m) of Cenvat Credit Rules, "input service distributor" means (a) an office managing the business of manufacturer or producer of final products or provider of output service, (b) which receives invoices issued under rule 4A of the Service Tax Rules, 1994 towards purchases of input services ***and*** (c) issues invoice, bill or, as the case may be, challan for the purposes of distributing the credit of service tax paid on the said services to such manufacturer or producer or provider, as the case may be. An office of assessee (manufacturer or service provider) is 'Input Service Distributor' if it satisfies all the three aforesaid requirements. It is not that each and every office of assessee is 'Input Service Distributor' and must register. The office should be registered as 'Input Service Distributor' only if it wants to distribute. There is no law that 'distribution' is the only way of availing Cenvat credit of services received at office of assessee. There are various documents eligible for availing Cenvat credit. Invoice/challan issued by 'Input Service Distributor' is only one of the specified document.

2.6.2 Document eligible for Cenvat credit - As per rule 9(1)(g); 'invoice, bill or challan' issued by an 'input service distributor' under rule 4A of Service Tax Credit Rules is an eligible document for purpose of taking Cenvat credit.

2.6.3 Concept of Input Service Distributor is a facility – not compulsion – Sometimes, an assessee has offices at various places but accounting is done centrally in the factory. Sometimes, there are various factories of assessee but accounting is done in main factory. In such cases, in my opinion, the main factory can directly take Cenvat credit of service tax on the basis of documents. The reason is that 'Input Service Distributor' is a facility. It is nowhere stated that the utilisation should be only through mechanism of Input Service Distributor. There is no law that 'distribution' is the only way of availing Cenvat credit of services received at office of assessee. A facility cannot be a compulsion.Law does not even specify that there must be distribution of Cenvat credit or that the distribution should be in some specified ratio. If no 'distribution' is necessary, there should not be any need of 'Input Service Distributor'.

2.6.4 Distribution of credit by input service distributor – The 'Input Service Distributor' may distribute Cenvat Credit in respect of service tax, among its manufacturing units or providing output service. The credit distributed should not be more than the service tax paid. If an input service is attributable to service use in a unit exclusively engaged in manufacture of exempted goods or providing exempted services, the credit of such credit of service tax shall not be distributed [rule 7].

The 'input service distributor' should issue a 'Invoice, Bill or Challan' on monthly basis after consolidating the service tax paid on services received during the month.

2.6.5 UTILISATION OF CENVAT CREDIT

- 'Cenvat Credit' is a pool of duties and taxes paid on inputs, capital goods and input services specified in rule 3(1) of Cenvat Credit Rules.
- The credit in this pool can be utilised for payment of any excide duty on excisable final product and service tax on taxable output service. The credit can also be used for payment of certain 'amounts'.
- Credit of various duties is inter-changeable, subject to few exceptions.
- Credit can be availed only of inputs and input services received upto end of the month.
- Cenvat credit will have to be reversed if the final product is subsequently exempt. The basic conditions for taking Cenvat Credit are as follows –
- There should be 'manufacture' or provision of taxable output service
- Inputs (goods) should be used in or in relation to manufacture of final product or for provision of output service
- Input service should be utilised for manufacture of final product or provision of taxable output service

2.6.6 ISSUES RELATING TO CENVAT

- Cenvat credit is available for duties and taxes specified in rule 3(1), paid on input, input services and capital goods, subject to restrictions as specified
- No credit is available if final product is exempt from duty or output service is not taxable
- Credit is available on the basis of specified documents only The conditions for allowing Cenvat Credit, as specified in rule 4 are as follows –
- Cenvat credit on inputs is available as soon as inputs are received in the factory of manufacturer or premises of the provider of output service [rule 4(1)].
- Cenvat credit of capital goods can be taken upto 50% in the financial year in which capital goods are received and balance in subsequent year/s [rule 4(2)]
- Cenvat credit of capital goods is allowable even if the capital goods are acquired on lease, hire purchase or loan [rule 4(3)]. However, assessee should not claim depreciation on the excise portion of value of capital goods [rule 4(4)]
- Inputs and capital goods can be sent outside for job work but should be brought back within 180 days [rule 4(5)]

- Cenvat credit is available on jigs, fixtures, moulds and dies even if sent to job worker for production of goods on behalf of manufacturer [rule 4(6)]
- Cenvat credit of input service is allowed only after payment towards value of service and service tax is made [rule 4(7)]

2.6.7 Duties eligible for Cenvat credit - Assessee can avail credit of duty/ service tax paid on inputs and input services. This credit is known as 'Cenvat Credit'. This is a 'pool' which is available for utilisation for payment of duty on any final product or output services, subject to certain restrictions and limitations.

2.6.8 Payment of NCCD on mobile phones can be only by Cenvat credit of NCCD and not any other Credit – As per fourth *proviso* to Cenvat Credit Rule 3(4) inserted w.e.f. 1-3-2008, only credit of NCCD can be utilised for payment of NCCD on mobile phones. Any other credit cannot be used. This restriction is only for mobile phones.

2.6.9 One to one correlation not necessary in Cenvat – Rule 3(4)(a) states that Cenvat credit may be utilised for payment of *any* duty of excise on *any* final product or service tax on output service.

Thus, there is no requirement of establishing relation between inputs/input services and final product/output services. One to one relation is not required.

There is no correlation of the raw material and the final product; that is to say, it is not as if credit can be taken only on a final product that is manufactured out of the particular raw material to which the credit is related - *CCE* v. *Dai Ichi Karkaria Ltd.* 112 ELT 353 = AIR 1999 SC 3234 = 1999 AIR SCW 3205 = (1999) 7 SCC 448 (SC 3 member bench) – quoted with approval in *CCE* v. *Bombay Dyeing* (2007) 10 STT 286 (SC).

2.6.10 Full credit even if seller gave trade discount or price reduction later – Even if manufacturerseller gave trade discount later, full credit of excise duty paid by him is available to buyer so long as duty paid at supplier's end is not changed – *CCE* v. *Tirumala Fine Texturiser P Ltd*. (2007) 217 ELT 85 (CESTAT SMB) – same view in *Evergreen Engineering Co.* v. *CCE* (2007) 215 ELT 134 (CESTAT SMB) * *Brown Kraft Indus. Ltd*. v. *CCE* (2007) 212 ELT 369 (CESTAT) – same view in *Force Motors* v. *CCE* (2007) 213 ELT 302 (CESTAT), where it was held that credit available is of duty 'paid' and not duty 'payable'.

2.6.11 Restriction on Cenvat credit of goods supplied by EOU - From following data, determine the Cenvat allowable if the goods are produced or manufactured in a FTZ or by a 100% EOU and used in any other place in India. Assessable value : ₹ 770 per unit, Quantity cleared 1,000 units, BCD – 10%, CVD – 14%, plus education cess as applicable.

Answer - As per Rule 3(7)(a) of Cenvat Credit Rules, 2004 the following formula is to be used if a unit in DTA purchases goods from EOU, for clearances on or after 1-3-2006 – Assessable value x{[1+BCD/400] X CVD/100}

Hence, Cenvat Available per unit is as follows –

Total Cenvat allowable on 1,000 units = 1,000 x 113.81 = ₹ 1,13,81,000

2.7 REVERSAL OF CENVAT

Cenvat credit is taken as soon as inputs are received in factory or input services are paid for. In some cases, Cenvat credit may have to be reversed.

2.7.1 Reversal under rule 6 - If a manufacturer manufactures exempted as well as taxable goods and/or a service provider provides taxable as well as exempt services, he (manufacturer/service provider) is required to either pay 'amount' or reverse proportionate Cenvat credit. The issue is discussed in a later chapter.

2.7.2 Reversal if finished goods cleared at concessional rate of duty - Finished products can be sent under bond under Central Excise (Removal of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 2001 without payment of duty. If such goods are sent, Cenvat credit will have to be reversed. If common inputs and input services were used on which Cenvat was availed, payment of 'amount' as per rule 6(3)(b) will be required. Case law discussed in another chapter.

2.7.3 Reversal if remission obtained on duty payable on final product - If final product is destroyed or becomes unfit for consumption, when the goods were in store room, duty on such final product can be remitted under rule 21 of Central Excise Rules. Rule 3(5C) of Cenvat Credit Rules (as inserted w.e.f. 7-9-2007) provides that if duty on final products is remitted under rule 21 of Central Excise, Cenvat credit of duty paid on inputs used in manufacture or such goods shall be reversed.

Cenvat $= 770 \times \{[1 + 10/400] \times 14.42/100\}$

$= 770 \times \{1.025 \times 0.1442\}$

$= 770 \times 0.147805 =$ ₹ 113.81 per unit

2.7.4 Reversal of Cenvat credit in respect of obsolete goods written off - As per rule 3(5B) of Cenvat Credit Rules (inserted w.e.f. 11-5-2007), if (i) inputs or (ii) capital goods before being put to use, are written of fully or provision is made in books of account to write off fully, the manufacturer is equired to pay an 'amount' equal to Cenvat credit taken in respect of such inputs or capital goods. If these are subsequently used in manufacture of final products, manufacturer can take Cenvat credit of amount which was paid earlier.

2.7.5 Reversal if final product subsequently exempt – Cenvat Credit is taken as soon as goods enter factory premises. Final product may be cleared later. It may happen that the final product may be subsequently exempt (conditionally or unconditionally). At that time, some inputs (on which Cenvat has been availed) will be in stock. These inputs will be used for manufacture of exempted final product, if he decides to avail the exemption (in case of conditional exemption. In case of unconditional exemption, it is mandatory for him to avail exemption. In such case, basic principle is that Cenvat is available only if duty is paid on final product. According to this principle, the Cenvat credit availed on stock is required to be reversed.

Rule 11(3) as inserted w.e.f. 1-3-2007 provides that in such case, the manufacturer will have to pay an amount equivalent to Cenvat credit availed by him in respect of inputs received for such final productand lying in stock or in process or contained in final product. Similar provision has been made in respect of services exempt subsequent to availment of Cenvat credit on inputs availed in rule 11(4). Though the words used are 'pay such amount' in later para of rule 11(3)(ii) and in rule 11(4), it is stated that the said amount should be deducted from balance of Cenvat credit and balance will lapse. Thus, reasonable interpretation is that such amount should be first paid out of Cenvat credit available (if any) and balance should be paid through cash. The rule makes provision only in respect of reversal of Cenvat credit on inputs and not in respect of input services and capital goods.

In *Ashok Iron & Steel v.CCE(2002)* 140 ELT 277 = 100 ECR 431 (CEGAT 5 member bench), it has been held that if CENVAT credit availed on inputs and duty on final product is subsequently exempt, CENVAT credit on inputs lying in stock or inputs contained in final products as on date of exemption need not be reversed, as there is no provision for reversal of such credit – followed in *Raghuvar v. CCE2002(140) ELT 280* (CEGAT 5 member bench).

2.7.6 Reversal if remission obtained on duty payable on final product ? - If final product is destroyed by fire accident, when the goods were in store room, duty on such final product is remitted. There is dispute whether Cenvat is to be reversed in such cases. See under 'remission of duty' in another chapter.

2.7.7 No Cenvat reversal in certain cases

In following cases, Cenvat credit is not required to be reversed.

No reversal in case of export/deemed export of final product – Cenvat credit is not required to be reversed, if final product is exported or supplied to UN Agencies, or to EOU/STP/EHTP. Supplies to SEZ are 'exports'. This aspect has been discussed at other place in the book.

No reversal if intermediate product supplied and final product exported – If intermediate product is cleared without payment of duty under bond for manufacture of final product which is to be exported, Cenvat on inputs used in manufacture of intermediate product is not required to be reversed. This aspect has been discussed at other place in the book.

No reversal if input subsequently become ineligible for Cenvat – It may happen that an input may be eligible for availing Cenvat when it was received in the factory and Cenvat may be availed on it. However, later, the input may be removed from list of inputs eligible for Cenvat. In such cases, even if some inputs were lying in stock on the date of such withdrawal, Cenvat credit already availed need not be reversed – Dhar Cement Ltd. v. CCE 1996(86) ELT 515 (CEGAT) following Amrit Banaspati v. UOI1990(50) ELT 64 (P & HHC) and Dipak Vegetables v. UOI 1991(52) ELT 222 (Guj HC).

No reversal if supplier gives reduction in price after clearance - Excise duty is payable on the basis of price at the time of clearance. Thus, assessable value does not change if supplier gives credit of duty after removal of goods. In view of this, credit is not to be reversed only because the supplier of inputs has given some reduction in prices after removal of goods. In CCE v. Kinetic Engg1997(95) ELT 396 (CEGAT), it was held that classification of goods made at the supplier's end cannot be altered at the manufacturer's end. Same principle will apply to valuation also.

2.7.8 Full Credit Available Even If Price Subsequently Reducted –

Full credit is available even if supplier subsequently gives price reduction. In CCE v. Trinetra Texturisers 2004 (166) ELT 384 (CESTAT), supplier of inputs gave reduction in price subsequent to clearance of goods. It was held that the buyer is eligible to avail full Cevat credit of duty paid, unless the duty liability of supplier was reduced. [Thus, even if supplier of input gives rice reduction, Cenvat Credit is available of full duty paid]. In MRF Ltd. v. CCE 1997(92) ELT 309 (SC), it was held that any fluctuation in price subsequent to removal of goods has no relevance whatsoever to the liability of excise duty.

2.7.9 No reversal on mere instructions of excise officers –

Cenvat credit should not be reversed on instructions or insistence of excise authorities, if assessee is not agreeable to legal validity of such instructions, unless an appealable order is issued. In Punjab Concast Steels v. CCE 2001(127) ELT 559 (CEGAT SMB), it was held that if Cenvat credit is reversed as per directions of excise authorities, the amount cannot be claimed as refund. The order asking reversal should be appealed against.

2.8 DOCUMENTS FOR AVAILING CENVAT CREDIT

Rule 9(1) of Cenvat Credit Rules prescribes that Cenvat Credit can be taken on the basis of -

- Invoice of manufacturer from factory
- Invoice of manufacturer from his depot or premises of consignment agent
- Invoice issued by registered importer
- Invoice issued by importer from his premises or consignment registered with Central Excise
- Invoice issued by registered first stage or second stage dealer
- Supplementary Invoice by manufacturer
- Bill of Entry
- Certificate issued by an appraiser of customs in respect of goods imported through foreign post office
- TR-6 or GAR-7 Challan of payment of tax where service tax is payable by other than input service provider
- Invoice, bill or challan issued by provider of input service on or after 10-9-2004
- Invoice, Bill or Challan issued by input service distributor under rule 4A of Service Tax Rules.

Credit in case of defects in duty paying document only with permission of AC/DC – Cenvat credit is available on basis of proof of duty paying document like Invoice or Bill of Entry. Sometimes, there are some minor defects in the duty paying document, which are technical in nature. However, fact of duty payment is not in doubt.

Rule 9(2) as amended w.e.f. 1-3-2007 provides that Cenvat credit can be taken only if ***all*** the particulars as prescribed in Central Excise Rules, 2002 or Service Tax Rules, 1994 are contained in the eligible duty paying document.

As per *proviso* to rule 9(2), if all prescribed details are not available in duty paying document, at least following minimum details should be available - (a) Details of duty or service tax payable (b) description of goods or taxable service (c) assessable value (d) Central Excise or Service Tax Registration Number and (e) name and address of the factory or warehouse or premises of first or second stage dealers or provider of taxable service.

If all prescribed details are not available in duty paying document (but minimum details as prescribed above are available) and if Jurisdictional Assistant / Deputy Commissioner is satisfied that such goods or services covered by the document have been received and accounted for in books of account of receiver, he may allow Cenvat credit.

Thus, even if there is minor defect or omission in duty paying document, the assessee will have to make application to AC/DC and seek his permission to avail Cenvat credit

Provisions when dealer of imported goods is claiming refund of Special CVD of Customs – A dealer who imports goods and sales them in India after paying Vat/sales tax can claim refund of special CVD of 4% paid u/s 3(5) of Customs Tariff Act, as per Notification No. 102/2007-Cus dated 14-9-2007. If he intends to claim refund, he is required to make mention in his invoice to buyer that no credit of such additional duty shall be admissible (to buyer).

If a first stage or second stage dealer receives goods under an invoice which mentions that Cenvat credit of the special CVD paid u/s 3(5) of Customs Tariff Act is not admissible, he should make similar endorsement in his invoice to buyer. – *proviso* to rule 11(7) of Central Excise Rules. If such remark is there, the buyer cannot avail Cenvat credit of such special CVD *proviso* to rule 9(1) inserted w.e.f. 14-9-2007.

2.9 EXEMPTED GOODS/OUTPUT SERVICES

- Cenvat credit is available only if final product is dutiable.
- If assessee is manufacturing exempted as well as dutiable goods in same factory, he should maintain separate records.
- If common inputs/input services are utilised for exempted as well as taxable final product, assessee is required to pay 5% of value of exempted goods (if he is 'manufacturer) and/or 6% 'amount' on exempted final product.

Partial manufacture/provision of exempted products/services **–** Cenvat credit of inputs and input services is not available if final product/output service is exempt from excise duty/service tax. In case of manufacturer manufacturing both exempt and dutiable goods (or service provider providing taxable as well as exempt services), it may happen that same inputs/input services are used partly for manufacture of dutiable goods/taxable services and partly for exempted goods/services.

In such cases, the manufacturer/service provider has following three options (w.e.f. 1-4-2008) –

(a) Maintain separate inventory and accounts of receipt and use of inputs and input services used for exempted goods/exempted output services – Rule 6(2) of Cenvat Credit Rules.

(b) Pay amount equal to 5% of value of exempted goods (if he is 'manufacturer) and/or 6% of value of exempted services (if he is service provider) if he does not maintain separate inventory and records – Rule 6(3)(i) w.e.f. 7-7-2009.

(c) Pay an 'amount' equal to proportionate Cenvat credit attributable to exempted final product/ exempted output services – Rule 6(3)(ii) w.e.f. 1-4-2008.

Cenvat credit on capital goods – If capital goods are partly used for exempted goods and party for dutiable final products, entire Cenvat credit of duty paid on capital goods is available. Cenvat credit of duty on capital goods is not allowable only when it is *exclusively* used for manufacture of final products [rule 6(4)]

No reversal or payment of amount in certain cases – If excisable goods are removed to SEZ, EOU, EHTP, STP, UN agencies or for exports or removal of gold or silver arising in manufacture of copper or zinc by smelting, payment of 10% 'amount' is not required [rule 6(6)].

Cenvat credit of service tax in case of supplies made by DTA to EOU - Supplies from DTA to EOU are entitled to Cenvat credit of service tax paid – para 6.11(v) of FTP.

2.9.1 Options available to manufacturer manufacturing both dutiable and exempt goods and service provider providing taxable as well as exempt services

The manufacturer/service provider has three options –

Maintain separate inventory and accounts - Maintain separate inventory and accounts of receipt and use of inputs and input services used for exempted goods/exempted output services. In such cases, he should not avail Cenvat credit of the inputs and input services which are used in exempted final services at all – Rule 6(2) of Cenvat Credit Rules.

Pay 5% 'amount' on value of exempted goods or 6% 'amount' on value of exempted services if separate inventory and records not maintained - If the manufacturer/service provider opts not to maintain such separate accounts, he has to pay an amount equal to 5% of the 'value' of such exempted goods or 6% of the value of 'exempted services' [Rule 6(3)(i) w.e.f. 7-7-2009 (Such payment can be made by debit to Cenvat credit account or PLA [*explanation* II to rule 6(3A)].

He cannot utilise Cenvat credit of inputs/input services utilised exclusively for manufacture or exempted final product or exempted output services, as is clarified in Explanation II to rule 6(3) inserted w.e.f. 1-4-2008.

Thus, he cannot utilise Cenvat credit in respect of inputs/input services utilised exclusively for manufacture of exempted final products or exempted taxable services. In addition, he has to pay 5%/6% amount. Thus, the option of payment of 5%/6% amount is not likely to be very attractive in most of the cases.

Such option has to be exercised in respect of all exempted goods manufactured and all exempted output services provided. The option once exercised shall not be changed in remaining part of financial year – *Explanation* I to Rule 6(3) inserted w.e.f. 1-4-2008.

Education cess and SAH education cess is payable only on 'duties of excise'. 'Amount' is not 'duty'. Hence, education cess or SAH education cess is not payable on such 'amount'.

Pay proportionate amount attributable to Cenvat credit utilised for exempted final product/ exempted output services – The manufacturer/service provider can opt to pay an 'amount' which is proportional to Cenvat credit availed on exempted final product/exempted output services [rule 6(3)(ii) w.e.f. 1-4-2008]

He cannot utilise Cenvat credit of inputs/input services utilised exclusively for manufacture or exempted final product or exempted output services, as is clarified in Explanation II to rule 6(3) inserted w.e.f. 1-4-2008.

Thus, he cannot utilise Cenvat credit in respect of inputs/input services utilised exclusively for manufacture of exempted final products or exempted taxable services. In addition, he has to pay proportionate amount relating to exempted final products/exempted output services.

This option seems to be much better than payment of 6%/5%.

If he wants to exercise this option, he has to inform details as prescribed in rule 6(3A) of Cenvat Credit Rules to Superintendent of Central Excise.

Such option has to be exercised in respect of all exempted goods manufactured and all exempted output services provided. The option once exercised shall not be changed in remaining part of financial year – *Explanation* I to Rule 6(3) inserted w.e.f. 1-4-2008.

Education cess and SAH education cess is payable only on 'duties of excise'. 'Amount' is not 'duty'. Hence, education cess or SAH education cess is not payable on such 'amount'.

2.9.2 Determination of Cenvat credit attributable to exempted final product/exempted services

If assessee intends to pay amount on proportionate basis, the 'amount' is to be calculated as provided in rule 6(3A) of Cenvat Credit Rules. He has to pay 'amount' provisionally on monthly basis. At the yearend, he has to calculate exact amount and pay difference if any or adjust excess amount paid.

Principle behind the calculations – The mode of calculation is as follows –

Assessee should first take entire Cenvat credit of inputs and input services used in exempted as well as taxable final products and exempted as well as taxable services. Then, at the end of month, he should calculate Cenvat credit attributable to exempted final products and exempted services on provisional basis, as follows –

Inputs used for exempted final products (Based on his own Input/Output ratio, even in case of common inputs like consumables etc.) + Inputs used for exempted services (On proportionate basis, based on ratio of previous year) + Input services used for exempted final products and exempted services (On proportionate basis based on ratio of previous year).

This amount should be reversed after end of each month.

At end of the year, assessee should calculate the ratios on actual basis and make fresh calculations and pay difference, if any, before 30th June. If it is found that he had paid excess amount based on provisional ratio, he can adjust the difference himself by taking credit.

In the first year of production or provision of services, ratios of previous year are not available. In that case, the calculations need not be made for the whole year. However, calculations should be made after the year is over and amount attributable to Cenvat credit on exempted final products and exempted services should be calculated and paid.

The basic idea behind the mode of calculations is sound and correct as per Vat principles. However, calculations are not easy and are prone to litigation.

There is no provision to calculate input services used exclusively for exempted services. This has to be done on ratio basis only.

Payment of 'amount' when intermediate product captively consumed in manufacture of another final product – In *CCE* v. *Texmo Industries* (2007) 213 ELT 615 (CESTAT), assessee used common inputs to manufacture rough castings. Some castings were sold while about 20% castings were captively consumed for manufacture of pumps. The pumps were also exempt from duty. It was held that 10% 'amount' is payable on value of castings and not on value of pumps. 'Casting' is the 'final product' and not 'pumps' – same view in *Texmo Industries* v. *CCE* (2007) 208 ELT 338 (CESTAT 3 member bench).

2.10 REMOVAL OF INPUT, CAPITAL GOODS AND WASTE

- Inputs and capital goods on which Cenvat credit was taken can be removed 'as such' on payment of 'amount' equal to Cenvat credit availed.
- If capital goods are sold as scrap after use, an 'amount' equal to duty on scrap value is payable.
- Inputs on which Cenvat was availed can be sent outside for job work. These should come back within 180 days.
- Direct despatch from place of job worker can be done with permission.
- Waste is final product for excise purposes and duty is payable as if final product is being cleared.
- If a particular waste is not mentioned in Central Excise tariff, neither any amount nor duty is payable at the time of clearance.

Removal of capital goods after use

Provisions of rule 3(5) apply when inputs or capital goods are removed 'as such'. Rule 2(a)(A) of Cenvat Credit Rules states that capital goods should be 'used'. Duration is not specified. Hence, even if the capital goods are used for one day, Cenvat eligibility of capital goods is established. After use, the capital goods can be removed either as scrap or as second hand capital goods.

Removal of capital goods as waste and scrap – *As per rule 3(5A) (inserted w.e.f. 16-5-2005), if capital goods are removed as scrap, the manufacturer shall pay an 'amount' equal to duty payable on transaction value. In other words, an 'amount' equal to duty on scrap value should be paid. It should be shown as 'amount' in the invoice and not 'duty'. Rule 3(6) makes it clear that the buyer can avail Cenvat credit of the 'amount'.*

Removal of capital goods as second hand goods – *It is not that manufacturer will remove old capital goods only as scrap. He can as well sell it as second hand capital goods, if he does not need them. The machinery may be in working condition or could be brought in working condition after some expenditure.*

In such case, if capital goods are removed after use, the manufacturer or output service provider shall pay an 'amount' (not 'excise duty') equal to Cenvat credit taken on the said capital goods, reduced by 2.5% for each quarter of a year or part thereof from the date of taking the Cenvat credit [second proviso *to rule 3(5) of Cenvat Credit Rules, inserted w.e.f. 13-11-2007].*

For example, if capital goods are received in July 2007 (duty paid ₹1,00,000), 50% i.e. ₹50,000 credit was taken in November 2007, balance 50% credit was taken in April 2008, capital goods were installed in January 2008 and were sold after use in July 2009, the 'quarters' involved are 8 (2007 – 1, 2008-4, 2009 – 3) for first 50% and 6 for balance 50%.

Thus, assessee can get deduction of 20% of first ₹50,000 (₹10,000) and 15% of balance ₹50,000 (₹7,500). He has to pay 'amount' of ₹82,500 (1,00,000 – 10,000 – 7,500).

The buyer can avail Cenvat credit of this 'amount' as made clear in rule 3(6) of Cenvat Credit Rules. Hence, seller should clear the second hand capital goods under 'invoice' charging 'amount' in invoice (not excise duty).

Example :

H Ltd. purchased a Boring-Drilling machine at a cum-duty price of ₹ 32,14,476. The Excise duty rate charged on the said machine was @ 10% plus education cess of 2% plus SAH education cess of 1%. The machine was purchased on 01.04.2008 and disposed of on 30.09.2009 for a price of ₹ 12 lakhs in working condition as second hand machinery. The company was claiming depreciation @ 25% following Straight Line Method. Using the said information, answer the following questions: (i) What is the Excise duty paid on the machine? (ii) What is the Cenvat credit allowable under Cenvat Rules? (iii) What is the amount of Cenvat credit reversible or duty payable at the time of clearance of the said machinery?

Cum-duty price ₹ 32,14,476. Hence, Basic Price i.e. Assessable value = 32,14,476 * 100/110.30 = ₹ 29,14,302.81
Total duty paid = Cum Duty Price – Assessable Value

= ₹ (32,14,476 – 29,14,302.81) = ₹ 3,00,173.19

As per Cenvat Credit Rules, 50% Cenvat credit can be availed in current financial year and balance 50% of Cenvat is allowable only in following financial year, if the capital Goods are in possession and use. Hence, 50% Cenvat credit can be taken on 1-4-2008. Since the Capital goods were in use for six months in the year 2008-09, Cenvat of balance 50% is allowable on 1-4-2009.

As per second proviso to rule 3(5) of Cenvat Credit Rules, if capital goods are removed after use, the manufacturer or output service provider shall pay an 'amount' (not 'excise duty') equal to Cenvat credit taken on the said capital goods, reduced by 2.5% for each quarter of a year or part thereof from the date of taking the Cenvat credit. It is assumed that assessee took credit on 1-4-2008. Since machinery was disposed of on 30-9-2009, reduction for 6 quarters @ 2.5% per quarter i.e. 15% will be available. Thus, assessee is required to pay 'amount' equal to 85% of ₹ 3,00,173.19 i.e. ₹ 2,55,147.21.

2.11 OTHER PROVISIONS OF CENVAT

Refund of service tax paid in respect of certain services utilised for exports – A manufacturer exporter can avail Cenvat credit of certain input services utilized in relation to export. However, according to Government press release dated 6-10-2007 – 10 STT 25 (St), press note dated 17-9-2007 – 10 STT 14 (St), press release dated 29-11-2007 – 11 STT 55 (St), some services utilised for exports do not fall within the definition of input services [In my view, they do fall within the definition of 'input service' for a manufacturer. The reason is that exports are invariably on FOB basis and hence port is the 'place of removal'. Another reason is the wide definition of 'input service']. Similarly, a merchant exporter utilises various input services for export of goods which he cannot avail any Cenvat credit. In respect of following such services, an exporter can claim refund of service tax paid on such services, under Notification No. 41/2007-ST dated 6-10-2007.

These services are – (a) General Insurance Services (b) Technical testing and analysis (c) Technical inspection and certification (d) Port and other port (e) Transport of export goods by road or by rail (f) Cleaning activity (g) Storage and warehousing (h) Courier services (i) Transport of goods by road from place of removal (j) Transport of goods by container from place of removal (k) CHA service (l) Banking and financial services (m) Services of commission agent.

(No refund is available in respect of other input services utilised for export)

Transfer of credit of duty paid on material lying at place of job worker permissible - **I**n *CCE* v. *Vaishali India* (2008) 224 ELT 247 (CESTAT SMB), assessee was shifting factory to new premises and sought permission for transfer of credit of duty paid on inputs lying at the premises of job worker. It was held that such credit cannot be denied.

Cash Refund if Cenvat cannot be utilised by exporter - If the credit cannot be used for payment of duty on any other final goods or service tax on other services, manufacturer or service provider can get cash refund of the same, if final products or output services were exported without payment of duty (either under bond or after giving Letter of undertaking), or if these were used in the intermediate product cleared for export. Refund is not admissible if exporter has availed duty drawback or has claimed rebate of duty in respect of such duties or has claimed rebate of service tax under Export of Service Rules - Rule 5 of Cenvat Credit Rules.

This provision is only for physical exports and not for deemed exports or home clearances.

The rule 5 states that no drawback should be claimed. Actually, duty drawback of customs portion should be allowable, since refund of Cenvat credit is only in respect of excise portion of duty drawback. Unfortunately, the way rule 5 is worded, this does not seem possible.

Para 2.48.1 of Foreign Trade Policy (as amended w.e.f. 7-4-2006), reads as follows, 'For all goods and services which are exported from units in DTA (Domestic Tariff Area) and units in EOU/EHTP/STP/BTP, remission of service tax shall be allowed'.

Para 6.11(c)(v) of Foreign Trade Policy (as amended w.e.f. 7-4-2006) states that EOU/EHTP/STP/BTP units shall be entitled to Cenvat Credit of service tax paid.

Rule 5 of Cenvat Credit Rules has been amended w.e.f. 14-3-2006 to provide for refund of Cenvat credit when final products or output service is exported.

Procedure for claiming refund of service tax paid on input services and excise duty on inputs has been specified in notification No. 5/2006-CE(NT) dated 14-3-2006.

Penalty for violation of Cenvat Credit Rules – Penalty upto ₹ 5,000 can be imposed for violation of Cenvat Credit Rules [rule 15A of Cenvat Credit Rules inserted w.e.f. 1-3-2008].

2.12 ACCOUNTING TREATMENT OF INPUTS IN CENVAT

Accounting for Cenvat in books of account of assessee needs following considerations

(a) Since credit is available of excise duty/service tax paid while obtaining inputs/input services, duty/service tax paid on inputs while purchase is not an expense but an asset.

(b) Unavailed Cenvat is not available as refund (except when it is a case of exports). This may happen when duty/service tax paid on inputs is more than duty payable on final product.

(c) Cenvat is available instantly on receipt of inputs/ payment of input service and Cenvat credit may be utilised even before inputs/input services on which Cenvat is availed are actually used in production.

(d) Rule 4(4) of Cenvat Credit Rules provides that depreciation should not be claimed on Cenvat credit availed.

(e) Credit on inputs and capital goods can be taken as soon as goods are received in the factory.

(f) In case of service tax, credit can be availed only after payment of Bill is made to the person who had provided input service.

(g) Credit of education Cess and NCCD can be utilised for payment of education Cess and NCCD only.

(h) Valuation of stock of inputs, WIP and finished goods also needs consideration.

Conflict between AS-2 and section 145A - As per section 145A of Income Tax Act, stock valuation should be inclusive of any tax, duty, cess or fee actually paid by assessee to bring the goods to the place of its location and condition as on date of valuation, even if such tax or duty is refundable. Thus, duty paid on inputs will have to be added while valuing stock, even if Cenvat credit is availed of such duty paid. In respect of finished stock, excise duty payable should be added to the inventory valuation even if not paid as goods are still lying in the factory. Both opening as well as closing stock should be valued on same basis.

However, as per Accounting Standard of ICAI (AS-2), inventory cost should comprise of all cost of purchases, cost of conversion and other costs incurred in bringing the inventories to the present location and condition. Cost of purchase consists of purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditure directly attributable to such acquisition. Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase. Cost of purchases should be exclusive of duties which are recoverable from the taxing authorities. (e.g. Cenvat). Inventory should be valued at lower of cost or net realisable value. Inventory should be valued on FIFO (First in First Out) method or weighted average method. [LIFO is not permitted].

If Cenvat credit of duty paid on inputs is not available for any reason, the closing stock should be valued inclusive of duty paid on inputs. [Refer Guidance Note of ICAI on Accounting Treatment of Modvat / Cenvat].

Thus, for purposes of Income Tax, inventory is required to be valued inclusive of excise duty, even if assessee is entitled to get Cenvat credit of duty. However, for purposes of balance sheet as per Companies Act, inventory should be valued exclusive of excise duty, if assessee is entitled to get Cenvat credit of duty paid on inputs.

2.13 DOCUMENTS AND ACCOUNTS

The CENVAT credit shall be taken by the manufacturer or the provider of output service or input service distributor, as the case may be, on the basis of any of the following documents, namely :

(a) an invoice issued by -

(i) a manufacturer for clearance of -

(I) inputs or capital goods from his factory or depot or from the premises of the consignment agent of the said manufacturer or from any other premises from where the goods are sold by or on behalf of the said manufacturer;

(II) inputs or capital goods as such;

  (i) an importer;

  (ii) an importer from his depot or from the premises of the consignment agent of the said importer if the said depot or the premises, as the case may be, is registered in terms of the provisions of Central Excise Rules, 2002;

  (iii) a first stage dealer or a second stage dealer, as the case may be, in terms of the provisions of Central Excise Rules, 2002; or

(b) a supplementary invoice, issued by a manufacturer or importer of inputs or capital goods in terms of the provisions of Central Excise Rules, 2002 from his factory or depot or from the premises of the consignment agent of the said manufacturer or importer or from any other premises from where the goods are sold by, or on behalf of, the said manufacturer or importer, in case additional amount of excise duties or additional duty leviable under section 3 of the Customs Tariff Act, has been paid, except where the additional amount of duty became recoverable from the manufacturer or importer of inputs or capital goods on account of any non-levy or short –levy by reason of fraud, collusion or any wilful misstatement or suppression of facts or contravention of any provisions of the Excise Act, or of the Customs Act, 1962 (52 of 1962) or the rules made there under with intent to evade payment of duty.

Explanation.- For removal of doubts, it is clarified that supplementary invoice shall also include challan or any other similar document evidencing payment of additional amount of additional duty leviable under section 3 of the Customs Tariff Act; or

(c) a bill of entry; or

(d) a certificate issued by an appraiser of customs in respect of goods imported through a Foreign Post Office; or

(e) a challan evidencing payment of service tax by the person liable to pay service tax under sub-clauses (iii) and (iv) of clause (d) of sub-rule (1) of rule (2) of the Service Tax Rules, 1994; or

(f) an invoice, a bill or challan issued by a provider of input service on or after the 10th day of, September, 2004; or

(g) an invoice, bill or challan issued by an input service distributor under rule 4A of the Service Tax Rules, 1994.

The CENVAT credit shall not be denied on the grounds that any of the documents mentioned Above does not contain all the particulars required to be contained therein under these rules, if such document contains details of payment of duty or service tax, description of the goods or taxable service, assessable value, name and address of the factory or warehouse or provider of input service: Provided that the Deputy Commissioner of Central Excise or the Assistant Commissioner of Central Excise, as the case may be, having jurisdiction over the factory of a manufacturer or provider of output service intending to take CENVAT credit, or the input service distributor distributing CENVAT credit on input service, is satisfied that the duty of excise or service tax due on the input or input service has been paid and such input or input service has actually been used or is to be used in the manufacture of final products or in providing output service, then, such Deputy Commissioner of Central Excise or the Assistant Commissioner of Central Excise, as the case may be, shall record the reasons for not denying the credit in each case.

The manufacturer or producer of excisable goods or provider of output service taking CENVAT credit on input or capital goods or input service, or the input service distributor distributing CENVAT credit on input service shall take all reasonable steps to ensure that the input or capital goods or input service in respect of which he has taken the CENVAT credit are goods or services on which the appropriate duty of excise or service tax as indicated in the documents accompanying the goods or relating to input service, has been paid.

Explanation – The manufacturer or producer of excisable goods or provider of output service taking CENVAT credit on input or capital goods or input service or the input service distributor distributing CENVAT credit on input service on the basis of, invoice, bill or, as the case may be, challan received by him for distribution of input service credit shall be deemed to have taken reasonable steps if he satisfies himself about the identity and address of the manufacturer or supplier or provider of input service, as the case may be, issuing the documents as specified, evidencing the payment of excise duty or the additional duty of customs or service tax, as the case may be, either-

(a) from his personal knowledge; or

(b) on the basis of a certificate given by a person with whose handwriting or signature he is familiar; or

(c) on the basis of a certificate issued to the manufacturer or the supplier or, as the case may be, the provider of input service by the Superintendent of Central Excise within whose jurisdiction such manufacturer has his factory or such supplier or provider of output service has his place of business or where the provider of input service has paid the service tax, and where the identity and address of the manufacturer or the supplier or the provider of input service is satisfied on the basis of a certificate, the manufacturer or producer or provider of output service taking the CENVAT credit or input service distributor distributing CENVAT credit shall retain such certificate for production before the Central Excise Officer on demand.

The CENVAT credit in respect of input or capital goods purchased from a first stage dealer or second stage dealer shall be allowed only if such first stage dealer or second stage dealer, as the case may be, has maintained records indicating the fact that the input or capital goods was supplied from the stock on which duty was paid by the producer of such input or capital goods and only an amount of such duty on pro rata basis has been indicated in the invoice issued by him.

The manufacturer of final products or the provider of output service shall maintain proper records for the receipt, disposal, consumption and inventory of the input and capital goods in which the relevant information regarding the value, duty paid, CENVAT credit taken and utilized, the person from whom the input or capital goods have been procured is recorded and the burden of proof regarding the admissibility of the CENVAT credit shall lie upon the manufacturer or provider of output service taking such credit.

The manufacturer of final products or the provider of output service shall maintain proper records for the receipt and consumption of the input services in which the relevant information regarding the value, tax paid, CENVAT credit taken and utilized, the person from whom the input service has been procured is recorded and the burden of proof regarding the admissibility of the CENVAT credit shall lie upon the manufacturer or provider of output service taking such credit.

The manufacturer of final products shall submit within ten days from the close of each month to the Superintendent of Central Excise, a monthly return in the form specified, by notification, by the Board:

Provided that where a manufacturer is availing exemption under a notification based on the value or quantity of clearances in a financial year, he shall file a quarterly return in the form specified, by notification, by the Board within twenty days after the close of the quarter to which the return relates.

(h) A first stage dealer or a second stage dealer, as the case may be, shall submit within fifteen days from the close of each quarter of a year to the Superintendent of Central Excise, a return in the form specified, by notification, by the Board.

The provider of output service availing CENVAT credit, shall submit a half yearly return in form specified, by notification, by the Board to the Superintendent of Central Excise, by the end of the month following the particular quarter or half year.

The input service distributor, shall submit a half yearly Statement, giving the details of credit received and distributed during the said half year to the Superintendent of Central Excise, by the end of the month following the half year.

2.14 OTHER PROVISIONS

2.14.1 Transfer of CENVAT Credit (Rule 10) – If a manufacturer of the final products shifts his factory to another site or the factory is transferred on account of change in ownership or on account of sale, merger, amalgamation, lease or transfer of the factory to a joint venture with the specific provision for transfer of liabilities of such factory, then, the manufacturer shall be allowed to transfer the CENVAT credit lying unutilized in his accounts to such transferred, sold, merged, leased or amalgamated factory.

If a provider of output service shifts or transfers his business on account of change in ownership or on account of sale, merger, amalgamation, lease or transfer of the business to a joint venture with the specific provision for transfer of liabilities of such business, then, the provider of output service shall be allowed to transfer the CENVAT credit lying unutilized in his accounts to such transferred, sold, merged, leased or amalgamated business.

The transfer of the CENVAT credit under sub-rules as stated above shall be allowed only if the stock of inputs as such or in process, or the capital goods is also transferred along with the factory or business premises to the new site or ownership and the inputs, or capital goods, on which credit has been availed of are duly accounted for to the satisfaction of the Deputy Commissioner of Central Excise or, as the case may be, the Assistant Commissioner of Central Excise.

Special dispensation in respect of inputs manufactured in factories located in specified areas of North East region, Kutch district of Gujarat, State of Jammu and Kashmir and State of Sikkim —

Notwithstanding anything contained in these rules, where a manufacturer has cleared any inputs or capital goods, in terms of notifications of the Government of India in the Ministry of Finance (Department of Revenue) No. 32/99-Central Excise, dated the 8th July, 1999 [G.S.R. 508(E), dated the 8th July, 1999] or No. 33/99- Central Excise, dated the 8th July, 1999 [G.S.R. 509(E), dated the 8th July, 1999] or No. 39/2001-Central Excise, dated the 31st July, 2001 [G.S.R. 565(E), dated the 31st July, 2001] or notification of the Government of India in the erstwhile Ministry of Finance and Company Affairs (Department of Revenue) No.56/2002-Central Excise, dated the 14th November, 2002 [G.S.R. 764(E), dated 14th November, 2002]or No.57/2002- Central Excise, dated the 14th November, 2002 [GSR 765(E), dated the 14th November, 2002] or notification of the Government of India in the Ministry of Finance (Department of Revenue) No. 56/2003-Central Excise, dated the 25th June, 2003 [G.S.R. 513 (E), dated the 25th June, 2003] or 71/2003-Central Excise, dated the 9th September, 2003 [G.S.R.717 (E), dated the 9th September, 2003, the CENVAT credit on such inputs or capital goods shall be admissible as if no portion of the duty paid on such inputs or capital goods was exempted under any of the said notifications.

2.14.2 Power of Central Government to notify goods for deemed CENVAT credit (Rule 13) — Notwithstanding anything contained in rule 3, the Central Government may, by notification, declare the input or input service on which the duties of excise, or additional duty of customs or service tax paid, shall be deemed to have been paid at such rate or equivalent to such amount as may be specified in that notification and allow CENVAT credit of such duty or tax deemed to have been paid in such manner and subject to such conditions as may be specified in that notification even if, in the case of input, the declared input, or in the case of input service, the declared input service, as the case may be, is not used directly by the manufacturer of final products, or as the case may be, by the provider of taxable service, declared in that notification, but contained in the said final products, or as the case may be, used in providing the taxable service.

2.14.3 Recovery of CENVAT credit wrongly taken or erroneously refunded (Rule 14) –Where the CENVAT credit has been taken or utilized wrongly or has been erroneously refunded, the same along with interest shall be recovered from the manufacturer or the provider of the output service and the provisions of sections 11A and 11AB of the Excise Act or sections 73 and 75 of the Finance Act, shall apply mutatis mutandis for effecting such recoveries.

2.14.4 Confiscation and penalty (Rule 15) – (1) If any person takes Cenvat Credit for inputs or capital goods wrongly or without ensuring that appropriate duty on them has been paid or he contravenes any provisions of the Cenvat Credit Rules in respect of any inputs or capital goods, then, all such goods shall be liable to confiscation and such person shall also be liable for penalty not exceeding the duty on such goods or ₹ 10,000/- whichever is greater.

(2) If Cenvat Credit is taken/utilised wrongly by fraud, wilful misstatement, collusion or suppres-sion of facts etc., with intent to evade payment of duty, the manufacturer shall also be liable for penalty under Section llAC of the Excise Act.

(3) Similar penal provisions would apply in respect of input services. In a case, where the CENVAT credit in respect of input services has been taken or utilized wrongly by reason of fraud, collusion, willful mis-statement, suppression of facts, or contravention of any of the provisions of the Finance Act or of the rules made there under with intention to evade payment of service tax, then, the provider of output service shall also be liable to pay penalty in terms of the provisions of section 78 of the Finance Act.

(4) Any order of confiscation or penalty under Rule 15, shall be issued following the principles of natural justice.

2.14.5 Supplementary provision (Rule 16) – Any notification, circular, instruction, standing order, trade notice or other order issued under the CENVAT Credit Rules, 2002 or the Service Tax Credit Rules, 2002, by the Central Government, the Central Board of Excise and Customs, the Chief Commissioner of Central Excise or the Commissioner of Central Excise, and in force at the commencement of these rules, shall, to the extent it is relevant and consistent with these rules, be deemed to be valid and issued under the corresponding provisions of these rules, i.e Cenvat Credit Rules 2004.

2.15 ILLUSTRATIONS

Illustration 1.

An assessee cleared various manufactured final products during June 2010. The duty payable for June 2010 on his final products was as follows – Basic – ₹ 2,00,000 Education Cesses – As applicable. During the month, he received various inputs on which total duty paid by suppliers of inputs was as follows – Basic duty – ₹ 50,000, Education Cess – ₹ 1,000, SAH education Cess ₹ 500. Excise duty paid on capital goods received during the month was as follows – Basic duty – ₹ 12,000. Education Cess - ₹ 240. SAH education cess - ₹ 120. Service tax paid on input services was as follows – Service Tax – ₹ 10,000. Education cess – ₹ 200 SAH Education Cess - ₹ 100. How much duty the assessee will be required to pay by GAR-7 challan for the month of June 2010, if assessee had no opening balance in his PLA account?

What is last date for payment?

Answer :

Education Cess payable on final products is ₹ 4,000 (2% of ₹ 2,00,000). SAH education cess payable is ₹ 2,000.

The Cenvat credit available for June 2010 is as follows –

Description	Basic duty	Service Tax	Education Cess	SAH Education Cess
Inputs	50,000		1,000	500
Capital Goods (50% will be eligible and balance next year)	6,000		120	60
Input Service		10,000	200	100
Total	**56,000**	**10,000**	**1,320**	**660**

Credit of ₹ 66,000 (56,000 + 10,000) can be utilised for basic duty Credit of education cess and SAH education cess can be utilised only for payment of education cess and SAH education cess on final product only.

Hence, duty payable through GAR-7 challan for June 2010 is as follows –

	Basic Duty ₹	Education Cess ₹	SAH Education Cess ₹
(A) Duty payable	2,00,000	4,000l	2,000
(B) Cenvat Credit	66,000	1,320	660
Net amount payable (A-B)	1,34,000	2,680	1,340

Last date for payment is 5th July, 2010.

Illustration 2.

In aforesaid example, calculate duty payable by GAR-7 challan if assessee had following balance in his PLA account on 6-6-2010 (after debiting utilised amount for payment of duty for May 2010) - Basic duty - ₹ 1,70,000, Service tax - ₹ 30,000. Education Cess - ₹ 4,000. SAH education Cess - Nil.

Answer : If credit was available on 1-6-2010, the total Cenvat credit available for June 2010 is as follows :

Description	Basic duty ₹	Service Tax ₹	Education Cess ₹	SAH Education Cess ₹
Inputs	1,70,00	30,000	4,000	Nil
Capital Goods (50% will be eligible and balance next year)	6,000		120	60
Input Service		10,000	200	100
Total	**2,26,000**	**40,000**	**5,320**	**660**

The duty payable will be as follows :-

Hence, duty payable through GAR-7 challan for June 2010 is as follows –

	Basic Duty ₹	Education Cess ₹	SAH Education Cess ₹
(A) Duty payable	2,00,000	4,000	2,000
(B) Cenvat Credit	2,66,000	5,320	660
Net amount payable (A-B)	(–66,000)	(–1,120)	1,340

The credit of education cess of ₹ 1,120 is to be carried forward since the credit cannot be utilised for payment of any other duty. Credit of basic duty can be utilised for payment of SAH education cess. Hence, the balance left in basic duty account will be ₹ 64,660.

Thus, no excise duty is required to be paid for the month of June 2010. Balance carried forward will be as follows - (a) Basic duty - ₹ 64,660 (b) Education Cess - ₹ 1,120.

Illustration 3.

An assessee cleared his manufactured final products during December 2010. The duty payable for the month on his final products was as follows: Basic duty – ₹ 44,000, NCCD – ₹ 2,000, Education cesses – As applicable. During the month, he received various inputs on which total duty paid by suppliers of inputs was as follows - Basic duty – ₹ 40,000 plus applicable education cess. Service tax paid on input services was as follows: Service tax – ₹ 8,000. Education cess – ₹ 160. There is no opening balance in his PLA account. How much duty the assessee will be required to pay through account current for the month of December 2010?

Answer :

Education Cess payable on final products is ₹ 920 (2% of ₹ 46,000). SAH education cess payable on final products is ₹ 460.

Education cess on his inputs is ₹ 800 (2% of ₹ 40,000)> SAH education cess on inputs is ₹ 400. The Cenvat credit available for the month of December 2010 is as follows –

Description	Basic duty ₹	Service Tax ₹	Education Cess ₹	SAH Education Cess ₹
Inputs	40,000		800	400
Input Service		8,000	160	80
Total	**40,000**	**8,000**	**960**	**480**

Credit of ₹ 48,000 (40,000 + 8,000) can be utilised for payment of any duty.

Credit of education cess of ₹ 960 can be utilised only for payment of education cess on final product.

Credit of SAH education cess of ₹ 960 can be utilised only for payment of education cess on final product.

	Basic Duty ₹	NCCD	Education Cess ₹	SAH Education Cess ₹
(A) Duty payable	44,000	2,000	920	460
(B) Cenvat Credit Credit (basic plus service tax)	48,000		960	480
Net amount payable (A-B)	(–4,000)		(–40)	(–20)

The credit of basic duty and service tax of ₹ 4,000 can be utilised for payment of NCCD of ₹ 2,000. Hence for the month of January, 2008, assessee is not required to pay any duty through PLA.

He will carry forward following balances for February 2008 - Basic duty - ₹ 2,000. Education Cess - ₹ 40. SAH education Cess - ₹ 20.

STUDY NOTE - 3
OVERVIEW OF CUSTOMS LAW

This Study Note includes

- Introduction
- Type of Custom Duties
- Valuation in Customs
- Procedures for Import
- Procedures for Export
- Baggage, Courier and Import Through Post
- Other Provisions in Customs
- Value for Prupose of Customs Act
- Valuation of Export Goods
- Provisional Assessment of Duty
- Relevant Date for Rate and Valuation of Import Duty
- Drawback
- Refund of Special CVD of Customs to Traders
- Anti Dumping Duty on dumped articles
- Value for Purpose of Customs Duty
- Methods of Valuation of Imported Goods
- Valuation of Export Goods
- Self Assessment on basis of 'Risk Management System
- Illustrations

3.1 INTRODUCTION

Customs duty is on imports into India and export out of India. Section 12 of Customs Act, often called *charging section*, provides that duties of customs shall be levied at such rates as may be specified under 'The Customs Tariff Act, 1975', or any other law for the time being in force, *on goods imported into, or exported from, India*.

- There are many common provisions in Central Excise and Customs Law
- In case of imports, taxable event occurs when goods mix with landmass of India - *Kiran Spinning Mills* v. *CC* 1999(113) ELT 753 = AIR 2000 SC 3448 = 2000 AIR SCW 2090 (SC 3 member bench).
- In case of warehoused goods, the goods continue to be in customs bond. Hence, 'import' takes place only when goods are cleared from the warehouse - confirmed in *UOI* v. *Apar P Ltd.* 1999 AIR SCW 2676 = 112 ELT 3 = 1999(6) SCC 118 = AIR 1999 SC 2515 (SC 3 member bench).- followed in *Kiran Spinning Mills* v. *CC* 1999(113) ELT 753 = AIR 2000 SC 3448 = 2000 AIR SCW 2090 (SC 3 member bench).
- In case of exports, taxable event occurs when goods cross territorial waters of India – *UOI* v. *Rajindra Dyeing and Printing Mills* 2005 (180) ELT 433 (SC)
- Territorial waters of India extend upto 12 nautical miles inside sea from baseline on coast of India and include any bay, gulf, harbour, creek or tidal river. (1 nautical mile = 1.1515 miles = 1.853 Kms). Sovereignty of India extends to the territorial waters and to the seabed and subsoil underlying and the air space over the waters.
- Indian Customs waters extend upto 12 nautical miles beyond territorial waters. Powers of customs officers extend upto 12 nautical miles beyond territorial waters.
- '*Exclusive economic zone*' extends to 200 nautical miles from the base-line.

Common aspects of Customs and Central Excise

There are many common links between Customs and Central Excise.

- Both are Central Acts and derive power of levy from list I - Union List - of the Seventh Schedule to Constitution.
- Both are under administrative control of one Board (Central Board of Excise and Customs) under Ministry of Finance.
- Organizational hierarchy is same from top upto Assistant Commissioner level. Transfers from customs to excise and *vice versa* are not uncommon.
- Chief Commissioner in charge of each Zone is same for excise and customs at many places.
- In the interior areas, Excise officers also work as customs officers.
- Classification Tariffs of both acts are based on HSN and principles of classification are identical.
- Principles of deciding 'Assessable Value' have some similarities i.e. both are principally based on 'transaction value'. Concept of 'related person' appears in Customs as well as Excise valuation.
- Provisions of refund, including principle of 'unjust enrichment' are similar. Provisions for interest for delayed payment are also identical.
- Provisions of raising demand for short levy, non-levy or erroneous refund are similar. Provisions in respect of recovery, mandatory penalty etc. are also similar.
- Provisions for granting exemptions from duty - partial or full - conditional or unconditional are identical.
- Powers of search, confiscation etc. are quite similar in many respects. In fact, some of provisions of Customs Act have been made applicable to Central Excise with suitable modifications.
- Provisions in respect of Settlement Commission and Authority for Advance Ruling are identical.
- Appeal provisions are identical.
- Appellate Tribunal (CESTAT) is same. Hence, procedures of appeal to Tribunal are identical.

3.2 TYPE OF CUSTOM DUTIES

3.2.1 Basic customs duty levied u/s 12 of Customs Act.

- The rate of basic customs duty is specified in Customs Tariff Act, read with relevant exemption notification. Generally, basic customs duty is 10% of non-agricultural goods.
- CVD equal to excise duty is payable on imported goods u/s 3(1) of Customs Tariff Act. General excise duty rate is 10.30% (10% basic plus 2% education cess and SAH Education cess of 1%)
- Special CVD (SAD) is payable @ 4% on imported goods u/s 3(5) of Customs Tariff Act. This is in lieu of Vat/ sales tax to provide level playing field to Indian goods.
- Education cess of customs @ 2% and SAH Education cess of 1% is payable.
- Total import duty considering all duties plus education cess on non-agricultural goods is generally 26.85% w.e.f 27-2-2010
- NCCD has been imposed on a few articles. In addition, on certain goods, anti-dumping duty, safeguard duty, protective duty etc. can be imposed.

3.2.2 Additional Customs Duty u/s 3(1) (CVD)

- CVD (Countervailing Duty) is payable on imported goods u/s 3(1) of Customs Tariff Act to counterbalance impact of excise duty on indigenous manufactures, to ensure level paying field.
- CVD is payable equal to excise duty payable on like articles if produced in India. It is payable at effective rate of excise duty, which is generally 10.30%.
- CVD is payable on assessable value plus basic customs duty. In case of products covered under MRP provisions, CV duty is payable on MRP basis as per section 4A of Central Excise.

- CVD can be levied only if there is 'manufacture'.
- CVD is neither excise duty nor basic customs duty levied under Customs Act. However, all provisions of Customs Act apply to CVD. Calculation of duty payable is as follows -

3.2.3 Computing Customs Value

Customs Value ₹ 10,000; Basic Customs Duty @ 10%. If the goods were produced in India, excise duty payable in India would have ben 10%. Education & SHE Cess is as applicable. Special CVD is payable at appropriate rates. Compute Customs Duty payable. How much CENVAT can be availed, if he is a manufacturer?

Computation of Duty Payable is as follows :

	Rate of Duty %	Amount ₹	Total Duty ₹
(1) Assessable Value	—	10,000.00	—
(2) Basic Customs Duty	10	1,000.00	1,000.00
(3) Sub-Total for calculating CVD '(1+2)'		11,000.00	
(4) CVD = (3) × Rate of Excise Duty	10	1,100.00	1,100.00
(5) Education Cess of Excise @ 2% of (4)	2	22.00	22.00
(6) SAHE of Excise @ 1% of (4)	1	11.00	11.00
(7) Sub-Total for Education Cess on Customs (2+4+5+6)	—	2,133.00	—
(8) Education Cess of Customs @ 2% of (7)	2	42.66	42.66
(9) SAHE @ 1% of (7)	1	21.33	21.33
(10) Sub-Total for Special CVD (=3+4+5+6+8+9)	—	12,196.99	—
(11) Special CVD u/s 3(5) @ 4% on (10)	4	487.88	487.88
(12) Total Duty Payable (2+4+5+6+8+9)	—	—	**2,684.87**
(13) Total Duty Payable rounded off	—	—	2,685

Notes – Buyer who is manufacturer, is eligible to avail Cenvat Credit of D, E, F and K above. A buyer, who is service provider, is eligible to avail Cenvat Credit of D, E and F above. A trader who sells imported goods in India after charging Vat/sales tax can get refund of Special CVD of 4% i.e. 'K' above

3.2.4 Additional Duty under section 3(5) (Special CVD - SAD)

Section 3(5) of Customs Tariff Act empowers Central Government to impose additional duty. This is in addition to Additional Duty leviable u/ss 3(1) and 3(5) of Customs Tariff Act. Provision for this duty has been made w.e.f. 1-3-2005. Purpose of the Additional Duty is to counter balance sales tax, VAT, local tax or other charges leviable on articles on its sale, purchase or transaction in India.

The obvious intention is to provide level playing field to manufacturers in India who are manufacturing similar goods. Hence, it is termed as 'Special CVD" or 'SAD' (Special Additional Duty).

Exemption from SAD - Some categories of imports have been exempted from this special CVD (SAD), vide customs notification No. 20/2006-Custom dated 1-3-2006. The main among these are: Articles of jewellery attracts a lower rate of special CVD at 1%.

Departmental clarifications - Department has clarified as follows, vide MF(DR) circular No. 18/2006-Cus dated 5-6-2006 –

- Special CVD of 4% is not leviable in case of imports under advance authorisation, EOU, EPCZ and SEZ schemes
- In case of export promotion schemes like DEPB, target plus, service from India, DFCE and Vishesh Krishi and Gram Udyog Yojana, 4% Special CVD is required to be debited to the duty scrip/entitlement certificate.
- In case of DFRC scheme, 4% special CVD is payable.

- Duty debited through DEPB, DFCE, target plus scheme etc. will be eligible for Cenvat credit or duty drawback.

3.2.5 ***Refund of Special CVD to traders*** – Traders selling imported goods in India after charging sales tax/Vat can claim refund of special CVD from customs department – Notification No. 102/ 2007-Cus dated 14-9-2007.

3.2.6 Anti-Dumping Duty

- Anti dumping duty is leviable u/s 9A of Customs Tariff Act when foreign exporter exports his good at low prices compared to prices normally prevalent in the exporting country.
- Dumping is unfair trade practice and the anti-dumping duty is levied to protect Indian manufacturers from unfair competition.
- Margin of dumping is the difference between normal value (i.e. his sale price in his country) and export price(price at which he is exporting the goods).
- Price of similar products in India is not relevant to determine 'margin of dumping'.
- 'Injury margin' means difference between fair selling price of domestic industry and landed cost of imported products. Dumping duty will be lower of dumping margin or injury margin.
- Benefits accruing to local industry due to availability of cheap foreign inputs is not considered. This is a drawback.
- CVD is not payable on antidumping duty. Education cess and SAH education cess is not payable on anti-dumping duty · In case of imports from WTO countries, antidumping duty can be imposed only if it cause material injury to domestic industry in India.
- Dumping duty is decided by Designated Authority after enquiry and imposed by Central Government by notification. Provisional antidumping duty can be imposed.
- Appeal against antidumping duty can be made to CESTAT.

3.3 VALUATION IN CUSTOMS

3.3.1 Customs duty is payable as a percentage of 'Value' often called '*Assessable Value*' or '*Customs Value*'. The **Value** may be either (*a*) 'Value' as defined in section 14(1) of Customs Act or (*b*) Tariff value prescribed under section 14(2) of Customs Act (section amended w.e.f.10-10-2007)

- Transaction value at the time and place of importation or exportation, when price is sole consideration and buyer and sellers are unrelated is the basic criteria for 'value' u/s 14(1) of Customs Act. Thus, CIF value in case of imports and FOB value in case of exports is relevant.
- In case of high sea sale, price charged by importer to assessee would form the assessable value and not the invoice issued to the importer by foreign supplier. – *National Wire* v. *CC* 2000(122) ELT 810 (CEGAT) * *Godavari Fertilizers* v. *CC* (1996) 81 ELT 535 (CEGAT).
- Rate of exchange will be as determined by CBE&C or ascertained in manner determined by CBE&C.
- Valuation for customs is required to be done as per provisions of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007
- CIF value of goods plus 1% landing charges is the basis for deciding 'Assessable Value'.
- Commission to local agents, packing cost, value of goods and toolings supplied by buyer, royalty relating to imported goods are addible.
- Interest on deferred payment, demurrage and value of computer software loaded is not to be added.
- Old machinery and old cars are often valued on basis of depreciated value, though such method has no sanction of law.

3.3.2 Additions to 'Customs Value'

Rule 10 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [Rule 9 upto 10-10-2007] provide that following cost and services are to be added, *if these are not already included in the invoice price*. –

- Commission and brokerage, except buying Commission, if not already included in the invoice price [rule 10(1)(a)(i)].

- Cost of container which are treated as being one with the goods for customs purposes, if not already included in the invoice price [rule 10(1)(a)(ii)].
- Cost of packing whether labour or materials, if not already included in the invoice price [rule 10(1)(a)(iii)].
- Materials, components, tools, dies, moulds, and consumables used in production of imported goods, supplied by buyer directly or indirectly, free of charge or at reduced cost, to the extent not already included in price [rule 10(1)(b)(i), (ii) and (iii)]
- Engineering, development, art work, design work, plans and sketches undertaken elsewhere than in India and necessary for production of imported goods, to the extent not already included in price [rule 10(1)(b)(iv)].
- Royalties and license fees relating to imported goods that buyer is required to pay, directly or indirectly, as a condition of sale of goods being valued [rule 10(1)(c)]
- Value of proceeds of subsequent resale, disposal or use of goods that accrues directly or indirectly to seller (i.e. to foreign exporter) [rule 10(1)(d)]
- All other payments made as condition of sale of goods being valued made directly or to third party to satisfy obligation of seller, to the extent not included in the price [rule 10(1)(e)]
- Cost of transport upto place of importation [rule 10(2)(a)]
- Loading, unloading and handling charges associated with delivery of imported goods at place of importation [These are termed as landing charges and are to be taken as 1%] [rule 10(2)(b)]
- Cost of insurance [rule 10(2)(c)]

The additions should be on the basis of objective and quantifiable data [rule 10(3) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9(3)].

3.3.3 ***Services / documents / technical know-how supplied by Buyer -*** Cost of engineering, development, art work, design work and plans and sketches undertaken by buyer which is necessary for production of imported goods is includible, ***only if*** such work is undertaken *outside India*. [Rule 10(1) (b) (iv) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9)] The addition should be done on objective and quantifiable data. Data available with importer should be used as far as possible. If the services are purchased or leased by importer, such purchase/lease cost should be added. If the importer has himself done the work abroad, its cost should be added on basis of structure and management practices of importer and his accounting methods (in other words, if development work, plans, sketches etc. is done by importer himself *outside India*, its cost should be calculated based on normal accounting practices - like apportionment of overheads, apportionment over various jobs if the same development work, design work etc. is used for more than one jobs etc.) [Interpretative Note to rule 10(1)(b)(iv) of Customs Valuation Rules].

3.3.4 ***Technical know how related to imported machinery*** - In *CC* v. *Essar Gujarat Ltd.* (1997) 9 SCC 738 = 88 ELT 609 = 17 RLT 588 (SC 3 member bench), it was held that payment of licence fee and transfer of technology, without which the imported plant could not function, will have t o be added to the value of imported plant. However, training charges cannot be included. —wrongly followed in *CC* v. *Himson Textile Engg. Ltd.* 1997(93) ELT 301 (CEGAT).

3.3.5 ***Royalties and licence fee -*** Royalties and license fees related to imported goods that the buyer is required to pay, directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable, are required to be added in assessable value. [Rule 10(1)(c) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9)].

3.3.6 ***Royalty payment un-connected with imported goods not to be added*** - Often, a lump-sum payment of royalty is made to foreign collaborators for technical know-how. In addition, components / parts/ CKD packs are procured from foreign collaborators. Customs department normally holds that the price of parts/CKD packs should be loaded, on assumption that the part of price of component parts/CKD packs has been paid as 'royalty payment'.

3.3.7 ***Charges for reproduction of goods in India not to be added*** - Interpretative Note to rule 10(1)(c) of Customs Valuation Rules makes it clear that charges for right to reproduce the imported goods in India shall not be added.

3.3.8 ***Barge/lighterage charges includible*** – In some cases, the ship is not brought upto jetty. Goods are discharged at outer anchorage. This may be for various reasons, e.g. (a) deep draught at port (b) Ports are busy (c) Odd dimensional or heavy lifts or hazardous cargo discharged at anchorage. Charges for brining the goods from outer anchorage are known as 'barging/lighterage charges'.

As per *explanation* to rule 10(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [inserted w.e.f. 10-10-2007], ship demurrage charges on chartered vessels, lighterage or barge charges are includible. Mode of computation of freight of time chartered/daughter vessel has been specified in MF(DR) circular No. 4/2006-Cus dated 12-1-2006.

3.3.9 ***Landing charges to be added -*** Cost of unloading and handling associated with delivery of imported goods in port (*called landing charges*) shall be added. These will be calculated @ 1% of CIF value, i.e. FOB price plus freight plus insurance. [Rule 10(2)(b) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 – earlier rule 9].

3.3.10 ***Cost of Transport upto port should be added -*** Cost of transport from exporting country to India is to be added in 'Assessable Value'. [Rule 10(2)(a) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9).] In other words, CIF value is the basis for valuation. If the goods are imported by air, the air freight will be very high. Hence, in case air freight is higher than 20% of FOB price of goods, only 20% of FOB price will be added for Customs Valuation purposes.

If cost of transport is not ascertainable, it will be taken as 20% of FOB valu of goods. However, cost of transport within India is not to be considered.

3.3.11 ***Insurance cost should be added -*** Insurance charges on goods are to be added. [Rule 10(2)(c) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007]. If these are not ascertainable, these will be calculated @ 1.125% of FOB Value of goods.

3.3.12 Exclusions from Assessable Value

Interpretative Note to rule 3 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007provide that following charges shall be excluded :

(a) Charges for construction, erection, assembly, maintenance or technical assistance undertaken *after* importation of plant, machinery or equipment

(b) Cost of transport *after* importation

(c) Duties and taxes in India

Other payments from buyer to seller *that do not relate* to imported goods are not part of the customs value.Demurrage charges payable to port trust authorities for delay in clearing goods are not to be added . - *Deepak Fertilisers* v. *CC* 1989(41) ELT 550 (CEGAT) * *Hindustan Lever* v. *UOI* 2002(142) ELT 33 (Cal HC). [However, ship demurrage is includible w.e.f. 10-10-2007].

Ship demurrage includible w.e.f. 10-10-2007 - explanation to rule 10(2)

3.3.13 Methods of Valuation

The methods of valuation for customs methods are as follows -

- Transaction Value of Imported goods [Section 14(1) and Rule 3(1)]
- Transaction Value of Identical Goods [Rule 4]
- Transaction Value of Similar Goods [Rule 5]
- Deductive Value which is based on identical or similar ***imported*** goods sold in India [Rule 7]
- Computed value which is based on cost of manufacture of goods plus profits [Rule 8]
- Residual method based on reasonable means and data available [Rule 9]

3.3.14 ***Methods to be applied sequentially*** - These methods are to be applied in sequential order, i.e. if method one cannot be applied, then method two comes into force and when method two also cannot be applied, method three should be used and so on. The only exception is that the 'computed value' method may be used before 'deductive value' method, if the importer requests and Assessing Officer permits.

3.3.15 Rejection of' Value' -

Importer has to declare 'value' of goods. If the assessing officer has reason to doubt about truth or accuracy of the value declared by the importer, he can ask the importer to submit further information and evidence. If the customs officer still has *reasonable doubt,* he can reject the 'value' as declared by the importer. [rule 12(1) w.e.f. 10-10-2007 – earlier rule 10A(1) of Customs Valuation Rules added w.e.f. 19-2-1998]. If the importer requests, the assessing officer has to give reasons for doubting the truth or accuracy of value declared by importer. [rule 12(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 – earlier rule 10A(2) of Customs Valuation Rules upto 10-10-2007].

3.3.16 ***Rule 12 is only mechanism to reject the declared value*** – As per *explanation* (1)(i) to rule 12, the Rule 12 does not provide any method for determination of value. It only provides mechanism to reject declared value, where there is reasonable doubt. If transaction value is rejected, valuation has to be done as per rule 4 to 9 [*Explanation* (1)(i) to rule 12 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007].

3.3.17 Export Goods - Valuation for Assessment

Customs value of export goods is to be determined under section 14 of Customs Act, read with Customs Valuation (Determination of Value of Export Goods), Rules, 2007. Transaction value at the time and place of exportation, when price is sole consideration and buyer and sellers are unrelated is the basic criteria If there is no sale or buyer or seller are related or price is not the sole consideration, value of the goods will be determined as per Valuation Rules [Clause (ii) of second proviso to section 14(1)].

3.3.18 ***Valuation when buyer and seller are related*** – Definition of related person as per rule 2(2) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007 is same as per definition of rule 2(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.

As per rule 3(2) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007, the transaction value, the transaction value will be accepted as 'value' even if buyer and seller are 'related', if the relationship has not influenced price.

3.3.19 ***Valuation if value cannot be determined on basis of transaction value*** – If valuation is not possible on basis of transaction value, valuation will be done by proceeding sequentially through rules 4 to 6 [Rule 3(3) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007].

The methods are - Export value by comparison on the basis of transaction value of 'goods of like kind and quality' exported at or about the same time to other buyers in same destination country [Rule 4}, Computed value on basis of cost of production plus profit [Rule 5] and Residual method using reasonable means consistent with principles and general provisions of rules [Rule 6].

3.3.20 ***Rejection of value as declared by exporter -*** As per rule 7 of Customs Valuation (Determination of Value of Export Goods) Rules, 2007, the exporter has to file declaration about full 'value' of goods. If the assessing officer has doubts about the truth and accuracy of 'value' as declared, he can ask exporter to submit further information, details and documents. If the doubt persists, the assessing officer can reject the value declared by importer. [rule 8(1) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007]. If the exporter requests, the assessing officer has to give reasons for doubting the value declared by exporter. [rule 8(2)].

3.3.21 ***Rule 8 is only mechanism to reject the declared value*** – As per *explanation* (1)(i) to rule 8, the Rule 8 does not provide any method for determination of value. It only provides mechanism to reject declared value, where there is reasonable doubt.

Declared value shall be accepted if assessing officer is satisfied about truth and accuracy of the declared value [Explanation (1)(ii) to rule 8 of Customs Valuation (Determination of Value of Export Goods) Rules, 2007].

3.4 PROCEDURES FOR IMPORT

3.4.1 Goods should arrive at customs port/airport only.

- Person in charge of conveyance is required to submit Import Manifest or Export Manifest.
- Goods can be unloaded only after grant of 'Entry Inwards'.

- Importer has to submit Bill of Entry giving details of goods being imported, along with required documents. Electronic submission of documents is to be done in many ports.
- Goods are assessed to duty, examined and customs duty is paid. Bond is executed if required.
- Goods can be cleared from port after 'Out of Customs Charge' order is issued by customs officer.
- Self Assessment on basis of 'Risk Management System' (RNS) has been introduced in some ports in respect of specified goods and importers.
- Demurrage is payable if goods are not cleared within three days from port. Goods can be disposed of if not cleared within 30 days.

3.4.2 ***Overview of procedures for import* -** The broad procedures to be followed for assessment and clearance of imported goods are as follows –

- Importer to submit Bill of Entry giving details of goods to be cleared from customs
- Bill of Entry can be for home consumption (i.e. clearance after payment of duty) (white colour) or for warehousing (keeping in warehouse without payment of duty and later clearing on payment of duty when required) (yellow colour)
- Importer to submit other documents like Invoices, contracts, product literature, packing lists, import license etc. so that customs officer can assess the imported goods under clearance
- Noting of Bill of Entry by customs officer
- Examination of goods and assessment by customs officer (if first appraisement system) or assessment of goods on basis of documents (if second appraisement system)
- Pre-audit by customs department
- Customs Officer to approve assessment (valuation of goods) on the Bill of Entry and return to importer
- Importer to execute bond if clearance at concessional rate of duty subject to some conditions or clearance is under provisional assessment
- Importer to pay duty, if clearance is for home consumption or execute bond, if clearance is for warehousing
- Inspection of goods (if assessment was under second appraisement system)
- Out of customs charge order by customs officer
- Pay dues of port trust, pay demurrage (if applicable), pay other dues
- Transport the goods from customs

These procedures are for import by ship/air/road. There is separate procedure for goods imported as a baggage or by post.

3.4.3 ***Submission of Bill of Entry* -** Bill of Entry is a very vital and important document which every importer has to submit to customs officer in respect of imported goods other than goods intended for transit or transhipment. Bill of Entry should be in prescribed form. It can be either for home consumption or for warehousing [section 46(1)]. It should include all goods mentioned in Bill of Lading or other receipt given by carrier to consignor [section 46(2)]. Importer has to declare that c ontents of Bill of Entry are true [section 46(4)]

- White Bill of Entry is for home consumption. Imported goods are cleared on payment of customs duty.
- Yellow Bill of Entry is for warehousing. It is also termed as 'into bond Bill of Entry' as bond is executed. Duty is not paid and imported goods are transferred to warehouse where these are stored.
- Green Bill of Entry is for clearance from warehouse on payment of customs duty. It is for ex-bond clearance.

3.4.4 ***Documents to be submitted by Importer* -** Documents required by customs authorities are required to be submitted to enable them to (*a*) check the goods (*b*) decide value and classification of goods and (*c*) to ensure that the import is legally permitted. *The documents that are essentially required are* : (i) Invoice (ii) Packing List (iii) Bill of Lading / Delivery Order (iv) GATT declaration form duly filled in (v) Importers / CHAs declaration duly signed (vi) Import License or attested photocopy when clearance is under license (vii) Letter of Credit / Bank Draft wherever necessary (vii-a) Insurance memo or insurance policy (viii) Industrial License if required (ix) Certificate of country of origin, if preferential rate is claimed. (x) Technical literature. (xi) Test report in case of chemicals

(xii) Advance License / DEPB in original, whereapplicable (xiii) Split up of value of spares, components and machinery (xiv) No commission declaration. – A declaration in prescribed form about correctness of information should be submitted. – *Chapter 3 Paras 6 and 7 of CBE&C's Customs Manual, 2001*.

3.4.5 ***Electronic submission under EDI system*** – Customs work at many ports has been computerised. In that case, the Bill of Entry has to be filed electronically, i.e. through Customs EDI system through computerisation of work. Procedure for the same has been prescribed vide Bill of Entry (Electronic Declaration) Regulations, 1995.

The broad procedures to be followed for exports are as follows –

- Submit Shipping Bill for export to customs authorities
- Submit invoice, packing lists, contracts, export license (if applicable) and other related documents
- Submit necessary declarations for export. Submit * GR/SDF/SOFTEX form as required under FEMA * Excise ARE-1 form
- Noting of Shipping Bill by customs officer
- Assessment i.e. valuation and classification of goods. Checking of Advance License, if applicable
- Custom check whether export is restricted/prohibited
- Examination of goods by customs officer
- Pay export duty, if applicable
- Stuffing of container, if not already done
- 'Let export' Order by customs officer
- Obtain ARE-1 form duly signed by customs officer. Obtain Bill of Lading from shipping company. Submit proof of export to excise authorities.
- Complete formalities relating to claim of duty drawback.

3.4.6 ***Prior submission of Bill of Entry*** – After the goods are unloaded, these have to be cleared within stipulated time - usually three working days. If these are not so removed, demurrage is charged by port trust/airport authorities, which is very high. Hence, importer wants to complete as many formalities as possible before ship arives. *Proviso* to section 46(3) of Customs Act allows importer to present bill of entry upto 30 days before *expected date of arrival* of vessel. In such case, duty will be payable at the rate applicable on the date on which 'Entry Inward' is granted to vessel and not the date of presentation of Bill of Entry, *but rate of exchange will be as prevalent on date of submission of bill of entry.* - confirmed in CC, New Delhi circular No 64/96 dated 10.12.1996 and CBE&C circular No. 22/97-Cus dated 4.7.1997.

Department has clarified that if vessel does not arrive within 30 days, filing of fresh bill of entry will be necessary and in such cases, date of filing fresh Bill of Entry will be considered for calculating rate of exchange.

3.5 PROCEDURES FOR EXPORT

3.5.1 The broad procedures to be followed for exports are as follows —

- Submit Shipping Bill for export to customs authorities
- Submit invoice, packing lists, contracts, exports authorisation (if applicable) and other related documents
- Submit necessary declarations for export. Submit* GG/SDF/SOFTEX form as required under FEMA* Excise ARE-1 form
- The 'Export Value Declaration' should be in form given in Annexure A to MF(DR) circular No. 37/2007-Cus dated 9-10-2007.
- Noting of Shipping Bill by customs officer.
- Assessment i.e. valuation and classification of goods. Checking of Advance Authorisation, if applicable.
- Custom check whether export is restricted/prohibited
- Examination of goods by customs officer
- Pay export duty, if applicable
- Stuffing of container, if not already done.

- 'Let export' Order by customs officer.
- Obtain ARE-1 form duly signed by customs officer. Obtain Bill of Landing from shipping company. Submit proof of export to excise authorities.
- Complete formalities realting to claim of duty drawback.

3.5.2 Every exporter should take following initial steps -

- Obtain BIN (Business Identification Number) from DGFT. It is a PAN based number
- Open current account with designated bank for credit of duty drawback claims
- Register licenses/advance license/DEPB etc. at the customs station, if exports are under Export Promotion Schemes.

3.5.3 ***RCMC certificate from Export Promotion Council*** - Various Export Promotion Councils have been set up to promote and develop exports (e.g. Engineering Export Promotion Council, Apparel Export Promotion Council, etc.) Exporter has to become member of the concerned Export Promotion Council and obtain RCMC - Registration cum membership Certificate. Exporter should apply for registration with EPC that relates to his main line of business. However, exporter can take membership of any other EPC in addition – DGFT circular No. 2/2004-09 dated 6-10-2004.

3.5.4 ***Third party exports*** - Third party exports means exports made by an Exporter or Manufacturer on behalf of another exporter/s. The Shipping Bill shall indicate the names of both the exporter/ manufacturer and exporter. The BRC, GR declaration, export order and the Invoice shall be in name of the third party exporter [para 9.62 of FTP]

SEZ unit can export goods or software through a merchant exporter/status holder.

Merchant Exporter - Merchant Exporter means a person engaged in trading activity and exporting or intending to export goods.

3.6 BAGGAGE, COURIER AND IMPORT THROUGH POST

3.6.1 Baggage includes unaccompanied baggage but does not include motor vehicles [section 2(3)]

- Indians going out can take out any amount of foreign currency as long as it is obtained from authorised foreign exchange dealer. He can take out and bring in Indian currency only upto ₹ 1,000.
- Baggage includes all dutiable articles imported by passenger or crew but does not include motor vehicles, alcoholic drinks (beyond limits) and goods imported through courier.
- Incoming passenger with no dutiable goods can pass through green channel.
- General rate of duty on import of baggage is 36.05% (35% basic customs duty plus 2% education cess plus 1% SAH education cess). One laptop computer is exempt.
- *Bona fide* luggage including used personal effects are exempt from customs duty. In addition to bona fide luggage and one laptop computer, Indian resident or foreigner residing in India over 12 years of age is allowed general free allowance (GFA) of ₹ 25,000, after stay abroad for more than three days. GFA is lower when passenger comes from some countries like Nepal, Bhutan, Myanmar or China.
- Besides GFA, one laptop can be imported free of customs duty.
- GFA cannot be clubbed with other person.
- If a person comes after 6 months of stay, he can bring gold upto 10 Kg on payment of customs duty @ ₹ 250 per 10 gms (plus education cess) and silver upto 100 Kg on payment of customs duty @ ₹ 500 per Kg (plus education cess)
- Commercial samples can be brought in or taken out within prescribed limits.

- Additional concession is available if a person transfers his residence after stay abroad for two years. He is eligible for concessional rate of 15% duty (plus 2% education cess) of goods upto ₹ 5 lakhs. In case of some goods, duty is Nil. He is also entitled to GFA.
- In case of mini TR (i.e. person returning after 365 days), used personal effects and household articles upto ₹ 75,000 can be brought duty free, in addition to GFA. However, items specified in Annex I, II and III as specified in Baggage Rules are not allowed duty free.
- Foreign tourists can bring personal effects and travel souvenirs free of duty. Articles upto ₹ 8,000 can be brought as gifts duty free.
- If value of foreign currency notes exceeds US $ 5,000 or aggregate value of foreign exchange (in the form of currency note, bank notes, traveller cheques etc.) exceeds US $ 10,000, the passenger has to make declaration in Currency Declaration Form (CDF).
- Unaccompanied baggage can be brought. GFA is not allowed on unaccompanied baggage.

3.6.2 Import and export through Courier –

Imports and export through couriers are treated as imports or exports as any other mode. It is not treated as 'baggage'. There is no restriction on value of goods that can be brought through courier. The duty payable is normal duty as applicable to all other goods normally imported by ship or air transport. Duty concessions, if any, are also permissible. Courier Imports and exports (Clearance) Regulations, 1998 specify the procedures, which are summarised in Chapter 17 of CBE&C's Customs Manual, 2001.

3.6.3 Import through post

- Label/declaration on postal article is treated as 'Entry'. Separate Bill of Entry is not required.
- Postal articles are sent to Foreign parcel Department of Post Office. The list is handed over to Principal Appraiser of Customs.
- He will inspect mail. Packets suspected of dutiable articles will be opened and examined by him . He will assess the goods and then seal the parcel.
- Goods will be handed by postmaster to addressee only on receipt of customs duty paya ble on the goods.
- Gifts upto ₹ 10,000 are free. Post parcel is exempt if customs duty is upto ₹ 100.

3.7 OTHER PROVISIONS IN CUSTOMS

3.7.1 Exemptions and remission

- Exemption can be granted by Government by issuing a notification.
- Capital goods and spares can be imported under project imports at concessional rate of customs duty.
- Remission can be obtained on goods lost/pilfered in port
- Title of imported goods can be relinquished and then no customs duty will be payable.
- Goods exported can be re-imported. Concessional customs duty is payable in most of such re-imports.

3.7.2 Warehousing in customs

- Imported goods can be kept in customs warehouse without payment of customs duty.
- Goods can be kept in warehouse awaiting receipt of import authorisation.
- Goods can be kept in warehouse upto one year, but interest is payable beyond 90 days, @ 15%.
- Goods can be manufactured in warehouse and exported without payment of customs duty. This facility is useful to EOU.
- Warehoused goods cane be (a) Cleared on payment of duty (b) Cleared for export without payment of duty or (c) transferred to another warehouse without payment of duty.

3.7.3 Penalties under Customs Act

- Smuggling in relation to goods is an act or omission which will make the goods liable to confiscation.
- Penalty can be imposed for improper imports or improper exports.
- Monetary penalty upto value of goods or ₹ 5,000 whichever is higher can be imposed.
- Goods can be confiscated. Permission can be granted for re-export of offending goods..
- In case of goods covered under section 123 of Customs Act, burden of proof that the goods are not smuggled goods is on the accused.

3.7.4 REFUND OF SPECIAL CVD OF CUSTOMS TO TRADERS

Traders selling imported goods in India after charging sales tax/Vat can claim refund of special CVD of 4% from customs department – Notification No. 102/2007-Cus dated 14-9-2007. The dealer (trader) (if he is registered with Central Excise and is issuing Cenvatable Invoice) selling such imported goods must mention in his invoice that the buyer will not be able to avail Cenvat credit of such duty. This is required if he is claiming refund of the special CVD. If he is not claiming refund, obviously, such remark is not required. A manufacturer using these goods in his manufacture can avail Cenvat credit of this duty. Thus, he gets credit through central excise route.

3.7.5 ANTI DUMPING DUTY ON DUMPED ARTICLES

Often, large manufacturer from abroad may export goods at very low prices compared to prices normally prevalent in export market. Such dumping may be with intention to cripple domestic industry ***or*** to dispose of their excess stock. This is called 'dumping' and is an unfair trade practice. In order to avoid such dumping and to protect domestic industry, Central Government can impose, under section 9A of Customs Tariff Act, anti-dumping duty, if the goods are being sold at less than its normal value. Levy of such anti-dumping duty is permissible as per WTO agreement. Anti dumping action can be taken only when there is an Indian industry producing 'like articles'. In *Shenyang Mastusushita* v. *Exide Batteries* 2005 (181) ELT 320 (SC 3 member bench), it was observed, 'Principle behind anti-dumping laws is to protect the domestic industry from being adversely affected by import of goods at export prices which are below the normal value of the goods in the domestic market of the exporter. The duty is calculated on the margin of dumping which is the difference between the export price and the normal value'.

In *SS Enterprise* v. *Designated Authority* AIR 2005 SC 1527 = 181 ELT 375 (SC 3 member bench), it was held that purpose being imposition of anti-dumping duty is to curb unfair trade practices resorted to by exporters of a particular country of flooding the domestic markets at rates which are lower than the rate at which the exporters normally sell the same or like goods in their own countries, so as to cause or be likely to cause injury to the domestic market. The levy of dumping duty is a method recognised by GATT (*should be WTO*) which seeks to remedy the injury and at the same time balances the rights of exporters from other countries to sell their products within the country with the interest of domestic markets. Thus the factors to constitute 'dumping' is (i) an import at prices which are lower than the normal value of goods in exporting country (ii) the exports must be sufficient to cause injury to domestic industry.

However, negligible quantity of imports would not be sufficient to cause such injury.

Presently, countries like China, Taiwan are said to be involved in dumping. Even Indian steel exporters are facing charges of dumping goods in USA.

3.7.6 *Provisional anti-dumping duty* - Pending determination of margin of dumping, duty can be imposed on provisional basis. After dumping duty is finally determined, Central Government can reduce such duty and refund duty extra collected than that finally calculated. Such duty can be imposed upto 90 days prior to date of notification, if there is history of dumping which importer was aware or where serious injury is caused due to dumping.

3.7.7 *No CVD on anti dumping duty* - Anti Dumping Duty and Safeguard Duty is not required to be considered while calculating CVD – view confirmed in *Tonira Pharma* v. *CCE* (2007) 208 ELT 38(CESTAT 2 v. 1 order).

3.7.8 ***No education cess and SAHE cess on anti-dumping duty*** – Education cess and SAH education cess is not payable on anti-dumping duty.

3.7.9 ***No anti dumping duty in case of imports by EOU and SEZ*** - Anti-dumping duty is not applicable for imports by EOU or SEZ units, unless it is specifically made applicable in the notificationimposing anti-dumping duty. [section 9A(2A) of Customs Tariff Act]

3.7.10 ***Margin of Dumping*** - '*Margin of dumping*' means the difference between normal value and export price (i.e. the price at which these goods are exported). [section 9A(1)(a)].

'*Normal Value*' means comparable price in ordinary course in trade, for like article, when destined for consumption in the exporting country or territory. If such price is not available or not comparable (a) comparable representative price of like article exported from exporting country or territory to appropriate third country or (b) cost of production plus reasonable profit, can be considered [section 9A(1)(c) of Customs Tariff Act]. The 'normal value' is to be determined as per rules.

In *Reliance Industries Ltd.* v. *Designated Authority* 2006 (202) ELT 23 (SC), it was held that 'normal value' are not exporter specific but exporting country specific. Once dumping of specific goods from a country is established, dumping duty can be imposed on all exports of those goods from that country in India, irrespective of the exporter. Rate of duty may vary from exporter to exporter depending upon the export price.

'*Export Price*' means the price at which goods are exported. If the export price is unreliable due to association or compensatory arrangement between exporter and importer or a third party, export price can be constructed (revised) on the basis of price at which the imported articles are first sold to independent buyer or according to rules made for determining margin of dumping. [section 9A(1)(b)].

Margin of dumping is determined on basis of weighted average of 'normal value' and the 'export price' of product under consideration.

3.7.11 ***Quantum of dumping duty*** - The anti-dumping duty will be dumping margin or injury margin, *whichever is lower*. 'Injury margin' means difference between fair selling price of domestic industry and landed cost of imported product. The landed cost will include landing charges of 1% and basic customs duty. Thus, only anti-dumping duty enough to remove injury to domestic industry can be levied.

For example, if normal value in exporting country is ₹ 11 and export price is ₹ 8, dumping margin is ₹ 3. If landed cost is ₹ 9 and fair selling price of domestic industry is ₹ 10, then injury margin is Re 1/-. Hence, anti-dumping duty of only Re 1 can be imposed.

In *Reliance Industries Ltd.* v. *Designated Authority* 2006 (202) ELT 23 (SC), it was held that noninjurious price (NIP) has to be calculated for domestic industry as a whole and not in respect of any particular company or enterprise. [Hence, even if product is captively consumed by Indian manufacturer, transfer price (market value) of inputs is to be considered and not actual cost of captive consumption]. It was observed that there has to be a single NIP for a product and not several NIP for the same product. NIP is not exporter specific.

In *Alkali Manufacturers Association of India* v. *Designated Authority* 2006 (194) ELT 161 (CESTAT). Designated Authority had calculated domestic price on basis of profit of 22% of investment. It was held that this is reasonable.

3.7.12 ***Dumping duty for WTO countries*** - Section 9B of Customs Tariff Act provides restrictions on imposing dumping duties in case of imports from WTO countries or countries given 'Most Favoured Nation' by an agreement. Dumping duty can be levied on import from such countries, only if Central Government declares that import of such articles in India causes material injury to industry established in India or materially retards establishment of industry in India.

[WTO agreement permits levy of anti-dumping duty when it causes injury to domestic industry as a result of specific unfair trade practice by foreign producer, by selling below normal value].

'Injury to domestic industry' will be considered on basis of volume effect and price effect on Indian industry. There must be a 'casual link' between material injury being suffered by dumped articles and the dumped imports.

3.7.13 ***Rules for deciding subsidy or dumping margin*** - Central Government has been empowered to make rules for determining (*a*) subsidy or bounty in case of bounty fed goods (*b*) the normal value and export price to determine margin of dumping in case of dumping. Accordingly, Customs Tariff (Identification, Assessment and Collection of Anti-dumping duty on Dumped Articles and for determination of Injury) Rules, 1995 [*Customs Notification No. 2/95 (N.T.) dated 1-1-95*] provide detailed procedure for determining the injury in case of dumped articles.

3.7.14 ***Procedure for fixing anti dumping duty*** - After the 'designated authority' is satisfied about *prima facie* case, he will give notice to Governments of exporting countries. Opportunity to inspection of documents and making representations will be given to interested parties who are likely to be affected. Designated Authority will first give preliminary finding and then final finding within one year. Provisional duty can be imposed on basis of preliminary finding which can continue upto 6 months, extendable to 9 months. Additional duty may be imposed on basis of the final finding.

As per rule 18 of Anti-Dumping Duty Rules, Central Government has to issue a notification fixing anti-dumping duty within three months from date of notification issued by designated authority.

3.7.15 ***Appeal against order determining dumping duty*** - Appeal against the order determining the duty can be made to CESTAT. The appeal will be heard by at least three member bench consisting of President, one judicial member and one technical member [section 9C of Customs Tariff Act].

3.7.16 ***No appeal against order of Tribunal*** – Section 9C does not provide for statutory appeal against order of Tribunal. Hence, only remedy is either writ in High Court or SLP in Supreme Court.

5.7.17 ***High Court should not exercise writ jurisdiction*** – In view of appeal provisions, High Court should not entertain writ petitions and grant interim relief. Otherwise, the provisions of appeal would be rendered otiose – *Association of Synthetic Fibre Industry* v. *J K Industries* 2006 (199) ELT 196 (SC) * *Nitco Tiles* v. *Gujarat Ceramic Floor Tiles Mfg Association* 2006 (199) ELT 198 (SC).

3.7.18 ***Mid-term review*** – Mid-term review of anti-dumping duty is permissible under rule 23 of Anti-Dumping Duty Rules. In *Rishiroop Polymers* v. *Designated Authority* 2006 (196) ELT 385 (SC), it was held that scope of review enquiry by Designated Authority is limited to the satisfaction as to whether there is justification for continuing imposition of anti-dumping duty. The inquiry is limited to change in various parameters like normal value, export value, dumping margin, fixation of non-injury price and injury to domestic industry. Only changed parameters should be considered.

3.7.19 ***New Shipper Review*** – After imposing of anti-dumping duty, a new exporter may want to export same goods to India. As per rule 22, if he had not exported earlier, he can ask for review of anti-dumping duty. During the period of review, Government may resort to provisional assessment and may allow imports on submission of guarantee, pending review. If anti-dumping duty is determined, it will be payable retrospectively from date of initiation of review. Such review is termed as 'new Shipper Review'.

3.7.20 ***Discontinuation of anti-dumping duty i.e. sunset review*** - Anti dumping duty ceases on the expiry of five years from date of imposition. However, Central Government can extend the anti-dumping duty, if it is of the opinion that cessation is likely to lead to continuation or recurrence of dumping and injury.

3.7.21 ***Illustration on anti-dumping duty*** **–** An importer imported Description of goods: Mulberry Raw Silk (not thrown) (HS Code 5002 00) from People's Republic of China. CIF value was US $ 20,000 and quantity 1,000 Kgs.

Exchange rate was 1 US $ = ₹ 44 on date of presentation of Bill of Entry. Customs Duty rates are – (i) Basic Customs Duty 10% (ii) Education Cess 2% (iii) SAH Education cess - 1%. There is no excise duty payable on these goods if manufactured in India. As per Notification No. 106/2003-Cus dated 10-7-2003, anti-dumping duty has been imposed on these goods imported from China, manufactured by any producer in People's Republic of China. The anti-dumping duty will be equal to difference between amount calculated @ US $ 31.69 per Kg and 'landed value' of goods. Compute Customs Duty liability & anti-dumping liability.

Answer :

(a)	Computation of Customs duty :	
	Total CIF Price	US $ 20,000
	CIF @ ₹ 44 per 1 US $	₹ 8,80,000.00
	Add – Landing charges @ 1%	₹ 8,800.00
	Assessable Value	₹ 8,88,800.00
	Basic duty @ 10%	₹ 88,880.00
	Education Cess @ 2% on 88,880.00	₹ 1,777.60
	SAH education Cess 1%	888.80
	Total Customs Duty payable (Basic + Education Cess)	₹ 91,546.40
	Rounded off	₹ 91,546.40
(b)	Computation of landed value	
	Assessable Value Under Customs Act	₹ 8,88,800.00
	Add: All Duties of Customs	₹ 91,546.40
	Landed Value as per Anti-Dumping Notification	₹ 9,80,346.00
(c)	Computation of anti-dumping duty	
	Rate of Silk Yarn as per Anti-Dumping Notification	
	(US $ 31.69 per kg) × 1000 kgs =	US $ 31,690
	Value @ ₹ 44 per US $ =	₹ 13,94,360
	Less : Landed value as per Anti-Dumping =	₹ 9,80,346
	Anti-Dumping Duty Payable	₹ 4,14,014

3.8 VALUE FOR PURPOSE OF CUSTOMS ACT

3.8.1 Customs duty is payable as a percentage of 'Value' often called '*Assessable Value*' or '*CustomsValue*'. The **Value** may be either (*a*) 'Value' as defined in section 14(1) of Customs Act or (*b*)Tariff value prescribed under section 14(2) of Customs Act. The provisions relating to customs valuation have been completely revamped by introducing new section 14 w.e.f. 10-10-2007.

3.8.2 *Tariff Value* - Tariff Value can be fixed by CBE&C (Board) for any class of imported goods or export goods. CBE&C should consider trend of value of such or like goods while fixing tariff value. Once so fixed, duty is payable as percentage of this value. (The percentage applicable is as prescribed in Customs Tariff Act). Fixing tariff value is not permitted under GATT convention. However, the provision of fixing tariff values has been retained.

Tariff value for crude palm oil, RBD Palmolein, palm oil, crude soyabean oil and brass scrap has been fixed by notification No. 36/2001-Cus (NT) dated 3-8-2001.

3.8.3 Essential Ingredients of Valuation Section 14

The essential ingredients of section 14 may be analysed as under :

(a) Section 14 would be applicable only when customs duty is chargeable on goods based on their value either under the Customs Tariff Act, 1975 or under any other law for the time being in force.

(b) The value of goods under section 14(1) is deemed value.

(c) The assessable value will be price at which like goods are ordinarily sold.

(d) Where there is no sale price, the value shall be the price at which such or like goods are ordinarily offered for sale.

(e) The terms of the price should be for delivery at the time and place of importation or exportation, as the case may be.

(f) The sale or offer for sale should be in the course of international trade.

(g) There should be no mutuality of interest between the seller and the buyer.

(h) Price should be the sole consideration for sale or offer for sale.

Analysis in the light of Judicial Decisions

The above ingredients may be further explained with the help of judicial rulings as under :

(a) Assessable Value is Deemed Value

Section 14(1)(a) brings about the concept of deemed value, which is a fictional value that relates to the concept of intrinsic value of goods, which it may fetch in the international market.

In the case of *Union of India v Glaxo Laboratories Ltd.*, the Court observed that the assessable value as per section 14(1), need not as a matter of fact, be the invoice price or the price that is agreed between the parties. It may be deemed value.

(b) Price

In N *Gulabair D Parekh v Union of India,* it was observed that the invoice price based on the prevailing price list, should be accepted in terms of section 14(1)(a) of the Customs Act.

A declared price list can be used for the purpose or arriving at the value but there is no hard and fast rule and the invoice may supercede the price list as held by the Supreme Court in *Mirah Exprots Pvt. Ltd. v CC.*

In *Rajkumar Knitting Mills P Ltd. v CC*, a three member bench of Supreme Court held that for valuation purposes, 'ordinary' price at the time of importation is relevant and *not* the price prevalent on the date of contract.

(c) At which such or like goods are ordinarily sold

In *Chander Prakash & Co v Collector of Customs,* it was held that when the invoice price was very low and when the prices of comparable goods were available, it would not be appropriate to adopt the invoice price.

(d) Where there is no sale price, the 'offer for sale' price will be applicable

In case a sale price is not available, the offer for sale price may be construed as the basis determining the assessable value. For example, in case a price list is available, such price list is the quotation as well.

(e) Ordinarily sold

In *Collector of Customs, Bombay v Maruti Udyog Limited* (1987), Maruti Udyog Limited, which had collaboration with Suzuke Motor Co, Limited was the only buyer of Suzuki SKD/CKD packs and complete vehicles. A controversy arose so to whether the price charges by Suzuki could be considered as one at which goods were ordinarily sold or offered for sale. In this case, the court held that the price charged by the Suzuki was a commercial price. Also, it was held that there was nothing to prove that the transaction between the two companies were not at arms length.

(f) In the course of international trade

In *Satellite Engineering Limited v Union of India* (1983), the assessee, who were manufacturers of fluorescent starter switches imported lead glass tubing at rate of 0.15 pounds per kg. However, the customs department which was of the opinion that the value was low, obtained two more quotations which were 0.430 pounds per kg. And 0.429 pounds per kg. respectively. It was held that the price indicated in the two quotations were in the course of international trade and hence that rate will form the basis for determining the assessable value.

(g) Price being the sole consideration

In *Sanjay Chandiram v Collector of Customs,* the court held that as there is no proof of comparable goods being imported at a higher rate and as it cannot be shown that the importer had paid to the supplier, an amount more than that required to be paid, there is no ground for rejection of the transaction value.

3.8.4 Method of valuation

The Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, based on WTO Valuation Agreement (earlier GATT Valuation Code), consist of rules providing six methods of valuation.

The methods of valuation for customs methods are as follows —

- Transaction Value of Imported goods [Section 14(1) and Rule 3(1)].
- Transaction Value of Identical Goods [Rule 4]
- Transaction Value of Similar Goods [Rule 5]
- Deductive Vaue which is based on identical or similar **imported** goods sold in India [Rule 7]
- Computed value which is based on cost of manufacture of goods plus profits [Rule 8]
- Residual method based on reasonable means and data available [Rule 9]

Methods to be applied sequentially — These methods are to be applied in sequential order, i.e. if method one cannot be applied, then method two comes into force and when method two also cannot be applied, method three should be used and so on. The only exception is that the 'computed value' method may be used before 'deductive value' method, if the importer requests and Assessing Officer permits.

3.8.5 Transaction Value of Imported Goods

As per rule 3(1), value of imported goods shall be transaction value adjusted in accordance with provisions of rule 10 [Rules effective from 10.10.2007].

As per rule 10 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, various additions like sales commission, cost of containers, cost of packing; cost of materials, components etc. or services supplied by buyer; royalties payable, transport charges, insurance etc. are includible, *if these do not already form part of transaction value*.

Rule 3(1) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 is subject to rule 12, which means that provisions of rule 12 overrides provisions of rule 3. As per rule 12 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, the value as declared by importer can be rejected by Assessing Officer, if he has doubts about truth or accuracy of the value as declared. However, the Assessing Officer has to give reasons for his doubts in writing and provide opportunity of personal hearing. Thus, it is not obligatory on customs officer to accept the transaction value if he has reasons to doubt the truth or accuracy of the same.

Transaction value can be rejected either for special circumstances as per section 14(1) or conditions as specified in rule 3(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.

Special circumstances as per section 14(1) - The 'special circumstances' in section 14(1) are (*a*) Buyer and seller should not be related ***and*** (b) Price should be the sole consideration for the sale. If these 'special circumstances' are not satisfied, transaction value can be rejected. Any other 'special circumstances' cannot be considered.

Conditions as per rule 3(2) - As per rule 3(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [Earlier rule 4(2) of Customs Valuation Rules], transaction value can be accepted only if following requirements are satisfied –

No restriction on buyer for disposal of goods - There are no restriction on buyer on disposition or use of goods *except* the following: (*a*) restrictions prescribed by public authorities in India (*b*) restriction on geographical area within which goods may be resold e.g. goods should not be sold outside particular State or outside India *or* (*c*) restriction that does not materially affect value of goods - e.g. exporter puts a condition to importer of automobile that car should not be exhibited before a particular date – illustration given in Interpretative Note to rule 3(2)(a)(iii). [rule 3(2)(a)] [earlier rule 4(2)(e) upto 10-10-2007]

Sale not subject to conditions of which value cannot be determined - The sale or price should not be subject to a condition or consideration for which value cannot be determined. Examples given in interpretative note to rule 3(2)(b) are – (a) Price is subject to condition that buyer buys some other goods in specified quantities from seller (b) price is dependant on price at which buyer of imported goods sells other goods to seller (c) Price is based on form of payment extraneous the imported goods. However, (i) buyer furnishing engineering and plans undertaken in India to seller (ii) Buyer undertaking activities of marketing of imported goods in India will not form part of value of imported goods [rule 3(2)(b)] [earlier rule 4(2)(f) upto 10-10-2007].

No further consideration to seller of which adjustment cannot be made - Seller should not be entitled to further consideration like part of subsequent resale, disposal or use of goods by the buyer will accrue directly or indirectly to seller, unless proper adjustment in value terms can be made as per rule 10 e.g. if the importer is a trader and the condition is that after he sells the goods in India, the foreign exporter will get a fixed amount after the sale, that extra amount can be added for Customs Valuation [rule 3(2)(c)] [earlier rule 4(2)(g)]

Unrelated buyer and seller, except when price acceptable under rule 3(3) - Buyer and seller are not be related, unless the transaction value is acceptable under rule 3(3) [rule 3(2)(d)] [earlier rule 4(2)(h) upto 10-10-2007]. *If any of the aforesaid requirement is not satisfied, 'transaction value' cannot be accepted for valuation purposes*.

3.8.6 Transaction Value of Identical Goods

Rule 4(l)(a) of Customs Valuation (Determination of Value of Imported Goods) Rules 2007 of Customs Valuation Rules provide that if valuation on the basis of 'transaction value' is not possible, the 'Assessable value' will be decided on basis of transaction value of identical goods sold for export to India and imported at or about the same time.

Rule 4(1)(b) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 provides that transaction value of identical goods at the same commercial level and in substantially same quantity as the goods being valued shall be used to determine value of imported goods.

If transaction value at different commercial level or in different quantities *or both* is available, suitable adjustments can be made to take into account the difference.

Identical goods' are defined under Rule 2(1)(d) of Custom Valuation (Determination of value of Imported Goods) Rules, 2007 as those goods which fulfil all following conditions i.e. *(i)* the goods should be same in all respects, including physical characteristics, quality and reputation; except for minor differences in appearance that do not affect value of goods. *(ii)* the goods should have been produced in the same country in which the goods being valued were produced. *(iii)* they should be produced by same manufacturer who has manufactured goods under valuation - if price of such goods are *not* available, price of goods produced by another manufacturer in the same country. — However, if engineering, development work, art work, design work, plan or sketch undertaken in India were completed by the buyer on these imported goods free of charge or at reduced rate for use in connection with the production and sale for export of these imported goods, these will not be 'identical goods'.

3.8.7 Transaction Value of Similar Goods

If first method of transaction value of the goods or second method of transaction value of identical goods cannot be used, rule 5 (earlier rule 6) provide for valuation on basis of 'Transaction value of similar goods imported at or about the same time'.

What are Similar goods - Rule 2(1)(f) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [earlier rule 2(1)(e) upto 10-10-2007] define 'similar goods' as *(a)* alike in all respects, have like characteristics and like components and perform same functions. These should be commercially inter-changeable with goods being valued as regards quality, reputation and trade mark. *(b)* the goods should have been produced in the same country in which the goods being valued were produced. *(c)* they should be produced by same manufacturer who has manufactured goods under valuation - if price of such goods are not available, price of goods produced by another manufacturer in the same country can be considered. -. However, if engineering, development work, art work, design work, plan or sketch under-taken in India were completed by the buyer on these imported goods free of charge or at reduced rate for use in connection with the production and sale for export of these imported goods, these will not be 'similar goods'.

3.8.8 Deductive Value Method

Rule 7 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 provide for the next i.e. fourth alternative method, which is called 'deductive method'.

This method should be applied if transaction value of identical goods or similar goods is not available; but these products are sold in India. The assumption made in this method is that identical or similar imported goods are sold in India and its selling price in India is available. *The sale should be in the same condition as they are imported*. Assessable Value is calculated by reducing post-importation costs and expenses from this selling price. This is called 'deductive value' because assessable value has to be arrived at by method of deduction.

3.8.9 Computed Value Method

If valuation is not possible by deductive method, the same can be done by computing the value under rule 8 of Customs Valuation (Determination of Valuation of Imported Goods) Rules, 2007, which is the fifth method.

In this method, value is the sum of (*a*) Cost of value of materials and fabrication or other processing employed in producing the imported goods (*b*) an amount for profit and general expenses equal to that usually reflected in sale of goods of the same class or kind, which are made in the country of exportation for export to India. (*c*) The cost of value of all other expenses under rule 10(2) i.e. transport, insurance, loading, unloading and handling charges.

3.8.10 Residual Method

The sixth and the last method is called "residual method". It is also often termed as 'fallback method'. This is similar to 'best judgment method' of the Central Excise, Income Tax and Sales Tax. This method is used in cases where 'Assessable Value' cannot be determined by any of the preceding methods. While deciding Assessable Value under this method, reasonable means consistent with general provisions of these rules should be the basis and valuation should be on basis of data available in India. [Rule 9(1) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007].

The value cannot exceed normal price - The value so determined cannot be more than the 'normal price' i.e. price at which such or like goods are ordinarily sold or offered for sale for delivery at the time and place of importation in course of International Trade, when seller and buyer have no interest in the business of each other or one of them has no interest in the other and price should be sole consideration for sale or offer for sale [proviso to rule 9(1). There was no parallel proviso in earlier rule 8(1)].

3.8.11 Inclusions/Exclusions in Customs Value

- Valuation for customs is required to be done as per provisions of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.
- CIF value of goods plus 1% landing charges is the basis for deciding 'Assessable Value'.
- Commission to local agents, packing cost, value of goods and toolings supplied by uyer, royalty relating to imported goods are addible.
- Interest on deferred payment, demurrage at port is not required to be added
- Value of computer software loaded on machine is to be added to value of machinery.
- Old machinery and old cars are valued on basis of depreciated value, though such method has no sanction of law.

No other additions - No other addition shall be made to price paid or payable, except as provided for in rule 10 [rule 10(4) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9(4)]. Interpretative Note to rule 3 (earlier rule 4) also clarifies that activities undertaken by buyer other than those for which adjustments are provided in rule 10 (earlier rule 9) are not to be added, even though it may be regarded as benefit to the seller.

3.9 VALUATION OF EXPORT GOODS

3.9.1 SELF ASSESSMENT ON BASIS OF 'RISK MANAGEMENT SYSTEM' (RMS)

One major step is being taken to move in the direction of implementing international best

practices in customs clearance. A 'Risk Management System' for customs clearance of import and export cargo has been introduced. The details of scheme are contained in MF(DR) circular No. 43/2005-Cus dated 24-11-2005 – see also CC, Bangalore-I PN 88/2006 dated 31-7-2006 (201 ELT T5). Initially, the scheme will be introduced in Air Cargo Complex, Sahar Mumbai and then it will be introduced in other customs houses in phases. Under Risk Management System (RMS), only high risk cargo is selected for examination. Thesystem provides for special customs clearance for Accredited Clients having good track record and meet specified criteria.

The scheme proposes to do away with existing system of routine assessments and concurrent audit. Goods will be normally cleared on basis of self assessment of importer. Bill of Entry submitted electronically will be transmitted to RMS. The RMS will process the data and produce an electronic output. This output will determine whether the Bill of Entry will be taken up for appraisement/examination or be cleared after payment of duty without any assessment and examination. Any change is system will require prior approval of Commissioner of Customs and after recording reasons. Focus will be on quality assessment, examination and post clearance audit of Bills of Entry selected by the Risk Concurrent audit will be replaced by Post Clearance Audit on Bill of Entry selected by the Risk Management System. Subsequently, demand can be raised even if goods have been cleared from customs.

3.9.2 ***No change in Custom Act and Rules*** - The scheme is being introduced without making any change in Customs Act or Rules, the basic procedures of sanctions and approvals remain unaltered and hence is not similar to scheme of self-assessment under Central Excise, where clearances are effected by assessee without supervision or presence of excise inspectors. Scope of the scheme is also very limited.

3.9.3 ***Scheme open only to 'Accredited Clients' -*** The scheme is limited to only 'Accredited Clients' as defined in MF(DR) circular No. 42/2005-Cus dated 24-11-2005. They should have imported goods valued at ₹ 10 crores in previous financial year or paid duty more than ₹ one crore. In case of importers who are central excise, they should have paid at least ₹ one crore of duty through PLA in previous financial year. They should have filed at least 25 Bills of Entry in the previous financial year.

3.9.4 ***Person who had received any show cause notice in last three financial years is ineligible*** – In order to ensure that scope of the scheme remains limited (and the scheme fails), it is provided that no case should be pending against them. Even show cause notice invoking penal provisions should not have been issued against them is last three financial years. Such importers can be probably counted on fingers. If this condition is insisted upon, the scheme is stillborn and will be a non-starter.

3.9.5 ***Application for getting accreditation*** - Importers desirous of availing the facility of 'Accredited Client' has to make application for registration in form given in MF(DR) circular No. 42/2005-Cus dated 24-11-2005. Application has to be accompanied by a CA certificate that the accounting system of applicant is as per accounting standards prescribed by ICAI.

3.9.6 ***Decision regarding ACP status within 30 days*** - In case of status holders, Customs will communicate decision on conferring ACP status (Accredited Client under Risk Management System of customs clearance, within 30 days from receipt of application by customs.

Risk management division in systems directorate – A risk management division has been created in Systems Directorate. Risk Management Committees will be constituted at National level and Local level – MF(DR) circular No. 23/2007-Cus dated 28-6-2007.

3.10 PROVISIONAL ASSESSMENT OF DUTY [SECTION 18]

(1) Notwithstanding anything contained in this Act, but without prejudice to the provisions contained in section 46 —

(a) where the proper officer is satisfied that an importer or exporter is unable to produce any document or furnish any information necessary for the assessment of duty on the imported goods or the export goods, as the case may be; or

(b) where the proper officer deems it necessary to subject any imported goods or export goods to any chemical or other test for the purpose of assessment of duty thereon; or

(c) where the importer or the exporter has produced all the necessary documents and furnished full information for the assessment of duty but the proper officer deems it necessary to make further enquiry for assessing the duty, the proper officer may direct that the duty leviable on such goods may, pending the production of such documents or furnishing of such information or completion of such test or enquiry, be assessed provisionally, if the importer or the exporter, as the case may be, furnishes such security as the proper officer deems fit for the payment of the deficiency, if any, between the duty finally assessed and the duty provisionally assessed.

3.11 RELEVANT DATE FOR RATE AND VALUATION OF IMPORT DUTY

Section 15 of Customs Act prescribes that rate of duty and tariff valuation applicable to imported goods shall be the rate and valuation in force at one of the following dates (*a*) if the goods are entered for home consumption, the date on which bill of entry is presented (*b*) in case of warehoused goods, when Bill of Entry for home consumption is presented u/s 68 for clearance from warehouse and (*c*) in other cases, date of payment of duty.

3.12 DRAWBACK

In 'duty drawback', the excise duty and customs duty paid on inputs and service tax paid on input services is given back to the exporter of finished product by way of 'duty drawback'.

It may be noted that duty drawback under section 75 is granted when imported materials are used in the manufacture of goods which are then exported, while duty drawback under section 74 is applicable when imported goods are re-exported as it is, and article is easily identifiable.

Duty drawback rates are of following types - (a) All Industry Rate (b) Brand Rate and (c) Special Brand Rate.

Duty drawback rates can be fixed with retrospective effect [rule 5(2) of Drawback Rules, 1995].

All Industry Drawback Rates – All Industry Drawback rates are fixed by Directorate of Drawback, Dept. of Revenue, Ministry of Finance, Govt. of India, Jeevan Deep, Parliament Street, New Delhi-110 001. The rates are perodically revised-normally on 1st June every year. The All Industry Drawback Rate is fixed under rule 3 of Drawback Rules by considering average quantity and value of each class of inputs imported or manufactured in India.

Duty drawback rate shall not exceed 33% of market price of export goods (Rule 8A w.e.f. 15-2-2006).

Brand Rate of Duty Drawback – It is possible to fix All Industry Rate only for some standard products. It cannot be fixed for special type of products. In such cases, *brand rate* is fixed under rule 6. The manufacturer has to be submit application with all details to Commissioner, Central Excise. Such application must be made within 60 days of export.

Upper limit of drawback rate - Duty drawback rate shall not exceed 33% of market price of export goods (Rule 8A w.e.f. 15-2-2006).

Special Brand Rate of duty drawback

All Industry rate is fixed on average basis. Thus, a particular manufacturer or exporter may find that the actual excise/customs duty paid on inputs or input services is higher than All Industry Rate fixed for his product. In such case, he can apply under rule 7 of Drawback Rules for fixation of Special Brand Rate, within 30 days from export.

The conditions of eligibility are (*a*) the All Industry Rate fixed should be lees than 80% of the duties paid by him (*b*) rate should not be less than 1% of FOB value of product except when amount of drawback per shipment is more than ₹ 500 (*c*) export value is not less than the value of imported material used in them - i.e. there should not be '*negative value addition*'.

Duty Drawback on Re-Export – Section 74 of Customs Act, 1962 provide for drawback if the goods are re-exported as such or after use. This may happen in case like import for exhibitions, goods rejected or wrong shipment etc. The re-exported goods should be identifiable as having been imported and should be re-exported within two years from date of payment of duty when they were imported. This period (of two years) can be extended by CBE&C on sufficient cause being shown. These should be declared and inspected by Customs Officer. Original shipping bill under which the goods were imported should be produced. The goods can be exported as cargo by air or sea, or as baggage or by post -. -. - After inspection, export and submission of application with full details, 98% of the customs duty paid while importing the goods is repaid as drawback.

3.13 REFUND OF SPECIAL CVD OF CUSTOMS TO TRADERS

Traders selling imported goods in India after charging sales tax/Vat can claim refund of special CVD of 4% from customs department – Notification No. 102/2007-Cus dated 14-9-2007. The dealer (trader) (if he is registered with Central Excise and is issuing Cenvatable Invoice) selling such imported goods must mention in his invoice that the buyer will not be able to avail Cenvat credit of such duty. This is required if he is claiming refund of the special CVD. If he is not claiming refund, obviously, such remark is not required.

A manufacturer using these goods in his manufacture can avail Cenvat credit of this duty. Thus, he gets credit through central excise route.

3.14 ANTI DUMPING DUTY ON DUMPED ARTICLES

Often, large manufacturer from abroad may export goods at very low prices compared to prices normally prevalent in export market. Such dumping may be with intention to cripple domestic industry ***or*** to dispose of their excess stock. This is called 'dumping' and is an unfair trade practice. In order to avoid such dumping and to protect domestic industry, Central Government can impose, under section 9A of Customs Tariff Act, anti-dumping duty, if the goods are being sold at less than its normal value. Levy of such anti-dumping duty is permissible as per WTO agreement. Anti dumping action can be taken only when there is an Indian industry producing 'like articles'.

In *Shenyang Mastusushita* v. *Exide Batteries* 2005 (181) ELT 320 (SC 3 member bench), it was observed, 'Principle behind anti-dumping laws is to protect the domestic industry from being adversely affected by import of goods at export prices which are below the normal value of the goods in the domestic market of the exporter. The duty is calculated on the margin of dumping which is the difference between the export price and the normal value'.

In *SS Enterprise* v. *Designated Authority* AIR 2005 SC 1527 = 181 ELT 375 (SC 3 member bench), it was held that purpose being imposition of anti-dumping duty is to curb unfair trade practices resorted to by exporters of a particular country of flooding the domestic markets at rates which are lower than the rate at which the exporters normally sell the same or like goods in their own countries, so as to cause or be likely to cause injury to the domestic market. The levy of dumping duty is a method recognised by GATT (*should be WTO*) which seeks to remedy the injury and at the same time balances the rights of exporters from other countries to sell their products within the country with the interest of domestic markets. Thus the factors to constitute 'dumping' is (i) an import at prices which are lower than the normal value of goods in exporting country (ii) the exports must be sufficient to cause injury to domestic industry. - - However, negligible quantity of imports would not be sufficient to cause such injury.

Presently, countries like China, Taiwan are said to be involved in dumping. Even Indian steel exporters are facing charges of dumping goods in USA.

Provisional anti-dumping duty - Pending determination of margin of dumping, duty can be imposed on provisional basis. After dumping duty is finally determined, Central Government can reduce such duty and refund duty extra collected than that finally calculated. Such duty can be imposed upto 90 days prior to date of notification, if there is history of dumping which importer was aware or where serious injury is caused due to dumping.

No CVD on anti dumping duty - Anti Dumping Duty and Safeguard Duty is not required to be considered while calculating CVD – view confirmed in *Tonira Pharma* v. *CCE* (2007) 208 ELT 38 (CESTAT 2 v. 1 order).

No education cess and SAHE cess on anti-dumping duty – Education cess and SAH education cess is not payable on anti-dumping duty.

No anti dumping duty in case of imports by EOU and SEZ - Anti-dumping duty is not applicable for imports by EOU or SEZ units, unless it is specifically made applicable in the notification imposing anti-dumping duty. [section 9A(2A) of Customs Tariff Act]

Margin of Dumping - '*Margin of dumping*' means the difference between normal value and export price (i.e. the price at which these goods are exported). [section 9A(1)(a)].

'*Normal Value*' means comparable price in ordinary course in trade, for like article, when destined for consumption in the exporting country or territory. If such price is not available or not comparable (a) comparable representative price of like article exported from exporting country or territory to appropriate third country or (b) cost of production plus reasonable profit, can be considered [section 9A(1)(c) of Customs Tariff Act]. The 'normal value' is to be determined as per rules.

In *Reliance Industries Ltd.* v. *Designated Authority* 2006 (202) ELT 23 (SC), it was held that 'normal value' are not exporter specific but exporting country specific. Once dumping of specific goods from a country is established, dumping duty can be imposed on all exports of those goods from that country in India, irrespective of the exporter. Rate of duty may vary from exporter to exporter depending upon the export price.

'*Export Price*' means the price at which goods are exported. If the export price is unreliable due to association or compensatory arrangement between exporter and importer or a third party, export price can be constructed (revised) on the basis of price at which the imported articles are first sold to independent buyer or according to rules made for determining margin of dumping. [section 9A(1)(b)].

Margin of dumping is determined on basis of weighted average of 'normal value' and the 'export price' of product under consideration.

Quantum of dumping duty - The anti-dumping duty will be dumping margin or injury margin, *whichever is lower*. 'Injury margin' means difference between fair selling price of domestic industry and landed cost of imported product. The landed cost will include landing charges of 1% and basic customs duty. Thus, only anti-dumping duty enough to remove injury to domestic industry can be levied.

For example, if normal value in exporting country is ₹ 11 and export price is ₹ 8, dumping margin is ₹ 3. If landed cost is ₹ 9 and fair selling price of domestic industry is ₹ 10, then injury margin is ₹ 1/-. Hence, anti-dumping duty of only ₹ 1 can be imposed.

In *Reliance Industries Ltd.* v. *Designated Authority* 2006 (202) ELT 23 (SC), it was held that non-injurious price (NIP) has to be calculated for domestic industry as a whole and not in respect of any particular company or enterprise. [Hence, even if product is captively consumed by Indian manufacturer, transfer price (market value) of inputs is to be considered and not actual cost of captive consumption]. It was observed that there has to be a single NIP for a product and not several NIP for the same product. NIP is not exporter specific.

In *Alkali Manufacturers Association of India* v. *Designated Authority* 2006 (194) ELT 161 (CESTAT). Designated Authority had calculated domestic price on basis of profit of 22% of investment. It was held that this is reasonable.

Dumping duty for WTO countries - Section 9B of Customs Tariff Act provides restrictions on imposing dumping duties in case of imports from WTO countries or countries given 'Most Favoured Nation' by an agreement. Dumping duty can be levied on import from such countries, only if Central Government declares that import of such articles in India causes material injury to industry established in India or materially retards establishment of industry in India. [WTO agreement permits levy of anti-dumping duty when it causes injury to domestic industry as a result of specific unfair trade practice by foreign producer, by selling below normal value].

'Injury to domestic industry' will be considered on basis of volume effect and price effect on Indian industry. There must be a 'casual link' between material injury being suffered by dumped articles and the dumped imports.

Rules for deciding subsidy or dumping margin - Central Government has been empowered to make rules for determining (*a*) subsidy or bounty in case of bounty fed goods (*b*) the normal value and export price to determine margin of dumping in case of dumping. Accordingly, Customs Tariff (Identification, Assessment and Collection of Anti-dumping duty on Dumped Articles and for determination of Injury) Rules, 1995 [*Customs Notification No. 2/95 (N.T.) dated 1-1-95*] provide detailed procedure for determining the injury in case of dumped articles.

Procedure for fixing anti dumping duty - After the 'designated authority' is satisfied about *prima facie* case, he will give notice to Governments of exporting countries. Opportunity to inspection of documents and making representations will be given to interested parties who are likely to be affected. Designated Authority will first give preliminary finding and then final finding within one year. Provisional duty can be imposed on basis of preliminary finding which can continue upto 6 months, extendable to 9 months. Additional duty may be imposed on basis of the final finding.

As per rule 18 of Anti-Dumping Duty Rules, Central Government has to issue a notification fixing anti-dumping duty within three months from date of notification issued by designated authority.

Appeal against order determining dumping duty - Appeal against the order determining the duty can be made to CESTAT. The appeal will be heard by at least three member bench consisting of President, one judicial member and one technical member [section 9C of Customs Tariff Act].

No appeal against order of Tribunal – Section 9C does not provide for statutory appeal against order of Tribunal. Hence, only remedy is either writ in High Court or SLP in Supreme Court.

High Court should not exercise writ jurisdiction – In view of appeal provisions, High Court should not entertain writ petitions and grant interim relief. Otherwise, the provisions of appeal would be rendered otiose – *Association of Synthetic Fibre Industry* v. *J K Industries* 2006 (199) ELT 196 (SC) * *Nitco Tiles* v. *Gujarat Ceramic Floor Tiles Mfg Association* 2006 (199) ELT 198 (SC).

Mid-term review – Mid-term review of anti-dumping duty is permissible under rule 23 of Anti-Dumping Duty Rules. In *Rishiroop Polymers* v. *Designated Authority* 2006 (196) ELT 385 (SC), it was held that scope of review enquiry by Designated Authority is limited to the satisfaction as to whether there is justification for continuing imposition of anti-dumping duty. The inquiry is limited to change in various parameters like normal value, export value, dumping margin, fixation of non-injury price and injury to domestic industry. Only changed parameters should be considered

New Shipper Review – After imposing of anti-dumping duty, a new exporter may want to export same goods to India. As per rule 22, if he had not exported earlier, he can ask for review of anti-dumping duty. During the period of review, Government may resort to provisional assessment and may allow imports on submission of guarantee, pending review. If anti-dumping duty is determined, it will be payable retrospectively from date of initiation of review. Such review is termed as 'new Shipper Review'.

Discontinuation of anti-dumping duty i.e. sunset review - Anti dumping duty ceases on the expiry of five years from date of imposition. However, Central Government can extend the anti-dumping duty, if it is of the opinion that cessation is likely to lead to continuation or recurrence of dumping and injury.

Practical example on anti-dumping duty **– An importer imported Description of goods: Mulberry Raw Silk (not thrown) (HS Code 5002 00) from People's Republic if China. CIF value was US $ 20,000 and quantity 1,000 Kgs. Exchange rate was 1 US $ = ₹ 44 on date of presentation of Bill of Entry. Customs Duty rates are – (i) Basic Customs Duty 30% (ii) Education Cess 2% (iii) SAH Education cess - 1%. There is no excise duty payable on these goods if manufactured in India. As per Notification No. 106/2003-Cus dated 10-7-2003, anti-dumping duty**

has been imposed on these goods imported from China, manufactured by any producer in People's Republic of China. The anti-dumping duty will be equal to difference between amount calculated @ US $ 27.97 per Kg and 'landed value' of goods. Compute Customs Duty liability & anti-dumping liability.

Answer – (a) Computation of Customs duty :-

Total CIF Price	US $	20,000
CIF @ ₹ 44 = 1 US $	₹	8,80,000.00
Add – Landing charges @ 1%	₹	8,800.00
Assessable Value	₹	8,88,800.00
Basic duty @ 30%	₹	2,66,640.00
Education Cess @ 2% on 2,66,640.00	₹	5,332.80
SAH education Cess 1%		2,666.40
Total Customs Duty payable (Basic + Education Cess)	₹	2,74,639.20
Rounded to	₹	2,74,639.00

(b) Computation of landed value

Assessable Value Under Customs Act,	₹	8,88,800.00
Add: All Duties of Customs	₹	2,74,639.00
Landed Value as per Anti-Dumping Notification	₹	11,63,439.00

(c) Computation of anti-dumping duty

Rate of Silk Yarn as per Anti Dumping Notification. (US $ 27.97 per Kg)	US $	27,970
Value @ ₹ 44 = 1 US $	₹	12,30,680.00
Less : Landed Value as per Anti-Dumping Notification	₹	11,63,439.00
Anti Dumping Duty payable	₹	67,241.00

Thus, anti-dumping duty payable will be ₹ 67,241.

3.15 VALUE FOR PURPOSE OF CUSTOMS DUTY

Customs duty is payable as a percentage of 'Value' often called '*Assessable Value*' or '*Customs Value*'. The **Value** may be either (*a*) 'Value' as defined in section 14(1) of Customs Act or (*b*) Tariff value prescribed under section 14(2) of Customs Act.

The provisions relating to customs valuation have been completely revamped by introducing new section 14 w.e.f. 10-10-2007.

Tariff Value - Tariff Value can be fixed by CBE&C (Board) for any class of imported goods or export goods. CBE&C should consider trend of value of such or like goods while fixing tariff value. Once so fixed, duty is payable as percentage of this value. (The percentage applicable is as prescribed in Customs Tariff Act). Fixing tariff value is not permitted under GATT convention. However, the provision of fixing tariff values has been retained.

Tariff value for crude palm oil, RBD Palmolein, palm oil, crude soyabean oil and brass scrap has been fixed by notification No. 36/2001-Cus (NT) dated 3-8-2001.

Customs Valuation on basis of transaction value - New section 14(1) of Customs Act (effective from 10-10-2007) states that 'value' of imported and export goods will be 'transaction value' of such goods i.e. the price actually paid or payable for the goods when sold for export to India for delivery at the time and place of importation, or for export from India for delivery at the time and place of exportation, where the buyer and seller of the goods are not related and price is the sole consideration for the sale, subject to such other conditions as may be specified in the rules made in this behalf.

Accordingly Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 and Customs Valuation (Determination of Value of Export Goods) Rules, 2007 have been notified effective from 10-10-2007.

Section 2(41) of Customs Act has also been amended as follows w.e.f. 10-10-2007 - 'value', in relation to any goods, means the value thereof determined in accordance with the provisions of sub-section (1) or sub-section (2) of section 14.

Addition to transaction value – *First proviso* to new section 14(1) states that such transaction value in the case of imported goods shall include, in addition to the price as aforesaid [i.e. as specified in section 14(1)], any amount that the buyer is liable to pay for costs and services, including commissions and brokerage, engineering, design work, royalties and licence fees, costs of transportation to the place of importation, insurance, loading, unloading and handling charges to the extent and in the manners specified in the Rules.

Though the *proviso* does not specifically say so, it is obvious that only those expenses which are relating to imported goods alone can be added.

***Rate of foreign exchange* -** Third *proviso* to new section 14(1) states that such price shall be calculated with reference to the rate of exchange as in force on the date on which a bill of entry is presented under section 46, or a shipping bill or bill of export, as the case may be, is presented under section 50. As per *Explanation* (a) to section 14(2), the rate of exchange will be determined by CBE&C or ascertained in such manner as CBE&C may direct.

Tariff value - New section 14(2) empowers CBE&C to fix tariff values of imported goods or export goods by issuing a notification.

Valuation Rules if transaction value is not determinable - If there is no sale or buyer or seller are related or price is not the sole consideration, value of the goods will be determined as per Valuation Rules [Clause (ii) of second proviso to section 14(1)].

***Valuation for CVD when goods are under MRP provisions* -** In respect of some consumer goods, excise duty is payable on basis of MRP (Maximum Retail Price) printed on the carton. If such goods are imported, CVD will be payable on basis of MRP printed on the packing. See discussions under 'CVD' in previous chapter.

Sale to related person – Transaction value is not acceptable if buyer and seller are 'related'. Definition of 'related person' is identical in rule 2(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 and rule 2(2) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007. The definition is discussed in a later chapter.

3.15.1 Transaction value at the time and place of importation

Price should be for delivery at the place of importation – Value at the place of importation does not mean that only expenses till goods enter Indian Customs water should be included. Import is an integrated process which culminates when goods land on land-mass of India so that they can be introduced in stream of supplies to form part of mass of goods within the country. Thus, all expenses upto the destination port, including freight, transit insurance, unloading and handling charges are to be included.

Price must be the sole consideration - Price should be sole consideration for sale. If there is other consideration, it should be added to the transaction value.

In *Jindal Photo Films* v. *CC* 2002(141) ELT 202 (CEGAT), it was held that license fee related to know how embedded in machine has to be added to Assessable Value. In this case, the foreign supplier had not charged license fee but had stated that if semi-processed raw material is not purchased from the foreign supplier, flat annual license fee will be payable for seven years. It was thus obvious that price was not the sole consideration and hence the license fee, which was additional consideration, was addible.

Price to include value of intellectual property contained in it – A software cannot be valued on basis of price of CD. In *Globe Entertainment* v. *CC* 2005 (180) ELT 258 (CESTAT), it was held that value of video cassettes cannot be valued on basis of material cost plus recording charges. Value of intellectual property i.e. serial recorded in cassettes has also to be taken into consideration. It is not value of material but value of intellectual property which is recorded in the cassettes.

Inclusions/Exclusions in Assessable Value under Customs

- Valuation for customs is required to be done as per provisions of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007
- CIF value of goods plus 1% landing charges is the basis for deciding 'Assessable Value'.
- Commission to local agents, packing cost, value of goods and toolings supplied by buyer, royalty relating to imported goods are addible.
- Interest on deferred payment, demurrage at port is not required to be added
- Value of computer software loaded on machine is to be added to value of machinery.
- Old machinery and old cars are valued on basis of depreciated value, though such method has no sanction of law.

3.15.2 Assessable Value – Inclusions

Rule 10 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [Rule 9 upto 10-10-2007] provide that following cost and services are to be added, *if these are not already included in the invoice price*. –

- Commission and brokerage, except buying Commission, if not already included in the invoice price [rule 10(1)(a)(i)].
- Cost of container which are treated as being one with the goods for customs purposes, if not already included in the invoice price [rule 10(1)(a)(ii)].
- Cost of packing whether labour or materials, if not already included in the invoice price [rule 10(1)(a)(iii)].
- Materials, components, tools, dies, moulds, and consumables used in production of imported goods, supplied by buyer directly or indirectly, free of charge or at reduced cost, to the extent not already included in price [rule 10(1)(b)(i), (ii) and (iii)]
- Engineering, development, art work, design work, plans and sketches undertaken elsewhere than in India and necessary for production of imported goods, to the extent not already included in price [rule 10(1)(b)(iv)].
- Royalties and license fees relating to imported goods that buyer is required to pay, directly or indirectly, as a condition of sale of goods being valued [rule 10(1)(c)]
- Value of proceeds of subsequent resale, disposal or use of goods that accrues directly or indirectly to seller (i.e. to foreign exporter) [rule 10(1)(d)]
- All other payments made as condition of sale of goods being valued made directly or to third party to satisfy obligation of seller, to the extent not included in the price [rule 10(1)(e)]
- Cost of transport upto place of importation [rule 10(2)(a)]
- Loading, unloading and handling charges associated with delivery of imported goods at place of importation [These are termed as landing charges and are to be taken as 1%] [rule 10(2)(b)]
- Cost of insurance [rule 10(2)(c)]

The additions should be on the basis of objective and quantifiable data [rule 10(3) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9(3)].

No other additions - No other addition shall be made to price paid or payable, except as provided for in rule 10 [rule 10(4) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9(4)]. Interpretative Note to rule 3 (earlier rule 4) also clarifies that activities undertaken by buyer other than those for which adjustments are provided in rule 10 (earlier rule 9) are not to be added, even though it may be regarded as benefit to the seller.

Services / documents / technical know-how supplied by Buyer - Cost of engineering, development, art work, design work and plans and sketches undertaken by buyer which is necessary for production of imported goods is includible, ***only if*** such work is undertaken *outside India*. [Rule 10(1) (b) (iv) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9)]

The addition should be done on objective and quantifiable data. Data available with importer should be used as far as possible. If the services are purchased or leased by importer, such purchase/lease cost should be added. If the importer has himself done the work abroad, its cost should be added on basis of structure and management practices of importer and his accounting methods (in other words, if development work, plans, sketches etc. is done by importer himself *outside India*, its cost should be calculated based on normal accounting practices - like apportionment of overheads, apportionment over various jobs if the same development work, design work etc. is used for more than one jobs etc.) [Interpretative Note to rule 10(1)(b)(iv) of Customs Valuation Rules].

Technical know how related to imported machinery - In *CC* v. *Essar Gujarat Ltd.* (1997) 9 SCC 738 = 88 ELT 609 = 17 RLT 588 (SC 3 member bench), it was held that payment of licence fee and transfer of technology, without which the imported plant could not function, will have to be added to the value of imported plant. However, training charges cannot be included. - wrongly followed in *CC* v. *Himson Textile Engg. Ltd.* 1997(93) ELT 301 (CEGAT).

Royalties and licence fee - Royalties and license fees related to imported goods that the buyer is required to pay, directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable, are required to be added in assessable value. [Rule 10(1)(c) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9)].

Royalty payment un-connected with imported goods not to be added - Often, a lump-sum payment of royalty is made to foreign collaborators for technical know-how. In addition, components / parts/ CKD packs are procured from foreign collaborators. Customs department normally holds that the price of parts/CKD packs should be loaded, on assumption that the part of price of component parts/CKD packs has been paid as 'royalty payment'.

Charges for reproduction of goods in India not to be added - Interpretative Note to rule 10(1)(c) of Customs Valuation Rules makes it clear that charges for right to reproduce the imported goods in India shall not be added.

Barge/lighterage charges includible – In some cases, the ship is not brought upto jetty. Goods are discharged at outer anchorage. This may be for various reasons, e.g. (a) deep draught at port (b) Ports are busy (c) Odd dimensional or heavy lifts or hazardous cargo discharged at anchorage. Charges for brining the goods from outer anchorage are known as 'barging/lighterage charges'.

As per *explanation* to rule 10(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [inserted w.e.f. 10-10-2007], ship demurrage charges on chartered vessels, lighterage or barge charges are includible.

Mode of computation of freight of time chartered/daughter vessel has been specified in MF(DR) circular No. 4/2006-Cus dated 12-1-2006.

Landing charges to be added - Cost of unloading and handling associated with delivery of imported goods in port (*called landing charges*) shall be added. These will be calculated @ 1% of CIF value, i.e. FOB price plus freight plus insurance. [Rule 10(2)(b) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 – earlier rule 9].

3.15.3 Exclusions from Assessable Value

Interpretative Note to rule 3 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 provide that following charges shall be excluded :

(a) Charges for construction, erection, assembly, maintenance or technical assistance un dertaken *after* importation of plant, machinery or equipment

(b) Cost of transport *after* importation

(c) Duties and taxes in India

Other payments from buyer to seller *that do not relate* to imported goods are not part of the customs value.

3.16 METHODS OF VALUATION OF IMPORTED GOODS

The Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, based on WTO Valuation Agreement (earlier GATT Valuation Code), consist of rules providing six methods of valuation.

The methods of valuation for customs methods are as follows -

- Transaction Value of Imported goods [Section 14(1) and Rule 3(1)]

- Transaction Value of Identical Goods [Rule 4]
- Transaction Value of Similar Goods [Rule 5]
- Deductive Value which is based on identical or similar ***imported*** goods sold in India [Rule 7]
- Computed value which is based on cost of manufacture of goods plus profits [Rule 8]
- Residual method based on reasonable means and data available [Rule 9]

Conditions for accepting Transaction Value

In *Eicher Tractors* v. *CC* 2000 AIR SCW 4080 = AIR 2001 SC 196 = 2001(1) SCC 315 = 122 ELT 321 = 41 RLT 621 (SC), it has been held that actual transaction value can be rejected only for reasons specified in rule 4(2) [Now rule 3(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 w.e.f. 10-10-2007] of Valuation Rules and 'special circumstances' or 'extraordinary circumstances' as specified in section 14(1). Subject to the three conditions laid down in section 14(1) of time, place and absence of special circumstances, price of imported goods is to be determined u/s 14(1A) in accordance with Valuation Rules framed in this behalf.

Thus, transaction value can be rejected either for special circumstances as per section 14(1) or conditions as specified in rule 3(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.

Special circumstances as per section 14(1) - The 'special circumstances' in section 14(1) are (*a*) Buyer and seller should not be related ***and*** (b) Price should be the sole consideration for the sale. If these 'special circumstances' are not satisfied, transaction value can be rejected. Any other 'special circumstances' cannot be considered.

Methods to be applied sequentially - These methods are to be applied in sequential order, i.e. if method one cannot be applied, then method two comes into force and when method two also cannot be applied, method three should be used and so on. The only exception is that the 'computed value' method may be used before 'deductive value' method, if the importer requests and Assessing Officer permits.

Conditions as per rule 3(2) - As per rule 3(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [Earlier rule 4(2) of Customs Valuation Rules], transaction value can be accepted only if following requirements are satisfied –

No restriction on buyer for disposal of goods - There are no restriction on buyer on disposition or use of goods *except* the following: (*a*) restrictions prescribed by public authorities in India (*b*) restriction on geographical area within which goods may be resold e.g. goods should not be sold outside particular State or outside India *or* (*c*) restriction that does not materially affect value of goods - e.g. exporter puts a condition to importer of automobile that car should not be exhibited before a particular date – illustration given in Interpretative Note to rule 3(2)(a)(iii). [rule 3(2)(a)] [earlier rule 4(2)(e) upto 10-10-2007]

Sale not subject to conditions of which value cannot be determined - The sale or price should not be subject to a condition or consideration for which value cannot be determined. Examples given in interpretative note to rule 3(2)(b) are – (a) Price is subject to condition that buyer buys some other goods in specified quantities from seller (b) price is dependant on price at which buyer of imported goods sells other goods to seller (c) Price is based on form of payment extraneous the imported goods. However, (i) buyer furnishing engineering and plans undertaken in India to seller (ii) Buyer undertaking activities of marketing of imported goods in India will not form part of value of imported goods [rule 3(2)(b)] [earlier rule 4(2)(f) upto 10-10-2007].

No further consideration to seller of which adjustment cannot be made - Seller should not be entitled to further consideration like part of subsequent resale, disposal or use of goods by the buyer will accrue directly or indirectly to seller, unless proper adjustment in value terms can be made as per rule 10 e.g. if the importer is a trader and the condition is that after he sells the goods in India, the foreign exporter will get a fixed amount after the sale, that extra amount can be added for Customs Valuation [rule 3(2)(c)] [earlier rule 4(2)(g)]

Unrelated buyer and seller, except when price acceptable under rule 3(3) - Buyer and seller are not be related, unless the transaction value is acceptable under rule 3(3) [rule 3(2)(d)] [earlier rule 4(2)(h) upto 10-10-2007].

If any of the aforesaid requirement is not satisfied, 'transaction value' cannot be accepted for valuation purposes.

3.17 VALUATION OF EXPORT GOODS

Customs value of export goods is to be determined under section 14 of Customs Act, read with Customs Valuation (Determination of Value of Export Goods), Rules, 2007.

Transaction value is the main criteria for valuation - Section 14(1) of Customs Act (effective from 10-10-2007) states that 'value' of imported and export goods will be 'transaction value' of such goods i.e. the price actually paid or payable for the goods when sold for export to India for delivery at the time and place of importation, or for export from India for delivery at the time and place of exportation, where the buyer and seller of the goods are not related and price is the sole consideration for the sale, subject to such other conditions as may be specified in the rules made in this behalf.

Thus, if buyer and seller are not related and if price is the sole consideration, transaction value at the time and place of exportation will be the assessable value.

Transaction value is the primary basis for valuation of export goods and the method specified in rule 3 will be applicable in the vast majority of cases of export by acceptance of declared value – par 4 of MF(DR) circular No. 37/2007-Cus dated 9-10-2007.

Rate of foreign exchange **-** Third *proviso* to new section 14(1) states that such price shall be calculated with reference to the rate of exchange as in force on the date on which a bill of entry is presented under section 46, or a shipping bill or bill of export, as the case may be, is presented under section 50. As per *Explanation* (a) to section 14(2), the rate of exchange will be determined by CBE&C or ascertained in such manner as CBE&C may direct.

Tariff value - section 14(2) empowers CBE&C to fix tariff values of imported goods or export goods by issuing a notification.

Valuation Rules if transaction value is not determinable - If there is no sale or buyer or seller are related or price is not the sole consideration, value of the goods will be determined as per Valuation Rules [Clause (ii) of second proviso to section 14(1)].

Valuation when buyer and seller are related – Definition of related person as per rule 2(2) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007 is same as per definition of rule 2(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.

As per rule 3(2) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007, the transaction value, the transaction value will be accepted as 'value' even if buyer and seller are 'related', if the relationship has not influenced price.

Valuation if value cannot be determined on basis of transaction value – If valuation is not possible on basis of transaction value, valuation will be done by proceeding sequentially through rules 4 to 6 [Rule 3(3) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007].

The methods are - Export value by comparison [Rule 4}, Computed value [Rule 5] and Residual method [Rule 6].

3.18 SELF ASSESSMENT ON BASIS OF 'RISK MANAGEMENT SYSTEM' (RMS)

One major step is being taken to move in the direction of implementing international best practices in customs clearance. A 'Risk Management System' for customs clearance of import and export cargo has been introduced. The details of scheme are contained in MF(DR) circular No. 43/2005-Cus dated 24-11-2005 – see also CC, Bangalore-I PN 88/2006 dated 31-7-2006 (201 ELT T5).

Initially, the scheme will be introduced in Air Cargo Complex, Sahar Mumbai and then it will be introduced in other customs houses in phases.

Under Risk Management System (RMS), only high risk cargo is selected for examination. The system provides for special customs clearance for Accredited Clients having good track record and meet specified criteria.

The scheme proposes to do away with existing system of routine assessments and concurrent audit. Goods will be normally cleared on basis of self assessment of importer. Bill of Entry submitted electronically will be transmitted to RMS. The RMS will process the data and produce an electronic output. This output will determine whether the Bill of Entry will be taken up for appraisement/examination or be cleared after payment of duty without any assessment and examination. Any change is system will require prior approval of Commissioner of Customs and after recording reasons.

Focus will be on quality assessment, examination and post clearance audit of Bills of Entry selected by the Risk Concurrent audit will be replaced by Post Clearance Audit on Bill of Entry selected by the Risk Management System. Subsequently, demand can be raised even if goods have been cleared from customs.

No change in Custom Act and Rules - The scheme is being introduced without making any change in Customs Act or Rules, the basic procedures of sanctions and approvals remain unaltered and hence is not similar to scheme of self-assessment under Central Excise, where clearances are effected by assessee without supervision or presence of excise inspectors. Scope of the scheme is also very limited.

Scheme open only to 'Accredited Clients' - The scheme is limited to only 'Accredited Clients' as defined in MF(DR) circular No. 42/2005-Cus dated 24-11-2005. They should have imported goods valued at ₹ 10 crores in previous financial year or paid duty more than ₹ one crore. In case of importers who are central excise, they should have paid at least ₹ one crore of duty through PLA in previous financial year. They should have filed at least 25 Bills of Entry in the previous financial year.

Person who had received any show cause notice in last three financial years is ineligible - In order to ensure that scope of the scheme remains limited (and the scheme fails), it is provided that no case should be pending against them. Even show cause notice invoking penal provisions should not have been issued against them is last three financial years. Such importers can be probably counted on fingers. If this condition is insisted upon, the scheme is stillborn and will be a non-starter.

Application for getting accreditation - Importers desirous of availing the facility of 'Accredited Client' has to make application for registration in form given in MF(DR) circular No. 42/2005-Cus dated 24-11-2005. Application has to be accompanied by a CA certificate that the accounting system of applicant is as per accounting standards prescribed by ICAI.

Decision regarding ACP status within 30 days - In case of status holders, Customs will communicate decision on conferring ACP status (Accredited Client under Risk Management System of customs clearance, within 30 days from receipt of application by customs.

Risk management division in systems directorate – A risk management division has been created in Systems Directorate. Risk Management Committees will be constituted at National level and Local level – MF(DR) circular No. 23/2007-Cus dated 28-6-2007.

3.19 ILLUSTRATIONS

Illustration 1:

An importer imports some goods @ 10,000 US $ on CIF basis. Following dollar rates are available on the date of presentation of bill of entry : (a) RBI Floor rate : ₹ 43.21 (b) Inter-bank closing rate : ₹ 43.23 (c) Rate notified by CBE&C under section 14 (3) (a) (i) of Customs Act : ₹ 44.66 (d) Rate at which bank has realised the payment from importer : ₹ 44.02. Find the assessable value for customs purposes.

Answer :

The relevant exchange rate is ₹ 44.66. Thus, CIF Value of goods is ₹ 4,46,000. Landing charges [rule 9 (2) of Customs Valuation Rules] @1% of CIF Value are to be added - i.e. ₹ 4,460. Thus, Customs Value or Assessable Value is ₹ 4,50,460.

Illustration 2 :

A consignment is imported by air. CIF price is 4,000 US Dollars. Freight is 2800 US $. Insurance cost was $ 140. Exchange rate is same as above. Find Value for customs purposes.

Answer :

CIF Price	$ 4,000
(–) Freight	$ 1,280
(–) Insurance	$ 140
FOB Price	$ 2,580
(+) Freight @ 20% on FOB	$ 516
(+) Insurance	$ 140
CIF Value for Customs	$ 3,236
Equivalent INR VSD 3,236 × 44.66 =	₹ 1,44,519.76
(+) Landing charges @ 1% =	₹ 1,445.20
	₹ 1,45,964.96

Illustration 3 :

FOB Cost of a consignment is 6,000 UK Pounds. Insurance and transport costs are not available. What is Customs Value ? On the date of filing of bill of entry, Reserve Bank of India reference rate of US $ was 43.37 and inter-bank closing rates were : ₹ 43.38 per US $ and ₹ 69.38 per UK Pound. Exchange rate announced by Board (CBE&C) by customs notification was ₹ 69.78 per British Pound. T T buying rate was 69.70 and T T selling rate was ₹ 69.61 per UK pound.

Answer :

FOB Price	$ 6,000
Add : Freight @ 20%	$ 1,200
Add : Insurance @ 1.125% on FOB	$ 67.50
CIF	$ 7,267.50
Exchange Rate	₹ 69.78 per $
∴ CIF Value (in ₹) ($ 7,267.50×69.78)	₹ 5,07,126.15
Add : Landing charges @ 1% on CIF Value =	₹ 5,071.26
Assessable Value for Customs	₹ 5,12,197.41

Illustration 4:

Customs value (Assessable Value) of imported goods is ₹ 4,00,000. Basic Customs duty payable is 10%. If the goods were produced in India, excise duty payable would have been 10%. Education cess is as applicable. Special CVD is payable at appropriate rates. Find the Customs duty payable. What are the duty refunds/ benefits available if the importer is (a) manufacturer (b) service provider (c) Trader?

Answer:

		Duty %	Amount	Total Duty
(A)	Assessable Value		4,00,000.00	
(B)	Basic Customs Duty	10	40,000.00	40,000.00
(C)	Sub-Total for calculating CVD '(A+B)'		4,40,000.00	
(D)	CVD 'C' × excise duty rate	10	44,000.00	44,000.00
(E)	Education cess of excise – 2% of 'D'	2	880.00	880.00
(F)	SAH Education cess of excise – 1% of 'D'	1	440.00	440.00
(G)	Sub-total for edu cess on customs 'B+D+E+F'		85,320.00	
(H)	Edu Cess of Customs – 2% of 'G'	2	1,706.40	1,706.40
(I)	SAH Education Cess of Customs – 1% of 'G'	1	853.20	853.20
(J)	Sub-total for Spl CVD 'C+D+E+F+H+I'		4,87,879.60	
(K)	Special CVD u/s 3(5) – 4% of 'J'	4	19,515.18	19,515.18
(L)	Total Duty			1,07,394.78
(M)	Total duty rounded off			1,07,395.00

Notes – Buyer who is manufacturer, is eligible to avail Cenvat Credit of D, E, F and K above. A buyer, who is service provider, is eligible to avail Cenvat Credit of D, E and F above. A trader who sells imported goods in India after charging Vat/sales tax can get refund of Special CVD of 4% i.e. 'K' above.

Illustration 5 :

An importer imported some goods for subsequent sale in India at $ 24,000 on CIF basis. Relevant exchange rate as notified by the Central Government and RBI was ₹ 45 and ₹ 45.50 respectively. The item imported attracts basic duty at 10% and education cess as applicable. If similar goods were manufactured in India, Excise Duty payable as per Tariff is 12% plus education cess of 2%. Spl CVD is payable at applicable rates. Arrive at the Assessable value and the total duty payable thereon. What are the duty refunds/benefits available if the importer is (a) manufacturer (b) service provider (c) Trader?

[Note : For the purpose of determination of spl. CVD rate, Excise Duty is considered to be 12%, though existing rate is 10%]

Answer :

CIF Value = 24,000 US $

Total CIF in ₹ @ 45.00 per US $ =	₹ 10,80,000
Add : Landing Charges @ 1% of CIF =	₹ 10,800
(A) Assessable Value =	₹ 10,90,800

Calculation of duty payable is as follows :

		Duty %	Amount	Total Duty
(A)	Assessable Value		10,90,800.00	
(B)	Basic Customs Duty	10	1,09,080.00	1,09,080.00
(C)	Sub-Total for calculating CVD '(A+B)'		11,99,880.00	
(D)	CVD 'C' × excise duty rate	12	1,43,985.60	1,43,985.60
(E)	Education cess of excise – 2% of 'D'	2	2,879.71	2,879.71
(F)	SAH Education cess of excise – 1% of 'D'	1	1,439.86	1,439.86
(G)	Sub-total for edu cess on customs 'B+D+E+F'		2,57,385.17	
(H)	Edu Cess of Customs – 2% of 'G'	2	5,147.70	5,147.70
(I)	SAH Education Cess of Customs – 1% of 'G'	1	2,573.85	2,573.85
(J)	Sub-total for Spl CVD 'C+D+E+F+H+I'		13,55,906.72	
(K)	Special CVD u/s 3(5) – 4% of 'J'	4	54,236.27	54,236.27
(L)	Total Duty			3,19,342.99
(M)	Total duty rounded off			3,19,343

Notes – Buyer who is manufacturer, is eligible to avail Cenvat Credit of D, E, F and K above. A buyer, who is service provider, is eligible to avail Cenvat Credit of D, E and F above. A trader who sells imported goods in India after charging Vat/sales tax can get refund of Special CVD of 4% i.e. 'K' above.

Illustration 6 :

An actual user imports following goods from England per Mr. Harimohan : (1) Second hand numerically controlled horizontal lathe machine - Tariff heading – 84.5811, Value FOB - 1,000/- Pound Sterling (2). A. C. motors - Tariff heading – 85.0110, Value FOB - 500/- Pound Sterling. - - Other relevant data are: - Exchange rate 1 UK Pound = ₹ 65, Freight – 150 UK Pounds, Insurance – 25 UK Pounds. - - Rate of duty : Basic customs duty - 10%, CVD - 10%, Education Cess and Spl CVD at applicable rates. - - It is found that the lathe machine is undervalued. It is proposed to load the FOB value of the lathe machine by 25%. Party does not want show cause notice and personal hearing. Compute – (i) Assessable value; (ii) Total duty payable. What are the duty refunds/benefits available if the importer is (a) manufacturer (b) service provider (c) Trader?

Answer :

Since FOB value of lathe machine is being loaded by 25% for under-valuation, the FOB Value of lathe machine for purpose of assessment is 1250 UK Pounds. Value of AC Motors is 500 UK Pounds. Thus, total FOB value for purposes of customs valuation is 1,750 UK Pounds. — Total insurance and freight is 175 UK Pounds [freight is 150 UK Pounds and insurance is 25 UK Pounds]. This will be allocated on lathe machine and AC motors in proportion to value (as no other basis is available).

	A/C Motors	Lathe Machine
FOB Value (UK $)	500.00	1250.00
Add : Allocated Total freight & insurance [@ 500 : 1250] $ 175	50.00	125.00
CIF Value	$ 550.00	$ 1,375.00
Exchange Rate per $	₹ 65.00	₹ 65.00
∴ CIF Value in INR	₹ 35,750.00	₹ 89,375.00
Add : Landing carhges @ 1%	₹ 357.50	₹ 893.75
Assessable Value	₹ 36,107.50	₹ 90,268.75
Rounded off	₹ 36,107.00	₹ 90,269.00

Calculation of duty payable is as follows :

		On Lathe Machine		On A/C Motor	
	Duty %	**Amount**	**Total Duty**	**Amount**	**Total Duty**
(A) Assessable Value ₹ 10,000		90,269.00	—	36,107.00	—
(B) Basic Customs Duty	10	9,026.90	9,026.90	3,610.70	3,610.70
(C) Sub-Total for calculating CVD '(A+B)'		99,295.90	—	39,717.70	—
(D) CVD 'C' × excise duty rate	10	9,929.50	9,929.50	3,971.77	3,971.77
(E) Education cess of excise – 2% of 'D'	2	198.59	198.59	79.44	79.44
(F) SAH Education cess of excise – 1% of 'D'	1	99.29	99.29	39.72	39.72
(G) Sub-total for edu cess on customs 'B+D+E+F'		19,254.28	—	7,701.62	—
(H) Edu Cess of Customs – 2% of 'G'	2	385.09	385.09	154.03	154.03
(I) SAH Education Cess of Customs – 1% of 'G'	1	192.54	192.54	77.02	77.02
(J) Sub-total for Spl CVD 'C+D+E+F+H+I'		1,10,100.91	—	44,039.67	—
(K) Special CVD u/s 3(5) – 4% of 'J'	4	4,404.04	4,404.04	1,761.59	1,761.59
(L) Total Duty			24,235.95		9,694.26
(M) Total duty rounded off			24,236.00		9,694.00

Notes – Buyer who is manufacturer, is eligible to avail Cenvat Credit of D, E, F and K above. A buyer, who is service provider, is eligible to avail Cenvat Credit of D, E and F above. A trader who sells imported goods in India after charging Vat/sales tax can get refund of Special CVD of 4% i.e. 'K' above..

Illustration 7:

An importer has imported a machine from UK at FOB cost of 10,000 UK Pounds. Other details are as follows :

(a) Freight from UK to Indian port was 700 pounds.

(b) Insurance was paid to insurer in India : ₹ 6,000

(c) Design and development charges of 2,000 UK pounds were paid to a consultancy firm in UK

(d) The importer also spent an amount of ₹ 50,000 in India for development work connected with the machinery.

(e) ₹ 10,000 were spent in transporting the machinery from Indian port to the factory of importer.

(f) Rate of exchange as announced by RBI was : ₹ 68.82 = one UK Pound

(g) Rate of exchange as announced by CBE&C (Board) by notification under section 14(3)(a)(i) : ₹ 68.70 = One UK pound

(h) Rate at which bank recovered the amount from importer : ₹ 68.35 = One UK Pound.

(i) Foreign exporters have an Agent in India. Commission is payable to the agent in Indian Rupees @ 5% of FOB price.

Customs duty payable was 10%. If similar goods were produced in India, excise duty payable as per tariff is 24%. There is an excise exemption notification which exempts the duty as is in excess of 10%. Education cess is as applicable Spl CVD is payable at applicable rates.

Find customs duty payable. What are the duty refunds/benefits available if the importer is (a) manufacturer (b) service provider (c) Trader?

Answer:

FOB Value	$ 10,000.00
Add : Design & Development Charges	$ 2,000.00
Add : Ocean freight	$ 700.00
Total C & F	$ 12,700.00
Equvalent C&F @ ₹ 68.70 per UK Pound =	₹ 8,72,490.00
Add : Insurance	₹ 6,000.00
Add : Local Agency commission 500 $	
@ ₹ 68.70 per pound =	₹ 34,350.00
Total CIF Price	₹ 9,12,840.00
Add : Landing Charges @ 1% of CIF	₹ 9,128.40
Assessable Value	₹ 9,21,968.40
Assessable Value (rounded to)	₹ 9,21.968.00

Calculation of duty payable is as follows :

		Duty %	Amount	Total Duty
(A)	Assessable Value		921,968.00	
(B)	Basic Customs Duty	10	92,196.80	92,196.80
(C)	Sub-Total for calculating CVD '(A+B)'		1,014,164.80	
(D)	CVD 'C' × excise duty rate	10	101,416.48	101,416.48
(E)	Education cess of excise – 2% of 'D'	2	2,028.33	2,028.33
(F)	SAH Education cess of excise – 1% of 'D'	1	1,044.16	1,044.16
(G)	Sub-total for edu cess on customs 'B+D+E+F'		196,655.77	
(H)	Edu Cess of Customs – 2% of 'G'	2	3,933.12	3,933.12
(I)	SAH Education Cess of Customs – 1% of 'G'	1	1,966.56	1,966.56
(J)	Sub-total for Spl CVD 'C+D+E+F+H+I'		1,124,523.45	
(K)	Special CVD u/s 3(5) – 4% of 'J'	4	44,980.94	44,980.94
(L)	Total Duty			247,536.39
(M)	Total duty rounded off			247,536.00

Notes – Buyer who is manufacturer, is eligible to avail Cenvat Credit of D, E, F and K above. A buyer, who is service provider, is eligible to avail Cenvat Credit of D, E and F above. A trader who sells imported goods in India after charging Vat/sales tax can get refund of Special CVD of 4% i.e. 'K' above.

Note : (1) Design and development work done in India and transport costs within India are not to be considered for purposes of 'Customs Value'. (2) Excise duty rate has to be considered after considering excise exemption notification. (3) Assessable Value and Final duty payable should be rounded off to nearest Rupee.

Duty payable is same whether the importer is manufacturer or a trader.

Illustration 8 :

Mrs. & Mr. Kapoor visited Germany and brought following goods while returning to India on 8th June, 2010. (i) Their personal effects like clothes, etc., valued at ₹ 35,000. (ii) A personal computer bought for ₹ 36,000. (iii) A laptop computer bought for ₹ 95,000. (iv) Two litres of liquor bought for ₹ 1,600. (v) A new camera bought for ₹ 37,400. What is the amount of customs duty payable?

Answer:

Under Rule 3 of the Baggage Rules, 1998, Mrs. & Mr. Kapoor, being more than 10 years of age with stay of more than 3 days, is eligible for the following general free allowance :

(1) Uesd personal effects of any amount; and

(2) Other articles, other than those mentioned in Annexure 1, upto a value of ₹ 25,000.

Personal effects and one laptop are exempt from customs duty. Two liters of liquor can be accommodated in General free Allowance. Hence, Mr. Kapoor can bring one personal computer and two litres of liquor on his account. Total value is ₹ 37,600 (PC ₹ 36,000 plus liquor ₹ 1,600). He will get General Free Allowance of ₹ 25,000 and duty payable will be on ₹ 12,600. Customs Duty @ 35% of ₹ 12,600 will be ₹ 4,410 plus education cess of ₹ 88.20 @ 2% of customs duty and SAH education cess of ₹ 44.10 @ 1% of customs duty.

Mrs. Kapoor can bring one camera on her account. Total value is ₹ 37,400. She will get General Free Allowance of ₹ 25,000 and duty payable will be on ₹ 17,400. Customs Duty @ 35% of ₹ 17,400 will be ₹ 6,090 plus education cess of ₹ 121.80 @ 2% of customs duty and ₹ 60.90 as SAH education cess.

Illustration 9 :

Nircom lcecream Company imported under one single order a consignment of plant and machinery namely continuous ice cream freezer with accessories such as electric dozer, can filter, fruit feeder and ripple machine wittily spare parts. According to Nircom the main function of the machine is to make ice cream. The ice freezer is stated to be refrigerating equipment classifiable under Heading 84.18 of the Customs Tariff Act, 1975. None of the aforesaid accessories can function independently as each of them has been specifically made to be connected to work along with the ice cream freezer. It is the department's view that the can filter, fruit feeder and ripple machine are independent, machines and not accessories. State with reasons as to how you would decide the issue with reference to the "General Rules for Interpretation" under First Schedule-Import Tariff to the Customs Tariff Act, 1975.

Answer :

Rule 2(a) of the Interpretation rules of Customs Tariff Act, 1975 states that any reference in a heading to an article shall be taken to include a reference to that article incomplete or unfinished, provided that, as presented, the incomplete or unfinished article has the essential character of the complete or finished article.

In the given case the ice cream freezer is an independent ready assembled unit having universal movement and does not require erection at the site, then it has to be classified according to its function independently. The mere fact that the machines called accessories can be connected with freezers would not charge their character of being independent machines. The accessories if they are intended to give better production of ice cream only still could be classified as independent machines. It cannot be said that but for those machine the freezer cannot be utilized for the purpose of manufacture of ice cream.

Illustration 10 :

'V' steels imported various items for its captive power plant with technical knowhow from, 'N' Engineering U.S.A. the relevant drawings of the turbine shaft and layout of the turbine with other items were also supplied. One of the items which was a turbine shaft was in a semi-finished condition. Before fitting, this turbine shaft had to be further ground and finished as per the dimensions of the shaft indicated in the layout drawing. "VI' steels paid US $ 2000 for the layout drawing and did not pay any customs duty on this amount. The Customs Department has claimed that this amount of US $ 2000 forms part of the transaction value under Rule 9(1) of the Customs Valuation Rules, 1988. "V" steel claims that the drawing indicating the dimensions of the turbine shaft was merely a layout drawing of the turbine shaft was merely a layout drawing of the turbine with other items of the turbine room.

Explain with reference to the provisions of Rule 9 of the Customs Valuation Rules, 1988.

Answer :

As per the terms of Rule 9(1)(*e*) of the Customs Valuation Rules, 1988, in determination of the transaction value, any payment made by the buyer as a condition of sale of the goods will be included in the value of the goods.

In the given case, the turbine shaft was imported in a semi-finished condition and has to be fitted and finished as per the indications in the layout drawing. Thus, this drawing is necessary for further finishing of the imported turbine shaft i.e. in the final production of the imported item before it is fitted. Therefore, as the payment of US $ 2000 is made for layout drawing without which the plant cannot be installed and hence the value of such layout drawing will be included ill the value of the goods.

In view of the above, it is a drawing necessary for the production of the imported item and therefore has to be included in the transaction value of the imported item.

Illustration 11 :

A has imported from U.S.A. by Air under-mentioned goods at Mumbai :

Tariff Heading – 85-01, (1) Description – Micro motors – Value in FOB – US $ 10,000 (2) Soldering irons and guns – Value in FOB — $ 5000 – Other relevant data are : Air freight $ 400, Insurance actual $ 200, Local agent's commission ₹ 5,000, Rate of exchange 1 $ =₹ 50, Customs duty – 10% Ad-valorem, CVD – 10% Ad-valorem, SAD – 4% Ad-valorem. Effective Rate of duty on soldering irons and guns through a customs notification is 8%. Compute assessable value of each item and relative total customs duty and aggregate customs duty payable.

Answer :

Details	Micro Motor		Soldering Iron	
	Amount	Total Duty	Amount	Total Duty
FOB US $	10,000.00		5,000.00	
Air Freight & Insurance (Pro-rata)	400.00		200.00	
CIF USD	10,400.00		5,200.00	
Total CIF in ₹ @ ₹ 50 per 1 USD	520,000.00		260,000.00	
Agency Commission on pro-rata basis in ₹	3,333.33		1,666.67	
Total Value	523,333.33		261,666.67	
ADD - Landing Charges @ 1%	5,233.33		2,616.67	
(A) Assessable Value	528,566.66		264,283.34	
(B) Basic Customs Duty @ 10% for micor motors and 8% for soldering iron	52,856.67	52,856.67	21,142.67	21,142.67
(C) Sub Total for calculating CVD (A+B)	581,423.33		285,426.00	
(D) CVD "C" x Excise Duty rate	58,142.33	58,142.33	28,542.60	28,542.60
(E) Education cess of excise - 2% of D	1,162.85	1,162.85	570.85	570.85
(F) SAH Education cess of excise - 1% of 'D'	581.42	581.42	285.43	285.43
(G) Sub-total for education cess on customs 'B+D+E+F'	112,743.27		50,541.55	
(H) Education cess of customs - 2% of 'G'	2,254.87	2,254.87	1,010.83	1,010.83
(I) SAH Education cess of customs - 1% of 'G'	1,127.43	1,127.43	505.42	505.42
(J) Sub - total for Spl CVD 'C+D+E+F+H+I'	644,692.23		316,341.13	
(K) Special CVD - 4% of 'J'	25,787.69	25,787.69	12,653.65	12,653.65
(L) Total Duty		141,913.26		64,711.44
(M) Total duty rounded off		141,913.00		64,711.00

Illustration 12 :

Compute (keeping in mind the provisions of the Customs Act, 1962 and Customs Tariff Act, 1975), the total customs duty payable by an importer on goods 'X' imported by sea into India, from the following details. You may, wherever appropriate, make suitable assumption. FOB Value 1,000 (Dollars) * Weight of Goods 1,000 Kg * Freight Charges $ 100 (Dollars) * Insurance Charges $ 20 (Dollars) * Handling Charges ₹ 200 * Exchange Rate 4 Dollars =₹ 100 * Date of Presentation of Bill of Entry – 4.5.2010 * Date of Entry Inwards of Vessel – 1.5.2010 Rates of Customs Duty on 1.5.2010 - * Basic 100% Adv. * SAD – 4% * Additional (CVD) 15% * Rates of Customs Duty on 4.5.2010 - * Basic 110% Adv. * SAD 4% * Additional (CVD) 15%.- . – Note : No other particulars are relevant.

Answer :

CIF Value is US $ 1,120 [1,000 + 100 + 20].

Converted into Rupees, it will be ₹ 28,000 @ ₹ 25 per dollar.

Add handling charges of ₹ 200.

Presuming that these are 'landing charges' and hence separate landing charges are not added, the Customs Value (Assessable Value) will be ₹ 28,200.

	Amount	Total Duty
(A) Assessable Value	28,200.00	
(B) Basic Customs Duty @ 110%	31,020.00	31,020.00
(C) Sub Total for calculating CVD (A+B)	59,220.00	
(D) CVD "C" × Excise Duty rate	8,883.00	8,883.00
(E) Education cess of excise - 2% of D	177.66	177.66
(F) SAH Education cess of excise - 1% of 'D'	88.83	88.83
(G) Sub-total for education cess on customs 'B+D+E+F'	40,169.49	
(H) Education cess of customs - 2% of 'G'	803.39	803.39
(I) SAH Education cess of customs - 1 % of 'G'	401.69	401.69
(J) Sub - total for Spl CVD 'C+D+E+F+H+I'	69,574.57	
(K) Special CVD - 4% of 'J'	2,782.98	2,782.98
(L) Total Duty		44,157.56
(M) Total duty rounded off		44,158.00

Illustration 13 :

Zing Yong of China exports Lithium Cell to India, the FOB price of which is one Dollar for 30 cells; however the details of Fright & Insurance were not made available. Investigation reveals that the goods are imported into India at an increased quantity. Similar cells are manufactured in India, the cost of sales per cell of which indicates the following break-up :

Direct Material	₹ 2.00
Direct Labour	₹ 0.25
Direct Expenses	₹ 0.25
Indirect Expenses	₹ 0.50
Indirect Labour	₹ 0.25
Indirect Expenses	₹ 0.25
Administrative Overheads	₹ 0.50
Selling and distribution overheads	₹ 0.50
Profit Margin	₹ 0.50

The exchange rate 1 \$ = ₹ 50. Is there any case to impose Safeguard Duty? If yes, what is the duty leviable?

Answer :

	Amount	Total Duty
FOB US $ for 30 cells	1.00	
Freight @ 20% of FOB	0.20	
Insurance @ 1.125% of FOB	0.011	
CIF USD	1.21	
Total CIF in ₹ @ ₹ 50 per 1 USD	60.56	
ADD - Landing Charges @ 1%	0.61	
(A) Assessable Value	61.17	
(B) Basic Customs Duty @ 10%	6.12	6.12
(C) Sub Total for calculating CVD (A+B)	67.28	
(D) CVD "C" × Excise Duty rate (10%)	6.73	6.73
(E) Education cess of excise - 2% of D	0.13	0.13
(F) SAH Education cess of excise - 1% of 'D'	0.07	0.07
(G) Sub-total for education cess on customs 'B+D+E+F'	13.05	
(H) Education cess of customs - 2% of 'G'	0.26	0.26
(I) SAH Education cess of customs - 1% of 'G'	0.13	0.13
(J) Sub - total for Spl CVD 'C+D+E+F+H+I'	74.61	
(K) Special CVD - 4% of 'J'	2.98	2.98
(L) Total Duty		16.42

Hence, landed cost of 30 cells is ₹ 77.59 (₹ 61.17 + ₹ 16.42 as duty)

Accordingly, the landed cost will be ₹ 2.59 per cell

In case of Indian manufacturer, his total cost will be as follows –

Prime Cost (Direct Material + Direct Labour + Direct Expenses)	₹ 2.50
Cost of Production (Prime Cost + Indirect Material + Indirect Labour + Indirect Expenses)	₹ 3.50
Cost of Sales (Cost of production + Administration Overheads + Selling and Distribution Overheads).	₹ 4.50
Selling price (Cost of Sales plus profit).	₹ 5.00

Thus, landed cost of imported article will be ₹ 2.59 and selling price of Indian manufacturer will be ₹ 5,00 per cell. Accordingly, there is a case for imposition of product Specific Safeguard Duty on imports from China u/s 8C of Customs Tariff Act.

Maximum safeguard duty that can be imposed is ₹ 2.41 per cell.

Illustration 14 :

Determine the total Customs Duty payable from the following data –

Quantity imported: 100 MTs,
FOB value: Swiss Franc: 10000,
AIR Fright: Swiss Franc: 2500,
Insurance: Data not available,
Exchange rate: 1 Swiss Franc = ₹ 34,
Rate of BCD 10%,
Rate of Cenvat under First Schedule to CETA: 10%,
Rate of SED under Second Schedule to CETA: 10%,
Rate of AED(GSI) under Additional Duties of Excise (GSI) Act: ₹ 10/kg.
Rate of SAD 4%

Answer :

Given FOB price is 10,000.00 Swiss Francs.

Since airfreight is more than 20% of FOB, freight is required to be limited to 20% of FOB *i.e.* 2,000 SF (Swiss Francs).

Since insurance data is not available, insurance cost is to be taken @ 1.125% on FOB, *i.e.* 112.50 SF.

Accordingly, —

• CIF value is 12,112.50 SF (FOB 10,000 + Freight 2,000 + Insurance 112.50 SF).	12,112.50
Add : Landing charges of 1% of CIF	121.13
	SF 12,233.63
Assessable Value = SF 12,233.63 × ₹ 34	₹ 4,15,943.42
AV Rounded off	₹ 4,15,943.00

	Amount	Total Duty
(A) Assessable Value	415,943.00	
(B) Basic Customs Duty @ 10%	41,594.30	41,594.30
(C) Sub Total for calculating CVD (A+B)	457,537.30	
(D) CVD "C" × Excise Duty rate (20%)	91,507.46	91,507.46
(E) AED (GSI) @ ₹ 10 per Kg., Hence for 100 MT	1,000,000.00	1,000,000.00
(F) Sub-total for Education cess of excise	1,091,507.46	
(G) Education cess of excise - 2% of F	21,830.15	21,830.15
(H) SAH Education cess of excise - 1% of 'F'	10,915.07	10,915.07
(I) Sub-total for education cess on customs 'B+D+E+G+H'	1,165,846.98	
(J) Education cess of customs - 2% of 'I'	23,316.94	23,316.94
(K) SAH Education cess of customs - 1% of 'I'	11,658.47	11,658.47
(L) Sub - total for Spl CVD 'C+D+E+G+H+J+K'	1,616,765.39	
(M) Special CVD - 4% of 'J'	64,670.62	64,670.62
(N) Total Duty		1,265,493.01
(O) Total duty rounded off		1,265,493.00

Notes :

(1) Basic Excise Duty (Cenvat) is 10% and Special Excise Duty (SED) is 10%. Hence, CVD, which is equal to excise duty will be 20%.

(2) As per section 3A(5) of Customs Tariff Act, SAD is not payable if an article is liable to AED(GSI). However, since the question specifies SAD @ 4%, it has been calculated. If SAD is payable, it will be calculated on Assessable Value plus Basic Customs Duty plus CVD plus AED (GSI).

Illustration 15 :

Discuss briefly with reference to decided case laws as to how the 'value' shall be determined under section 14 of the Customs Act, 1962 read with Customs Valuation Rules, 1988 in the following cases :

(i) Goods are offered at specially reduced price to buyer and the buyer is asked not to disclose the specially reduced price to any other party in India.

(ii) There has been a price rise between the date of contract and the date of importation. The contract was over 6 months before the date of shipment.

(iii) The sale involves special discounts limited to exclusive agents.

(iv) The goods are purchased on High seas.

Answer :

(i) Where sales are made to buyers at specially reduced prices, the prices so offered cannot be said to be the ordinary prices. In *Padia Sales Corporation v Collector of Customs* (1993) 66 ELT 35 (SC) the Supreme Court held that where the goods are offered to the buyers is asked not to disclose the specially reduced price to any other party, then the said price will not be acceptable.

(ii) Where there is a price rise at the time when the goods are imported in comparison to the price when the contract was made then, the price at the time of importation will be taken to be the value of the goods. In *Rajkumar Knitting Mills Pvt. Ltd. v Collector of Customs* (1998) 98 ELT 292 (SC), the Supreme Court held that the contract price may have bearing while determining the value of the goods, but he value is to be determined at the time of importation of the goods.

(iii) In *Eicher Tractors Ltd. v Commissioner of Customs, Mumbai* (2000) 122 ELT 321 (SC) the Supreme Court held that the price paid by the importer to the vendor in the ordinary course of commerce shall be taken to be the value of imported goods. Since the buyer and the seller are not related and the price is the sole consideration for sale, the discounted price was taken as the assessable value. However this decision has been nullified by the Customs Valuation Price of Imported Goods Rules, 2002 and consequently, where the sale involves special discounts limited to exclusive agents, such discounted price shall not be accepted as the assessable value.

(iv) Where high sea sales are made, the price charged by the importer from the assessee will be taken to be the value of the goods. Similar view was expressed by the Tribunal in *Godavari Fertilizers v C.C.Ex.* (1996) 81 ELT 535 (Tri.).

Illustration 16 :

'A' imports by air from USA a Gear cutting machine complete with accessories and spares. Its HS classification is 84.610 and Value US $ f.o.b. 20,000.

Other relevant data/information : (1) At the request of importer, US $ 1,000 have been incurred for improving the design, etc. of machine, but is not reflected in the invoice, but will be paid by the party, (2) Freight – US $ 6,000. (3) Goods are insured but premium is not shown/available in invoice. (4) Commission to be paid to local agent in India ₹ 4,500. (5) Freight and insurance from airport to factory is ₹ 4,500. (6) Exchange rate is US $ 1 = ₹ 45. (7) Duties of Customs : Basic – 10% CVD – 10% SAD – 4%. – Compute (i) Assessable value (ii) Customs duty.

Answer :

(i) Computation of Assessable Value –

FOB Value of Machine	= $ 20,000
Add : Expenditure for improving design	= $ 1,000
Add – Freight limited to 20% of FOB [Rule 9(2)]	= $ 4,000
Insurance @ 1.125% of FOB [Rule 9(2)c(iii)]	= $ 225
Sub-Total	= $ 25,225
Sub-Total In ₹ @ ₹ 45 per Rupee	= ₹ 11,35,125
Add – Agents Commission [Rule 9(1)(i)]	= ₹ 4,500
Total CIF Value	= ₹ 11,39,625
Add – Landing charges 1% of CIF	= ₹ 11,396
Assessable Value	= ₹ 11,51,021

Duty payable will be as follows –

(ii) Gear cutting machine Complete with accessories and spares

	Amount	Total Duty
(A) Assessable Value	1,151,021.00	
(B) Basic Customs Duty @ 10%	115,102.10	115,102.10
(C) Sub Total for calculating CVD (A+B)	1,266,123.10	
(D) CVD "C" × Excise Duty rate (10%)	126,612.31	126,612.31
(E) Education cess of excise - 2% of 0	2,532.25	2,532.25
(F) SAH Education cess of excise - 1% of 'D'	1,266.12	1,266.12
(G) Sub-total for education cess on customs 'B+D+E+F'	245,512.78	
(H) Education cess of customs - 2% of 'G'	4,910.26	4,910.26
(I) SAH Education cess of customs - 1% of 'G'	2,455.13	2,455.13
(J) Sub - total for Spl CVD 'C+D+E+F+H+I'	1,403,899.16	
(K) Special CVD - 4% of 'J'	56,155.97	56,155.97
(L) Total Duty		309,034.13
(M) Total duty rounded off		309,034.00

Illustration 17 :

Determine the assessable value and customs duty amount from the following data :

Name of the raw material X

FOB value Euro 1 million

Ocean freight Actual data not available

Ocean Insurance Actual data not available

Freight from sea port to godown paid in India ₹ 10,000

Transit insurance in India ₹ 2,000

Selling commission paid to agent in India 5%

Royalty on manufacture and sale of final product to foreign collaborator 5%

Interest payable on raw material imported at 180 days credit (on FOB value) 12% p.a.

Dividend paid to the foreign supplier of raw material on their equity participation for the year 2009-10 ₹ 2 per share on 1 million shares of face value ₹ 10/share

Importer supplied design and drawings worth Euro 10,000 to the foreign raw material supplier. # Landing charges as per Customs provisions

Customs duty rates : BCD – 10%, ACD – 10%, SAD – 4%

Exchange rate : 1 Euro = ₹ 42.

Answer :

Since ocean freight is not available, it has to be taken at 20% of FOB. Insurance will have to be taken @ 1.125% of FOB Value.

Royalty on manufacture and sale of final products payable to foreign collaborators has no relation to goods imported. Hence, it it not includible in Assessable Value for customs. Similarly, dividend paid to foreign supplier has no relation with supply of raw materials. It is not includible in Assessable Value.

Interest payable for credit is not includible in assessable value for customs purposes, as it is not part of 'transaction value'.

Freight from seaport to godown and transit insurance in India are post-importation costs and are not includible.

It is assumed that selling commission to selling agent in India is payable on basis of CIF Value of goods including cost of drawings supplied by buyer.

As per rule 9(1)*(b)(iv)* of Customs Valuation Rules, cost of engineering drawings is includible only if work was undertaken outside India. Since, payment has been made in Euro, it is assumed that the design and drawing work was done outside India.

Landing charges will be 1% of CIF Value, as per Customs Valuation Rules.

Hence, calculation of customs duty will as follows –

	Amount	Total Duty
FOB in EURO	1,000,000.00	
Freight @ 20 % of FOB	200,000.00	
Insurance @ 1.125% of FOB	11,250.000	
CIF in EURO	1,211,250.00	
Design and drawing charges	10,000.00	
Total CIF Value	1,221,250.00	
Total CIF Value in ₹	51,292,500.00	
Local agency commission @ 5%	2,564,625.00	
Total Value	53,857,125.00	
ADD - Landing Charges @ 1%	538,571.25	
(A) Assessable Value	54,395,696.25	
(B) Basic Customs Duty @ 10%	5,439,569.63	5,439,569.63
(C) Sub Total for calculating CVD (A+B)	59,835,265.88	
(D) CVD "C" x Excise Duty rate (10%)	5,983,526.59	5,983,526.59
(E) Education cess of excise - 2% of D	119,670.53	119,670.53
(F) SAH Education cess of excise - 1% of 'D'	59,835.27	59,835.27
(G) Sub-total for education cess on customs 'B+D+E+F'	11,602,602.01	
(H) Education cess of customs - 2% of 'G'	232,052.04	232,052.04
(I) SAH Education cess of customs - 1% of 'G'	116,026.02	116,026.02
(J) Sub - total for Spl CVD 'C+D+E+F+H+I'	66,346,376.32	
(K) Special CVD - 4% of 'J'	2,653,855.05	2,653,855.05
(L) Total Duty		14,604,535.12
(M) Total duty rounded off		14,604,535.00

Illustration 18 :

Compute the Customs duty from the following data :

	US Dollars
Machinery imported from USA by Air (FOB)	8,000
Accessories compulsorily supplied with Machine (Electric Motor & others) (FOB)	2,000
Air Freight	3,000
Insurance	100

Local agents' commission to be paid in Indian Rupees is ₹ 4,500 (say equivalent to US Dollars 100), The exchange rate is 1 US Dollars = Indian Rupees 45., Customs duty on Machinery – 10% ad valorem, Customs duty on Accessory (normal rate 15% ad valorem), Surcharge on Customs duty – 10%, CVD – 10% (Effective Rate is 8% by a notification), SAD – 4%.

Answer :

As per Accessories (Conditions) Rules, 1963, accessories and spare parts compulsorily supplied with main implements are chargeable at the same rate as applicable to main machine. Thus, in case of accessories also, rate applicable will be 10%. Thus, customs duty on both machinery and accessory is 10%.

Total FOB value of machinery (including compulsory accessories) is US $ 10,000. Though actual air freight is 3,000 US $, it is limited to 20% as per rule 9(2) of Customs Valuation Rules. The freight to be considered for customs valuation is 20% of FOB i.e. 2,000 US $. Insurance (actual as given) is US $ 100. Thus, CIF Price (excluding agency commission) is 12,100 US $, *i.e.* ₹ 5,44,500 (@ ₹ 45 per US $).

Agency Commission is ₹ 4,500. Thus, total CIF price is ₹ 5,49,000. [Note that Agency Commission is really part of price of product and hence is includible in CIF Price]. Add landing charges of 1%) ₹ 5,490) to arrive at 'Assessable Value' or 'Customs Value' of ₹ 5,54,490.

	Amount	**Total Duty**
(A) Assessable Value	554,490.00	
(B) Basic Customs Duty @ 10%	55,449.00	55,449.00
(C) Sub Total for calculating CVD (A+B)	609,939.00	
(D) CVD "C" x Excise Duty rate (10%)	60,993.90	60,993.90
(E) Education cess of excise - 2% of D	1,219.88	1,219.88
(F) SAH Education cess of excise - 1% of 'D'	609.94	609.94
(G) Sub-total for education cess on customs 'B+D+E+F'	118,272.72	
(H) Education cess of customs - 2% of 'G'	2,365.45	2,365.45
(I) SAH Education cess of customs - 1% of 'G'	1,182.73	1,182.73
(J) Sub - total for Spl CVD 'C+D+E+F+H+I'	676,310.90	
(K) Special CVD - 4% of 'J'	27,052.44	27,052.44
(L) Total Duty		148,873:33
(M) Total duty rounded off		148,873.00

Notes:

(a) If different rates of customs duty have to be applied to main machinery and accessories, freight, agency commission and insurance will have to be allocated on pro-rata basis.

(b) If insurance charges are not given, these will have to be taken as 1.125% of FOB.

(c) Surcharge of 10% has now been removed. Special duty has also been removed w.e.f. 1-3-2001. Thus, now, surcharge or special duty is not applicable w.e.f. 1-3-2001

Illustration 19 :

Compute the Customs duty liability as per the provisions of the Customs Act, 1962, from the following information. Make suitable assumptions and indicate the same in your answer :

- Product Imported – 'X'
- Total FOB Value of the goods – US $ 74000
- Quantity Imported – 100 MTs.
- Ocean freight – US $ 10000
- Insurance – US $ 740
- Landing charges – 1% of CIF value
- Exchange rate – 1 US $ = ₹ 37
- Date of presentation of Bill of Entry – 28.02.10
- Date of Entry Inwards of the Vessel – 03.03.10
- Customs duty Rates on 28.02.10 –
  (a) Basic Customs Duty 15%
  (b) Special Additional Duty 4%
  (c) Countervailing Duty (Additional Duty) 10%.
- Customs duty rates on 3.3.10 –
  (i) Basic Customs Duty 10%
  (ii) Special Additional Duty 4%
  (iii) Countervailing Duty (Additional Duty) 8%

Will your answer change if the actual cost of Freight and Insurance is not available?

Answer :

Although the Bill of Entry is stated to be presented earlier, entry inward was granted later. Therefore, relevant rate of customs duty will be as on 3-3-2010 *i.e.* Basic 10%, Special – 4% and CVD 8%.

	Amount	Total Duty
FOB in USD	74,000.00	
Ocean Freight	10,000.00	
Insurance charges	740.000	
ClF in USD	84,740.00	
Total CIF Value in ₹	3,135,380.00	
ADD - Landing Charges @ 1%	31,353.80	
(A) Assessable Value	3,166,733.80	
(B) Basic Customs Duty @ 10%	316,673.38	316,673.38
(C) Sub Total for calculating CVD (A+B)	3,483,407.18	
(D) CVD "C" × Excise Duty rate (8%)	278,672.57	278,672.57
(E) Education cess of excise - 2% of D	5,573.45	5,573.45
(F) SAH Education cess of excise - 1% of 'D'	2,786.73	2,786.73
(G) Sub-total for education cess on customs 'B+D+E+F'	603,706.13	
(H) Education cess of customs - 2% of 'G'	12,074.12	12,074.12
(I) SAH Education cess of customs - 1% of 'G'	6,037.06	6,037.06
(J) Sub - total for Spl CVD 'C+D+E+F+H+I'	3,788,551.12	
(K) Special CVD - 4% of 'J'	151,542.04	151,542.04
(L) Total Duty		773,359.36
(M) Total duty rounded off		773,359.00

<u>If Actual Cost of Freight & Insurance is not available</u> :-

Since actual cost of freight and insurance is not given, it is taken as 20% of FOB and 1.125% of FOB respectively. Accordingly, the freight will be US $ 14,800 and insurance US $ 832.50.

CIF value will, thus, be US $ 89,632.50.

The total amount of Customs duty payable on that basis will be to ₹ 8,18,009.59 (Rounded off to ₹ 8,18,010).

Notes : The students may note that when the question was set, there was not Special Additional Duty (SAD), but there was special customs duty of 2%, which was chargeable on basic customs duty. However, now special customs duty is removed and SAD has been introduced, the example has been calculated considering 4% SAD.

Illustration 20 :

An importer has imported a machine from Japan at FOB cost of 9,00,000 Yens. Other details are as follows :

(a) Freight from Japan to Indian port was 18,000 Yens.
(b) Transit insurance charges were 1% of FOB value.
(c) Design and development charges of 90,000 Yens were paid to a consultancy firm in Japan for design of machinery.
(d) Packing charges of 22,000 Yen were charged extra.
(e) ₹ 20,000 were spent in design cost on machine in India.
(f) An amount of 98,500 Yen was payable to Japanese manufacturer towards charges for installation and commissioning the machine in India.
  (i) Rate of exchange as announced by RBI was: 1 yen = ₹ 0.309
  (ii) Rate of exchange as announced by Central Government by notification under section 14(3)(a)(i) : 1 Yen = 0.302 ₹
  (iii) Customs duty was 10% and special additional duty was 4%. Excise duty on similar machinery in India would be 10%.

Find the customs duty payable.

Answer :

Design charges of ₹ 20,000 are not includible in Assessable Value, but design charges paid abroad are includible. Erection and commissioning charges are not includible. Relevant rate of exchange is 1 Yen = ₹ 0.302. Hence, duty payable is calculated as follows –

	Amount	Total Duty
FOB in Yen	900,000.00	
Ocean freight	18,000.00	
Insurance charges	9,000.000	
Design and consultancy charges	90,000.000	
Packing charges	22,000.000	
CIF in Yen	1,039,000.00	
Total CIF Value in ₹	313,778.00	
ADD - Landing Charges @ 1%	3,137.78	
(A) Assessable Value	316,915.78	
(B) Basic Customs Duty @ 10%	31,691.58	31,691.58
(C) Sub Total for calculating CVD (A+B)	348,607.36	
(D) CVD “C” × Excise Duty rate (10%)	34,860.74	34,860.74
(E) Education cess of excise - 2% of D	697.21	697.21
(F) SAH Education cess of excise - 1% of ‘D’	348.61	348.61
(G) Sub-total for education cess on customs ‘B+D+E+F’	67,598.14	
(H) Education cess of customs - 2% of ‘G’	1,351.96	1,351.96
(I) SAH Education cess of customs - 1% of ‘G’	675.98	675.98
(J) Sub - total for Spl CVD ‘C+D+E+F+H+I’	386,541.86	
(K) Special CVD - 4% of ‘J’	15,461.67	15,461.67
(L) Total Duty		85,087.75
(M) Total duty rounded off		85,088.00

Illustration 21 :

A consignment of 800 metric tons of skimmed milk powder of US origin was imported by a Non-profit making Organisation for free distribution of milk to the children in a tribal area under a World Health Programme. This being a special transaction a nominal price of US $ 10 per metric ton was charged for the consignment to cover freight and insurance charges. The customs department found out at or about the time of importation of this gift consignment there were the following imports of the skimmed milk poweder of US origin :

S.No.	Quantity imported Unit	
	In Metric tons	Price in US $ (C.I.F.)
1.	20	260
2.	100	220
3.	500	200
4.	900	175
5.	400	180
6.	780	160

The rate of exchange on the relevant date was 1 US $ = ₹ 46

Briefly explain how the assessable value for purposes of customs duty will be arrived at into his case under the Customs Act, 1962 and the Customs Valuation Rules, 1988.

Answer :

In the given case only a nominal value of US $ 10 per metric ton is charges to cover the freight and insurance and no amount is paid or payable towards the cost of the goods. Therefore the transaction value will have to be determined considering the transaction value of the identical goods under Rule 5 of the Customs Valuation Rules, 1988.

As per Rule 5, the contemporaneous imports at the same commercial level and in substantially the same quantity as the goods being valued will be considered.

In absence of any specific information, it is presumed that the transactions are at the same commercial level. Considering that the quantity, the consignments of 20 and 100 metric tons cannot be accepted, while the remaining 4 consignments can be considered to be of substantially the same quantity. As the unit prices are different, we have to resort to Rule 5(3) which stipulate that if more than one transaction value of identical goods is found, the lowest of such value shall be used to determine the value of the imported goods. Accordingly, the unit price of the consignment under valuation shall be US $ 1 60 per metric tonne.

Particulars	Value
CIF value of 800 metric tones @ US $ 160 per m.t	1,28,000
Rate of exchange	1 US $ = ₹ 46
CIF value in Indian Rupees (1)	₹ 58,88,000
Add landing charges @ 1% of CIF value (2)	₹ 58,880
Assessable value (1) + (2)	₹ 5946880

Illustration 22 :

Anukool imported several consignments of goods under proper license valid up to 31st December, 2009. A consignment was imported per "S.S.Vaishali" on 29th December, 2009. Before the goods were unloaded, strike broke out and goods could not be unloaded. Ship was forced to leave the port. The strike ended on 7th January, 2010. The ship Re-entered the port on 9th January, 2010 and the goods were unloaded. Anukool claims that the leaving or the port by the ship was involuntary and to save the goods. Anukool also claims that since the vessel has entered the territorial waters earlier, import was complete. Could the goods be cleared in the same license?

Answer :

India has sovereign rights in territorial waters, which are 12 nautical miles insides the sea. Thus, once goods enter territorial waters, the goods can be said to have entered into 'India'. In this case, since the goods had entered territorial waters before 31^{st} December, 2009, the 'import' was complete.

Illustration 23 :

A ship carrying the goods for XYZ Ltd. entered the territorial waters of India from a foreign country on November 25, 2009. The goods were exempted from payment of customs duty under the Customs Act, 1962 on the that day under a notification issued in terms of the said Act by the Central Government the goods were warehoused in a warehouse under Chapter IX of the Customs Act, 1962 on November 26, 2009. The goods were removed from the warehouse on December 15, 2009 by which time the earlier notification exempting the goods from payment of customs duty stood rescinded. The importer has sought your advice whether he could resist the claim for duty on the goods made upon him by the Department on the ground that when the goods entered the territorial waters on November 25, 2009 no duty was payable and the taxable event had occurred in terms of Section 12 of the Customs Act, 1962.

Answer :

The facts of the case are similar to that of *UOI v Apar Pvt. Ltd.* (1999) 112 ELT 3 (SC), in which the Supreme Court held that the crucial date for rate of duty applicable to any imported goods is the date determined in accordance with section 15(1) of the Customs Act, 1962, viz.

(a) in case of goods cleared for home consumption, the date of presentation of bill of entry under section 46 or the date of grant of entry inwards to the vessel which ever is later; and

(b) in the case of goods removed from a bonded warehouse, the date of actual removal of goods from the warehouse. The date when the vessel entered territorial waters of India is irrelevant.

Similarly, in *Garden Silk Mills Ltd v UOI* (1999) 113 ELT 58 (SC), the Supreme Court held that the import of goods commences when the goods cross the territorial waters of India, but it is completed when it becomes part of the mass of the goods within the country. Taxable event is reached when the goods reach the customs barrier and the bill of entry for home consumption is filed.

In view of these judicial decision, XYZ Ltd. are liable to pay customs duty at the rate in force on the date of removal of the goods from the warehouse.

Illustration 24 :

Hero Alloys imported during October, 2009 by sea, a consignment of metal scrap weighing 3000 metric tones from U.K. They filed a Bill of Entry for Home consumption and the Assistant Commissioner passed an order for clearance of goods and the applicable duty was also paid. The importer thereafter found on taking delivery from the Port Trust Authorities, that only 2,500 metric tones of scrap were available at the docks although they had paid duty for the entire 3000 metric tones since there was no short landing of cargo. The short delivery of 500 metric tones was also substantiated by the Port Trust Authorities, who gave a weighment certificate to the importer to that effect.

Upon a representation to the Customs Department the importer has been directed in writing to justify as to which provision of the Customs Act, 1962 governs the importer's claim for restoration of duty paid on the quantity of 500 metric tones scrap not delivered by the Port Trust.

Examine the issues involved and briefly discuss the same with reference to the provisions of the Customs Act, 1962.

Answer :

The issue for consideration here is whether the importer shall be entitled to remission of duty, when goods are lost at the port.

As per section 23 provides that where the imported goods have been lost without pilferage or destroyed at any time before clearance for home consumption, duty on such goods would be remitted. Here "loss" means that the loss is forever and there is no possibility of tracing it or recovering it.

In the given case, 500 metric tones of goods has been lost in the custody of the Port Trust after the order for clearance was passed and duty payment was made. The weighment certificate of the port Trust Authorities substantiates the same.

Therefore, the importer can claim the remission of the duty on the lost goods *i.e.* 500 metric tones under section 23 of the Customs Act, 1962.

Illustration 25 :

The shipping bill in respect of an export consignment was presented to the customs Authority on August 8, 2009. The Customs Authority granted "entry outwards" to the ship on August 11, 2009, the loading of the goods in the ship had commenced only after August 17, 2009. A notification was issued under the Customs Act, 1962 exempting the export item from customs duty on August 17, 2009. The assessee contends that since the loading of the goods in the ship had commenced after August 17, 2009, the export consignment is eligible for the benefit of the exemption notification. Discuss with reasons whether the assesee's contention is tenable in law.

Answer :

The issue for consideration in the present case is whether the respondents are entitled to avail the benefit of the exemption from customs duty granted under Notification.

As stated, the shipping bill in respect of the said export was presented to the Customs on August 8, 2009, the Customs authorities granted entry outwards to the ship on March 11, 2009. The loading of the goods had not commenced till August 17, 2009.

The facts of the case are similar to that of *Principal Appraiser (Exports), Collectorate of Customs and Central Excise v Esajee "Tayabally, Kapasi, Calicut* (1995) 80 ELT 3 (SC), wherein the Supreme Court held that the relevant rate of customs duty in connection with the export o goods would be the rate which prevailed when the 'entry outwards' for the vessel, which ultimately exported the goods was effected and subsequent change in the rate of duty would be irrelevant.

In view of above, the assessee would not be entitled to seek exemption from duty under the Notification dated 17-8-2009, since the entry outwards has been made on 11-8-2009.

Illustration 26 :

K Power Corporation (KP) are the promoters of Naptha based short gestation 355 M.W. combined cycle power plant. For setting up the power plant KP entered into a power purchase agreement with the State Electricity Board. With a view to implement the project on schedule and to avail the concessional customs duty provided under the Project Import Regulations, 1986 the contract between KP and the foreign suppliers of power equipment based in Korea was registered with the Customs House. The project equipment was off loaded after filing necessary documents relating to clearance of goods vide Bill of Entry No. 109, Dated 20-5-2009. The Customs Authorities in terms of the contract registered under the Project Import Regulations assessed the customs duty on the project equipment amounting to ₹ 2.15 crores provisionally. The duty was paid as per the provisionally assessed bill of entry. The cargo was discharged between 21-5-2009 and 24-5-2009.

As the project equipment imported at the port was more than 200 M.T. in weight and the equipments were in assembled condition it was felt that the equipment could not be transferred by road from the port to the project site. Therefore it was decided to transport the equipment by sea in a costal barge to another nearby place (M) and then to move them by road to the project site. The said equipment, which was oversized cargo was therefore transferred to the barge to be towed by a tug to place (M). All the packages containing the said equipment were discharged to Trailers/barges. The barge set out on Costal Voyage on 1-6-2009 after taking necessary permission from various authorities. Unfortunately the barge capsized during the Voyage on 2-6-2009 and finally overturned resulting in total loss of all packages containing the said equipment.

The importers have sought for remission of duty and refund of duty already paid on provisional basis in *terms of* Section 23 of the Customs Act, 1962.

Write a brief note on the validity of the claim made by the importers.

Answer :

Section 23 of the Customs Act, 1962 provides that in case any goods have been lost or destroyed before clearance of goods for home consumption, then, the importer shall not be liable to pay the duty. However, in this case, the Bill of Entry was assessed provisionally and the goods were allowed to be cleared out of the customs area. The loss occurred when the goods have been physically removed *i.e.* while in transit. Hence, the benefit of section 23 of the Customs Act, 1962, will not be available.

Illustration 27 :

A big ship carrying merchandize and stores enters the territorial waters of India but it cannot enter the port. In order to unload the merchandize lighter ships are employed. Stores are consumed on board the ship as well as by the small ships.

Examine whether such consumption of stores attracts customs duty, quote relevant section and case law, if any.

Stores are supplied to the above ships. Will such supplies be treated as exports and be entitled to drawback?

Answer :

'Stores' means goods for use in a vessel and includes diesel and spare parts and other articles and equipment. Bringing of 'stores' is treated as import. However, there is special provision for stores under section 87. Imported stores consumed on board an ocean going vessel are exempt from import duty under section 87.

Since the ship is ocean going, stores consumed on board will not attract customs duty. Regarding the smaller ships which are employed to unload the cargo from the mother ship, there are termed as 'Tran shippers'. These are also treated as ocean going vessels, as was decided in *UOI v V M Salgaoncar* AIR 1998 SC 1367: 99 ELT 3(SC).

Hence, Stores consumed by small vessels would also be exempt from customs duty.

Stores supplied to will be treated as export as per section 89 of Customs Act and hence will be eligible for duty drawback.

Illustration 28 :

Mr. B, an Indian resident, aged 52 years, returned to India after visiting England on 31.10.2009. He had been to England on 10.10.2009. On his way back to India he brought following goods with him –

(a) His personal effect like clothes etc. valued at ₹ 40,000.

(b) 1 litre of Wine worth ₹ 1,000.

(c) A video cassette recorder worth ₹ 1,000

(d) A microwave oven worth ₹ 20,000.

What is the customs duty payable?

Answer :

As per Rule 3 of the baggage Rules, 1998 passengers above 10 years of age and returning after stay abroad of more than 3 days are eligible for the following general free allowance :

(i) Used personal effect of any amount;

(ii) Articles other than those mentioned in Annex, I upto a value of ₹ 25,000 if these are carried on the person or in the accompanied baggage of the passenger;

Therefore, in the instant case, the total customs duty payable by the passenger will be as follows :

Articles	Duty
1. Used personal effects	No Duty
2. Wine upto 1 Ltr. Can be accommodated in General Free Allowance	₹ 1,000
3. Video cassette recorder is dutiable	₹ 11,000
4. A microwave oven	₹ 20,000
Total Dutiable goods imported (that can be accommodated in General Free Allowance)	₹ 32,000
Total General Free allowance (As per rule 3 of the Baggage Rules)	₹ 25,000
Balance Goods on which duty is payable	₹ 7,000
Duty payable @ 36.05% [35% + 2% of 35% + 1 % of 35% = 36.05%]	₹ 2,523.50

Illustration 29 :

An exporter has exported under-mentioned goods under draw-back claim:

Sub. S. No. of DBK Table	Description	FOB Value ₹	Rate of Drawback
74.24	1000 Kg handicrafts of bras @ ₹ 200 per kg	2,00,000	16.5% of FOB Value subject to maximum of ₹ 33 per kg of brass content
74.27	1000 kg of Artware of copper @ ₹ 300 per kg	3,00,000	₹ 33 per kgs
85.81	20,000 pc GLS Lamps @ ₹ 5 per piece	1,00,000	1% of FOB

Notes – 1. On examination it is found that brass content in brass artware is 80%.
2. Artware has copper content of weight 950 kg.

Compute the amount of drawback admissible taking into account the above facts.

Answer :

Description	Calculation of Duty Drawback	Duty Drawback Available ₹
1000 kg handi-crafts of brass @ ₹ 200 per kg	16.5% FOB value is ₹33,000. However, maximum is ₹ 33 per Kg of brass content. Brass content in brassware @ 80% is 800 Kg. Hence, Maximum permissible drawback is ₹ 26,400	₹ 26,400
1000 kg of Artware of copper @ ₹ 300 per kg	Actual weight is 950 Kg. Hence, drawback will be 950 Kg × ₹ 33 per Kg	₹ 31,350
20,000 pc GLS Lamps @ ₹ 5 per piece	1% of FOB *i.e.* 1% of ₹ 1,00,000	₹ 1,000
Total		₹ 58,750

Illustration 30 :

'A' has exported under-mentioned goods under drawback claim –

S. No. of DBK Table	Description of goods & quantity exported	Value FOB ₹	Rate of Drawback
64.01	Leather footware Boots 200 nos. @ ₹ 1,000 per pair	2,00,000	11% of FOB subject to maximum of ₹ 85 per pair
64.11	Leather chappals 2000 no. @ ₹ 50 per pair	1,00,000	3% of FOB subject to maximum of ₹ 5 per pair.
71.01	Brass Jewellery 200 kgs. @ ₹ 200 per kg		₹ 22.50 per kg of Brass content
71.05	Plastic bangles with embellishment 200 kgs @ ₹ 100 per kg		₹ 5.00 per kg of plastic content.

On examination it is found that brass jewellery is 50% of weight and in plastic bangles the plastic content is 50% but the total weight comes to 190 kgs only.

Compute drawback on each item and total drawback.

Answer :

Description	FOB Value ₹	Rate of Drawback	Drawback in ₹
Leather footwear Boots – 200 pairs @ ₹ 1,000 per pair	2,00,000	11% of FOB subject to max of ₹ 85 per pair	17,000
Leather chappals – 2,000 pairs @ ₹ 50 per pair	1,00,000	3% of FOB subject to Max ₹ 5 per pair	3,000
Brass jewellery 200 Kgs @ ₹ 200 per Kg – Brass content 50% of weight Plastic bangles with embellishment 200 Kgs – Plastic content 50%. Actual weight 190 Kgs only		22.50 per Kg of Brass content	2,250
		₹ 5 per Kg of Plastic content	475
		Total Duty Drawback	22,725

Illustration 31 :

'A' exported a consignment under drawback claim consisting of the following items :

Particulars Serial/Sub-serial FOB value Drawback rate –

(1) 200 pieces of pressure stoves mainly of brass @ ₹ 80/piece 74.04 ₹ 16,000 4% of FOB

(2) 200 kg Brass utensils @ ₹ 200 per kg. 74.13 ₹ 40,000 ₹ 24/kg

(3) 200 kg Artware of brass @ ₹ 300/Kg 74.22 ₹ 60,000 17.50% of FOB subject to a maximum of ₹ 38/per kg.

On examination in docks, weight of brass artware was found to be 190 Kgs and was

Recorded on shipping bill. Compute the drawback on each item and total drawback admissible to the party.

Answer :

Duty drawback available in each case is as follows –

	Particulars	*Duty Drawback in ₹*
1.	200 pieces of pressure stoves	640 [4% of ₹ 16,000]
2.	200 kgs brass utensils	4,800 [200 × 24]
3.	200 kgs of artware	7,220 [190 × 38]

Thus, drawback on individual clearances ₹ 640, ₹ 480 and ₹ 7,220.

Total drawback ₹ 12,660.

Note – In case of artware, the drawback on FOB value @ 17.5%, is ₹ 10,500. The condition is that maximum drawback will be ₹ 38/kg. Hence, on 190 kgs. works to ₹ 7,720.

Illustration 32 :

Sun Industries Ltd sent certain good by a ship from Kolkata to Colombo in Sri Lanka under claim for drawback on the said goods under Section 75 of the Customs Act, 1962 against shipping bill. The ship had passed beyond the territorial waters of India and the engine developed trouble while the ship was in the high seas failing within the ambit of expression 'taking out to a place outside India'. The ship returned back and ran aground in Indian territorial waters at the port of Paradeep. The fittings, stores and cargo was salvaged. Discuss the admissibility of claim for drawback by the company.

Answer :

Section 75 provides that the duty drawback is permissible on the goods which have 'entered for export' and in respect of which an order permitting the clearance and loading thereof is granted by the proper officer.

Therefore, the admissibility of the claim for drawback will not depend on the fact whether the goods have reached the destination or no.

The facts of the given problems are similar to that of *Sun Industries v Collector of Customs, Kolkata* 1988(35) ELT 241(SC), wherein the Supreme Court held that export is complete on loading after clearance and accordingly allowed the drawback claim where the ship carrying goods ran aground after crossing territorial waters due to engine trouble and the goods in question were neither salvaged nor re-landed; it further held that off-loading of goods at foreign port is not an essential requirement for export to take place.

Illustration 33 :

GEOTECH has imported 5 main frame computer systems from USA in August, 2009 paying customs duty of ₹ 60 lakhs.

Due to some technical snags that developed in the system in November, 2009 the supplier sent his technicians to India to resolve the same. No solution was found. In July, 1999 INFOTECH decided to re-ship/return the goods to the foreign supplier.

You are the Finance Manager of GEOTECH and have been approached for advice whether import duty already paid can be got back from the Central Government, when the goods are reshipped/returned.

Briefly examine with reference to the provisions of Customs Act, 1962.

Answer :

As per the provisions of section 74 of the Customs Act, 1962, which deals with the drawback of Customs duty on articles which are imported, duty paid, then re-exported. This Section was basically introduced to allow the drawback of duty to the party in case the goods are as such re-exported say where these were received as defective goods, or wrong shipments were made by the suppliers abroad or after use within the country these are being sent back. However, the article should be easily identifiable.

The conditions to be, fulfilled to claim the drawback under section 74 are as:

1. The goods must have been originally imported into India and import duty must have been paid thereon.
2. The goods must be capable of being easily identified
3. The export of the goods should be under the cover of the drawback Shipping Bill.

If these conditions are fulfilled, the proper officer will make an order permitting clearance of the goods for exportation and the duty paid is repaid as drawback at the industry rates as prescribed by the Central Government. However, if the goods are not put to use at all, then 98% of the duty will be repaid as drawback.

However, in order to claim drawback under this Section, the goods are to be entered for export within two years from the date of payment of duty on the importation thereof.

In the instant case, the goods were imported in August, 2009 on payment of the customs duty and the company now seeks to re-export the same. If the goods entered for export before August 2011 (2 years from the date of payment of duty), the company will be eligible for the drawback claim under Section 74 either at industry rates (in case the goods are put to any use) or at the rate of 98% of the duty (where the goods are not put to use at all).

Illustration 34 :

An officer of the Customs has reason to believe that a person has secreted gold/diamonds or documents about his person liable to confiscation. He wants to search him. The person requests the officer to take him to a Gazetted Officer or Magistrate. Should his request be acceded to? What precautions should be taken in such a search?

Answer :

The relevant section are 100,101 and 102 of Customs Act.

Section 100 empowers Customs Officer to search a person if he has reason to believe that smuggled goods or document are secreted in his person. Section 102(2) of Customs Act lays down that the person being searched can request that the search should be carried out before a gazetted officer or magistrate. If such request is made, the person should be taken to the nearest gazatted officer of Customs or a Magistrate. The Gazetted officer or magistrate will decide whether the search should be done or to discharge the person. If search to be conducted, two persons should be brought as witnesses. The search is conducted before the 'panchas' and the seized articles are listed and signed. Female should be searched by a female only.

Illustration 35 :

A person make an unauthorized import of 1000 pieces of ophthalmic rough blanks CIF priced at $ 1 per piece by air from USA (Tariff heading 70.1510). The consignment is liable to be confiscated. Import is adjudicated. AC gives to the party an option to pay fine in lieu of confiscation. It is proposed to impose fine equal to 50% of margin of profit. The market price is ₹ 100 per piece of ophthalmic rough blank. The rates of duty are – Basic customs – 10%, CVD – nil, SAD – 4%, Exchange rate is - $ 1 = ₹ 45.

Compute : (i) Amount of fine; (ii) Total payment to be made by party to clear the consignment. What is the maximum amount of fine that can be imposed in this case? Quote section.

Answer :

As the declared CIF value of goods is $ 1 per piece and price for consignment of 1000 pieces will be $ 1000 (CIF). Rate of exchange is $ 1 = ₹ 45. Hence, CIF value is ₹ 45,000. Add landing charges @ 1%. Therefore, total Assessable Value in Rupees will be ₹ 45,450 [₹ 45,000 CIF plus 450 landing charges]

Basic duty @ 10% will be ₹ 4,545 (10% of ₹ 45,450). There is no CVD. So no cess of excise to be paid. But, Education & SAH Education of customs to be paid on Basic Customs Duty @ 3%. Total cess will be ₹ 136.35 (3% of ₹ 4,545). SAD @ 4% is payable on AV + Basic + Education Cess i.e. on ₹ 50,131.35 (45,450 + 4,545 +136.35). Thus SAD is ₹ 2005.25.

Therefore, total duty payable is ₹ 6,686.60 (4,545.00 + 136.35 + 2005.25)

Total Duty rounded off to ₹ 6,687.

Total cost to the importer is price plus duty, i.e. ₹ 45,450 plus ₹ 6,687. Thus, total cost to the importer is ₹ 52,137. The market value is ₹ 100 per piece, i.e. ₹ 1,00,000 for the consignment. Therefore, his margin of profit is ₹ 47,863. Fine equal to 50% of Margin of profit will be ₹ 23,932.

Therefore, total amount payable will be –

Duty	₹ 6,687
Fine	₹ 23,932
Total	₹ 30,619

The maximum amount of fine that can be imposed as per proviso to Sec. 125 will be the market value of goods less amount of duty.

Thus, the maximum fine that can be imposed in ₹ 93,313 (Market price ₹ 1,00,000 less amount of duty ₹ 6,687).

Illustration 36 :

An importer imports some goods @ 10,000 US $ on CIF basis. Following dollar rates are available on the date of presentation of bill of entry : (a) RBI Floor rate : ₹ 43.37 (b) Inter-bank closing rate : ₹ 43.38 (c) Rate notified by CBE&C under section 14 (3) (a) (i) of Customs Act : ₹ 43.55 (d) rate at which bank has realised the payment from importer : ₹ 43.58. Find the assessable value for customs purposes.

Answer :

The relevant exchange rate is ₹ 43.55. Thus, CIF Value of goods is ₹ 4,35,500. Landing charges [rule 9 (2) of Customs Valuation Rules] @1% of CIF Value are to be added - i.e. ₹ 4,355. Thus, Customs Value or Assessable Value is ₹ 4,39,855.

Illustration 37 :

A consignment is imported by air. CIF price is 1,000 US Dollars. Freight is 320 US $. Insurance cost was $ 35. Exchange rate is same as above. Find Value for customs purposes.

Answer :

FOB Price of consignment is $ 645 (1,000 less 320 less 35). Air freight is to be restricted to 20% of FOB Value for purpose of customs valuation. Hence, freight should be considered as 20% of 645 i.e. 129 US $ for valuation. Thus, CIF Value for customs purposes is $ 809 (645 + 129 + 35) i.e. ₹ 35,231.95 @ ₹ 43.55 per dollar. Add 1% of CIF i.e. ₹ 352.32 as landing charges. Thus, Value for Customs purposes will be 35,584.27.

Illustration 38 :

FOB Cost of a consignment is 3,000 UK Pounds. Insurance and transport costs are not available. What is Customs Value? On the date of filing of bill of entry, Reserve Bank of India reference rate of US $ was 43.37 and inter-bank closing rates were : ₹ 43.38 per US $ and ₹ 69.38 per UK Pound. Exchange rate announced by Board (CBE&C) by customs notification was ₹ 69.78 per British Pound. T T buying rate was 69.70 and T T selling rate was ₹ 69.61 per UK pound.

Answer :

FOB Price is 3,000 UK pounds. Add 20% as freight cost i.e. 600 as actual cost is not available. Since insurance charges are not known, insurance cost should be taken @ 1.125% of FOB price i.e. 33.75. Thus, CIF price is 3,633.75 UK pounds. Conversion rate is 69.78. Hence, CIF Value is ₹ 2,53,563.08 (3,633.75 x 69.78). Landing charges @ 1% of CIF will be ₹ 2,535.63. Thus, Customs Value is ₹ 2,56,098.71

Illustration 39 :

Customs value (Assessable Value) of imported goods is ₹ 2,00,000. Basic Customs duty payable is 10%. If the goods were produced in India, excise duty payable would have been 16%. Education cess is as applicable. Special CVD is payable at appropriate rates. Find the Customs duty payable. What are the duty refunds/ benefits available if the importer is (a) manufacturer (b) service provider (c) Trader?

Answer :

		Duty %	Amount	Total Duty
(A)	Assessable Value ₹10,000		200,000.00	
(B)	Basic Customs Duty	10	20,000.00	20,000.00
(C)	Sub-Total for calculating CVD '(A+B)'		220,000.00	
(D)	CVD 'C' x excise duty rate	16	35,200.00	35,200.00
(E)	Education cess of excise - 2% of 'D'	2	704.00	704.00
(F)	SAH Education cess of excise - 1% of 'D'	1	352.00	352.00
(G)	Sub-total for edu cess on customs 'B+D+E+F'		56,256.00	
(H)	Edu Cess of Customs - 2% of 'G'	2	1,125.12	1,125.12
(I)	SAH Education Cess of Customs - 1% of 'G'	1	562.56	562.56
(J)	Sub-total for Spl CVD 'C+D+E+F+H+I'		257,943.68	
(K)	Special CVD u/s 3(5) - 4% of 'J'	4	10,317.75	10,317.75
(L)	Total Duty			**68,261.43**
(M)	Total duty rounded to			68,261

Notes : Buyer who is manufacturer, is eligible to avail Cenvat Credit of D, E, F and K above. A buyer, who is service provider, is eligible to avail Cenvat Credit of D, E and F above. A trader who sells imported goods in India aftercharging Vat/sales tax can get refund of Special CVD of 4% i.e. 'K' above.

An importer imported some goods for subsequent sale in India at $ 12,000 on CIF basis. Relevant exchange rate as notified by the Central Government and RBI was ₹ 45 and ₹ 45.50 respectively. The item imported attracts basic duty at 10% and education cess as applicable. If similar goods were manufactured in India, Excise Duty payable as per Tariff is 16% plus education cess of 2%. Spl CVD is payable at applicable rates. Arrive at the Assessable value and the total duty payable thereon. What are the duty refunds/benefits available if the importer is (a) manufacturer (b) service provider (c) Trader?

CIF Value	=	12,000 US $
Total CIF in ₹ @ 45.00 per US $	=	₹ 5,40,000
Add : Landing Charges @ 1% of CIF	=	₹ 5,400
(A) Assessable Value	=	₹ 5,45,400

Calculation of duty payable is as follows :-

		Duty %	**Amount**	**Total Duty**
(A)	Assessable Value ₹10,000		545,400.00	
(B)	Basic Customs Duty	10	54,540.00	54,540.00
(C)	Sub-Total for calculating CVD '(A+B)'		599,940.00	
(D)	CVD 'C' x excise duty rate	16	95,990.40	95,990.40
(E)	Education cess of excise - 2% of 'D'	2	1,919.81	1,919.81
(F)	SAH Education cess of excise - 1% of 'D'	1	959.90	959.90
(G)	Sub-total for edu cess on customs 'B+D+E+F'		153,410.11	
(H)	Edu Cess of Customs - 2% of 'G'	2	3,068.20	3,068.20
(I)	SAH Education Cess of Customs - 1% of 'G'	1	1,534.10	1,534.10
(J)	Sub-total for Spl CVD 'C+D+E+F+H+I'		703,412.41	
(K)	Special CVD u/s 3(5) - 4% of 'J'	4	28,136.50	28,136.50
(L)	Total Duty			**186,148.91**
(M)	Total duty rounded to			186,149

Notes : Buyer who is manufacturer, is eligible to avail Cenvat Credit of D, E, F and K above. A buyer, who is service provider, is eligible to avail Cenvat Credit of D, E and F above. A trader who sells imported goods in India after charging Vat/sales tax can get refund of Special CVD of 4% i.e. 'K' above.

Illustration 40 :

An actual user imports following goods from England per S. S. Vishal: (1) Second hand numerically controlled horizontal lathe machine - Tariff heading – 84.5811, Value FOB - 1,000/- Pound Sterling (2). A. C. motors - Tariff heading – 85.0110, Value FOB - 500/- Pound Sterling. - - Other relevant data are: - Exchange rate 1 UK Pound = ₹ 65, Freight – 150 UK Pounds, Insurance – 25 UK Pounds. - - Rate of duty : Basic customs duty - 10%, CVD - 16%, Education Cess and Spl CVD at applicable rates. - - It is found that the lathe machine is undervalued. It is proposed to load the FOB value of the lathe machine by 25%. Party does not want show cause notice and personal hearing. Compute – (i) Assessable value; (ii) Total duty payable. What are the duty refunds/benefits available if the importer is (a) manufacturer (b) service provider (c) Trader?

Answer :

Since FOB value of lathe machine is being loaded by 25% for under-valuation, the FOB Value of lathe machine for purpose of assessment is 1250 UK Pounds. Value of AC Motors is 500 UK Pounds. Thus, total FOB value for purposes of customs valuation is 1,750 UK Pounds. - - Total insurance and freight is 175 UK Pounds [freight is 150 UK Pounds and insurance is 25 UK Pounds]. This will be allocated on lathe machine and AC motors in proportion to value (as no other basis is available). Thus, allocation of freight and insurance charges will be in ratio of 1250/1750 and 500/1750, i.e. 125 UK Pounds to lathe machine and 50 UK Pounds to AC motors.

Hence, CIF value of lathe machine for purpose of customs valuation is 1,375 UK Pounds (1,250 +125) i.e. ₹89,375 (@ ₹ 65 per UK Pound) and CIF value of AC motors is 550 UK Pounds (500 + 50), i.e. ₹ 35,750 (@ ₹ 65 per UK Pound). Assessable Value will be CIF plus landing charges of 1%. Hence, Assessable Value of lathe is 90,269 (89,375 + 894) and AV of motors is ₹ 36,107 (35,750 + 357).

Calculation of duty payable is as follows :-

		Duty %	Amount	Total Duty
(A)	Assessable Value ₹ 10,000		90,269.00	
(B)	Basic Customs Duty	10	9,026.90	9,026.90
(C)	Sub-Total for calculating CVD '(A+B)'		99,295.90	
(D)	CVD 'C' x excise duty rate	16	15,887.34	15,887.34
(E)	Education cess of excise - 2% of 'D'	2	317.75	317.75
(F)	SAH Education cess of excise - 1% of 'D'	1	158.87	158.87
(G)	Sub-total for edu cess on customs 'B+D+E+F'		25,390.86	
(H)	Edu Cess of Customs - 2% of 'G'	2	507.82	507.82
(I)	SAH Education Cess of Customs - 1% of 'G'	1	253.91	253.91
(J)	Sub-total for Spl CVD 'C+D+E+F+H+I'		116,421.59	
(K)	Special CVD u/s 3(5) - 4% of 'J'	4	4,656.86	4,656.86
(L)	Total Duty			**30,809.45**
(M)	Total duty rounded to			30,809

Notes : Buyer who is manufacturer, is eligible to avail Cenvat Credit of D, E, F and K above. A buyer, who is service provider, is eligible to avail Cenvat Credit of D, E and F above. A trader who sells imported goods in India after charging Vat/sales tax can get refund of Special CVD of 4% i.e. 'K' above.

Duty on Motors – Student should himself calculate duty by using aforesaid procedure. Total customs duty payable is ₹ **12,323.57**. See if your answer tallies.

Illustration 41 :

An importer has imported a machine from UK at FOB cost of 10,000 UK Pounds. Other details are as follows :

(a) Freight from UK to Indian port was 700 pounds.

(b) Insurance was paid to insurer in India : ₹ 6,000.

(c) Design and development charges of 2,000 UK pounds were paid to a consultancy firm in UK.

(d) The importer also spent an amount of ₹ 50,000 in India for development work connected with the machinery.

(e) ₹ 10,000 were spent in transporting the machinery from Indian port to the factory of importer.

(f) Rate of exchange as announced by RBI was : ₹ 68.82 = one UK Pound.

(g) Rate of exchange as announced by CBE&C (Board) by notification under section 14(3)(a)(i) : ₹ 68.70 = One UK pound.

(h) Rate at which bank recovered the amount from importer : ₹ 68.35 = One UK Pound.

(i) Foreign exporters have an Agent in India. Commission is payable to the agent in Indian Rupees @ 5% of FOB price.

Customs duty payable was 10%. If similar goods were produced in India, excise duty payable as per tariff is 24%. There is an excise exemption notification which exempts the duty as is in excess of 16%. Education cess is as applicable Spl CVD is payable at applicable rates. Find customs duty payable. What are the duty refunds/ benefits available if the importer is (a) manufacturer (b) service provider (c) Trader?

Answer:

FOB Value	=	10,000.00 UK Pounds
Add :Design & Development Charges	=	2,000.00 UK pounds
Add : Ocean freight	=	700.00 UK Pounds
Total C & F	=	12,700.00 UK Pounds
Total in ₹ @ 68.70	=	8,72,490.00 ₹
Add : Insurance	=	6,000.00 ₹
Add : Local Agency commission 500 UK pounds @ ₹ 68.70 = 1 UK Pound	=	34,350.00 ₹
Total CIF Price	=	9,12,840.00 ₹
Add : Landing Charges @ 1% of CIF	=	9,128.40 ₹
Assessable Value	=	9,21,968.40 ₹
Assessable Value (rounded to)	=	9,21.968.00 ₹

Calculation of duty payable is as follows :-

		Duty %	Amount	Total Duty
(A)	Assessable Value ₹ 10,000		921,968.00	
(B)	Basic Customs Duty	10	92,196.80	92,196.80
(C)	Sub-Total for calculating CVD '(A+B)'		1,014,164.80	
(D)	CVD 'C' x excise duty rate	16	162,266.37	162,266.37
(E)	Education cess of excise - 2% of 'D'	2	3,245.33	3,245.33
(F)	SAH Education cess of excise - 1% of 'D'	1	1,622.66	1,622.66
(G)	Sub-total for edu cess on customs 'B+D+E+F'		259,331.16	
(H)	Edu Cess of Customs - 2% of 'G'	2	5,186.62	5,186.62
(I)	SAH Education Cess of Customs - 1% of 'G'	1	2,593.31	2,593.31
(J)	Sub-total for Spl CVD 'C+D+E+F+H+I'		1,189,079.09	
(K)	Special CVD u/s 3(5) - 4% of 'J'	4	47,563.16	47,563.16
(L)	Total Duty			**314,674.25**
(M)	Total duty rounded to	₹		314,674

Notes : Buyer who is manufacturer, is eligible to avail Cenvat Credit of D, E, F and K above. A buyer, who is service provider, is eligible to avail Cenvat Credit of D, E and F above. A trader who sells imported goods in India after charging Vat/sales tax can get refund of Special CVD of 4% i.e. 'K' above.

Note : (1) Design and development work done in India and transport costs within India are not to be considered for purposes of 'Customs Value'. (2) Excise duty rate has to be considered after considering excise exemption notification. (3) Assessable Value and Final duty payable should be rounded off to nearest Rupee.

Duty payable is same whether the importer is manufacturer or a trader.

Illustration 42 :

Mrs. & Mr. Kapoor visited Germany and brought following goods while returning to India on 8th February, 2008. (i) Their personal effects like clothes, etc., valued at ₹ 35,000. (ii) A personal computer bought for ₹ 36,000. (iii) A laptop computer bought for ₹ 95,000. (iv) Two litres of liquor bought for ₹ 1,600. (v) A new camera bought for ₹ 37,400. What is the amount of customs duty payable?

Answer :

Personal effects and one laptop are exempt from customs duty. Two liters of liquor can be accommodated in General free Allowance. Hence, Mr. Kapoor can bring one personal computer and two litres of liquor on his account. Total value is ₹ 37,600 (PC ₹ 36,000 plus liquor ₹ 1,600). He will get General Free Allowance of ₹ 25,000 and duty payable will be on ₹ 12,600. Customs Duty @ 35% of ₹ 12,600 will be ₹ 4,410 plus education cess of ₹ 88.20 @ 2% of customs duty and SAH education cess of ₹ 44.10 @ 1% of customs duty.

Mrs. Kapoor can bring one camera on her account. Total value is ₹ 37,400. She will get General Free Allowance of ₹ 25,000 and duty payable will be on ₹ 17,400. Customs Duty @ 35% of ₹ 17,400 will be ₹ 6,090 plus education cess of ₹ 121.80 @ 2% of customs duty and ₹ 60.90 as SAH education cess.

Illustration 43 :

An importer 'WR Importers Ltd.' imported 1,000 Kgs of 'X' goods from a manufacturer-exporter 'AB Inc.' in USA in April 2008 and presented Bill of Entry indicating value of US $ 10,000 CIF. Customs Appraiser found from his records as follows :

(*a*) AB Inc, USA had supplied 150 Kgs of 'X' to another importer in India @ 16 $ CIF per Kg in March 2008.

(*b*) Same exporter had supplied 1,200 Kgs of X to an importer in India @ 18 US $ in September 2007.

(*c*) Price of 'AB Inc' for sale of that product in USA is 20 US $ per Kg.

(*d*) Another manufacturer-exporter from USA had supplied 800 Kgs 'X1' goods to an importer in India @ 14 US $ per Kg in February 2008. The 'X1' are alike 'X' and can be used instead of 'X'. Both manufacturers-exporters from USA are well reputed.

(*e*) Similar goods produced in India are available in India at equivalent dollar price of 12 US $ per Kg.

Show cause notice was issued to importer. The importer replied that he has been able to negotiate the lower price as a special introductory price. He also produced a copy of invoice from manufacturer in Germany, who had supplied the 900 Kgs of 'X2' goods @ 10.50 US dollars per Kg in February, 2008. The 'X2' goods are equivalent to 'X' and can be used instead of 'X'.

Prepare an Order finalising the 'Customs Value' for purpose of assessment.

Answer :

Office of Assistant Commissioner of Customs, Mumbai

Order No. 34/02 dated 16th May, 2008

Note : (1) This copy is granted free of charge for the private use of the persons to whom it is issued.

(2) Any person aggrieved by this order may appeal against this order to Commissioner (Appeals), Mumbai, within sixty days from date of communication of this order. Appeal should be accompanied by this copy of order or another certified copy of this order.

Order

(1) M/s WR Importers Ltd., Mumbai filed Bill of Entry No. 2587 dated 14th April, 2008 for 1,000 Kgs of 'X' for 10,000 US $ CIF in respect of goods imported from USA. It was observed that similar goods were imported at higher rates than the rates declared by Assessee.

(2) A show cause notice dated 21st April, 2008 was served on the assessee. The assessee submitted their reply dated 26th April, 2008. A personal hearing was granted on 8th May, 2008. Representative of WR Importers Ltd., Mr. A M Majumdar attended the personal hearing. He reiterated the submissions made in their reply dated 26th April, 2008 and stated that the price as shown by them in Bill of Entry is the correct Customs Value for purpose of assessment.

(3) I find that the same exporter i.e. AB Inc, USA had supplied 150 Kgs of 'X' to another importer in India @ 16 $ CIF per Kg in March 2008. Assessee raised contention that quantity of imports in March 2008 is much less and hence the price cannot be considered, as per provisions of rule 4(1)(b) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007. The assessee contended that the department has not produced any evidence regarding discount structure offered by the foreign supplier depending on the quantity purchased. Hence, this price cannot be considered for valuation. I agree with these contentions of assessee.

(4) I find that the same exporter i.e. AB Inc, USA had supplied 1,200 Kg of X to an importer in India @ 18 US $ in September 2007. Assessee contended that price of goods imported in September 2008 cannot be considered for valuation of goods imported in April 2008 as the import is not at or about the same time, as required in rule 4(1)(a) Customs Valuation (Determination of Value of Imported Goods) Rules, 2007. Hence, this price cannot be considered for valuation. I agree with this contention of assessee.

(5) It was brought to notice of assessee that Price of 'AB Inc' for sale within USA is 20 US $ per Kg. Assessee replied that only price in International Trade can be considered for valuation purposes as per section 14 of Customs Act. I agree with this contention of assessee.

(6) Similar goods are produced in India. These are available in India at equivalent dollar price of 12 US $ per Kg. However, I observe that such price cannot be considered for assessment in terms of rule 9(2)(i) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.

(7) Assessee contended that another manufacturer in Germany, has supplied the 'X2' goods @ 10.50 US dollars per Kg at around the same time. The 'X2' goods are equivalent to 'X' and can be used instead of 'X' and that price may be considered for assessment. I find that in terms of rule 5, price of similar goods can be considered only if both are from same country. The price of goods imported from Germany could have been considered under rule 9(1) as residual method. However, this method has application only if Customs Value cannot be determined by any other method.

(8) Another manufacturer-exporter from USA had supplied 800 Kgs 'X1' goods to an importer in India @ 14 US $ per Kg in February 2008. The 'X1' are alike 'X' and can be used instead of 'X'. Both manufacturers-exporters from USA are well reputed. Thus, in terms of rule 5 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, these could be considered as 'similar goods' and hence that price can be adopted for valuation.

(9) The importer in his reply stated that he has been able to negotiate the low prices of US $ 10/- as special introductory price on special consideration of assurance of future orders. However, he stated that in terms of explanation (1)(ii) to Valuation Rules, even if discount is abnormal, the declared value is required to be accepted if it is true and accurate.

(10) Assessee contended that even if the price is low, it is true and accurate. There is no evidence that the difference was paid through some different means to the exporter.

(11) I agree with the contention of the assessee.

ORDER

I order that Customs Value be fixed on the basis of CIF price of 10 US dollars per Kg. The assessment be finalised accordingly.

Sd/-Assistant Commissioner

STUDY NOTE - 4
BASICS OF SERVICE TAX

This Study Note includes

- Introduction
- Basics of Service Tax
- Value of Taxable Service
- Exemptions from Service Tax
- Classification of Service
- Procedures of Service Tax
- Invoice by Service Provider
- Payment of Service Tax
- Returns
- Adjudication
- Appeals
- Penalties
- Export of Services
- Import of Services
- Taxability of Various Kind of Services

4.1 INTRODUCTION

Service tax is tax of 21st Century. In India share of GDP in 2006-07 was - Agriculture - 18.5%, Industry - 26.4%, Services - 55.1% (Source - Economic Survey 2006-07). Service tax was imposed on three services w.e.f. 1-7-1994 and its scope is being widened every year. Highlights of the service tax are as follows –

- Service tax is imposed under Finance Act, 1994 as amended from time to time. There is no Service Tax Act.
- Service Tax @ 5% was introduced from 1-7-1994. The service tax rate was increased to 8% w.e.f. 14-5-2003. It was increased to 10% (plus 2% education cess, total 10.2%) w.e.f 10-9-2004. The service tax rate was increased to 12% (plus education cess of 2% i.e. total 12.24%) w.e.f 18-4-2006. In Finance Act, 2007, SAH (Secondary and Higher Education Cess) of 1% has been introduced w.e.f. 11-5-2007. Thus, total tax is 12.36% w.e.f. 11-5-2007. Service tax rate has been reduced to 10.30% w.e.f. 24-2-2009.
- Service tax is payable on taxable services as defined in various clauses of section 65(105) of Finance Act, 1994. Presently, about 117 services are taxable.
- Service tax is payable on gross amount charged for taxable service provided or to be provided [Section 67]. If consideration is partly not in money, valuation is required to be done as per Valuation Rules. Tax is payable when advance is received.
- Small service providers upto ten lakhs are exempt. Export of service is exempt from service tax under Notification No. 6/2005-ST dated 1-3-2005. Services provided in J&K are not taxable [section 64(1)]
- Cenvat credit is available of inputs, input services and capital goods used for providing taxable output services.
- In some cases, receiver of service is liable to pay service tax. This is termed as 'reverse charge' [Section 68(2)].

4.2 BASICS OF SERVICE TAX

- Every provider of taxable service should apply for registration in form ST-1 within 30 days from date of levy (in case of new services) and date of commencement of business of providing taxable service In case of existing services [Rule 4(1)]. Registration will be deemed to have been granted if not received within seven days [Rule 4(5)].
- Assessee providing service from various premises can have centralised registration [Rule 4(2)]
- Service provider is required to prepare the invoice within 14 days from the date of completion of taxable service or receipt of payment towards the value of taxable service, whichever is earlier.
- Tax should be paid by 5th of following month (6th in case of e-payment). If assessee is individual or proprietary or partnership firm, tax is payable on quarterly basis. This facility is not available to HUF. In March, tax is payable by 31st March [Rule 6].
- If payment of tax is delayed, interest is payable @ 13% [Section 75]
- Assessee has to submit half yearly return in form ST-3 in triplicate within 25 days of close of half year [Rule 7]
- Penalty is payable for non-registration, late payment of tax, non-submission of returns etc. Mandatory penalty is payable for suppression of facts, willful misstatement, fraud or collusion [sections 76 to 80]
- The tax is administered by excise department. Adjudication order is issued by excise officer.
- First appeal lies with Commissioner (Appeals) [section 85] and second appeal with Appellate Tribunal (Customs, Excise and Service Tax Appellate Tribunal) [Section 86]. Further appeal lies with High Court and Supreme Court.

4.2.1 Nature of levy of Service Tax - Service tax is levied under Entry No. 97 of List I of Seventh Schedule to Constitution of India. The entry reads as follows – 'Any other matter not included in List II, List III and any tax not mentioned in list II or list III'. *(These are called 'Residual Powers'.)*

As per section 65(95) of Finance Act, 1994, 'service tax' means tax leviable under the provisions of this Chapter (i.e. Chapter V of Finance Act, 1994). Section 66 (charging section) provides that there shall be levied a tax (service tax) @ 10% of the value of taxable service referred to in various clauses of section 65(105). It will be collected in a manner as may be prescribed.

4.2.2 Taxable Service - As per section 66 of Finance Act, 1994, service tax is payable on 'taxable service'. Various clauses of section 65(105) of Finance Act, 1994 define each type of 'taxable service'. The definition is different for each class of services, e.g. as per section 65(105)(a), any service provided by stock broker to any person in connection with sale or purchase of securities listed on a recognised stock exchange will be 'taxable service'.

4.2.3 Service tax is destination-based consumption tax - Service tax is a destination based consumption tax, as per CBE&C Circular No. 56/5/2003 dated 25-4-2003.

4.2.4 Service implies existence of two parties - Service tax is attracted when there are two parties. One cannot give service to himself.

4.2.5 Cenvat Credit–Assessee is entitled to avail Cenvat credit of excise duty and service tax paid on his inputs, input services and capital goods. This aspect has been discussed in another chapter.

4.2.6 Rate of Service Tax

This tax was first time introduced with effect from 1-7-1994 on three services. The rate was 5%. It was subsequently increased to 8% w.e.f. 14-5-2003. It was 10% plus education cess of 2% w.e.f. 10-9-2004 (total 10.2%) during 10-9-2004 to 17-4-2006. Service tax rate was 12% plus education cess of 2% (total 12.24%) during 18-4-2006 till 10-5-2007.

Presently, service tax is payable @ 10% of value of taxable services referred in section 65(105) of Finance Act, 1994. In addition, education cess of 2% and SAH education cess of 1% is payable. Thus, total service tax is 10.30%.

4.2.7 Service tax, education cess and SAH education cess to be shown separately in invoice – You have to show service tax, education cess and SAH education cess *separately* in invoice. You cannot just charge 10.30% as 'service tax'.

4.2.8 Taxable Event in Service Tax

Section 66 (which is a charging section), reads, 'There shall be levied a tax (hereinafter referred to as the service tax) at the rate of ten percent of value of taxable services referred to in subclauses (a), (b), (zzzzc) and (zzzzd) of clause (105) of section 65 and collected in such manner as may be prescribed. Opening sentence of section 65(105) as amended w.e.f. 16-6-2005 reads as follows, 'taxable service' means any service provided or 'to be provided'. Thus, following are taxable events -

(*a*) *Entering into contract for service* - Entering into contract for providing service. Once you enter into a contract, it is certainly '*service to be provided*'. (Service tax is actually payable after payment is received, but receipt of advance is not a taxable event. It only defers the liability).

(*b*) *Provision of service* - This will happen in cases where contract for providing service was entered into *before* the service became taxable, but service was provided *after* the service became a 'taxable service'.

4.2.9 Person liable to pay Service tax

In most of the cases, service provider, i.e. person who is providing taxable service is liable to pay service tax. However, in few cases, exceptions have been made and service receiver is made liable to pay service tax. The provision that service receiver is liable to pay service tax is termed as 'Reverse Charge'. The exceptions are as follows -

4.2.10 Services provided to non-resident - In relation to taxable service provided or to be provided by any person from a country other than India and received by any person under section 66A of Finance Act, service tax is payable by recipient of service [Rule 2(1)(d)(iv)]

4.2.11 Services of insurance agents - In case of insurance auxiliary service by an insurance agent, the tax will be payable by insurance company (general insurance or life insurance as the case may be). The insurance agent is not liable to register and pay tax. [*However, the insurance agent is not entitled to avail exemption available to a small service provider*].

4.2.12 Consignor/consignee paying freight, in case of GTA services - In case of services of Goods Transport Agency (GTA), service tax is payable by consignor/consignee who is paying freight [rule 2(1)(d)(v)] [*However, the consignor/consignee is not entitled to avail exemption available to a small service provider*].

4.2.13 Services of Agents of mutual fund - In case of distributors/agents of mutual funds, the liability will be on the recipient of service, namely, mutual funds [Rule 2(1)(vi)] [*However, the mutual fund agent is not entitled to avail exemption available to a small service provider*].

4.2.14 Body corporate or firm located in India receiving sponsorship service - In case of Sponsorship service provided to a body corporate or firm located in India, the body corporate or firm receiving such sponsorship service will be liable to pay service tax [rule 2(1)(d)(vii) inserted w.e.f. 1- 5-2006 and amended w.e.f. 1-4-2007]. If the recipient of sponsorship service is located outside India, service tax is required to be paid by the service provider and not by the recipient.

4.2.15 Cenvat credit of tax paid - The Body corporate or firm paying such service tax will be eligible to avail Cenvat credit of the service tax paid, on the basis of TR-6/GAR-7 challan by which the tax is paid [Rule 9(1)(e) of Cenvat Credit Rules, as amended w.e.f. 1-5-2006]. *It may be noted that when person receiving service is liable to pay service tax, he is not entitled to exemption which is available to a small service provider.*

4.2.16 *Large Taxpayer Unit (LTU) -* A concept of LTU has been introduced for large taxpayers of direct taxes and indirect taxes. In case of service tax, Large Taxpayer has meaning assigned to it in Central Excise Rules [rule 2(cccc) of Service Tax Rules]. LTU has started functioning in Bangalore w.e.f. 1-10-2006.

4.2.17 Service on sub-contract basis

CBE&C vide circular No. 999.03/23.8.07 has clarified that a sub-contractor is also a taxable service provider. His services are taxable even if these are used by main provider for completion of his work. The sub-contractor is liable even if the service is input service of the main contractor and main contractor is paying service tax on entire value of contract.

4.3 VALUE OF TAXABLE SERVICE

Section 67 of Finance Act, 1994 contains provisions for valuation of taxable services for charging service tax. The highlights of provisions of section 67 as effective from 18-4-2006 are as follows -

- Service tax is payable on gross amount charged by service provider for service provided or 'to be provided'. Thus, tax is payable as soon as advance is received.
- 'Value of taxable service' plus service tax payable is equal to 'gross amount charged' [section 67(2)].
- Where the consideration for providing services is entirely in money, gross amount charged by service provider of taxable service provided or to be provided by him will be relevant for 'valuation' [section 67(1)(i)].
- Where the consideration for providing services is not wholly or partly in terms of money, service tax is payable on amount of money, which with addition of tax service tax charged, is equivalent to the consideration [section 67(1)(ii)].
- Where consideration is not ascertainable, valuation will be on basis of Valuation Rules [section 67(1)(iii)]
- If gross amount charged by service provider is inclusive of service tax (i.e. service tax not charged separately in invoice), value of taxable service will be calculated by back calculations such that with addition of service tax payable, the total is equal to the gross amount charged [section 67(2)].
- Gross amount charged for taxable services can be before, during or after provision of service [section 67(3)].

4.3.1 *Highlights of service tax valuation rules -* In exercise of powers under section 67, Service tax (Determination of Value) Rules, 2006 have been issued w.e.f. 19-4-2006. The Service Tax Valuation Rules provide as follows -

- If consideration is not wholly or partly consisting of money, value will be determined by service provider in terms of rule 3.
- As per rule 3(a) of Service Tax Valuation Rules, valuation shall be on basis of gross amount charged by service provider for similar services.
- If value cannot be determined on basis of rule 3(a), valuation shall be on basis of equivalent money value of such consideration, which shall not be less than cost of provision of such services [rule 3(b) of Service Tax Valuation Rules]
- Central Excise Officer can reject 'value' determined by service provider and determine 'value' for purpose of service tax payment [rule 4].
- Rules 5 and 6 make provisions for certain specific inclusions and exclusions for valuation
- Payments made by service provider as 'pure agent' of service receiver and recovered from service receiver are excluded for purpose of valuation [rule 5(2)]
- In case of services provided from outside India, actual consideration received will be relevant for valuation [rule 7(1)].

4.3.2 Amount need not be 'charged' by service provider - money paid to third party may also be includible - It is not necessary that the money should be paid to service provider himself. Amount paid even to third party is includible in 'value' of service if it is for provision of service and at the instance of service provider.

4.3.3 Service tax payable on net amount excluding Vat/sales tax - Rule 2A(1)(i)(a) of Service Tax Valuation Rules and rule 3(1) of Works contract (Composition Scheme for Payment of Service Tax) Rules, 2007 make it clear that Vat/sales tax is not to be included in value for purpose of service tax. Thus, service tax is payable only on net amount excluding Vat/sales tax payable on the transaction.

4.3.4 Tax payable only on amount actually received - Rule 6(1) of Service Tax Rules makes it clear that service tax is payable on value of taxable services received. Thus, if service provider does not receive any payment from his customer, there is no liability of service tax. Service tax is payable only on 'value of taxable service' actually '*received'*, and not on amount *'billed'.*

4.3.5 Calculation of service tax by back calculations

The gross amount charged can be taken as inclusive of service tax and the 'value' and 'service' tax is to be calculated by back calculations. For example, if Bill amount is ₹ 1,000 and service tax is not shown separately in Invoice, the tax payable calculated by a simple mathematical formula is as follows –

Assessable Value = (Cum tax price)/(1 + rate of tax)

Assume that Assessable Value (AV) is equal to 'Z'.

AV = 1.000 Z

Duty @ 10.30% = 0.1030 × Z

Sub-Total = 0.1030 × Z

Now :

1.1030 × Z = 1,000

Hence, 'Z' = 1,000/1.1030

i.e. Z = 906.62

Thus, 'Z', i.e. Assessable Value is ₹ 906.62 and service tax @ 10% will be ₹ 90.66. Education cess @ 2% of service tax will be ₹ 1.81. SAH education cess is ₹ 0.91 Thus, total tax will be ₹ 93.38

4.3.6 Reimbursement of expenses or 'Out of pocket' expenses

The service provider often claims reimbursement of certain expenses incurred by him (like travelling, boarding and lodging, etc.) while providing a taxable service. These are often termed as 'out of pocket' expenses. These are really charges for taxable services and are includible.

4.3.7 Reimbursement of expenses incurred on behalf of service receiver not includible - Often, a service provider incurs some expenditure on behalf of service receiver and then recovers the amount from him. Such expenditure is not part of service provided by him to service receiver, but is incurred by him as per business practice or convenience. Following illustrations may clarify the provisions -

- Octroi/entry tax amount paid by Clearing & Forwarding Agent, CHA or Transporter on behalf of owner of goods/Principal.
- Customs duty, dock dues, demurrage, transport charges etc. paid by Customs House Agent on behalf of client.
- Advertisement charges paid by Advertising Agency to newspaper on behalf of clients.
- Ticket charges paid by Travel Agent and recovered from his customer.
- Reimbursement of godown, salary and loading/unloading expenses by Principal to C & F Agent.

These are not part of service provided and hence are not includible. Rule 5(2) provides that the expenditure or costs that a service provider incurs, as a pure agent of the client, shall be excluded from the value if such service provider fulfils prescribed conditions.

The principle is also discernible from various exclusions as contained in rule 6(2).

4.3.8 Valuation in case of indivisible contracts

In case of indivisible contracts involving sale of goods plus provision of service, it is difficult to identify service portion.

In *Bhatat Sanchar Nigam Ltd.* v. *UOI* (2006) 3 SCC 1 = 152 Taxman 135 = 282 ITR 273 = 3 VST 95 = 145 STC 91 = 3 STT 245 = AIR 2006 SC 1383 (SC 3 member bench), it has been clearly held that price of goods cannot be included in value of services.

In *Imagic Creative Pvt. Ltd.* v. *CCT* (2008) 2 SCC 614 = 12 STT 392 = 12 VST 371 (SC), it has been held that service tax and Vat (sales tax) are mutually exclusive. In case of a composite contract, Vat cannot be imposed on portion relating to value of service.

As an obvious corollary, service tax cannot be imposed on value of material.

4.3.9 Exclusion of value of material - Notification No. 12/2003-ST dated 20-6-2003 provides that if the amount charged includes value of goods and materials sold, service tax will not be payable on value of goods and materials sold. There should be documentary evidence showing value of goods and materials sold. This exemption is available *only if* Cenvat credit of such material is not taken. If such credit was taken, assessee should pay amount equal to the credit. Such payment should be before sale of such goods and materials.

Many exemption notifications provide that exclusion under notification 12/2003-ST is allowable only when the service tax is paid at full rate and any abatement under any other exemption notification is not claimed. Hence, in such cases, notification No. 12/2003-ST is of no use.

In *Bharat Sanchar Nigam Ltd*. v. *UOI* (2006) 3 SCC 1 = 152 Taxman 135 = 282 ITR 273 = 3 VST 95 = 145 STC 91 = 3 STT 245 = AIR 2006 SC 1383 = 2 STR 161 (SC 3 member bench), it has been clearly held that price of goods cannot be included in value of services. Conclusion (E) of the judgment (para 92 of SCC and para 81 of STT and Taxman) reads as follows, 'The aspect theory would not apply to enable the value of service to be included in the sale of goods or the price of goods in the value of service'.

4.3.10 All expenditure and costs relating to provision of service incurred by service provider are includible

Rule 5(1) provides that where certain expenditure or costs are incurred by the service provider in the course of providing any taxable service, all such expenditure or costs shall be treated as consideration for the taxable services provided or to be provided and shall be included in the 'value' for purpose of charging of service tax on the said service.

This is a general rule which makes it clear that, even when such expenditure or costs are recovered separately by service provider from service receiver, such expenditure or costs must be included in the value of taxable service.

However, expenditure incurred by service provider as 'pure agent' of service receiver is not includible, as per rule 5(2).

4.4 EXEMPTIONS FROM SERVICE TAX

4.4.1 Central Government can grant partial or total exemption, by issuing an 'exemption notification'u/s 93 of Finance Act, 1994. Such exemption may be partial or total. Exemption may be conditional or unconditional. The only limitation is that exemption cannot be granted by Central Government with retrospective effect. There are following general exemptions -

4.4.2 Small service providers - Small units whose turnover less than ₹ ten lakhs per annum are exempt from service tax. Provisions are discussed a little later (The exemption limit was ₹ four lakhs upto 31-3-2007).

4.4.3 Export of Services - There is no service tax on export of services, if service is exported as per 'Export of Service Rules'.

4.4.4 Services to UN Agencies - Services provided to UN and International Agencies are exempt [Notification No. 16/2002-ST dated 2-8-2002].

4.4.5 Services provided within SEZ - Services provided to SEZ unit or SEZ developer for consumption within SEZ are exempt [Notification No. 4/2004-ST dated 31-3-2004 in respect of SEZ]. The wording of notification is such that services consumed within the zone are alone exempt. Thus services provided outside SEZ (e.g. customs clearance, transport etc.) are *not* exempt. Taxable services provided to a developer or a unit in SEZ are exempt from service tax [section 26(1)(e) of SEZ Act]. [rule 31 to SEZ Rules]

Services provided to foreign diplomatic missions, family members of diplomatic missions etc. **– Any taxable service provided to foreign diplomatic mission or consular post in India is exempt vide Notification No. 33/2007-ST dated 23-5-2007. Similarly, any taxable service provided for private use of family members of diplomatic agents or career consular offices posted in a foreign diplomatic mission or consular post in India is exempt vide Notification No. 34/ 2007-ST dated 23-5-2007.**

Services provided by RBI exempt - Exemption from service tax has been provided to all taxable services provided by Reserve Bank of India. Services where RBI is liable to pay service tax are also exempt (Notification No. 22/ 2006-ST dated 31-5-2006 – earlier Notification No. 7/2006-ST dated 1.3.2006).

4.4.6 General Exemption to small service providers

The small service providers whose turnover of taxable services from one or more premises did not exceed ₹ Ten lakhs in 2007-08 will be exempt from service tax in next financial year i.e. in 2008-09 upto the turnover of ₹ Ten lakhs. The provisions are prescribed in Notification No. 6/ 2005-ST dated 1-3-2005 (The exemption limit was ₹ Four lakhs upto 31-3-2007). However, if value of taxable turnover exceeds ₹ 10 lakhs in 2008-09, there will be not exemption at all in 2009-10. For the purpose of determining eligibility in current year, what is relevant is that 'aggregate value of taxable services *rendered*' in previous financial year should not exceed ₹ Ten lakhs, while for purpose of exemption upto first- ₹ Ten lakhs in current year, service tax is exempt to the extent of 'aggregate value not exceeding ten lakhs', i.e. the sum total of first *consecutive payments received* during the current financial year.

The exemption to small service providers is available subject to following conditions -

- The provider of taxable service shall not avail the CENVAT credit of service tax paid on any input services.
- Where a taxable service provider provides one or more taxable services from one or more premises, the exemption under this notification shall apply to the aggregate value of all such taxable services and from all such premises and not separately for each premises or each services.
- The taxable services provided by a person under a brand name or trade name, whether registered or not, of another person; will not be eligible for exemption available to small service providers.
- Person providing taxable service in excess of ₹ Nine lakhs per annum (but less than ₹ Ten lakhs) will have to register with Superintendent of Central Excise under Service Tax provisions [Notification No. 26/2005-ST dated 7-6-2005], though they will be eligible for exemption if turnover is less than ₹ Ten lakhs per annum.

4.4.7 Specific Exemptions

In case of some services e.g. catering services, mandap keeper services and construction Services, service tax is payable at lower rates, i.e. partial abatement is available from gross value, vide 1/2006-ST dated 1-3-2006. The lower rate is applicable if the service provider does not avail Cenvat credit of duty/tax on inputs, input services and capital goods. *Till 28-2-2006, he was entitled to avail Cenvat credit on input services*. W.e.f. 1-3-2006, he cannot avail any Cenvat credit, if he avails the partial abatement.

Some important exemptions are as follows –

Taxable Service	Partial abatement available
Accommodation booking service by tour operator	10% of gross amount
Air Travel Agent	Option to pay service tax at flat rate on 'basice fare' @ 0.60% in case of domestic booking and 1.2% in case of international booking [rule 6(7) of Cenvat Credit Rules]
Business Auxiliary Service in relation to processing of parts and accessories used in manufacture of cycle, cycle rickshaws and hand operated sweing machines	Tax on 70% of gross amount if gross amount is inclusive of cost of inputs and input services, whether or not supplied by the clinet (*Is it exemption or punishment?)*
Erection, Commissioning and installation contract for supply of plant, machinery, equipment or structures plus erection, commissioning and installation services	Tax on 33% of gross amount if gross amount includes value of material
Construction Service	Tax on 33% of gross amount if gross amount includes value of material
Goods Transport Agency (GTA)	Tax only on 25% amount in his invoice [Payment will be made by consignor/consignee who is actually paying freight]
Mandap keeper, hotels and convention services, providing full catering services	Tax on 60% gorss amount charged
Outdoor caterer	Tax on 50% amount if he provides full and substantial meal
Pandal and shamiana Service	70% of gross amount charged if full catering service provided
Rent-a-cab operator	Tax payable on 40% of gross amount charged
Tour opeator - Package tours ("package tour" means a tour wherein transportation, accommo-dation for stay, food, tourist guide, entry to monuments and other similar services in relation to tour are provided by the tour operator as part of the package tour to the person undertaking the tour).	Tax is payable only on 25% of gross amount charged w.e.f. 23-8-2007 (till 22-8-2007, tax was payable on 40% of gross amount
Tour operator - providing services solely of arranging or booking accommodation for any person in relation to a tour (If Bill includes cost of accommodation)	Tax is payable only on 10% of gross amount charged
Tour operator - Other than pacakage tours and other than service of booking accommodation where Bill includes cost of accommodation	Tax is payable only on 10% of gross amount charged
Transport of goods in container by rail	Tax payable on 30% of gross amount charged

4.4.8 Services provided to EOU - Services provided to EOU/EHTP/STP/BTP are ***not*** exempt from service tax. Para 6.11(c)(v) of Foreign Trade Policy (as amended on 7-4-2006) states that EOU/EHTP/STP/BTP units can avail Cenvat credit of service tax paid. The EOU units can claim rebate of service tax paid on their input services vide rule 5 of Cenvat Credit Rules (as am ended on 14-3-2006). Procedure for claiming refund of service tax paid on input services and excise duty on inputs has been specified in notification No. 5/2006-CE(NT) dated 14-3-2006.

4.4.9 No service tax on service provided in J&K - Service tax provisions are not applicable in Jammu and Kashmir. Service tax will not be payable only if service is provided in J&K. If a person from J&K provides service outside J&K in any other part of India, that service will be taxable, as location where service is provided is relevant. Merely because office is situated in J&K does not mean that service is provided in J&K.

4.5 CLASSIFICATION OF SERVICE

There are various types of services on which service tax is payable. These are specified in various sub-clauses of section 65(105) of Finance Act, 1994. It is possible that a service may appear to be classifiable under more than one headings. It is necessary to specify the heading under which the service being provided is falling. This is termed as 'classification'. As per rule 4A(1) of Service Tax Rules, the invoice should indicate description and classification of service.

4.5.1 Principles of classification - The classification of services will be determined according to terms specified in various sub-clauses of section 65(105). [section 65A(1)]. If *prima facie*, a taxable service is classifiable under two or more sub-clauses of section 65(105), classification shall be effected as per following rules -

- The sub-clause which provides most specific description should be preferred over subclauses providing a more general description [section 65A(2)(a)]
- Classification should be as per essential character in case of composite services. Composite services are those consisting of combination of different services. In case of such services, if the service cannot be classified on the basis of specific description as per section 65A(2)(a) above, it shall be classified as if they consisted of a service which gives them their essential character [section 65A(2)(b)].
- Service which appears earlier in list, if service cannot be classified on above basis. If a service cannot be classified on basis of above provisions, the service should be classified under sub-clause which occurs first among the sub-clauses which equally merit consideration [section 65A(2)(c)].

***4.5.2 Service which has been specifically excluded in definition of one service cannot be covered under another head* -** In *Dr. Lal Path Lab (P) Ltd.* v. *CCE* (2006) 5 STT 171 (CESTAT), it was held when there is a specific entry for an item in the tax code, same cannot be taxed under any other entry. If a service has been specifically excluded from definition of one service, it cannot be covered under another taxable service.

***4.5.3 Introduction of new heading means earlier it was not taxable* -** In *Glaxo Smithkline Pharmaceuticals* v. *CCE* (2005) 1 STT 37 (CESTAT), it has been held that when an existing tariff definition remains same, introduction of new tariff entry would imply that the coverage under new Tariff was not covered by the earlier entry. When new category is introduced, it means that the service was not taxable under old category.

***4.5.4 Service should be mainly or principally a taxable service* -** A composite contract cannot be vivisected and service portion cannot be subjected to tax – *Widia GMBH* v. *CCE* (2006) 5 STT 414 (CESTAT) * *Blue Star* v. *CCE* (2007) 7 STT 68 (CESTAT). In *Daelim Industrial Co.* v. *CCE* 2003 STT 438 = 7 STT 184 (CEGAT), it was held that a works contract cannot be vivisected and part of it subjected to tax.

4.6 PROCEDURES OF SERVICE TAX

Administration of service tax is under Central Excise department. The main procedures to be followed are - (a) Registration (b) Maintenance of records (c) Payment of service tax and (d)Half yearly return. There are no prescribed form of records. The records maintained by assessee including computerised data maintained by assessee in accordance with various other laws are acceptable [rule 5(1)].

4.6.1 Registration under Service Tax

A 'person liable for paying service tax' has to register with Superintendent of Central Excise under whose jurisdiction your premises fall. He should register within 30 days from date of commencement of the business of providing taxable service. The person will have to apply for registration in form ST-1. If a person is providing more than one taxable service, he may make a single application. He should mention in the application all the taxable services provided by him. [rule 4(4)].

Applicant should submit following at the time of filing application for registration - (a) copy of PAN (b) proof of residence and (c) constitution of applicant. If application is signed by authorized person, power of attorney would be required.

Most important document that is required is copy of Income Tax PAN number. Copy of memorandum of association or partnership deed and a list of partners/directors should be submitted.

The registration certificate will be granted by Superintendent of Central Excise in seven days in form ST-2.

4.6.2 STC code i.e. registration number - Registration No., also known as 'Service Tax Code (STC)' is a fifteen digit PAN based number. First 10 digits of this number are the same as the PAN of such person. Next two digits are 'ST'. Next three digits are serial numbers indicating the number of registrations taken by the service taxpayer against a common PAN – para 2.6 of CBE&C Circular No. 97/8/2007-ST dated 23-8-2007.

4.6.3 Premises code - The registration certificate gives details of 'premises code' which is given on the basis of Commissionerate + Division + Range + Serial No. The number is given in the registration certificate ST-2 at Sl No. 5. This number is used for easy identification of location of registration of tax payer – para 2.6 of CBE&C Circular No. 97/8/2007-ST dated 23-8-2007.

4.6.4 Changes to be informed in form ST-1within 30 days - Rule 4(5A) is inserted w.e.f. 1-3-2006 provides that if there is any change in information and details submitted in form ST-1 at the time of registration, the same should be informed to jurisdictional AC/DC within thirty days of such changes. The form ST-1 is both for new registration as well as amendment to existing registration certificate.

4.6.5 Cancellation/surrender of registration - If the assessee ceases to carry on the activity for which he is registered, he should surrender the registration certificate to the Superintendent of Central Excise [Rule 4(7)]. Assessee should file up-to-date returns and apply for cancellation. Registration may not be cancelled if any demands are pending.

4.6.6 Centralised Registration - In some cases, a person liable for paying service tax on a taxable service - (i) provides *such* service from more than one premises or offices (e.g. providing banking service or maintenance service from various branches/offices); *or* (ii) receives *such* service in more than one premises or offices (e.g. GTA services, sponsorship services provided to body corporate or firm located in India, mutual fund agent's service, insurance agent's service etc. where he is liable under reverse charge method); *or*, (iii) is having more than one premises or offices, which are engaged in relation to *such* service in any other manner, making such person liable for paying service tax (e.g. import of services where person receiving service is liable u/s 66A).

In such cases, such person can obtain Centralised Registration***, at his option,*** if (a) he has centralised billing system or centralised accounting system in respect of such service, *and* (b) such centralised billing or centralised accounting systems are located in one or more premises. He can register such premises or offices from where centralised billing or centralised accounting systems are located [Rule 4(2) as amended w.e.f. 2-11-2006].

More than one centralised registration of regional/zonal offices at various places is permissible as per MF(DR) circular No. B1/6/2005-TRU dated 27-7-2005 – confirmed in para 2.5 of CBE&C Circular No. 97/8/2007-ST dated 23-8-2007.

Centralised Registration will be granted by Commissioner in whose jurisdiction the premises or offices, from where centralised billing or accounting is done, are located [rule 4(3) as amended w.e.f. 2-11-2006].

4.7 INVOICE BY SERVICE PROVIDER

Assessee should prepare invoice in respect of his services. The Invoice should be prepared within 14 days from date of completion of taxable service or receipt of payment towards the value of taxable service, whichever is earlier.

4.7.1 Details required to be shown in invoice/bill/challan - As per rule 4A(1), the invoice/challan/ Bill should be signed by authorised person of provider of input services, should be serially numbered and should contain following details -

(1) Name, address and registration number of person providing taxable service

(2) Name and address of person receiving taxable service

(3) Description, classification and value of taxable service provided or to be provided and

(4) Service tax payable on the taxable service

The rule does not make mention of date, but actually, date should be mentioned.

4.7.2 Education cess and SAH education cess to be shown separately - Education cess and SAH education cess to be shown separately in the Invoice for complying with requirements of Cenvat Credit Rules to facilitate availment of Cenvat credit by recipient – para 5.1 CBE&C Circular No. 97/8/2007-ST dated 23-8-2007.

4.7.3 Relaxation in case of banking and financial services - In case of banking and financial services provided by banking company, FI, NBFC or a commercial concern, the invoice/challan need not be serially numbered and name and address of person receiving taxable service need not be contained on the invoice/challan [*proviso* to rule 4A(1) of Service Tax Rules]. This facility is also available to input service distributors of such type of service providers – para 5.3 of CBE&C Circular No. 97/8/2007-ST dated 23-8-2007.

4.7.4 Invoice in case of continuous service - In some cases, service is provided continuously for successive periods of time and value of such taxable service is determined or payable periodically.

In such cases, the Invoice or challan shall be issued within 14 days from last date of the period [second proviso to rule 4A(1) of Service Tax Rules amended w.e.f. 16-6-2005].

Service like telephones or Annual Maintenance Services are provided on continuous basis. Billing is done periodically (usually monthly). In such case, invoice should be made within 14 days from close that period.

4.7.5 Invoice at end of billing period - In case of some services like services of commission agent, it is impractical to prepare invoice of commission for each sale. Billing is done at end of the agreed period (say month or quarter), which is termed as 'Billing Period'. In such cases, it can be argued that such services are provided on continuous basis and Billing at end of the period should be acceptable.

4.7.6 Rounding up of tax in each invoice not required – Section 37D of Central Excise Act, which is also made applicable to service tax, requires rounding up of tax. However, this is only while making monthly/quarterly payment to Government. Rounding up of duty in each Invoice is not envisaged in section 37D of Central Excise Act.

4.7.7 Advance payment from customers - After 13th May 2005, service tax will be payable as soon as advance is received, even if service is provided later. Thus, service tax is payable when advance is received. Invoice will have to be prepared.

4.7.8 Payment of tax

A person liable to pay tax shall pay the same in prescribed manner [section 68(1)]. The service tax is payable 5th (6th in case of e-payment) of the month following the month in which payments are received toward value of taxable services *except in March* [rule 6(1) of Service Tax Rules].

If the assessee is an individual or proprietary firm or partnership firm, the tax is payable on quarterly basis within 5 days (within 6 days if e-payment is made) at the end of quarter *except in March.* (rule 6). This facility is not available to HUF firm in view of clear wording of the provision.

Advance received before service was made taxable, but service was partly rendered after service became taxable - As per second *proviso* to rule 6(1) of Service Tax Rules, if advance was received, service tax will not be payable for part or whole value of services, which is attributable to services provided during the period when service was not taxable. Thus, service tax will be payable on *pro rata* basis in cases where advance was received prior to imposition of service tax and service was partly/fully provided after the service tax on that service became effective.

4.7.9 Exception in March - Exception has been made in case of March. Service tax on value of taxable services received during month of March or quarter of March is required to be paid by 31st March. Assessee may find it difficult to accurately estimate the amounts he is going to receive from his customers in last two days. Hence, he may pay excess amount upto ₹ 50,000; which can be adjusted in subsequent month/quarter, as per rule 6(4B) inserted w.e.f. 1-3-2007.

4.7.10 Payment of tax on amounts actually received - Rule 6(1) makes it clear that the liability is to pay service tax on payments towards value taxable services actually received. Thus, service tax is not payable on amounts charged in the bills/invoice, but on amounts actually received.

4.7.11 Self Adjustment of excess tax paid in earlier period

Facility of self-adjustment of excess service tax paid has been allowed to all assessees vide rule 6(4A) subject to the following conditions prescribed in rule 6(4B) of Service Tax Rules inserted w.e.f. 1-3-2007.

4.7.12 Self adjustment only in case of reasons like calculation mistake, exact amount not known etc.

- Self-adjustment of excess credit is *not* allowed on account of reasons like interpretation of law, taxability, classification, valuation or applicability of any exemption notification[rule 6(4B)(i)]. In such cases, refund application should be filed and self adjustment is not permissible. Thus, self adjustment is possible only in cases like – (a) Excess payment since exact amount to be paid could not be calculated (b) when tax is to be paid by 31st March and calculation of exact amount is practically impossible (c) calculation mistakes.

4.7.13 Adjustment upto ₹ 1,00,000 only permissible - Excess amount paid and proposed to be adjusted should not exceed ₹ 1,00,000 for the relevant month or quarter [rule 6(4B)(iii)].

4.7.14 Adjustment in subsequent month/quarter - Adjustment can be made in the succeeding month or quarter [rule 6(4A)] [Rule does not say that adjustment can be made in subsequent month or quarter *only*. As per section 13 of General Clauses Act, unless there is anything repugnant to the subject or context, the word singular includes plural and vice versa. Hence, it can be argued that adjustment can be made in any subsequent month/s or quarter/s].

4.7.15 Inform details of adjustment within 15 days - The details of self-adjustment should be

intimated to the Superintendent of Central Excise within a period of 15 days from the date of adjustment [rule 6(4B)(iv)] [[It can be argued that this is directory provision and not mandatory provision, since in many cases, it is impossible to inform in 15 days. In such cases, information at the time of filing return should be sufficient].

4.7.16 Adjustment in case of service tax on renting of immovable property - In case of service tax on renting of immovable property, abatement is available in case of property tax paid to local authorities. If such tax is paid at a later date, self-adjustment in service tax payable is permissible within one year from date of payment of tax, without any monetary limit. Assessee should inform Superintendent within 15 days of making adjustment [rule 6(4C) of Service tax Rules].

4.7.17 Assessees having centralized registration - Assessees who have centralised registration can adjust the excess service tax paid on their own without any monetary limit provided the excess amount paid is on account of delayed receipt of details of payments from branch offices [rule 6(4B)(ii)].

4.7.18 Adjustment if service not provided partly or fully - If excess tax is paid, in respect of service which is not provided either wholly or partly for any reason, the excess service tax paid can be adjusted against service tax payable for subsequent period, if the value of services and tax thereon is refunded to the person from whom it was received. [rule 6(3)]. *Such adjustment is permissible only when refund is on account of services not provided.* Thus, if the person refunds on account of giving some discount to client, this provision does not apply.

4.8 PAYMENT OF SERVICE TAX

The service tax is payable 5th of the month following the month (6th in case of e-payment) in which payments are received toward value of taxable services [rule 6(1) of Service Tax Rules].
Thus, service tax is *not* payable on basis of amounts charged in the bills/invoice, but only on amounts *actually received* during the relevant period.

4.8.1 Payment from Cenvat credit plus/GAR-7 - Assessee should first utilise Cenvat credit available. Balance amount is payable in cash.

4.8.2 Account code - The tax is payable by a GAR-7 Challan in the bank where excise duty is accepted in that Commissionerate. The major account head is '044'. In addition, separate accounting code has been given to each service. See next chapter pages for account head for each type of service. TR-6 challan (in yellow colour in quadruplicate) is for payment in conventional mode while GAR-7 (one challan in yellow colour with counterfoil) is used when Bank is having 'EASIEST facility'. In both cases, payment is by cash or cheque. The tax paid should be rounded off in rupees. Education cess and SAH education cess should be shown separately under separate account head in TR-6/GAR-7 challan.

4.8.3 Presentation of cheque on or before due date is sufficient - Rule 6(2A) provides that cheque of proper amount should be deposited with bank on or before due date. It will be deemed to have been paid on due date, even if the cheque is realised later. However, if cheque is not realised, service tax will not be deemed to have been paid.

4.8.4 If last date is a holiday - If last day of payment and filing return is a public holiday, tax can be paid and return can be submitted on next working day - CBE&C circular No. 63/12/2003-ST dated 14-10-2003.

4.8.5 Electronic Accounting System In Excise and Service Tax (EASIEST) - 'Easiest' has been developed to make payment of tax easy. The facility is available with some 28 banks. The payment is made by GAR-7 challan. Assessee has to make one copy of challan and its counterfoil.

4.8.6 Mandatory e-payment if annual service tax payment exceeds ₹ 50 lakhs - e-payment is a mode of payment in addition to the conventional methods of payment offered by the banks under specific security norms of Reserve Bank of India. This scheme facilitates anytime, anywhere payment and an instant cyber receipt is generated once the transaction is complete. It provides the convenience of making online payment of Central

Excise and Service Tax through Bank's Internet banking service. About 28 Banks are authorised for this purpose. Proviso to rule 6(2) of Service Tax Rules makes e-payment mandatory for payment of duty by all assessees who have paid Service tax of rupees 50 lakh or more in cash during the preceding financial year, w.e.f. 1-10-2006.

4.8.7 Mandatory interest for late payment of service tax - In case of delayed payment of service tax, there is mandatory payment of simple interest under section 75 for the period which the payment is delayed. The interest rate is 13% w.e.f. 10-9-2004, vide notification No. 26/2004-ST dated 10-9-2004 [Earlier interest @ 15% per annum from 11-5-2002. The interest rate was 24% upto 11-5-2002].

4.9 RETURNS

4.9.1 Every assessee has to submit half yearly return in form ST-3 in triplicate within 25 days of the end of the half-year. 'Half year' means 1st April to 30th September and 1st October to 31st March of financial year. The return should be accompanied by TR-6/GAR-7 challans, evidencing payment of duty. Details in respect of each service are to be provided separately. However, service tax payment details and Cenvat credit details are common and combined. There is no column to show excess amount paid, if any. Presumably, this will have to be intimated by a separate letter and/or given in the ST-3 form as a 'remark' or 'note'.

4.9.2 Last date for filing return is a bank holiday - If last day of payment and filing return is a public holiday, tax can be paid and return can be submitted on next working day - CBE&C circular No. 63/12/2003-ST dated 14-10-2003.

4.9.3 Revised return - Rule 7B of Service Tax Rules has been inserted w.e.f. 1-3-2007 to allow an assessee to rectify mistakes and file revised return within 90 days from the date of filing of the original return. Rule 9(11) of Cenvat Credit Rules (inserted w.e.f. 1-3-2007) allows an assessee to rectify mistakes and file revised return within 60 days from the date of filing of original return. This provision applies only to service providers and not to manufacturers.

4.9.4 What is to be done if mistake comes to notice after 90 days? – There is no provision for submission of revised return after 90 days. In such cases, if assessee finds that he has made some mistake, he should pay the amount by TR-6/GAR-7 challan and inform department suitably. If he has paid excess amount by mistake, he is required to file refund claim. He cannot adjust excess payment on his own, except in cases where it has been specifically permitted. If he has not taken Cenvat credit of certain inputs, input services or capital goods, he can avail it in subsequent period, since there is no time limit for availing Cenvat credit. This will be reflected in his return for that subsequent period, as in normal course.

4.9.5 Electronic filing of return - Department has introduced e-filing of service tax return on experimental basis from April, 2003. It is optional. The procedure has been described in CBE&C circular No. 52/1/2003-ST dated 11-3-2003. Guidelines are also issued in question answer form on CBE&C website. The facility is available to all service providers.

4.9.6 Late fee and penalty for filing late return - Section 70(1), as amended by Finance Act, 2007 w.e.f. 11-5-2007, makes provision for late filing of return with late fee which can be upto ₹ 2,000. Late fee payable will be prescribed by Central Government by issuing a notification. The late fee payable is as follows – (a) Delay Upto 15 days – ₹ 500 (b) Beyond 15 days and upto 30 days – ₹ 1,000 (b) Delay beyond 30 days – ₹ 1,000 plus ₹ 100 per day of delay beyo nd 30 days, from 31st day maximum ₹ 2,000- rule 7C inserted w.e.f. 12-5-2007.

4.9.7 Penalty can be waived if no tax was payable – Once a person is registered, he has to file return even if there is no tax liability. He should file Nil return if there was no service tax payable. However, if he does not file return, penalty can be waived/reduced if non-filing of return was for sufficient cause [Rule 7C]

4.9.8 Department is required to accept late return even if late fee is not paid – In case of returns filed late, the appropriate late fees should be paid at the time of filing the return, without waiting for any communication or notice from the department. Mere non-submission of evidence of payment of late fee along with the return is, however, not a ground for refusal to allow filing of the return – para 6.4 of CBE&C Circular No. 97/8/2007-ST dated 23-8-2007.

4.9.9 Provisional assessment

Assessee can make request in writing for provisional assessment to Assistant/Deputy Commissioner.Provisions of Central Excise Rules in respect of provisional assessment are applicable, but there is no requirement of any bond [rule 6(4)].Of course, reason has to be stated why he is not able to correctly determine his tax liability. After such request is made, assessee has to submit memorandum in form ST-3A showing difference between service tax collected and deposited. Application for provisional assessment should be made to Assistant/ Deputy Commissioner. Provisional assessment can be finalized by Assistant/Deputy Commissioner after calling further documents as may be necessary. -Rule 6(4), 6(5) and 6(6) of Service Tax Rules, 1994.

4.9.10 Self Assessment

Like Income tax and central excise, service tax assessment is basically self-assessment. There is no provision for compulsory assessment of assessee's return. Show cause cum demand notice can be issued within one year. Notice beyond one year can be issued only if there is fraud, suppression of facts, wilful misstatement or collusion.

Every person liable to pay tax shall himself assess the tax due on the services provided by him. A return in prescibed form will be submitted to Superintendent of Central Excise [section 70(1)]. The ST-3 return filed by assessee contains a 'Self-Assessment Memorandum'.

4.10 ADJUDICATION

4.10.1 Central Excise Officers have been empowered to adjudicate in following -

(*a*) Demand of service tax and its recovery - section 73.

(*b*) Rectification of mistake by amending own order - section 74.

(*c*) Imposition of penalty - section 83A

(*d*) Refund of service tax - section 11B of Central Excise Act made applicable to Service Tax.

4.10.2 Time limit for issue of show cause notice - If it is found that assessee has paid less tax, department will issue a show cause notice cum demand.

If any service tax is not levied or not paid or short levied or short paid or erroneously refunded, Central Excise Officer shall issue a show cause notice for demand can be made within one year from 'relevant date' [section 73(1)].

If such short payment etc. was by reason of fraud, collusion, wilful mis-statement, suppression of facts or contravention of any provision of Finance Act, 1994 or rules, show cause notice can be issued within five years [*proviso* to section 73(1)]. After considering the representation, Central Excise Officer will determine the service tax payable. Such tax cannot be more than the amount specified in show cause notice. Thereupon, the person shall pay the amount so determined [section 73(2)].

4.10.3 Voluntary Payment before receipt of show cause notice - Assessee may pay such tax on the basis of his own ascertainment or on the basis of tax ascertained by Central Excise Officer, before issue of show cause notice. After payment of tax, assessee should inform the Central Excise Officer in writing about such payment, and then the central excise officer shall not issue any show cause notice under section 73(1) in respect of service tax so paid [section 73(3)].

4.10.4 *Rectification* - The Central Excise Officer who has passed order (of assessment or demand or penalty) can rectify any mistake apparent from the record, within two years of the date in which the order was passed. The mistake must be 'apparent from the records'.

4.10.5 *Revision* - The Commissioner of Central Excise can revise the orders passed by adjudicating authority subordinate to him. The revision order can be passed any time within two years of the original order, but not afterwards. No revision can be made if appeal against such order is pending with Commissioner (Appeals) [section 84]. Appeal against the order of Commissioner (after revision) lies with CESTAT under section 86.

4.11 APPEALS

4.11.1 Appeal to Commissioner (Appeals) - Appeal to Commissioner (Appeals) can be made against order of any Central Excise Officer subordinate to Commissioner in respect of demand, interest or penalty or denial of refund of service tax. Appeal should be in prescribed form and duly verified. Appeal must be filed within three months from date of receipt of order. Delay upto three months can be condoned by Commissioner (Appeals). The procedures and powers will be similar to those under Central Excise. [section 85 of Finance Act, 1994].

4.11.2 Appeal to Tribunal - Appeal to CESTAT (Tribunal) can be made against order of Commissioner passed by him under section 73, 83A or 84 or order of Commissioner (Appeals) passed by him under section 85 [order in appeal from order of AC/DC] by assessee or the department. Appeal has to be filed within three months from date of receipt of order by assessee, Board or Commissioner as the case may be. [section 86 of Finance Act, 1996]. Tribunal can condone the delay in filing appeal on showing sufficient cause. Appeal has to be accompanied with prescribed fees, if appeal is by the assessee. Tribunal is final fact finding authority.

4.11.3 Appeals to HC/SC – If issue involves classification or valuation, appeal lies with Supreme Court. If issue does not involve classification or valuation dispute, appeal lies with High Court only on substantial question of law.

4.12 PENALTIES

The penalties can be imposed by Central Excise / Service Tax Officers. There is no provision for prosecution under the Act.

4.12.1 Penalty for non-payment or delayed payment of service tax **-** If service tax is not paid or belatedly paid, penalty shall be imposed, which will be minimum ₹ 200 per day during which such failure continues or @ 2% per month, whichever is higher, starting with the first day after due date till date of actual payment of outstanding amount. Mercifully, the penalty cannot exceed the service tax which was payable. In addition, of course, service tax and interest is payable. [section 76 of Finance Act, 1994]. As per section 80, this penalty can be waived or reduced if proper cause is shown.

4.12.2 Penalty for not obtaining registration - If a person who is liable to pay service tax, or required to take registration, fails to take registration in accordance with the provisions of section 69 or rules, he shall be liable to pay a penalty which may extend to five thousand rupees or two hundred rupees for every day during which such failure continues, whichever is higher, starting with the first day after the due date, till the date of actual compliance [section 77(1)(a) of Finance Act, 1994].

4.12.3 Penalty for non-maintenace of books of account and documents - If a person fails to keep, maintain or retain books of account and other documents as required in accordance with the provisions of this Chapter or the rules made thereunder, he shall be liable to a penalty which may extend to five thousand rupees [section 77(1)(b) of Finance Act, 1994].

4.12.4 Penalty for not furnishing information required - If a person fails to furnish information called by an officer in accordance with the provisions of this Chapter or rules made thereunder; or fails to produce documents called for by a Central Excise Officer in accordance with the provisions of this Chapter or rules, he shall be liable to pay a penalty which may extend to five thousand rupees or two hundred rupees for every day during which such failure continues, whichever is higher, starting with the first day after the due date, till the date of actual compliance [section 77(1)(c)(i) and 77(1)(c)(ii) of Finance Act, 1994].

4.12.5 Penalty for non-appearance before officers* on *issue of summons - If a person fails to appear before the Central Excise Officer, when issued with a summon for appearance to give evidence or to produce a document in an inquiry, he shall be liable to a penalty which may extend to five thousand rupees or two hundred rupees for every day during which such failure continues, whichever is higher, starting with the first day after the due date, till the date of actual compliance [section 77(1)(c)(iii) of Finance Act, 1994].

4.12.6 Penalty for failure* to *pay tax electronically when required - If a person, who is required to pay tax electronically, through internet banking, fails to pay the tax electronically, shall be liable to a penalty which may extend to five thousand rupees [section 77(1)(d) of Finance Act, 1994].

4.12.7 Penalty for issuing incorrect invoice or not accounting invoices in his books of account - If a person issues invoice in accordance with the provisions of the Act or rules made thereunder with incorrect or incomplete details or fails to account for an invoice in his books of account, shall be liable to a penalty which may extend to five thousand rupees [section 77(1)(e) of Finance Act, 1994].

4.12.8 Residual Penalty for contravention of Act or Rules - Penalty for contravention of any provision of the Chapter or Rules (of service tax) for which separate penalty has not been provided shall be upto ₹ 5,000 [section 77(2) of Finance Act, 1994].

4.12.9 Penalty in case of fraud, suppression of facts etc. - Where any tax is not levied or paid or erroneously refunded, the person shall be liable to pay penalty which shall not be less than amount of service tax but can be upto twice the amount of service tax amount of service tax not levied or not paid or erroneously refunded [section 78]. The penalty can be waived under section 80, if assessee proves that failure was due to reasonable cause. [The penalty will be reduced to 25%, if tax, interest and penalty is paid within 30 days from date of receipt of order of Central Excise Officer].

4.13 EXPORT OF SERVICES

If service is exported, there is no service tax liability. If the service is exported, the Cenvat credit is not required to be reversed. Assessee can utilise credit for payment of service tax on other services. However, if this is not possible, he can get refund. Service tax is required to be exempted only if there is actual export of service. 'Export of Services Rules, 2005' have been notified w.e.f. 15-3-2005. The rules make it clear that exemption from services/rebate of service tax and excise duty paid is admissible only if there is 'export of service' as defined in these rules. Mere receipt of payment in free foreign exchange will not be sufficient to treat the service as 'export service'.

4.13.1 Exemption or Rebate of Service tax - Exporter of service has three options -

(*a*) Export without payment of service tax and utilise Cenvat Credit for payment of service tax on other services.

(*b*) Export without payment of service tax and claim rebate of service tax paid on input services and excise duty paid on inputs (or forget about rebate as procedure is too complicated and impractical)

(*c*) Pay service tax on exported services and claim rebate (by this, he can utilise his input credit)

4.13.2 Meaning of Export of taxable service - Following conditions are common in respect of *all* taxable services -

(a) The service should be provided from India and used outside India [rule 3(2)(a) of Export of Service Rules] and

(b) Payment for such service is received by the service provider in convertible foreign exchange [rule 3(2)(b) of Export of Service Rules].

In addition, further conditions apply to different categories of services. Rule 3 of Export of Service Rules classifies the taxable services in four categories –

(i) Immovable property should be situated abroad [rule 3(i)]

(ii) Service should be at least partly performed outside India [rule 3(ii)]

(iii) Service can be provided firm Indian but recipient should be located outside India and order should be received from outside India [rule 3(iii)]

(iv) Services which not be treated as 'export of services' under any situation.

Services falling under each category are given in next chapter.

4.13.3 Rebate of service tax paid on exported services or tax paid on inputs/input services - Subsequent to issue of Export of Service Rules, 2005; two notifications have been issued making provisions for rebate.

(*a*) Notification No. 11/2005-ST dated 19-4-2005, providing for rebate of service tax and education cess paid on taxable services exported i.e. tax paid on output services

(*b*) Notification No. 12/2005-ST dated 19-4-2005, providing for rebate of excise duty paid on inputs and service tax paid on input services, which are used in providing exported taxable services.

4.13.4 Refund of input service tax and duty under Cenvat Credit Rules - Rule 5 of Cenvat Credit Rules has been amended w.e.f. 14-3-2006 to provide for refund of Cenvat credit when output service is exported. Procedure for claiming refund of service tax paid on input services and excise duty on inputs has been specified in notification No. 5/2006-CE(NT) dated 14-3-2006. Application should be submitted in Form 'A' to Assistant/Deputy Commissioner. Application can be submitted every quarter. However, in following cases, refund can be claimed on monthly basis - (a) persons whose average export clearances are more than 50% of total clearances (b) EOU units. Refund of input service credit will be restricted to the extent of ratio of export turnover to the total turnover for the given period e.g. if total credit of input services is ₹ 100, total turnover is ₹ 500 and export turnover is ₹ 250, refund of input service tax credit will be only ₹ 50 (i.e. 50%, since export turnover is 50% of total turnover). The procedure seems to be simple. EOU is eligible to avail this procedure.

4.14 IMPORT OF SERVICES

The statutory provisions use the words 'Services provided from outside India and received in India'. However, generally, the tax is known as tax on 'Import of Services'. Section 66A(1) (effective from 18-4-2006) provides that where any service specified in section 65(105) of Finance Act, is,— (a) provided or to be provided by a person who has established a business or has a fixed establishment from which the service is provided or to be provided or has his permanent address or usual place of residence, in a country other than India, and (b) received by a person (hereinafter referred to as the recipient) who has his place of business, fixed establishment, permanent address or usual place of residence, in India, such service shall, for the purposes of this section, be taxable service, and such taxable service shall be treated as if the recipient had himself provided the service in India, and accordingly all the provisions of this Chapter shall apply.

4.14.1 Exemption to individual receiving the service - First *proviso* to section 66A(1) states that where the recipient of the service is an individual and such service received by him is otherwise than for the purpose of use in any business or commerce, the provisions of this sub-section shall not apply.

4.14.2 When service provider has establishment at more than one places - Second *proviso* to section 66A(1) states that where the provider of the service has his business establishment both in that country and elsewhere, the country, where the establishment of the provider of service directly concerned with the provision of service is located, shall be treated as the country from which the service is provided or to be provided. Thus, even if a service provider has office in India as well as in foreign country, the service will be treated as provided from foreign country, if service is provided from that country.

4.14.3 Two permanent establishments to be treated as two separate persons - As per section 66A(2),where a person is carrying on a business through a permanent establishment in India and through another permanent establishment in a country other than India, such permanent establishments shall be treated as separate persons for the purposes of this section.

4.14.4 Intention seems only to tax services received in India - Though section 66A is broadly worded and covers even services provided and consumed abroad, it appears that intention is to tax only services received in India. *If so, then only possible objection can be violation of DTA.*

4.14.5 Service provided from outside India and received in India - Though scope of section 66A is wide, it can be argued that service tax is payable only if the service falls within the definition of 'Service provided from Outside India and Received in India'.

4.14.6 Classification of services - The rules classify all taxable services in four categories, namely (i) Services in relation to immovable property – the property should be situated in India – rule 3(i) (ii) Services should be at least partly performed in India [rule 3(ii)] (iii) Services received by recipient located in India [rule 3(iii)] (iv) Services which will never be treated as import of service. The classification is same as per export of Service Rules.

4.14.7 Service receiver liable to pay service tax - As per rule 2(1)(d)(iv) of Service tax Rules, person liable for paying the service tax means - in relation to any taxable service provided or to be provided by any person from a country other than India and received by any person in India under section 66A of the Act, the recipient of such service.

Thus, person receiving service in India will be liable to pay service tax. He will have to register under Service tax provisions and submit returns. Service receiver was made liable to pay service tax on services provided by non-resident by amending rules on 16-8-2002. In cases prior to that, it was held that service receiver cannot be made liable to pay service tax in case of services provided by non-resident.

4.14.8 Tax to be paid in cash without Cenvat credit - Rule 5 of Taxation of Services (Provided from outside India and Received in India) Rules, 2006 clarifies that the taxable service will not be treated as output service of the recipient for purpose of availing of Cenvat credit of duty of excise paid on inputs or service tax paid on any input services. Thus, the recipient of service has to pay the service tax in cash by TR-6/GAR-7 challan. He cannot utilise his Cenvat credit for payment of this amount, as it is not his 'output service', though he is liable to pay service tax.

4.14.9 Service receiver avail Cenvat credit of service tax paid by him - Though the person receiving the service is liable to pay service tax, the service is his 'input service'. Para 4.2-13 of MF(DR) circular No. B1/4/2006-TRU, dated 19-4-2006 confirms as follows 'Where such service is used as an input for providing any taxable output, the service tax paid on such service can be taken as input credit' (The TRU letters have not been withdrawn even when all other circulars have been withdrawn on 23-8-2007. Hence, TRU letters are still valid) [There is some controversy on this issue]

4.15 TAXABILITY OF VARIOUS KIND OF SERVICES

Description of service	Coverage	Exclusions/Exemptions
Advertising agency	**Statutory coverage** •"advertisement" includes any notice, circular, label, wrapper, document, hoarding or any other audio or visual represen-tation made by means of light, sound, smoke or gas [Section 65(2)] •Service connected with the making, preparation, display or exhibition of advertisement taxable. •Services of advertising consultant.Taxable [Section 65(3)] **Case Law/Board Circulars** •Tax only on commission, not on advertisement charges paid to media or TV	**Exclusions** •Sale of space or time for advertisement taxable under different head. •Space selling taxable under BAS •Preparing sign board or hoardings not taxable. **Exemptions** Refer 4.4
Air transport of passengers Embarking for interna-tional travel	**Statutory coverage** •Service in relation to scheduled or non-scheduled air transport of such passenger embarking in India for international journey, in any class other than economy class. **Case Law/Board Circulars** •Tax is payable for entire journey even if there is stop over in between. •In case of round trip or return ticket, service tax is payable on total value of ticket.	**Exclusions** •Economy class passengers are excluded. **Exemptions** Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
• Airport Services	• **Statutory coverage** • Service by airports authority or any person authorised by it, in an airport or a civil enclave. • **Case Law/Board Circulars** • Services statutorily provided by AAI as stated in MF(DR) circular No.B2/8/ 2004-TRU dated 10-9-2004 are only taxable.	• **Exemptions** • See for general exemptions Study Refer 4.4
• Air travel agent	• **Statutory coverage** • Service in relation to the booking of passage for travel by air. • **Case Law/Board Circulars** •Tax is payable only on commission and other charges but relating to booking of passage for air travel.	• **Exclusions** • Services of GSA (General SalesAgent) appointed by foreign airlines are taxable under' Business Auxiliary Service'and not under Air Travel Agent Service. • **Valuation** • Air travel agent has option to pay service tax @ 0.60% of basic fare in case of domestic booking and @ 1.20% of the basic fare incase of inter-national bookings, of passage for travel by air. In addition, education cess @ 2% and SAH education cess @ 1% will be payable. • **Exemptions** Refer 4.4
• Architect	• **Statutory coverage** • Services in the field of architecture. • **Case Law/Board Circulars** • Designing or planning of construction of buildings, bridges, dams etc. and its supervision	• **Exclusions** • Actual execution of work is not Architect's services. • Interior design may be covered only to the extent of architecture. • No tax on material, furniture and temporary structures • **Exemptions** Refer 4.4
Asset Management including Portfolio management	**Statutory coverage** _ Asset management including portfolio management and all forms of fund management. **Case Law/Board Circulars** _ Services provided by individual service providers especially to high net worth individuals taxable	**Exclusions** _ Services by banking company or a financial institution, NBFC or any other body corporate or commercial concern taxable under 'Banking and other Financial Services' **Exemptions** Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
ATM operations, main-tenance or management	**Statutory coverage** — Automated teller machine (ATM)operations, maintenance or management service, in any manner — Includes site selection, con-tracting of location, acquisition, financing, installation, certi-fication, connection, main-tenance, transaction processing, cash forecasting, replenishment, reconciliation and value-added services [section 65(9b)]	**Exclusions** — No service tax on cashwithdrawn from ATM. **Exemptions** Refer 4.4
Auctioneers' Service	**Statutory coverage** — Service in relation to auction of property, movable or immovable, tangible or intangible — Calling the auction or providing afacility, adver-tising or illustrating services, pre-auction price estimates, short-term storage services, repair or restoration services in relation to auction of property [section 65(7a)]	**Exclusions** — Auction of property under the directions or orders of a court of law or auction by the Government excluded. **Exemptions** Refer 4.4
Authorised servicestation (Motorcar/ Two wheelers/LMV)	**Statutory coverage** • Service by an authorised service station, in relation to any service, repair, reconditioning or restoration of motor cars, light motor vehicles or two wheeled motor vehicles, in any manner. • Light Motor Vehicle (LMV) meansany motor vehicle constructed or adapted to carry more than six passengers, but not more than twelve passengers, *excluding* thedriver [section 65(62)] **Case Law/Board Circulars** • Free service to our customers for which reimbursement obtained from manufacturers is taxable. • Service tax payable on spare partsused during provision of service -Ref Code 036.03/23.8.07 of CBE&C Circular No. 96/7/2007-ST dated23-8-2007 [doubtful]	**Exclusions** • Service provided at the time of purchase of new vehicle is not liable to tax. • Service to transport vehicle, buses, trucks, omnibus, road-roller,tractor, or invalid carriage is not covered **Exemptions** Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Banking and Financial services	**Statutory coverage** • Service by a banking company or a financial institution including NBFC, or any other body corporate or *commercial concern*, is taxable. • Financial leasing services including equipment leasing and hire-purchase. • Merchant banking services •Securities and foreign ex-change (forex) broking; •Asset management including portfolio management, all forms of fund management, pension fund management, custodial, depository and trust services	**Exclusions** • Hire purchase financenot taxable – *Bajaj Auto Finance* v. *CCE* (2007) 9STT 569 (CESTAT). • Money changers whobuys and sells foreign exchange without charging commission or brokerage is not liable -Ref Code 034.01/ 23.8.07 of CBE & C Circular No.96/ 7/2007-ST dated 23-8-2007.
	• Advisory and other auxiliary financial services including investment and portfolio research and advice, advice on mergers andacquisitions and advice on corporate re-structuring and strategy • Provision and transfer of infor-mation and data processing; • Banker to an issue services • Other specified financial services [section65(12)] **Case Law/Board Circulars** • Cash management taxable • Business chit funds are taxable - CBE&C Ref Code 034.04/23.8.07 of CBE&C Circular No. 96/7/2007-ST dated 23-8-2007	• Stock Exchanges, commo-dity exchanges, stock clearing house services not liable –CBE & C letter No.137/57/2006-CX.4 dated 18-5-2007 • Simple chit funds not taxablebut business chit fundstaxable - CBE&C Ref Code034.04/23.8.07 of CBE&CCircular No. 96/7/2007-STdated 23-8-2007 • No service tax on entry andexit load charged by mutualfund to the investor **Exemptions** • Services provided to Government for tax collection exempt - Notification No.13/2004-ST dated 10-9-2004. • Services provided by RBIexempt –Notification No.22/2006-ST dated 31-5-2006. • No service tax on interest charged by service provider -rule 6(2)(iv) Refer 4.4
Beauty treatment	**Statutory coverage** • Services includes hair cutting, hairdyeing, hair dressing, face andbeauty treatment, cosmetictreatment, manicure, pedicure orcounselling services on beauty,face care or make-up or such othersimilar services [section 65(17)]. **Case Law/Board Circulars** • Materials used such as cosmetics and toilet preparations are includible for valuation	**Exclusions** • No tax on plastic surgery- CBE&C circular No.B.11/1/2002-TRU dated1-8-2002. **Exemptions** Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Broadcasting	**Statutory coverage** • Service by a broadcasting agency or organisation in relation to broad casting • In the case of a broadcasting agency or organisation, having it shead office situated in any place outside India, includes service provided by its branch office or subsidiary or representative in India or any agent appointed in India. • Services of selling of time slots for broadcasting of any pro-gramme or obtaining sponsor-ships for programme and collecting broadcasting charges is a taxable service. [section 65(16)]	**Exemptions** • Exemption to services by digital cinema service provider to distributor or producer - NotificationNo. 12/2007-Service Taxdated 01.03.2007. Refer 4.4
Business auxiliary services	**Statutory coverage** •Promotion or marketing or sale of goods produced or provided by orbelonging to the client •Promotion or marketing of service provided by the client •any customer care service provided on behalf of the client •procurement of goods or ser-vices, which are inputs for the client •production or processing of goods for, or on behalf of, the client •provision of service on behalf of theclient •a service incidental or auxiliary to any activity specified above, such asbilling, issue or collection orrecovery of cheques, pay-ments, maintenance of accounts and remittance, inventory management, evaluation or development of prospective customer or vendor, public relation services, management or supervision. •services as a commission agent [section 65(19)]	**Exclusions** • 'InformationTechnology Service' means any service in relation to (a) designingor developing of computer software, or (b) system networking, or (c) any other service primarily in relation too peration of computer systems, is excluded. • Activity that amounts to "manufacture" within the meaning of section 2(f) of the Central Excise Act isexcluded. **Exemptions** • The services of production or processing of goods in relation to ***agriculture, printing, textile processing oreducation*** are fully exempt [Notification No.14/2004-ST dated 10-9-2004].
	Case Law/Board Circulars • Job work liable to service tax, butjob work done under Cenvatprovisions exempt. Job work nottaxable if it amounts to'manufacture'.	• Job work exempt if the goods after processing are returned back toclient (raw material supplier) for use in or in relation to manufacture of 'other goods' by the client. The 'other goods' should be such that appropriate duty should be payable on such goods - notification No. 8/2005-ST dated 1-3-2005. • Job workers of parts and accessories of cycles, cycle rickshaws and

Description of service	Coverage	Exclusions/Exemptions
Business Exhibition	**Statutory coverage** • An exhibition, — (a) to market; or (b) to promote; or (c) to advertise; or (d) to show case, — any product or service, intended for the growth in business of the producer or provider of such product or service [section 65(19a)] **Case Law/Board Circulars** • Organizers of events such as trade fairs, road shows, fashion shows, display show-cases kept in airports, railway stations, hotels etc. would be covered under this new levy.	**Exemptions** Refer 4.4
Business Support Services	**Statutory coverage** • Services provided in relation to business or commerce • Evaluation of prospective customers, telemarketing, pro-cessing of purchase orders and fulfilment services, information and tracking of delivery schedules, managing distribution and logistics, customer relationship management services, accounting and pro-cessing of transactions, opera-tional assistance for marketing, formulation of customer service and pricing policies • Infrastructural support services • Other transaction processing [section 65 (104c)]	**Exemptions** Refer 4.4
Cable	**Statutory coverage** • Service provided by cable operator,including multi-system operator • transmission by cables of aprogramme including retransmissionby cable of any broadcast televisionsignals is taxable [section 65(22)]. **Case Law/Board Circulars** • Broadcasting services provided bycable operators are also taxable. • Service tax is not leviable on entertainment tax levied by State Government, if it is shown separately in the Bill of cable operator to the customer - CBE&C circular No.B.11/1/2002-TRU dated 1-8-2002.	**Exemptions** Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Cargo handling	**Statutory coverage** • Loading, unloading, packing or unpacking of cargo • Cargo handling services provided for freight in special containers or for noncontainerised freight • Services provided by a container freight terminal or any other freight terminal, for all modes of transport	**Exclusions** • Handling of export cargo or passenger baggage is excluded. • Mere transportation of goods excluded. **Exemptions** • Cargo handling services
Cleaning Activity	**Statutory coverage** • Cleaning • specialised cleaning services • disinfecting, exterminating or sterilising of objects or premises, of — (i) commercial or industrial buildings and premises thereof; or (ii) factory,plant or machinery, tank or reservoir of such commercial or industrial buildings and premises [section 65(24b)]	**Exclusions** • Services in relation to agriculture, horticulture, ani-mal husbandry or dairying • 'Cleaning' of goods i.e. movable property will not be taxable under this head • Cleaning of residential buildings and premises has been excluded from the provisions **Exemptions** Refer 4.4
Clearing & Forwarding Agent	**Statutory coverage** • Service, either directly or indirectly, connected with clearing and forwarding operations • It includes a consignment agent. [section 65(25)] **Case Law/Board Circulars** • Services of coal merchants, who are acting as buyer's agents and carry outsuch jobs/assignments as asked for byrespective consumers/buyers arecovered under definition of C&FAgent and are liable to service tax -CBE&C letter F No. 159/1/2003-CX.4 • Mere procuring or booking orders for the Principal by an agent on commission basis would not be 'Clearing and forwarding Agent service' - *Larsen and Toubro Ltd.* v. *CCE* (2006) 4 STT 231 (CESTAT 3 member bench) • A commission agent is not a 'C&F'agent – *CCE* v. *Chandan Chemicals* (2007) 9 STT 556 (CESTAT).	**Exemptions** Refer 4.4
Club or Association's services	**Statutory coverage** • Service to members, by any club or association in relation to provision of services, facilities or advantages for a subscription or any other amount	**Exclusions** "Club or association" does not include— (i) any body established or constituted by orunder any law for the time being in force; or

Description of service	Coverage	Exclusions/Exemptions
	Case Law/Board Circulars • As per section 2 of Charitable Endowments Act, 1890, 'charitable purpose' includes relief to poor, education, medical relief and the advancement of any other object of general public utility, but does not include a purpose which relates exclusively to religious teaching or worship. • Service tax will be payable on life membership fees - para 10.6 of MF(DR) circular No. B1/6/2005-TRU dated 27-7-2005.	(ii) any person or body of persons engaged in the activities of trade unions, promotion of agriculture, horticulture or animal husbandry (iii) any person or body ofpersons engaged inany activity having objectives which are in the nature of public service and are of a charitable, religious or political nature (iv) any person or body of persons associated with press or media [section 65(25a)] **Exemptions** • Exemption to Services of housing societies or Resident Welfare Associations to their members are exempt vide notification No.8/2007-ST dated 01-03-2007, if the monthly contribution is less than Rs 3,000. • Refer 4.4
Commercial or Industrial Construction	**Statutory coverage** Following services used, or to be used, primarily for commerce or industry, or work intended for commerce or industry are taxable— (a) construction of a new building or a civilstructure or a part thereof (b) construction of pipeline or conduit (c) completion and finishing services such as glazing, plastering, painting, floor and wall tiling, wall covering and wall papering, wood and metal joinery and carpentry, fencing and railing, construction of swimming pools, acoustic applications or fittings and other similar services, in relation to building or civil structure (d) repair, alteration, renovation orrestoration of, or similar services in relation to, building or civil structure, pipeline or conduit [section 65(25b)] **Case Law/Board Circulars** • Educational, religious, Government buildings etc. not taxable. • If builder / promoter /developer undertakes cons-truction work on his own without engaging the services of any other person, it is not taxable – Ref Code 079.01/23.8.07 of CBE&C Circular No. 96/7/2007-ST dated 23-8-2007. • Sub-contractors providing the construction services (to main contractor or to any other person) will be liable to service tax.	**Exclusions** • such services provided inrespect of roads, airports, railways, transport terminals, bridges, tunnels and dams [section 65(25b)] • If Vat/sales tax is payable on goods involved in the contract, the service will be classifiable under 'works contract' servicetax. **Valuation** • Any person providing taxable service of commercial or industrial construction can optto pay service tax on 33% of gross amount charged. *This is atthe option of service provider* This relaxation is *not* available if only completion and finishing services are provided - Notification No. 1/2006-ST dated 1-3-2006. The partial exemption is available only if the gross amount charged includes value of goods and materials supplied or provided or used by provider of the commer-cial or industrial construction of service for providing such service (*Explanation* to Notification No.1/ 2006-ST]. *However, value ofland is not required to be added asit is neither goods nor material.* **Exemptions** • Construction and works contract services relating to port or other port are exempt. However, services of completion and fini-shing, repair, alteration, reno-vation, restoration, maintenance or repair provided in relation to existing port or other port are not exempt - Notification No. 25/2007-ST dated 22-5-2007 • Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Construction of Residential Complex	**Statutory coverage** Following services relating toconstruction of residential complexcomprising of a building or buildings,having more than twelve residentialunits, a common area; and one or morecommon facilities – *(a)* construction of a new residentialcomplex or a part thereof *(b)* completion and finishing servicesin relation to residential complex such as glazing, plastering, painting, floor and wall tiling,wall covering and wall papering, wood and metal joinery and carpentry, fencing and railing, construction of swimming pools,acoustic applications or fittings and other similar services *(c)* repair, alteration, renovation or restoration of, or similar services in relation to, residential complex [section 65(30a) and [section 65(91a)]] **Case Law/Board Circulars** a. If builder / promoter / deve-loper undertakes cons-truction work on his own without engaging the services of any other person, it is not taxable – Ref Code 079.01/23.8.07 of CBE&C Circular No. 96/7/2007-ST dated 23-8-2007. b. Sub-contractors providing the construction services (to main contractor or to any other per-son) will beliable to service tax.	**Exclusions** 1. A complex which is constructed by a person directly engaging any other person for designing or planning of the layout, and the construction of such complex is intended for personal use as residence by such person- "personal use" includes permitting the complex for use as residence by another person on rent or without consideration 2. If Vat/sales tax is payable on goods involved in the contract, the service will be classifiable under 'works contract' service tax. **Valuation** — Any person providing taxable service of commercial or industrial construction canopt to pay service tax on 33% of gross amount charged. *This is at the option of service provider* This relaxation is *not* available if only completion and finishing services are provided - Notification No.1/2006-ST dated 1-3-2006. The partial exemption is available only if the gross amount charged includes value of goods and materials supplied or provided or used by provider of the commercial or industrial construction of service

Description of service	Coverage	Exclusions/Exemptions
Consulting Engineer	**Statutory coverage** • Advice, consultancy or technical assistance in any manner in one or more disciplines of engineering including the discipline of computer hardware engineering but excluding the discipline of computer software engineering. **Case Law/Board Circulars** • Technical assistance, training, software support are all 'taxable services' - In *Nokia (I) P Ltd.* v. *CC*(2006) 3 STT 209 (CESTAT) • Services of Valuation taxable - *V.Shanmughavel* v. *CCE* 2001 STT 132 = 6 STT 183 = 121 Taxman 274 = 2STR 466 (Mad HC DB) • Contract for execution of a project is not consulting engineering service - *Ircon International Ltd.* v. *CCE* (2005)2 STT 264 (CESTAT). • Royalty payment for use of technology and know-how cannot be equated with any services provided by foreign collaborator. Hence, no service tax is payable onsuch royalty payment - *Navinon Ltd*. v. *CCE* (2007) 6 STT 411 = 2004 STT 601 (CESTAT).	**Exclusions** • Services in discipline of computer software engineering **Exemptions** • Cess is payable under-section 3 of Research and Development Cess Act, 1986, on transfer of technology. If such cess is payable, the consulting engineer will be granted exemption from service tax to the extent of cess paid - Notification No. 18/2002-ST dated 16-12-2002. Thus, if value of service is Rs 100, tax payable is Rs 12 and cess paid is Rs 5, net service tax actually payable will be Rs 7. • Refer 4.4
Convention	**Statutory coverage** • "Convention" means a formal meeting or assembly which is not open to the general public, but does not include a meeting or assembly, the principal purpose of which is to provide any type of amusement, entertainment or recreation [section 65(32)] **Case Law/Board Circulars** • Service of providing room/hall for convention, video conferencing, head projectors, LCD projector, speakers, microphones, technical staff for operating these equipments, stationery etc. is covered.	**Exemptions** • In case of convention services provided by any person, service tax is payable only on 60% of the gross amount charged by the service provider for providing taxable service, if the gross amount includes charges for catering services. 'Catering service' means supply of a substantial and satisfying meal - Notification No.1/2006-ST dated 1-3-2006. • Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Courier	**Statutory coverage** • door-to-door transportation of time sensitive documents, goods or articles utilising the services of a person, either directly or indirectly, to carry or accompany such documents, goods or articles [section 65(33)]. **Case Law** **Board Circulars** • Basic postal services not taxable. However, courier services (Speed Post), insurance services (Postal Life Insurance), agency or intermediary services on commission basis which are also provided by other commercial organizations, are taxable - Ref Code 999.02/23.8.07of CBE& C Circular No. 96/7/2007-ST dated 23-8-2007. • Co-loaders i.e. persons providing services to courier liable (earlier circular with-drawn)	**Exclusions** • Basic postal services not taxable **Exemptions** • Refer 4.4
Credit Card,debit card, charge or other payment cards related services	**Statutory coverage** • Service in relation to credit card, debit card, charge card or other payment card service • Receipt and processing of application, transfer of embossing data to issuing bank's personalisation agency, automated teller machine personal identification number generation, renewal or replace-ment of card, change of address, enhancement of credit limit, payment updation and statement generation • settlement of any amount transacted through such card • Service by the owner of trade marks or brand name to the issuing bank under an agreement, for use of the trade mark [section 65(33a)]	**Exemptions** Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Credit Rating Agency	**Statutory coverage** • Credit rating of any debt obligation or of any project or programme requiring finance • Credit rating of any financial obligation, instrument or security for providing a potential investoror any other person any information pertaining to the relative safety of timely payment of interest or principal [section 65(34)] **Case Law/Board Circulars** • Surveillance fee collected by a Credit rating agency is taxable.	**Exclusions** • Information and advisory services rendered, research and information such asanalysis of industries in aspecific sector, financial and business outlook, indexing services, macrostudies, financial modelling etc. are not in relation to credit rating and hence are not taxable. **Exemptions** • Refer 4.4
Custom House Agent	**Statutory coverage** • Service in relation to the entry or departure of conveyances or the import or export of goods	**Exemptions** •Refer 4.4
Design Services	**Statutory coverage** • Services provided in relation to designing of furniture, consumer products, industrial product, packages, logos, graphics, websites and corporate identity designing and production of three dimensional models [section 65(36b)] **Case Law/Board Circulars** Design services, other than the above specifically mentioned taxable services, like furniture design, aesthetic design, consumer or industrial products, logos, packaging, production of three dimensional models, etc. will be taxable under this category	**Exclusions** • Service provided by interior decorator and a fashion designer (they are covered under different head) **Exemptions** • Refer 4.4
Development and supply of content services	**Statutory coverage** • Development and supply of content for use in telecommunication services, advertising agency services and on-line information and database access or retrieval services • Development and supply of mobile value added services, music, movie clips, ring tones, wallpaper, mobile games, data, whether or not aggregated, information, news and animation films [section 65(36c)]	**Exemptions** •Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Dredging	**Statutory coverage** • Removal of material including, silt, sediments, rocks, sand, refuse, debris, plant or animal matter in any excavating, cleaning, deepening, widening or lengthening, either permanently or temporarily, of any river, port, harbour, back water or estuary [section 65(36a)] **Case Law/Board Circulars** • Excavation of material from sea, river or lake bed and putting the excavated material elsewhere for disposal is covered.	**Exemptions** •Refer 4.4
Dry cleaning	**Statutory coverage** • 'Dry cleaning' includes dry cleaning of apparels, garments or other textile, fur or leather articles [section65(37)] **Case Law/Board Circulars** • Dry cleaning includes tagging and inspection, pre-treatment, dry cleaning and post sorting. No tax is payable on wet cleaning, i.e. cleaning with water and water soluble detergents. Service tax is also not payable on job of dyeing, darning etc. - CBE & C circular No.B.11/ 1/2002-TRU dated 1-8-2002.	**Exemptions** • Refer 4.4
Erection, Commissioning or installation	**Statutory coverage** •Erection, commissioning or installation of plant, machinery,equipment or structures, whether pre-fabricated or otherwise •Installation of— (a) electrical and electronic devices, including wirings or fittings therefor; or (b) plumbing, drain laying or other installations for transport of fluids; or (c) heating, ventilation or air-conditioning including related pipe work, ductwork and sheet metal work; or (d) thermal insulation, sound insulation, fire proofing or water proofing; or (e) lift and escalator, fire escape staircases or travelators; or (f) such other similar services [section 65(39a)] **Case Law/Board Circulars** • Supply of lift and its installation at site. It was held that it is a contract of 'sale' and not a 'works contract'. Skill and labour employed for converting the main components into lift was only incidental - *State of Andhra Pradesh* v. *Kone Elevators (India) Ltd.* 2005 (181) ELT 156 (SC3 member bench). • Service tax payable even if exciseduty paid on entire value of contract including erection charges– *Lincoln Helios (India) Ltd.* v. *CCE*(2006) 3 STT 311 (CESTAT).	**Exclusions** • If Vat/sales tax is payable on goods involved in the contract, the service will be classifiable under 'works contract' service tax. • Erection of Civil Structure not taxable **Valuation** • Value of erection, commissioning or installation may, *at the option of assessee*, be taken as 33% of gross amount of contract and service tax will be payable accordingly. The gross amount charged will include value of plant, machinery, equipment, structures, parts and other material sold - Notification No.1/2006-ST dated 1-3-2006. **Exemptions** • Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Event management	**Statutory coverage** • Service provided in relation to planning, promotion, organising or presentation of any arts, entertainment, business, sports, marriage or any other event • Includes any consultation provided in this regard [section 65(40)]	**Exclusions** • Service tax is not leviable on sale proceeds of tickets or revenue generated from the sale of space. - CBE&C circular No. B.11/1/2002-TRU dated 1-8-2002 **Exemptions** • Refer 4.4
Fashion designing	**Statutory coverage** • Any activity relating to concept ualizing, outlining, creating the designs and preparing patterns for costumes, apparels, garments, clothing accessories, jewellery or any other article intended to be worn by human beings • Any other service incidental thereto [section 65(43)]	**Exclusions** • If fashion designer designs and makes garments himself and sells them, there is no service tax, as he is providing designing service to himself. — Services of tailor and jewellers are not taxable, as no designing is involved. - — CBE&C circular No.B.11/1/2002-TRU dated 1-8-2002 **Exemptions** • Refer 4.4
Fashion designing	**Statutory coverage** • Any activity relating to conceptualizing, outlining, creating the designs and preparing patterns for costumes, apparels, garments, clothing accessories, jewellery or any other article intended to be worn by human beings • Any other service incidental thereto [section 65(43)]	**Exclusions** • If fashion designer designs and makes garments himself and sells them, there is no service tax, as he is providing designing service to himself. — Services of tailor and jewellers are not taxable, as no designing is involved. — CBE&C circular No.B.11/1/2002-TRU dated 1-8-2002 **Exemptions** • Refer 4.4
Forward contract	**Statutory coverage** • Service by a member of a recognized association or aregistered association, in relationto a forward contract. • "Forward contract" means the contract for delivery of goods at future date and which is not for ready delivery contract.	**Exemptions** Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
General insurance	**Statutory coverage** • Services by an insurer, including reinsurer, in relation to general insurance business. **Case Law/Board Circulars** • No service tax if assets are in J&K — DGST instruction No.V/DGST/03/GEN/INS/01/2004 dated 17-8-2004	**Exemptions** • Certain schemes like personal accident social security scheme,crop insurance, cattle insurance, janata policy, export credit insurance, insurance on export of goods from India are exempt- Notification No. 3/1994-ST dated 30-6-1994. • Jana Arogya Bima policy is exempt from service tax - Notification No. 12/1997-ST dated 14-2-1997. • Group personal accident policy for self employed women is exempt under notification No.3/1994-ST dated 30-6-1994. Scheme of Rajasthan Government is exempt under notification No. 1/2000-ST dated 9-2-2000. • (a) Cattle insurance services are exempt. — Noti-fication No. 4/2000-ST dated 31-7-2000 (b) National Agricultural Insurance Scheme, Seed Crop Insurance, Farm Income Insurance Scheme are exempt from service tax - Notification No. 3/2000-ST dated 6-7-2000 (c) Insurance of sheep is exempt upto 31-12-2009 – Notification No. 31/2006-ST dated 11-12-2006. • General Insurance Business service provided under Universal Health Insurance Scheme is exempt from service tax - Notification No. 16/2003-ST dated 11-7-2003. • Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Health and fitness	**Statutory coverage** • Service for physical well being suchas, sauna and steam bath, turkish bath, solarium, spas, reducing or slimming saloons, gymnasium, yoga, meditation, massage (*excluding* therapeutic massage) or any other like service [section 65(51)]	**Exclusions** • Institutions conducting diploma courses in yoga and research centers do not fall inthe category of health club and will not be liable to service tax. - CBE&C circular No. B.11/1/2002-TRU dated 1-8-2002 **Exemptions** •Refer 4.4
Insurance Auxiliary (General insurance)	**Statutory coverage** • Service to a policy holder or any person or insurer, including reinsurer, by an actuary, or inter mediary or insurance intermediary or insurance agent, in relation to insurance auxiliary services concerning general insurance business. • Risk assessment, claim settlement, survey and loss assessment [section 65(55)] **Reverse charge - Person liable to pay service tax** • In respect of services provided by an insurance agent, the insurance company is the 'person liable for paying the service tax'. [section 68(2) of Finance Act, 1994 read with rule 2(1)(d) (iii) of Service Tax Rules, 1994]. The service tax is payable on commission payable to the insurance agent. However, the exemption available to small service providers cannot be availed by insurance agent.	**Exemptions** Refer 4.4
Intellectual property	**Statutory coverage** • Transferring temporarily; or permitting the use or enjoyment of, any intellectual property right is taxable [section 65(55b)] • "intellectual property right" means any right to intangible property, namely, trademarks, designs, patents or any other similar intangible property, under any law for the time being in force, but does not include copyright [section 65(55a)]	**Exclusions** • Copyright service is excluded. • Permanent transfer of Intellectual Property not taxable **Exemptions** • Cess is payable under-section 3 of Research and Development Cess Act,1986, on transfer of technology. If such cess is payable, the holder of intellectual property right will be granted exemption from service tax to the extent of cess paid. -Notification No. 17/2004-ST dated 10-9-2004. Thus, if value of service is Rs 100, tax payable is Rs 12 and cess paid is Rs 5, net service tax actually payable will be Rs 7. • Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Interior decorator	**Statutory coverage** • Planning, design or beautification of spaces, whether man made or otherwise, in any manner • Advice, consultancy, technical assistance or in any other manner, services relating to planning, design or beautification of spaces • Landscape designer [section 65(59)] **Case Law/Board Circulars** • Services of vastu/Feng shui consultants are taxable • No tax on material, furniture, and temporary structures	**Exemptions** • Refer 4.4
Internet cafe	**Statutory coverage** • Facility for accessing internet	**Exemptions** • Refer 4.4
Internet telephony service	**Statutory coverage** • Telecommunication servic through internet and includes fax, audio conferencing and video conferencing	[section 65 (57a)] **Exemptions** • Refer 4.4
Life insurance	**Statutory coverage** • Service in relation to risk cover inlife insurance. **Case Law/Board Circulars** • Service tax is payable on gross amount charged in respect of risk portion of insurance premium. **Valuation**	• As per rule 6(7A), the insurance company will have option to pay tax at flat rate of 1% of the gross premium without showing any break-up. If policy is purely risk coverage, then service tax will be at full rate on the gross premium. **Exemptions** • Refer 4.4
Mailing list compilation and mailing	**Statutory coverage** • Service in relation to— (i) compiling and providing list of name, address and any other information from any source; or (ii) sending document, information, goods or any other material in a packet, by whatever name called, by addressing, stuffing, sealing, metering or mailing; for, or on behalf of the client [section 65(63a)]	**Exemptions** • Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Management, Mainte-nance or repair	**Statutory coverage** • Any service provided by (i) any person under a contract or an agreement; *or* (ii) a manu-facturer or any person authorised by him, in relation to, (a) management of pro-perties, whether immovable or not (b) maintenance or repair of properties whether immova-ble or not; or (c) maintenance or repair including reconditioning or restoration, or servicing of any goods or equipment, excluding motor vehicle • "Goods" includes computer software [section 65(64)] **Case Law/Board Circulars** • Services relating to maintenance or management of immovable property (such as roads, airports, railways, buildings, parks, electrical installations and the like) have been covered under the purview of service tax - para 16.2 of MF (DR) circular No.B1/6/2005-TRU dated 27-7-2005 • Services provided during the warranty period by the dealer or any other authorized person is taxable - CBE&C circular No. 59/8/2003 dated 20-6-2003. • Software maintenance is taxable. • AMC contracts taxable.	**Exclusions** • Services to motor vehicles not taxable under this head [section 65(64)] **Exemptions** • Refer 4.4
Management or Business Consultant	**Statutory coverage** • Service in connection with the management of any organi-sation or business in any manner • Advice, consultancy or technical assistance, in relation to financial management, human resources management, marketing management,productionmanagement, logis-tics management, procurement and management of infor-mation technology resources or other similar areas of manage-ment [section 65(65)]	**Exclusions** • Executory services would not fall under 'consultancy services' - *Glaxo Smithkline Pharmaceuticals* v. *CCE* (2005) 1STT 37 (CESTAT) – quoted with approval in *Glaxo Smithkline Consumer Healthcare*v. *CCE* (2007) 9 STT 496 (CESTAT). **Exemptions** • Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Mandap keeper	**Statutory coverage** • "mandap" means any immovable property and includes any furniture, fixtures, light fittings and floor coverings there in let out for consideration for organising any official, social or business function [section 65(66)] • Social function includes marriage [section 65(67)] • Service provided as a caterer are included [section 65 (105)(m)] **Case Law/Board Circulars** • Services of hotel or restaurant will betaxable if it provides 'mandap'services. — view confirmed in *Rajmalal Hotel* v. *CCE* (2007) 6 STT 11(CESTAT). **Exclusions**	In *Social Service League* v. *CCE* (2006) 4STT 283 (CESTAT), it has been held that drama performances conducted ina hall or mandap will not come under mandap keeper services. In a contrary view, in *ADA Rangamandira Trust* v.*CCE* (2007) 8 STT 206 (CESTAT), it washeld that drama, music and dances hould be held as social functions. **Exemptions** • If the mandap keeper provides catering services alsoand if his bill indicates that his bill is inclusive of charges for catering services, he has to pay service tax only on 60% of his gross charges to client.Catering service means supply of food - Notification No.1/ 2006-ST dated 1-3-2006. • Use of precincts of a religious place as *mandap* is exempted from service tax - notification No. 14/2003-ST dated 20-6-2003, • Refer 4.4
Manpower recruitment or supply agency	**Statutory coverage** • Recruitment or supply of manpower, temporarily or otherwise, in any manner • Services in relation to pre recruitment screening, veri-fication of the credentials and an tecedents of the candidate and authenticity of documents submitted by the candidate. **Case Law/Board Circulars** • Academic/educational ins-titutes providing recruitment services are taxable - Ref Code 010.01/23.8.07 of CBE&C Circular No. 96/7/2007-ST dated 23-8-2007. • Services of labour contractors are taxable w.e.f. 16-6-2005. • Service of providing employees of Agency to business or industrial organizations for a specific period is taxable - Ref Code 010.02/23.8.07 of CBE&C Circular No. 96/7/2007-ST dated 23-8-2007.	**Exemptions** • Refer 4.4 **Valuation** • Service tax is to be charged on the full amount of consideration for the supply of manpower, whether full-time or part-time. The value includes recovery of staff costs from the recipient e.g. salary and other contri-butions. Even if the arrange-ment does not involve the recipient paying these staff costs to the supplier (because the salary is paid directly to the individual or the contributions are paid to the respective authority) these amounts are still part of the consideration and hence form part of the gross amount - per MF(DR) circular No.B1/6/2005-TRU dated 27-7-2005 para 22.4 (It is difficult to agree with this view. However, if the principal employer is in a position to avail Cenvat credit, it may be advisable to pay service tax on entire amount, instead of entering into fruitless and costly litigation).

Description of service	Coverage	Exclusions/Exemptions
Market research agency	**Statutory coverage** • Market research in any manner, inrelation to any product, service orutility, including all types of customised and syndicated research services [section 65(69)]	**Exemptions** • Refer 4.4
Mining of mineral, oil or gas services	**Statutory coverage** • Service in relation to mining of mineral, oil or gas.	**Exemptions** • Refer 4.4
On-line information and database accessor retrieval	(Computer network) **Statutory coverage** • On-line information and data base access or retrieval or both in electronic form through computer network • Providing data or information, retrievable or otherwise, to a customer, in electronic form through a computer network [section 65(75)] **Case Law/Board Circulars** • Following would be covered - (a) Internet Service Providers (ISP) (b) On line information provision and retrieval services like paid websites. However, e-commerce transactions are not covered as they do not charge surfers. - CBE&C letter No.B.II/I/2000-TRU dated 9-7-2001. • Providing matrimonial services onwebsite is taxable – *prima facie* view in*Bharat Matrimony.com Pvt. Ltd.* v. *CST* (2007) 6 STT 85 (CESTAT)	**Exemptions** • Refer 4.4
Opinion poll	**Statutory coverage** • Service designed to secure information on public opinion regarding social, economic, politicalor other issues [section 65(75a)]	**Exemptions** Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Outdoor Caterer	**Statutory coverage** • Services in connection with cateringat a place other than his own, but including a place provided by way of tenancy or otherwise by the person receiving such services [section 65(76a)] • "Caterer" means any person who supplies, either directly or indirectly, any food, edible preparations, alcoholic or non-alcoholic beverages or crockery and similar articles or accoutrements for any purpose oroccasion [section 65(24)] **Case Law/Board Circulars** • Supply of food to airlines for in-flight service to passengers is taxable-*Saj Flight Services* v. *Superintendent of CE*(2006) 3 STT 165 (Ker HC)– confirmed in *Saj Flight Services* v. *Superintendent of CE* (2006) 5 STT 266(Ker HC DB) • In case of canteen in office or factory run by canteen contractor, if theservice is received by the employer, it will be taxable. If the service is directly provided to employees/workmen, then the canteen should not come within the definition.	**Exclusions** • Home delivery of food not taxable - MF(DR) circular No.B2/8/2004-TRU dated 10-9-2004. **Valuation** • The outdoor caterer can opt to pay service tax on 50% of his Bill amount. He can avail this concession if following conditions are satisfied - (a)The Bill or challan issued indicates that it is inclusive of charges for supply of food (Food means a substantial and satisfying meal, only snacks are not sufficient) (b) He does not take Cenvat credit ofduty/service tax paid oninputs, input services and capital goods and (c) He does not avail benefit of notification No. 12/2003-ST dated 20-6-2003 - Notifi-cation No. 1/2006-ST dated 1-3-2006. **Exemptions** • Refer 4.4
Packaging Activity	**Statutory coverage** • Packaging of goods including pouch filling, bottling, labelling or imprinting of the package [section 65(76b)] **Case Law/Board Circulars** • The intention seems to be to cover specialised packaging services like packing for transport etc. If packaging results in manufacture of new Article, excise duty will become payable.	**Exclusions** • Any packaging activity that amounts to 'manu-facture' within the meaning of section 2(f) of Central Excise Act, 1944 is excluded. **Exemptions** • Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Pandal or Shamiana	**Statutory coverage** • Service by a pandal or shamiana contractor • 'Pandal or shamiana' means a plac especially prepared or arranged for organizing an official, social or business function. Social function in-cludes marriage [section 65(77a)] • Preparation, arrangement, erectionor decoration of a pandal or shamiana • Supply of furniture, fixtures, lights and lighting fittings, floor coverings and other articles for use in pandal or shamiana [section 65(77b)]	**Valuation** If a pandal or shamiana contractorprovides catering services of fullmeals, tax will be payable only on70% of the gross amount charged toclient - Notification No. 1/2006-STdated 1-3-2006 **Exemptions** Refer 4.4
Photography	**Statutory coverage** • "Photography" includes still photography, motion picture photography, laser photo-graphy, aerial photography or fluorescent photography [section 65(78)] **Case Law/Board Circulars** • In *Live Tone* v. *State of Tripura* (2001) 122 STC 115 (Gau HC), it was held that works contract tax (Vat) can be levied on the value of goods transferred (i.e. negative and printing paper) but not on wholeprice which includes charge of artistic skill required in developing photo-graph – same view in *Classic Colour Lab* v. *DCCT* (1998) 110 STC269 (Kar HC) * *Bavens* v. *UOI* (1995) 97 STC 161 (Ker HC DB)	**Exclusions** • X-ray or CT scan will not be covered as in common parlance they are not photography studios or agencies. - CBE&C letter No.B.II/ I/2000-TRU dated 9-7-2001. **Valuation** • In *Laxmi Colour* v. *CCE* (2005)2 STT 220 = 3 STR 363(CESTAT), it was held that no deduction of material cost is allowable. It was also held that in service like photography, there is noelement of sale of goods. Thus, tax is payable on entire amount. **Exemptions** • Refer 4.4
Practising CA/CWA/CS Services	**Statutory coverage** • Service by a Practising CharteredAccountant/Cost Accountant/Company Secre-tary in his professional capacity	**Exemptions** • Services provided by practising CA/CWA/CS in his professional capacity to a client, relating to representing before any statutory authority in the course of proceedings initiated under any law for the time being in force, by way of issue of notice, are exempt from service tax. All other services provided by practising CA/CWA/ CS in his professional capacity are taxable (Notification No.25/2006-ST dated 13-7-2006). • Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Programme Production (of TV or Radio programmes)	**Statutory coverage** • Service by a programme producer, in relation to a programme. • "Programme" means any audio or visual matter, live or recorded, which is intended to be disseminatedby transmission of electro-magnetic waves through space or through cables intended to be received by the general public either directly or indirectly through the medium of relay stations [section 65(86a)]	**Exemptions** • Refer 4.4
Public relations management service	**Statutory coverage** • Service in relation to managing the public relations of another person • "Public relations" includes strategic counselling based on industry, media and perception research, corporate image management, media relations, media training, press release, press conference, financial public relations, brand support, brand launch, retail support and promotions, events and commu-nications and crisis commu-nications [section 65(86c)]	**Exemptions** • Refer 4.4
Rail Travel Agent	**Statutory coverage** • Service in relation to booking of passage for travel by rail	**Exclusions** • Tax is *not payable* on rail fare collected by rail travel agent -rule 6(2)(iii) of Service Tax Valuation Rules. **Exemptions** • Refer 4.4
Real Estate Agent	**Statutory coverage** • Advice, consultancy or technical assistance, in relation to evaluation, conception, design, development, cons-truction, implementation, super-vision, maintenance, marketing, acquisition or management, of real estate [section 65(89)] • Service in relation to sale, purchase, leasing or renting, of real estate. • Services of Real estate consultant [section 65(88)]	**Exemptions** • Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Recovery Agent	**Statutory coverage** • Service in relation to recovery of any sums due to banking company or financial institution, including a nonbanking financial company, or any other body corporate or a firm.	**Exemptions** • Refer 4.4
Registrar to an issue	**Statutory coverage** • Activities in relation to an issue including collecting application forms from investors, keeping arecord of applications and money received from investors or paid tothe seller of securities, assisting in determining the basis of allotment of securities, finalising the list of persons entitled to allotment ofsecurities and processing and despatching allotment letters, refund orders or certificates and other related documents [section 65(89c)] • "Issue" means an offer of sale or purchase of securities to, or from, the public or the holder of securities [section 65(59a)]	**Exemptions** • Refer 4.4
Rent-a-Cab operator	**Statutory coverage** • Service in relation to the renting of a cab • "cab" means - (i) a motorcab, or (ii)a maxicab, or (iii) any motor vehicle constructed or adapted to carry more than twelve passengers, excluding the driver, for hire or reward [section 65(20)] **Case Law/Board Circulars** • If a driver is provided with cab, it is still rent-a-cab service – *Shiva Travels* v. *CCE* (2006) 7 STT 75 (CESTAT).	**Exclusions** • Maxicab referred to in sub-clause(ii) or motor vehicle referred toin sub-clause (iii) rented for useby an educational body imparting skill or knowledge or lessons on any subject or field, other than a commercial training or coaching centre, is excluded. • Ambulances are not meant for carrying passengers for hire or reward. Hence, service taxliability does not arise - para 7.2.1 of D.O. F. No. 334/1/2007-TRU dated 28-2-2007. **Exemptions** • Service tax is payable only on 40% of the gross amount charged by the operator for providing taxable service, if the Rent-a-cab operator does not avail Cenvat of duty/tax paid on inputs, input services and capital goods and he does not avail benefit of notification No. 12/2003-ST dated 20-6-2003 – Notification No. 1/2006-ST dated 1-3-2006. • Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Renting of immovable property	**Statutory coverage** • Renting of immovable property for use in the course or furtherance of business or commerce. • "Immovable property" includes - (i)building and part of a building, and theland appurtenant thereto (ii) land incidental to the use of such building orpart of a building (iii) the common or shared areas and facilities relating thereto; and (iv) in case of a building located in a complex or an industrial estate, all common areas and facilities relating thereto, within such complex or estate. • "Renting of immovable property" includes renting, letting, leasing, licensing or other similar arrangements of immovable property for use in the course or furtherance of business or commerce [section 65(90a)] • Use of immovable property as factories, office buildings, warehouses, theatres, exhibition halls and multiple-use buildings is covered [Explanation to section 65(90a)]	**Exclusions** • Renting of following is not included – (a) vacant land solely used for agriculture, aquaculture, farming, forestry, animal husbandry, mining purposes (b) vacant land, whether or not having facilities clearly incidental to the use of such vacant land (c) and used for educational, sports, circus, entertainment and parking purposes; and (d) building usedsolely for residential purposes and buildings used for the purposes of accommo-dation, including hotels, hostels, boarding houses, holiday accommodation, tents, camping facilities [section 65(90a)] • Renting of immovable property by a religious body or to a religious body; or renting of immovable pro-perty to an educational body, imparting skill or knowledge or lessons on any subject or field, other than a commer-cial training or coaching center is excluded [section 65(90a)] **Exemptions** • Deduction of property tax will be allowed in respect of tax actually paid (and not on payable basis). Deduction will be on *pro rata* basis. Service tax is payable only on rent actually received from service receiver. • Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Sale of advertising space or time	**Statutory coverage** • Sale of space or time for advertisement,in any manner is a 'taxable service' • Providing space or time, as the case may be, for display, advertising, showcasing of any product or service in video programmes, television programmes or motion pictures or music albums, or onbillboards, public places, buildings,conveyances, cell phones, automatedteller machines, internet • Selling of time slots on radio or television by a person, other than a broadcasting agency or organisation • Aerial advertising • Sale of space in yellow pages, business directories	**Exclusions** • Sale of space for advertisement inprint media. "Print media" means- (i) "newspaper" (ii) "book" butdoes not include businessdirectories, yellow pages andtrade catalogues which areprimarily meant for commercialpurposes • Sale of time slots by abroadcasting agency ororganisation (It is taxable underdifferent head) **Exemptions** • Refer 4.4
Scientific and technical consultancy	**Statutory coverage** • Service by a scientist or a technocrat, or any science or technology institution or organisation, in relation to scientific or technical consultancy **Case Law/Board Circulars** • Executory services would not fall under 'consultancy services' - *Glaxo Smithkline Pharmaceuticals* v. *CCE* (2005) 1 STT 37(CESTAT) – quoted with approval in*Glaxo Smithkline Consumer Healthcare Ltd.*v. *CCE* (2007) 9 STT 496 (CESTAT).	**Exclusions** • Service tax is not payable by doctors, medical colleges, nursing homes, hospitals, diagnostic and pathological labs etc. as in common parlance they are not known as scientists, technocrats etc. - CBE&C letter No. B.II/I/2000-TRU dated 9-7-2001. **Exemptions** • Notification No. 9/2007-ST dated 01.03.2007 exempts all taxable services provided by incubators. • Service tax exemption is also provided to incubates vide notification No. 10/2007-ST dated 1-3-2007: • Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Security agency	**Statutory coverage** • Services by security agency in relation to the security of any movable or immovable property orperson, by providing security personnel or otherwise • Provision of services of investigation, detection or verification of any fact or activity [section 65(94)] **Case law/Board circulars** • Service tax payable on services of safe deposit lockers. • Services provided by ex-servicemen or charitable orga-nization taxable w.e.f. 18-4-2006.	**Valuation** • Service tax is payable on gross amount charged for service. It has been clarified that service tax is payable on entire amount charged by security agency to client, which includes salary of guards, employer's ESIC, PF, contribution towards labour funds, bonus, leave, uniform etc. No abatement can be granted in respect of such expenses incurred by security agency. • In *Panther Detective Services* v.*CCE* (2007) 8 STT 215 (CESTAT), it was held that service tax is payable on gross amount including ESI, PF and wages of guards. The amount should be inclusive of service tax and then back calcula-tions should be made – same viewin *Punjab Ex-Serviceman Corpn* v. *CCE* (2005) 2 STT 273(CESTAT). **Exemptions** • Refer 4.4
Share Transfer Agent	**Statutory coverage** • Maintaining record of holders of securities and deals with all matters connected with the transfer or redemption of securities or activities incidental there to [section 65 (95a)]	**Exemptions** • Refer 4.4
Site formation and clearance etc.	**Statutory coverage** • Services in relation to site formation and clearance, excavation and earthmoving and demolition and such other similar activities. • drilling, boring and core extraction services for construction,geophysical, geological or similar purposes • soil stabilization • horizontal drilling for the passage of cables or drain pipes • land reclamation work • contaminated top soil strippingwork • demolition and wrecking of building, structure or road [section65(97a)]	**Exclusions** • Services in relation toagriculture, irrigation, watershed development • Drilling, digging, repairing, renovating or restoring of water sources or water bodies. **Exemptions** • Exemption to services relating to roads, airports, railways, transport terminals etc. bridges, port etc. - Noti-fication No. 17/2005-ST dated 7-6-2005 •Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Sound recording	**Statutory coverage** • Recording of sound on any media or device including magnetic storage device • Services relating to recording of sound in any manner such as sound cataloguing, storing of sound and sound mixing or re-mixing or any audio post-production activity [section 65(98)]	**Exemptions** Refer 4.4
Sponsorship service	**Statutory coverage** • Service in relation to sponsorship • "Sponsorship" includes naming an event after the sponsor, displaying the sponsor's company logo or trading name, giving the sponsor exclusive or priority booking rights, sponsoring prizes or trophies for competition [section 65(99a)] • Service tax is leviable only when the sponsor is any body corporate or firm [section 65 (105) (zzzn)] **Reverse charge - Person liable for paymentof tax** • In case of sponsorship service provided to a body corporate or firm located in India, the body corporate or firm receiving such sponsorship service will be liable to pay service tax [rule 2(1)(d) (vii)]. • If the recipient of sponsorship service is located outside India, service tax is required to be paid by the service provider and not by the recipient.	**Exclusions** • Sponsorship of sports events is excluded from the scope of this levy • Any financial or other support in the form of donations or gifts, given by the donors is not taxable, if the service provider is under no obligation to provide anything in return to such donors [section 65(99a)] **Exemptions** • Refer 4.4
Steamer Agent	**Statutory coverage** • Service in relation to a ship's husbandry or dispatch or any administrative work related thereto • Booking, advertising or canvassing of cargo • Container feeder services [section 65(100)] **Case Law/Board Circulars** • Expenses paid by steamer agent on behalf of shipping line not liable toservice tax - CBE&C circular No. B43/ 1/97-TRU dated 6-6-1997.	**Exemptions** • Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Stock broking	**Statutory coverage** • Service by a stock-broker in connection with the sale or purchase of securities listed on recognized stock exchange. • As per rule 6(1)(i) of Service Tax Valuation Rules (Earlier, it was *Explanation* 1 clause (a) to section 67 upto 18-4-2006), the value of taxable services shall include the commission or brokerage charged by a broker on the sale or purchase of securities including the commission or brokerage paid by the stock-broker to any sub-broker. **Case Law/Board Circulars** • No tax on turnover charges payable to stock exchange – *prima facie* view in *JSEL Securities Ltd.* v. *CCE* (2007) 8 STT 428 (CESTAT).	**Exemptions** Refer 4.4
Storage and warehousing	**Statutory coverage** • Services in relation to storage and warehousing of goods, including liquids and gases [section 65(102)] **Case Law/Board Circulars** • Storage outside the port premises is taxable - *Gujarat Chem Port Terminal Co. Ltd.* v. *CC* (2005) 1 STT 98 (CESTAT) • Storage of empty containers taxable -CBE&C circular No. 60/9/2003-ST dated 10-7-2003	**Exclusions** • Service provided for storageof agricultural produce orany service provided by acold storage excluded [section 65(102)] **Exemptions** • Refer 4.4
Survey and exploration of mineral	**Statutory coverage** • Geological, geophysical or other prospecting, surface or sub-surface surveying or map making service, in relation to location or exploration of deposits of mineral, oil or gas [section 65 (104a)]	**Exemptions** • Refer 4.4
Survey and map-making	**Statutory coverage** • Geological, geophysical or any other prospecting, surface, sub-surface or aerial surveying or map-making of any kind [section 65(104b)]	**Exclusions** • Service provided by an agency under the control of, or authorised by, the Government, in relation to survey and map-making not taxable [section 65 (105) (zzzc)] • Survey and exploration of mineral excluded [section 65 (104b)] (as covered under another head) **Exemptions** • Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Technical inspection and certification	**Statutory coverage** • Inspection or examination of goods or process or material or any immovable property to certify that such goods or process or material or immovable property qualifies or maintains the specified standards, including functionality or utility or quality or safety or any other characteristic or parameter [section 65(108)]	**Exclusions** • Service in relation to inspection and certification of pollution levels is excluded [section 65(108)] **Exemptions** • Refer 4.4
Technical testing and analysis	**Statutory coverage** • Service in relation to physical, chemical, biological or any other scientific testing or analysis of goods or material or any immovable property • Clinical testing of drugs and formulations [section 65(106)] **Case Law/Board Circulars** • Sample collection centers not taxable – *Dr.Lal Path Lab (P) Ltd.* v. *CCE* (2006) 5 STT 171 (CESTAT),	**Exclusions** • Testing or analysis service provided in relation to human beings or animals is excluded. • Testing or analysis for the purpose of determination of the nature of diseased condition, identification of a disease, prevention of any disease or disorder in human beings or animals is not taxable. Medical testing and diagnosis has been excluded from service tax [section 65(106)]
		Exemptions • Testing and analysis of water quality by Government laboratories exempt - Noti-fication No. 6/2006-Service Tax dated 1.3.2006. • Exemption to clinical testing of newly developed drugs - Notification No. 11/2007-ST dated 1-3-2007. • Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Telecommunication Services	**Statutory coverage** • Service of any description provided by means of any transmission, emission or reception of signs, signals, writing, images and sounds or intelligence or information of any nature, by wire, radio, optical, visual or other electro-magnetic means or systems, including the related transfer or assignment of the right to use capacity for such transmission, emission or reception • voice mail, data services, audio tex services, video tex services, radiopaging • fixed telephone services including provision of access to and use of the public switched telephone network for the transmission and switching of voice, data and video, in bound and out bound telephone service to and from national and international destinations	**Exclusions** • Service in relation to on-line information and database access or retrieval, a broadcasting agency or organisation in relation to broadcasting and internet telephony excluded [section 65(109a)] (since cover edunder another head) **Sale of SIM Card** • In *Bharat Sanchar Nigam Ltd*. v. *UOI* (2006) 3 SCC 1 = 152 Taxman 135 = 3 STT 245 = 282ITR 273 = 3 VST 95 = 145 STC91 = AIR 2006 SC 1383 (SC 3 member bench), it has been held that what a SIM card represents is ultimately aquestion of fact. In determining the issue, the assessing authorities will have to keep in mind the following principles, 'If the SIM card is not sold by the assessee to the subscribers but is merely part of the services rendered by service providers, then a SIM card cannot be charge dseparately to sales tax.
	• cellular mobile telephone services including provision of access to and use of switched or non-switched networks for the transmission of voice, data and video, inbound and outbound roaming service to and from national and international destinations • carrier services including provision of wired or wireless facilities to originate, terminate or transit calls, charging for interconnection, settlement or termination of domestic orinternational calls, charging forjointly used facilities including poleattachments, charging for theexclusive use of circuits, a leasedcircuit or a dedicated link includinga speech circuit, data circuit or atelegraph circuit • provision of call management services for a fee including call waiting, call forwarding, caller identification, three-way calling, call display, call conferencing.	It would depend ultimately upon the intention of parties. If the parties intended that the SIM card would be a separate object of sale, it would be open to the sales tax authorities to levy sales tax thereon. If the sale of SIM card is merely incidental to the service being provided and only facilitates the identification of subscriber, their credit and other details, it would not be assessable to sales tax. In any event, cost of service cannot be included in the value of SIM card.

Description of service	Coverage	Exclusions/Exemptions
Tour operator	**Statutory coverage** • 'Tour' means a journey from one place to another irrespective of the distance between such places. • Business of planning, scheduling, organising or arranging tours (which may include arrangements for accommodation, sight seeing or other similar services) by any mode of transport • Business of operating tours in a tourist vehicle covered by a permit granted under the Motor Vehicles Act [section 65 (115)]	**Exemptions** • In case of package tour, w.e.f. 23-8-2007, service tax is payable on 25% of gross amount charged (Till 22-8-2007, service tax was payable on 40% of gross amount charged) - Notification No.1/2006-ST dated 1-3-2006 • Tax only on 10% amount when operator only provides booking services -Notification No. 1/2006-STdated 1-3-2006.
	Case Law/Board Circulars • In *Praseetha Suresh* v. *CCE* (2007) 8 STT324 (CESTAT), it was held that thevehicle is required to satisfy specifications as per rule 128 of Motor Vehicle Rules. If these are not satisfied, it is not a tourist vehicle and hence the service is not taxable.	• Tax payable 40% in case of other tours - Notification No.1/2006-ST dated 1-3-2006. • Refer 4.4
Transport of persons by cruise ships	**Statutory coverage** • Transport of person embarking from any port by a cruise ship. "cruiseship" means a ship or vessel used for providing recreational or pleasure trips.	**Exemptions** • Refer 4.4
Transport of goods by air	**Statutory coverage** • Transport of goods by aircraft	**Exemptions** • Service of transport of goods is exempt if it is in relation to transport of export goods by aircraft - Notification No.29/2005-ST dated 15-7-2005. • Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Transport of goods by road	**Statutory coverage** • Service by a goods transport agency, in relation to transport of goods by road in a goods carriage. • 'Goods transport agency' means any person who provides service in relation to transport of goods by road **and** issues consignment note, by whatever name called [section 65(50b)] **Reverse charge - Person liable for payment ofservice tax** As per rule 2(1)(d)(v) of Service Tax Rules,Consignor or consignee *who is paying freight* will be liable to pay service tax, if consignor or consignee is any one of the following -(*a*) any factory registered under or governed by the Factories Act, 1948 (63 of 1948).(*b*) any company formed or registered under the Companies Act, 1956 (1 of 1956).(*c*) any corporation established by or under any law.(*d*) any society registered under the Societies Registration Act, 1860 (21 of 1860) or under any law corresponding to that Act in force in any part of India.(*e*) any co-operative society established by or under any law.(*f*) any dealer of excisable goods, who is registered under the Central Excise Act, 1944 (1 of 1944) or the rules made the reunder.(*g*) any body corporate established, or a partnership firm registered, by or under any law.	**Cenvat Credit** • The service receiver should pay tax by GAR-7 challan @ 3.09%.Then, he can avail Cenvat credit of tax so paid by him [Notification No. 1/ 2006-ST dated 1-3-2006]. **Exemptions** • As per exemption notification No.13/2008-ST customer by goods transport agency. Thus, service tax payable will be 3% plus 2% education cess plus 1% SAH education cess i.e. total 3.09%.Transport of fruits, vegetables, eggs or milk by road (as exempt under notification 33/ 2004-STdated 3-12-2004) • Gross Amount charged on consignments transported in a goods carriage does not exceed Rs. 1,500 (as exempt under clause (i) of noti-fication No.34/2004-ST dated 3-12-2004) [This is total of all consignmentscarried in a goods carriage at onetime] • Gross Amount charged onindividual consignment transported in a goods carriage does not exceed Rs. 750 (as exempt under clause (ii) of notification No. 34/2004-ST dated 3-12-2004). • Refer 4.4
Transport of goods in containers by rail	**Statutory coverage** • Transport of goods in containers by rail	**Exclusions** • Service provide by Government railway exempt. **Exemptions** • Service tax is payable only on30% of gross value charged, if Cenvat credit not availed -Notification No. 1/2006-ST, dated 1-3-2006. • Refer 4.4
Transport of goods (other than water) through pipeline or conduit	**Statutory coverage** • Transport of goods other than water, through pipeline or other conduit	**Exclusions** Transport of water is excluded. **Exemptions** Refer 4.4

Description of service	Coverage	Exclusions/Exemptions
Travel agent (other than air travel agent and rail travel agent)	**Statutory coverage** • Booking of passage for travel other than air travel and rail travel	**Exemptions** Refer 4.4
Video tape production agency	**Statutory coverage** • Process of any recording of any programme, event or function on a magnetic tape or on any other media or device • Services such as editing, cutting, colouring, dubbing, title printing, imparting special effects, processing, adding, modifying or deleting sound, transferring from one media or device to another • Any video post-production activity [section 65(120)]	**Exemptions** • Refer 4.4
Works Contract Services	"Works contract" means a contract wherein, –*(i)* transfer of property in goods involved in the execution of such contract is leviable to tax as sale of goods, **and** *(ii)* such contract is for the purposes of carrying out, -*(a)* erection, commissioning or installation of plant, machinery, equipment or structures, whether pre-fabricated or other-wise, installation of electrical and electronic devices, plumbing, drain laying or other installations for transport of fluids, heating, ventilation or air-conditioning including related pipe work, duct work and sheet metal work, thermal insulation, sound insulation, fire proofing or waterproofing, lift and escalator, fire escape stair cases or elevators; or *(b)* construction of a new buildingor a civil structure or a part there of, or of a pipeline or conduit, primarily for the purposes of commerce or industry; or *(c)* construction of a new residential complex or a part thereof; or *(d)* completion and finishing services, repair, alteration, renovation or restoration of, or similar services, in relation to *(b)* and (c); or *(e)* turnkey projects including engineering, procurement and construction or commissioning (*EPC)* projects	**Exclusions** • Works contract in respect of roads, airports, railways, transport terminals, bridges, tunnels and dams, are excluded. **Value of taxable service** • Broadly, two options areavailable to service provider - (a) Calculate value of service as perrule 2A of Service Tax (Determination of Value) Rules, 2006 (in short 'Valuation Rules) and pay service tax at normal rate @ 12.36% (inclusive of educationcess and SAH education cess) on such 'value'. In such case, assessee can avail Cenvat creditof input services, inputs and capital goods (b) Pay service tax under 'com-position scheme' at 4.12% of 'gross amount charged for works contract' (inclusive of education cess and SAH education cess), under 'Works Contract (Com-position Scheme for Payment of Service tax) Rules, 2007' (the percentage was 2.06% upto 29-2-2008). As per rule 3(2)of Composition Scheme, the assessee cannot avail Cenvat credit of inputs. Thus, the assessee can avail Cenvat credit of input services and capital goods. • In both the cases, Vat/sales tax will not be included in the 'value' for purpose of calculating service tax.

Description of service	Coverage	Exclusions/Exemptions
	Case Law/Board Circulars • In *Bharat Sanchar Nigam Ltd.* v. *UOI*(2006) 3 SCC 1 = 152 Taxman 135 = 3VST 95 = 3 STT 245 = 282 ITR 273 = 145STC 91 = AIR 2006 SC 1383 (SC 3 member bench), it was held that'various 'aspects' of transaction can be taxed separately, but sales tax cannot be imposed on service portion and service tax cannot be imposed on value of goods. In *Gannon Dunkerley & Co.* v. *State of Rajasthan* (1993) 66 Taxman 229 = 1993AIR SCW 2621 = (1993) 1 SCC 364 = 88 STC 204 (SC 5 member Constitution bench) it was held that value of goods at the time of incorporation in the works can constitute measure for levy of tax. However, cost of incorporation of the goods in works contract cannot be made part of measure for the levy of tax.	**Exemptions** • Construction and works contract services relating toports exempt, but no exemption to finishing or repairing services- Noti-fication No. 25/2007-ST dated 22-5-2007 • Refer 4.4

STUDY NOTE - 5
OVERVIEW OF FOREIGN TRADE POLICY

This Study Note includes

- Background
- Policy Changes Since 1991
- Foreign Trade Policy 2004-09
- Administration of Policy by DGFT
- Import/Export Authorisation
- Export Promotion Councils
- Policy for Import of Goods
- Restriction on Exports

5.1 BACKGROUND

India had for long time adverse balance of payment position in international trade i.e. imports were more than exports; due to which there was shortage of foreign exchange in India. Foreign Exchange Regulation Act was introduced in 1947. This was later replaced with 'the Foreign Exchange Regulation Act, 1973' (FERA) , which came into effect on 1st Jan., 1974 (Now FEMA is in force w.e.f. 1-6-2000].

The policy adopted was to restrict imports by licensing and heavy customs duty on imports.

Import Trade Controls were first introduced in early stages of Second World War by notification under Defense of India Rules. Later, Imports and Exports (Control) Act, 1947 was passed. Foreign exchange rate was artificially controlled by RBI.

India's poor export performance - India's share in total world export of goods and commercial services was 0.6% in 1995. It rose to 0.7% in 2001 and is 1% in 2007. China's share in world exports was 4.3% in 2001 which rose to 8.4% in 2007 [source - Economic Survey 2007-08 - Government of India].

India has adverse balance of trade i.e. imports are more than exports. In 2006-07, imports were 1,85,747 million USD and exports were 1,26,360 million USD.

5.2 POLICY CHANGES SINCE 1991

Government realised the ill effects of controls on imports and foreign exchange rates. Liberalisation of policies started in 1991. Restrictions on imports have been considerably reduced. Rupee has been made freely convertible on current account. Customs duty has been gradually reduced to almost international level.

Policy for Foreign Direct Investment (FDI) in India has been considerably liberalised. India has established a good lead in service exports - particularly in software sector.

Import and export free in majority of cases - As per WTO stipulations, Quantitative Restrictions (QR) on imports (i.e. import licence restrictions) have to be removed. Such restrictions are permitted only if country has difficult position of foreign exchange reserves. However, since India's foreign exchange position is comfortable, European countries, USA, Japan and Canada took a stand that import restrictions must be removed. Finally, India agreed to remove all import restrictions w.e.f. 1-4-2001.

Para 2.1 of FTP states that exports and exports shall be free, except in cases where these are regulated by provisions of FTP or any other law for the time being in force. The item-wise export and import policy shall be as specified in ITS (HS) [Import Trade Classification (Harmonised System)] published and notified by DGFT, as amended from time to time.

Most of non-agricultural goods are freely importable. Even import of gold and silver has been considerably liberalised.

However, there are some restrictions on imports of agricultural produce, old cars etc. There will be prohibition of import of animal skins, narcotics, drugs, environmentally dangerous goods etc. Such prohibitions are permissible under WTO.

FT(D&R) Act in August 1992

Imports and Exports (Control) Act, 1947 was stifling the foreign trade and was a road block. That Act was replaced by the present Foreign Trade (Development and Regulation) Act (FTDR Act) in August 1992.

As per preamble of the FT(D&R) Act, the Foreign Trade (Development and Regulation) Act (FTDR Act) is designed to develop and regulate foreign trade by facilitating imports into India and augmenting exports from India; and for matters connected therewith.

Foreign Trade (Regulation), Rules 1993 have been framed under the FTDR Act. Foreign Trade Policy is announced from time to time under the Act. The Act is designed to authorise Central Government to formulate Export Import policy and change the policy as per changing situations. Authority is granted by Act to Government to implement the policy.

5.3 FOREIGN TRADE POLICY 2004-09

Section 5 of FT(D&R) Act authorises Central Government to formulate and announce Export and Import Policy and also amend the same from time to time, by notification in Official Gazette. The policy, which was earlier termed as Exim policy is now termed as 'Foreign Trade Policy'.

New Foreign Trade Policy for 2004-2009 (FTP) (earlier known as EXIM Policy) was announced on 31-8-2004. The policy is effective from 1-9-2004. Generally, it is amended every year in April (besides amendments done throughout the year). Annual amendments were made last year on 19-4-2007. This year, amended policy has been issued on 11-4-2008.

Contents of Foreign Trade Policy - The Foreign Trade Policy for the period 2004-2009 as announced on 31-8-2004 is a 5 volume document, as follows -

- Foreign Trade Policy having 9 chapters giving basic policy.
- Handbook of Procedures (HBP) Vol 1, containing 9 chapters, covering procedural aspects of policy. It also contains many Appendices, giving various forms, guidelines and lists.
- Vol 2 - Standard Input-Output Norms (SION) of various products for purpose of Duty Exemption Scheme
- ITC(HS) Classifications of Export and Import Items and policy in respect of each item.
- Handbook of DEPB Rates

Matters covered by Foreign Trade Policy

Following issues are covered under FTP -

- Policy for regulating import and export of goods and services.
- Export Promotional Measures
- Duty Remission and Duty Exemption schemes for promotion of exports
- Export Promotion Capital Goods (EPCG) scheme
- EOU/EHTP/STP and BTU schemes
- Special Economic Zones

5.4 ADMINISTRATION OF POLICY BY DGFT

The FTP is controlled and supervised by DGFT.

Central Government can appoint Director General of Foreign Trade (DGFT) and other officers like Additional Director, Joint Director, Deputy Director, Assistant Director, Export Commissioner etc. The DGFT advise Central Government in formulating policy and exercise specified powers under the Act [section 6 of FTDRA].

Handbook of Procedures (HBP) – Para 2.4 of FTP empowers Director General of Foreign Trade (DGFT) to specify procedures to be followed by importer, exporter and licensing authority. Under these powers Handbook (Vol 1 and 2), Schedule of DEPB rates and ITS(HS) are published by Public Notice by DGFT. These are also amended by public notice.

Transitional provisions in case of midway policy changes – Policy in respect of import and import changes frequently. If some restriction or regulation is placed on import or export, shipment of export or import within original validity with respect to balance and time period of irrevocable letter of credit will be permitted, if such LC was established before date of restriction. However, time limit for operationaling such LCs may be prescribed – para 1.5 of FTP.

Issue of authorisation by DGFT – DGFT issues 'authorisation' for import/export [*earlier, it was termed as 'license'*]

The word 'license' has been replaced by 'authorisation' w.e.f. 1-4-2006. Thus, 'Advance License' will be known as 'Advance Authorisation', 'Advance License for Annual Requirements' will be known as 'Advance Authorisation for Annual Requirements' and EPCG license will be known as 'EPCG Authorisation'.

As per para 9.9.1 of FTP, 'Authorisation' means a permission as per section 2(g) of Foreign Trade (Development and Regulation) Act, 1992 [FT(D&R] to import or export as per provisions of Foreign Trade Policy (FTP).

Regional Authority - DGFT has established Regional Authority (RA) [earlier known as Regional Licensing Authority (RLA) upto 31-3-2006] at various places under Joint Director General of Foreign Trade. As per para 9.49.1 of FTP, 'Regional Authority' means authority competent to grant an Authorisation under FTDR Act and Orders. Powers have been delegated to various regional offices to issue authorisation upto prescribed limits.

Interpretation of DGFT final and binding - Decision of Director General of Foreign Trade (DGFT) is final and binding in respect of (a) Interpretation of any provision of policy (b) Classification of any item in ITC(HS) or handbook Vol 1 or 2 (c) Schedule of DEPB rates (d) content, scope or issue of an authorisation issued under Policy. - Para 2.3 of Foreign Trade Policy.

Authorisation (earlier 'License') issued by DGFT or clarification issued by DGFT cannot be challenged by customs authorities. See case law discussed in an earlier chapter.

Committees – Following are some important committees – (i) Norms Committee to fix/modify norms under all schemes (ii) EPCG Committee for nexus with Capital Goods and benefits under EPCG (iii) Policy Relaxation Committee (PRC) for all other issues – para 2.5 of FTP.

Procedures for application, fees etc.

Handbook of Procedures (HBP) gives procedures for issue of authorisation. Objective of 'Handbook of Procedures' is to lay down simple and transparent procedures for easy compliance and administration. The Handbook contains provisions and procedures in respect of various heads under Foreign Trade Policy.

Filing of application forms - Electronic filing of application is permitted in many of the offices. Facility of clarification / interview through e-mail is provided. Digital signature has been introduced to facilitate online application. The website for filing e-application is http://dgft.gov.in. [para 2.74 of HBP Vol 1].

Aayat-Niryat form – Aayat Niryat Forms ANF 1 to ANF 8 have been designed and notified for various purposes.

Certificate of realisation of export proceeds – In case of imports made under export obligation, the importer is required to issue certificate from Bank regarding export realisation. The certificate should be in form given in Appendix 22A of HBP Vol 1. In case of domestic supplies, Bank certificate should be in form given in Appendix 22B of HBP Vol 1.

If RBI has permitted offsetting of export proceeds against import payables/equity investment/loan repayment etc., certificate for offsetting export proceeds should in form given in Appendix 22D of HBP Vol 1 to DGFT. The certificate should be duly certified by CA/Cost Accountant.

Payment through ECGC cover will be counted for benefits under FTP – para 2.25.1 of HBP Vol 1 (inserted w.e.f. 1-4-2008).

Payment of general insurance cover for transit loss would be treated as payment realised for exports under various export promotion schemes – para 2.25.2 of HBP Vol 1.

Late fee and supplementary claims – If application is filed after last date for submission but within six months from last date, application will be considered on payment of late cut @ 2% on entitlement. For delay between 6 months and one year, late cut will be 5% – para 9.3 of HBP Vol 1. Supplementary claim may also be considered after imposing a cut @ 2% on entitlement – para 9.4 of HBP Vol 1. (Till 31-3-2008, it was 10%, which was too high).

Import/Export Code Number

Every importer and exporter must obtain a 'Importer Exporter Code Number' (IEC) from DGFT (Director General of Foreign Trade) or officer authorised by him, by applying in prescribed form (section 7 of FT(D&R) Act).

Import and export without IEC number is not permitted, unless specifically exempted [para 2.12 of FTP].

Application for IEC number - Application for IEC number has to be made to DGFT in prescribed form ANF 2A, with fees of ₹ 250 (It was ₹ 1,000 upto 11-4-2008).

Format of bank certificate is given in Appendix 18A of HBP Vol 1. Profile of importer/exporter should be given in form ANF 1.

Declaration of IEC number on import/export documents – IEC number will be declared on Bill of Entry, Shipping Bill and other documents relating to customs [Rule 13 Foreign Trade (Regulation) Rules, 1993].

Application for IEC number has to be made to DGFT in prescribed form with specified documents, with fees of ₹ 1,000 in prescribed form.

Change in name, address and Constitution – Change in name/ address/ constitution should be incorporated within 90 days. Delay may be condoned on payment of penalty of ₹ 1,000 – para 9.1 of HBP Vol 1.

5.5 IMPORT/EXPORT AUTHORISATION

Application for licence for import or export has to be made to DGFT. Application fees are payable as prescribed. [section 8(1) of FT(D&R) Act].

Licence can be granted or refused. Refusal can be only by recording reasons in writing [section 8(2) of FT(D&R) Act].

Licence can be suspended or cancelled by giving notice and giving him opportunity of being heard.

If licence is refused, not renewed, suspended or cancelled, appeal against such order can be filed u/s 15 of FT(D&R) Act [section 9(5) of FT(D&R) Act].

Application for authorisation is to be made in form ANF 2B for import of restricted items, and in form ANF 2D for export of restricted items and ANF 2E for export of SCOMET items.

Two copies of authorisation - Authorisation (earlier termed as License) is issued in two originals - one is 'Exchange Control Copy' (which has to be submitted to bank for remitting foreign exchange) and other 'Customs Copy' to be submitted to customs authorities for permitting imports.

Denomination of import authorisation and EO – CIF value of Import authorisation and FOB value of Export Obligation (EO) will be denominated in free foreign currency as well as in Rupees. However, control will be on basis of foreign exchange amount and not on basis if Rupees. Export Obligation in case of intermediate supply and for deemed export shall be denominated in Indian Rupees – para 9.2 of HBP Vol 1.

Application fees for authorisation - Application fees payable are prescribed in Schedule to Foreign Trade (Regulation) Rules, 1993. Fee is not payable if application is by Government, local authority, institutions setup for educational, charitable or missionary purpose for import of goods, or import of goods (other than motor vehicle) for personal use - [rule 5(3) of Foreign Trade (Regulation) Rules, 1993].

5.6 EXPORT PROMOTION COUNCILS

19 Export Promotion Councils have been set up to promote and develop export of the country. These EPCs (Export Promotion Councils) are expected to monitor and encourage exports and to assist and guide the exporters. Their main aim is to project India's image abroad as a reliable supplier of high quality goods and services.

EPC are non-profit autonomous organisations – para 2.65 of HBP Vol 1.

Each Council is responsible for promotion of a particular group or products like Engineering Export Promotion Council, Apparel Export Promotion Council, Gem and Jewellery Export Promotion Council etc. These Councils are non-profit organisations registered as Companies or registered Societies.

Export Promotion Council for EOU and SEZ units has also been constituted.

Some Agencies like Coffee Board, Tea Board, Tobacco Board etc. are also considered as Export Promotion Councils. These are autonomous professional bodies. Government may provide financial support to these EPCs [para 2.65 of HBP Vol 1].

Services Export Promotion Council – Services Export Promotion Council has been established at 705, Bhikaji Cama Bhawan, Bhikaji Cama Place, New Delhi – 110 066. email – epces@vsnl.net.

RCMC - Exporter has to obtain Registration Cum Membership Certificate (RCMC) from Export Promotion Council or Commodity Board. Membership of EPC is compulsory, if an exporter intends to get export incentives. In other cases, membership is optional.

RCMC is valid from the 1st April of licensing year and is valid for five years –

Exporter should submit quarterly export returns to Export Promotion Council in Appendix 149C of HBP Vol 1. Status holders should also file return with FIEO – – para 2.70 of HBP Vol 1.

5.7 POLICY FOR IMPORT OF GOODS

As per WTO Stipulation, India had to remove all quantitative restrictions (QRs) on imports in phased manner. Hence, the imports were being liberalised every year and import restrictions were completely lifted on 1-4-2001. Now almost all non-agricultural items are freely importable.

Import free unless restricted or prohibited - Para 2.1 of FTP states that exports and exports shall be free, except in cases where these are regulated by provisions of FTP or any other law for the time being in force. The item-wise export and import policy shall be as specified in ITS (HS) [Import Trade Classification (Harmonised System)] published and notified by DGFT, as amended from time to time.

All items, except restricted, prohibited and importable through State Trading Enterprises (earlier termed as canalised items) can be freely imported [Items which could be freely imported were earlier termed as 'OGL' *i.e.* 'Open General Licence'].

ITC(HS)

The ITC (HS) [Import Trade Classification (Harmonised System)] notified by DGFT, gives item-wise policy for import of various articles para 2.1 of FTP].

The list is based on HSN system of classification (which is also followed in Customs Tariff Act]. Policy in respect of each item is given against each item, in following categories –

(a) Free – no restriction on imports (However, in some cases, prescribed conditions have to be fulfilled)

(b) Prohibited goods

(c) Restricted through authorisation or in terms of a public notice issued [para 2.7 of FTP]

(d) Importable through State Trading Enterprises (STE) (earlier terms as Canalised). However, these goods can be imported by anyone on obtaining Authorisation from DGFT [para 2.11 of FTP].

General restrictions – General prohibitions/restrictions on import/export are as follows –

- Import/export of arms and related material from/to Iraq [para 2.1.1 of FTP]

* Direct or indirect export and import of nuclear related or weapons of mass destruction from/to Democratic People's Republic of Korea [para 2.1.2 of FTP]
* Direct or indirect export and import of nuclear related or Iran's enrichment related or heavy water related activities [para 2.1.3 of FTP]

Restriction through notification by DGFT – DGFT can adopt and enforce any measure necessary for protection of public morals, protection of health, protection of IPR, conservation of natural resources etc., by issuing a notification [para 2.6 of FTP].

Actual User - If the import authorisation or licence is required, it is issued only to Actual User, unless the condition is specifically waived by RA (Regional Authority) [para 2.16 of FTP].

'Actual User' may be Industrial on non-industrial [para 9.4 of FTP].

The Actual User (Industrial) means a person who utilises the imported goods for manufacturing in his own industrial unit or manufacturing for his own unit in another unit including a jobbing unit [para 9.5 of FTP]. [Thus, actual user can supply the machinery / raw material etc. to other unit for manufacture on job work basis].

Actual User (Non Industrial) means a person who utilises imported goods for commercial establishment, laboratory, R&D Institution, University, educational institution or any service industry [para 9.6 of FTP].

In *Northern Plastics Ltd.* v. *CCE* 1998 AIR SCW 2355 = AIR 1998 SC 2371, it was held that a registered SSI unit can be an 'actual user'.

Transfer of goods imported under Actual User condition – Goods imported with Actual User condition can be transferred with prior permission of Regional Authority. Application giving details as prescribed in para 2.43 of HBP Vol. 1 should be made.

Broad Policy for import of goods

Broad outline of policy is as follows -

* Import of agricultural products like wheat, rice, maize, other coarse cereals, copra and coconut oil will be in State Trading category. Similarly, import of petroleum products including petrol, diesel and ATF will be in the category of State Trading. Urea will also be in State Trading.
* Import of Food Articles will be subject to compliance of provisions of Food Adulteration Act and Rules. Import of meat and poultry products will comply with provisions of Meat Food Product Order. Import of Tea Waste will be as per Tea Waste (Control) Order. Import of beef or even oils and food products containing beef is prohibited.
* Import of textile material using prohibited dyes like azo dyes is not permitted.
* New cars can be imported only from country of manufacture. They should comply with provisions of Central Motor Vehicle Rules. They should be right hand drive, with speedometer in KM. Import is permitted only through specified ports. Customs duty on new cars (CBU – Completely Built Units) has been kept high to discourage imports.
* Import of alcoholic beverages (liquor) will be as per mandatory requirements stipulated by State Governments.
* Second hand capital goods (except computers) are freely permitted without actual user condition. Thus, even traders can import and sale second hand capital goods Duty can be paid through DEPB credit.

Prohibited Items - Wild animals, their parts, ivory, tallow, fats or oils of animal origin, fish nail/tail/waste, pig fats, margarine of animal origin, degras, mutton tallow, chicory plants, and animal rennet are prohibited goods for obvious reason of saving wild life. These cannot be imported even on obtaining an 'authorisation'.

Second hand goods – Second hand capital goods including refurbished/reconditioned spares are freely permitted. Other second hand goods are restricted. Import of second hand PC, laptop, air conditioner, DG set, photocopier will require authorization. Import of re-manufactured goods will also require authorisation [para 2.17 of FTP].

Import of gold & silver – Import of silver and gold and coins is free subject to RBI regulations.

Import only through State Trading Enterprises - Some items should be imported only through State Trading Enterprises [earlier termed as 'Canalised items' upto 31.3.2001]. (*a*) Petroleum Products can be imported only through Indian Oil Corporation (*b*) Urea only through STC, MMTC and Indian Potash Ltd. (*c*) Wheat, maize, rice etc. Food Corporation of India (FCI) *(d)* Copra and crude oil – STC.

Users in India who require these goods have to register their indent with the canalising agency. Normally, the goods are released to only actual users. After the quota of goods is released in the favour of indentor, payment should be made within the stipulated period and delivery should be taken. Otherwise, the allotted quota lapses.

Import on export basis – New or second hand capital goods, equipments, components, parts, containers, jigs, fixtures, tools, moulds, dies etc. can be imported for export without an authorisation, if item is freely importable. A bond or bank guarantee for its re-export has to be submitted to Customs Authorities [para 2.21 of FTP].

Repairs abroad and re-import - Capital goods or their parts (whether imported or indigenous) can be sent abroad for repairs, testing or upgradation and re-imported without authorisation (licence) [para 2.22 of FTP].

Import of gifts - Import of gifts is permitted when goods are freely importable. In other cases, Customs Clearance Certificate (CCP) from DGFT will be required [para 2.19 of FTP]. Gifts upto ₹ 10,000 are exempt from customs duty.

Import of metallic waste and scrap – The metallic scrap should not contain hazardous, toxic waste, radio active material, arms, ammunition, mines, shells, cartridge or explosive material [para 2.32.1 of HBP Vol 1].

Import of steel, cast iron, copper, brass, Nickel, Aluminium, Zinc, Tin and Magnesium scrap is free subject to prescribed conditions. Pre-shipment inspection can be prescribed. Import will be permitted through specified ports only [para 2.32.2 of HBP Vol 1]. Import of other metallic scrap will be allowed only as per conditions given in ITC (HS) – para 2.32.2 of HBP Vol 1].

Pre-shipment inspection can be prescribed for this purpose. List of Inspection and Certification Agencies is given in Appendix 5 of HBP Vol. 1 Part II.

Import of live stock and live stock products, poultry products – Import of live-stock and live-stock products is prohibited in view of Aviation Influenza [para 16 of part 1, Schedule 1 of General Notes to ITC (HS)].

Samples upto ₹ 1,00,000 (₹ 3,00,000 for gem and jewellery sector) can be imported by all exporters without duty – para 2.27 of HBP Vol. 1 as amended w.e.f. 1-4-2008.

Samples in baggage - Commercial samples are not treated as '*bona fide*' luggage. Its import is as per provisions of Foreign Trade Policy as applicable to normal imports of commercial goods. These should be declared before customs officers at the time of arrival. [*New Delhi Commissionerate TN 12/96 dated 15-2-1996*]. The commercial samples are exempt from duty only to the extent explained below.

Small commercial samples and protopypes – *Bona fide* samples and prototypes upto ₹ 10,000 are exempt from customs duty, if imported by post or in aircraft or by courier service. While calculating vale of samples / prototypes, postal charges or airfreight are not considered. - Notification No. 154/94-Cus dated 13-7-1994.

5.8 RESTRICTIONS ON EXPORTS

Restrictions on exports are less compared to restrictions on imports. The Policy gives negative list of exports. This negative list is under three headings (*a*) Prohibited goods (*b*) Restricted through Authorisation (*c*) State Trading Enterprises [earlier termed as canalised].

Third party exports – Third party exports means exports made by an Exporter or Manufacturer on behalf of another exporter/s. The Shipping Bill shall indicate the names of both the exporter/manufacturer and exporter. The BRC, GR declaration, export order and the Invoice shall be in name of the third party exporter [para 9.62 of FTP and CBE&C circular No. 30/2005-Cus dated 12-7-2005].

Merchant Exporter – Merchant Exporter means a person engaged in trading activity and exporting or intending to export goods [para 9.40 of FTP].

General restrictions – General prohibitions/restrictions on import/export are as follows –

- Import/export of arms and related material from/to Iraq [para 2.1.1 of FTP]
- Direct or indirect export and import of nuclear related or weapons of mass destruction from/to Democratic People's Republic of Korea [para 2.1.2 of FTP]
- Direct or indirect export and import of nuclear related or Iran's enrichment related or heavy water related activities [para 2.1.3 of FTP]

Restriction through notification by DGFT – DGFT can adopt and enforce any measure necessary for protection of public morals, protection of health, protection of IPR, conservation of natural resources etc., by issuing a notification [para 2.6 of FTP].

Prohibited goods for export - Wild life including their products and parts, exotic birds, endangered plants, beef, pig fat, carcasses of buffalo, certain rock lobsters, meat and bones of wind animals, milk, skimmed milk, milk food for babies, peacock feathers and handicrafts of peacock feathers, dried leguminous vegetables, guar seeds, lentils, wheat and meslin, specified plant and plant portions, sea weeds, tallow/flat/oil of any animal origin excluding fish oil, sugar, sea shells, ivory, bovine semen, potato seeds, seeds, margarine of animal origin, human skeletons, wood and wood products, wood pulp, sandalwood and red sanders wood are prohibited.

Thus, items related to conservation of our natural resources, are mainly prohibited.

Export of personal luggage - *Bona fide* personal luggage can be exported either with passenger or one year before or after his departure from India. Export of items in negative list will require licence or authorisation [para 2.32 of FTP].

Export of gifts - Gifts upto ₹ 5,00,000 can be exported without authorisation. These can include edible items [para 2.32 of FTP].

For export of gifts/spares/replacement goods in excess of ceiling/period, application can be made to DGFT – para 2.53 of HBP Vol 1.

Exports of warranty spares and replacement - Warranty spares of plant, machinery etc. can be exported without authorisation along with the main equipment or subsequently within warranty period, subject to approval of RBI [para 2.33 of FTP]. [It is not clear why this new hurdle is created when we are talking of more and more liberalization].

If goods exported were found to be defective/damaged or otherwise unfit] can be replaced free of charge by exporter. Such replacement is allowed provided the replacement goods are not under restricted category – para 2.37 of FTP.

For export of gifts/spares/replacement goods in excess of ceiling/period, application can be made to DGFT – para 2.53 of HBP Vol 1.

SCOMET Items - Export of Special Chemicals, Organisms, Materials, Equipment and Technologies (SCOMET) is either prohibited or restricted. These cover nuclear material, nuclear reactors, equipment for nuclear explosive devises, rocket systems, toxic chemicals, micro-organisms, chemicals for weapons, viruses, etc.

Application for license for exporting these items is to be made to DGFT. Application will be considered by Exim Facilitation Committee (EFC). In respect of items specified in Appendix 3 to Schedule 2 of ITC(HS), application will be considered by Inter-Ministerial working group in DGFT based on criteria as specified in para 2.50 of FTP.

On export of SCOMET items, the end use is required to issue certificate in form given in Appendix 36 of HBP Vol 1.

General System of Preferences (GSP) – Under this scheme, industrialized i.e. developed countries extend tariff concessions to developing countries on unilateral basis. USA, EOU, Japan, Australia, Russia etc. Provide such concessions. Information is required to be submitted in prescribed form and is to be certified by authorised agencies. List of agencies authorised to issue GSP CoO (Certificate of Origin) is given in Appendix 4A of HBP Vol. 1 Part II – para 2.21.1 of HBP Vol. 1.

Global System of Trade Preference (GSTP) – Under this scheme, tariff concessions are exchanged among developing countries who have signed agreement. Some 46 countries are members of GSTP. India has exchanged tariff concessions with few countries in respect of some products. Certificate of Origin (CoO) is required to be obtained from Export Inspection Council [EIC] – para 2.21.1 of HBP Vol. 1.

SAARC Preferential Trading Agreement (SAPTA) – SAPTA came into operation in 1995. More than 3,000 tariff items are under tariff concessions. Certificate of Origin (CoO) is to be obtained from agencies as notified in Appendix 4B of HBP Vol. 1 Part II.

Asia-Pacific Trade Agreement (APTA) – Bangladesh, Sri Lanka, South Korea, India and China are exchanging tariff concessions under APTA - . Certificate of Origin (CoO) is required to be obtained from Export Inspection Council [EIC] – para 2.21.1 of HBP Vol. 1.

STUDY NOTE - 6
EXPORT PROMOTION SCHEMES

This Study Note includes

- Background
- Duty Drawback
- EOU and Similar Schemes
- Special Economic Zones
- Advance Authorisation
- Duty Entitlement Pass Book Scheme (DEPB Scheme)
- Duty Free Import Authorisation
- EPCG Authorisation
- Illustrations

6.1 BACKGROUND

- **Basic concept is that goods and services are to be exported, taxes are not to be exported.**
- **As per WTO stipulations, export incentives cannot be given, but exported goods can be made tax free.**
- **Various scheme have been devised to enable exporters to obtain inputs without payment of excise and customs duty and input services without payment of service tax. If tax paid, rebate can be obtained.**
- **Goods can be exported without payment of excise duty. If excise duty is paid, refund can be obtained.**

Broadly, the export incentives for manufacturers are —

(a) Indigenous inputs without payment of excise duty or rebate if duty paid
(b) No excise charged on final product or rebate if duty paid
(c) Imported inputs without payment of customs duty, or rebate if duty paid
(d) No export duty on export of final product
(e) Bank finance on priority basis and at concessional rate of interest
(f) Import of capital goods at concessional rate (under EPCG scheme)
(g) Exemptions/relaxations from Income tax
(h) Exemption from sales tax on final product (refund of CST paid on inputs in case of EOU. No CST for supply to SEZ and SEZ units)
(i) Usance bills of exchange executed by an exporter in relation to export transaction are fully exempt from stamp duty – SO 804(E) dated 8-7-2004.

WTO stipulation - As per stipulation of World Trade Organisation (WTO), no country can give 'export incentives' as such. The reason is that WTO intends to encourage free competition among nations. If incentives are given for exports, there will not be free competition. That is the reason why income-tax incentives on export income are being phased out. However, goods can be made tax-free for export purposes, which is permissible under WTO stipulations. Hence, all our export promotion schemes are directed towards ensuring that inputs as well as final products are made 'tax free'.

6.1.1 Input duty relief schemes

Various schemes have been devised to obtain inputs free from duty or to grant refund of the same. In some schemes, the unit has to be isolated from domestic production units, while in some schemes, the units producing goods for domestic production are also entitled to get inputs free of cost.

Schemes where export production unit has to be isolated from domestic production units - There are schemes where units producing goods for export purposes have to be isolated from domestic units. The schemes are - EOU, STP, EHTP, BTP and SEZ. [BTP – Bio-Technology Park]

Schemes where domestic production unit can get inputs free from taxes - The schemes of EOU, SEZ, STP, BTP and EHTP are suitable where the unit is exclusively or at least predominantly for export purposes. There are other schemes where a unit producing goods for domestic purposes is also entitled to get inputs / capital goods without payment of customs duty / excise duty. These can be broadly classified as follows.

Relief of excise duty on inputs – (a) Cenvat credit of duty paid on inputs can be utilised for payment of excise duty on other final products. Alternatively, refund of duty paid on inputs can be obtained (b) Same result can be achieved by paying duty on final product and claiming rebate. In this case, additional benefit is that duty paid on capital goods will also get refunded indirectly. In first case, only duty paid on inputs is refundable (c) Obtaining inputs without payment of excise duty under notification No. 43/2001-CE(NT). This is advisable when there are one or two major identifiable inputs (d) Rebate of duty paid on inputs under notification No. 41/2001-CE(NT) (e) Excise portion of Duty drawback.

Relief of customs duty on inputs – (a) Advance Authorisation (b) Duty Entitlement Pass Book scheme (DEPB) (c) DFIA (d) Customs portion of duty drawback.

Capital goods at concessional rate - Capital goods can also be obtained at concessional rate of customs duty under EPCG scheme.

It should be noted that an exporter can get relief only once. He cannot get double benefit.

6.1.2 Highlights of EOU/SEZ scheme

The highlights of EOU (Export Oriented Unit) and SEZ (Special Economic Zone) and distinctions are as follows –

Distinctions

- Supplies to SEZ from DTA are 'exports' while supplies to EOU from DTA are 'deemed exports'.
- SEZ unit has to be located within the specified zones developed, while EOU unit can be set up at any of over 300 places all over India. [Similarly, STP/EHTP/BTP unit can be situated within the zone specifically developed or at any place where EOU can be set up]
- There is physical control over movement of goods in Special Economic Zone, but there is no such physical control over goods to individual EOU.
- Minimum investment in plant and machinery and building is Rs 100 lakhs for EOU. This should be before commencement of commercial production. There is no such limit for SEZ.
- Fast Track Clearance Scheme (FTCS) for clearances of imported consignments for EOU. In case of SEZ units, customs clearance for export and import is obtained within the zone itself.
- In case of EOU, sale within India should be on payment of excise duty. In certain cases, excise duty payable will be only 50%/30% of normal customs duty payable on such goods if imported into India. In case of supplies from SEZ to Domestic Tariff Area, normal customs duty as payable on import of similar goods is payable.
- EOU unit can sale in DTA (Domestic Tariff Area) sale upto 50% of the FOB value of sales of preceding year, subject to fulfilment of positive NFE, on payment of concessional rate of duty. There is no such restriction in case of SE on percentage, but SEZ have to attain positive NFE.
- Restrictions under Companies Act on managerial remuneration are not applicable to SEZ units.
- The unit can exit (de-bond) with permission of Development Commissioner, on payment of applicable duties. However, in case of SEZ, the unit has to physically go out of SEZ. This is not the case of EOU.
- In case of EOU, Central Sales Tax (CST) paid on purchases is refundable (but not local tax), if goods are used for production (and not for services). In case of SEZ unit, supplier does not have to pay CST.

- Service tax is exempted in case of services provided with SEZ. In case of EOU, service tax exemption is not available but they can claim refund.
- 100% foreign equity is permissible in SEZ, except in a few cases. In case of EOU, restrictions of Foreign Direct Investment (FDI) are slightly more.
- Supplies made to EOU by Indian supplier are 'deemed exports' and supplier is entitled to benefits of 'deemed export' in form of refund of terminal excise duty and duty drawback. Supplies to SEZ are 'exports' and all export benefits i.e. DEPB and duty drawback are available.
- Restrictions on External Commercial Borrowings are less in case of SEZ, compared to restrictions on EOU.
- No exemption from labour laws, but State Government can relax certain provisions of labour laws in case of SEZ.
- SEZ are is specific locations where infrastructure is generally better.
- SEZ have more freedom of operations within zone compared to EOU.

Similarities

- The unit can import capital goods, raw materials, consumables, packing material, spares etc. without payment of customs duty. Similarly, these can be procured indigenously without payment of excise duty. Second hand capital goods can also be imported.
- They have to achieve positive NFE (Net Foreign Exchange Earnings).
- A bond in prescribed form has to be executed. [B-17 in case of EOU and form prescribed in Special Economic Zone Rules, 2003 in case of SEZ]. There is no physical supervision of customs / excise authorities over production and clearances, but prescribed records are required to be maintained.
- Generally, all final production should be exported, except rejects upto prescribed limit.
- Sub-contracting of production outside on job work basis is permissible after obtaining necessary permission on annual basis
- Job work for exports is permitted
- Samples can be sold / given free within prescribed limit
- Unutilised raw material can be disposed of on payment of applicable duties
- all foreign exchange earnings can be retained in EEFC account in foreign exchange.

STP / EHTP/BTP unit – Concept of STP/EHTP/BTP is similar to EOU. The STP/EHTP scheme is administered by Ministry of Information Technology, while BTP scheme is monitored by Department of Biotechnology. The STP/EHTP/BTP unit can be at a place specifically developed for the purpose or it can be located at any place where EOU can be set up. Thus, a STP/EHTP/BTP unit can be set up as an EOU unit anywhere in India or as a SEZ unit at specified developed locations in India.

6.1.3 Pros and cons of various schemes

It is true that no one scheme can be suitable to all. Each manufacturer has to weigh *pros* and *cons* of each scheme and determine which scheme is most beneficial to him.

Generally, if major production of the company is towards sale in DTA (Domestic Tariff Area) and only partly towards export, schemes like DEPB or DFRC or advance authorisation are suitable. Other things being equal, scheme of duty drawback is simple and easy to operate particularly when All Industry Rate fixed is good.

Schemes like EOU (Export Oriented Unit)/SEZ (Special Economic Zones) are suitable (a) when the undertaking is predominantly export oriented (b) Requirement of imported capital goods and imported raw material is high. EOU has lost most of its attractive features and recently, EOUs are getting step-motherly treatment from Government, while SEZ is 'favoured baby'.

6.2 DUTY DRAWBACK

- Duty drawback is rebate of excise duty and customs duty paid on inputs used in exported final product u/s 75 of Customs Act.
- All Industry drawback rate is fixed on industry average basis for various products. Incidence of service tax is also taken into account while fixing drawback rate.
- An individual exporter can get brand rate fixed for his product.
- Drawback rate is fixed by Commissioner of Central Excise.
- Duty drawback is available on re-export u/s 74 of Customs Act.

Drawback of customs and excise duty paid on inputs and service tax paid on input services – As per rule 2(a) of Customs, Central Excise Duties and Service Tax Drawback Rules, 1995, Drawback, in relation to any goods manufactured in India and exported, means the rebate of duty or tax, as the case may be, chargeable on any imported materials or excisable materials used or taxable services used as input services in manufacture of such goods [reference to service tax was inserted w.e.f. 13-7-2006]. 'Input service' has same meaning as assigned to it in Cenvat Credit Rules, 2004 [rule 2(da) of Drawback Rules, 1995].

As per para 9.22 of FTP, Drawback, in relation to any goods manufactured in India and exported, means the rebate of duty chargeable on any imported materials or excisable material used in manufacture of such goods in India. The goods include imported spares, if supplied with capital goods manufactured in India.

Duty Drawback even if CVD paid through DEPB – Duty drawback of CVD is available even when CVD is paid through DEPB credit – MF(DR) circular No. 41/2005-Cus dated 28-10-2005.

6.2.1 Drawback – When not eligible

Section 75 of Customs Act, 1962 provide some disallowances or cases when drawback allowed can be recovered. Further, section 76(2) of Customs Act, 1962 authorises Central Government to issue notifications prohibiting drawback if the goods are likely to be smuggled back to India after export. Drawback Rules also provide for some disallowances. These are summarised below :

- If sale proceeds of export goods are not received within time stipulated by RBI [This provision does not apply to goods supplied from DTA unit to SEZ unit]
- If no customs/excise duty is paid on the inputs or service tax is not paid on input services
- If imported inputs were obtained under Advance License (DEEC scheme) without payment of duty
- If importer avails DEPB or DFRC
- Goods manufactured under Customs Bond or Excise Bond where inputs were obtained without payment of duty
- Goods manufactured by EOU or a unit in Special Economic Zone (as they obtain inputs without payment of duty)
- If Cenvat was claimed on indigenous inputs. [In such case, excise portion of duty drawback will not be available].
- In case of negative value addition – i.e. selling price of exported goods is less than value of imported goods i.e. foreign exchange spent on import of raw material is more than FOB Value of exports.
- Jute batching oil used in manufacture of jute yarn, twist, twine etc.
- Packing materials used in relation to export of jute yarn, jute fabrics and jute manufacture.
- Where specific rates are provided, drawback will not be paid if it is less than 1% of FOB Value of the product, unless drawback claim per shipment is over ₹ 500 – para 11 of Notification No. 81/2006-Cus(NT) dated 13-7-2006 [earlier Notification No. 36/2005-Cus(NT) dated 2-5-2005].
- If wholesale market price of goods in India is less than the amount of drawback due.
- Exports to Nepal/Bhutan. However, exports to Nepal are eligible if payment is received under hard currency i.e. dollars, euro, Yen British pounds etc.

- No drawback of sales tax, octroi or other taxes – drawback is of customs and Central Excise duties *only*.
- Export of alcoholic liquor, cigarettes, cigar and pipe tobacco; *as stores*; to foreign going vessel of less than 200 tons.
- If goods exported by vessel of less than 1,000 tons; unless certificate is submitted that sale proceeds in foreign currency have been received and goods have landed at destination within three months.
- If drawback is less than ₹ 50.

Broadly, drawback is not allowed if excise/customs duty or service tax has not been paid on inputs or manufacturer has availed some other benefit in respect of duty paid on inputs or input services. Principle is that there cannot be double benefit.

6.2.2 Type of Drawback Rates

Duty drawback rates are of following types – (a) All Industry Rate (b) Brand Rate and (c) Special Brand Rate.

All Industry Drawback Rates - All Industry Drawback rates are fixed by Directorate of Drawback, Dept. of Revenue, Ministry of Finance, Govt. of India, Jeevan Deep, Parliament Street, New Delhi – 110 001. The rates are periodically revised – normally on 1st June every year. Data from industry is collected for this purpose.

Whenever specific rates are provided, drawback shall be payable only if amount is more than 1% of FOB value, except when the drawback claim per shipment exceeds Rs 500. Revised rates have been announced vide Notification No. 68/2007-Cus(NT) dated 16-7-2007 [earlier Notification No. 81/2006-Cus(NT) dated 13-7-2006].

The all industry drawback rates are given in two ways – (a) when Cenvat facility has been availed and (b) when Cenvat facility not availed. The difference between the two is central excise portion of duty drawback. If rate indicated in both is same, it means that it pertains to only customs portion and is available irrespective of whether exporter has availed Cenvat or not – Condition No 5 to Notification No. 68/2007-Cus(NT) dated 16-7-2007 [earlier No. 81/2006-Cus(NT) dated 13-7-2006].

Duty drawback rate shall not exceed 33% of market price of export goods (Rule 8A w.e.f. 15-2-2006).

In case of some cases, value cap has been fixed. In such cases, maximum drawback allowable per unit of quantity has been specified (This is to avoid misuse by over-valuation of export goods].

Brand Rate of duty drawback – It is possible to fix All Industry Rate only for some standard products. It cannot be fixed for special type of products. In such cases, *brand rate* is fixed under rule 6. The manufacturer has to submit application with all details to Commissioner, Central Excise. Such application must be made within 60 days of export. This period can be extended by Central Government by further 30 days. Further extension can be granted even upto one year in if delay was due to abnormal situations as explained in MF(DR) circular No. 82/98-Cus dated 29-10-1998.

Duty drawback rate shall not exceed 33% of market price of export goods (Rule 8A w.e.f. 15-2-2006).

Special Brand Rate of duty drawback – All Industry rate is fixed on average basis. Thus, a particular manufacturer or exporter may find that the actual excise/customs duty paid on inputs or input services is higher than All Industry Rate fixed for his product. In such case, he can apply under rule 7 of Drawback Rules for fixation of Special Brand Rate, within 30 days from export. The conditions of eligibility are (*a*) the All Industry Rate fixed should be less than 80% of the duties paid by him (*b*) rate should not be less than 1% of FOB value of product except when amount of drawback per shipment is more than ₹ 500 (*c*) export value is not less than the value of imported material used in them – i.e. there should not be '*negative value addition*'.

6.2.3 Drawback Rate Fixation

Forms and procedures have been prescribed for submitting details to jurisdictional Commissioner of Central Excise, who will fix the rate of duty drawback. [Earlier, it was done by Director of Drawback, New Delhi, upto 31-3-2003]. Manufacturer has to make application for fixation of duty drawback rate. Application for fixation of rate has to be filed to Commissioner of Central Excise within 30/60 days of export. [60 days in case of brand rate and 30 days in case of special brand rate]. This period can be extended by him upto further 30 days in exceptional and genuine cases, for which a special request should be made.

6.2.4 Drawback claim procedure

At the time of export, exporter shall endorse on the 'shipping bill' the description, quantity and other details to decide whether goods are eligible for duty drawback. He should submit one extra copy of shipping bill for drawback purposes. Copy of Invoice should be submitted.

If shipping bill under drawback is submitted electronically, that itself will be treated as claim for drawback [rule 13(5) of Drawback Rules amended w.e.f. 13-7-2006].

Declaration by Exporter – A declaration should be made rule 12(1)(a)(ii) of Duty Drawback Rules, on shipping bill or bill of export that claim of drawback. Further declarations are also required when brand rate or special brand rate has been fixed. These declarations have to be signed by exporter.

Forms of declarations for claiming All Industry Rates have been given in CC, Mumbai PN 10/2005-Cus dated 16-3-2005 [182 ELT T12].

Triplicate copy of Shipping Bill is the drawback copy and should be marked as 'Drawback Claim Copy'. It should be submitted with pre-receipt on reverse side with revenue stamp.

Declaration for non-availment of Cenvat – (a) If the manufacturer-exporter or supporting manufacturer of merchant exporter is registered with Central Excise, fact of non-availment of Cenvat credit can be verified from ARE-1 form furnished (b) If the manufacturer-exporter or supporting manufacturer of merchant exporter is not registered with Central Excise, they have to submit self-declaration about non-availment of Cenvat in prescribed form. – MF(DR) circular No. 8/2003-Cus dated 17-2-2003.

6.2.5 Duty drawback on Re-export

Section 74 of Customs Act, 1962 provide for drawback if the goods are re-exported as such or after use. This may happen in cases like import for exhibitions, goods rejected or wrong shipment etc. The re-exported goods should be identifiable as having been imported and should be re-exported within two years from date of payment of duty when they were imported. This period (of two years) can be extended by CBE&C on sufficient cause being shown. These should be declared and inspected by Customs Officer. Original shipping bill under which the goods were imported should be produced. The goods can be exported as cargo by air or sea, or as baggage or by post. - . - . – After inspection, export and submission of application with full details, 98% of the customs duty paid while importing the goods is repaid as drawback.

Section 74 is applicable when imported goods are re-exported as it is and article is easily identifiable, while section 75 is applicable when imported materials are used in the manufacture of goods which are then exported – *ABC India Ltd.* v. *UOI* 1992(61) ELT 205 (Del HC).

6.3 EOU AND SIMILAR SCHEMES

Key Points

- EOU scheme enables a manufacturer to import inputs without payment of customs duty and export final products.
- EOU should have positive NFE (Net Foreign Exchange Earning).
- They have to execute B-17 bond. Indigenous goods can be obtained without payment of excise duty by submitting CT-3 certificate.
- EOU can sale in DTA (Domestic Tariff Area) upto 50% of FOB value of their previous year's exports.
- Scheme of STP (Software technology Park), EHTP (Electronic Hardware Technology Park and BTP (Bio Technology Park) are similar to EOU.
- EOUs are presently getting step motherly treatment from Government.

6.4 SPECIAL ECONOMIC ZONES (SEZ)

SEZ is as if it is a separate island as if outside India, where inputs, capital goods and input services can be obtained without duty and service tax. SEZ are governed by Special Economic Zones Act and SEZ Rules. Supplies to SEZ from India is 'exports' and supplies from SEZ to DTA (Domestic Tariff Area) is 'import'.

SEZ are like a separate island within country. These are treated as if they are outside India for customs purposes. Goods can be brought in SEZ without payment of customs duty or excise duty. Supplies to SEZ from other parts of India are treated as 'exports' and are entitled to all export benefits. On the other hand, supplies from SEZ unit to any person outside SEZ is treated as 'import' by that person and normal customs duty is payable.

SEZ have full freedom of operations within SEZ and all facilities of import and export are provided within the zone itself.

SEZ units may be set up for manufacture of goods and rendering services. Trading units are also permitted.

Exemption from all taxes - SEZ and SEZ units will be exempt from all taxes like customs duty, excise duty, Central sales tax, State Vat, Income tax etc.

Types of SEZ - Multi-product SEZs should have an area of 1,000 hectares or more. Minimum 35% area shall be earmarked for processing. Remaining 65%/75% area will be available for developing residential and commercial areas. Sector specific SEZ can be as small as 10 hectares, out of which 50% should be for processing and balance can be for residential and commercial areas. SEZ for Free Trade and Warehousing (FTW) shall have an area of 40 hectares or more with a built up area of not less than one lakh square meters.

Integrated township plus manufacturing facilities - SEZ can be set up in public, private, joint sector or by Central Government or State Government, jointly or severally SEZ will be developed by Developers.. The Developer can allocate fully developed plots to entrepreneurs on purely commercial basis.

Developer of SEZ can provide services like water, electricity, security, restaurants, recreation etc. He can also develop township adjacent to SEZ. Proposal to establish a SEZ will be approved by Board of Approvals (BOA).

Trading in SEZ - Trading in imported goods as well as indigenous goods is permitted. However, benefit of section 10AA of Income Tax will not be applicable to such trading, other than trading in nature of re-export of imported goods – MC&I (DC) Instruction No. 4/2006 F No. 5/1/2006-EPZ) dated 24-5-2006 [210 ELT E12]. In case of trading, income tax benefits are available only in case of re-exports [see *explanation* to rule 76].

6.4.1 Special Economic Zones Act and Rules

Special Economic Zones Act, 2005 was passed by Parliament in May 2005. Basic purpose of the Act is smooth and hassle free operations in SEZ and a 'Single Window Clearance' for setting up an SEZ or a unit in SEZ. Major provisions of the Act have been made effective w.e.f. 10-2-2006. Sections 20 to 24 (dealing with offences in SEZ and civil suits arising in SEZ) and sections 31 to 41 (Establishment of SEZ Authority) have not been brought into force.

SEZ Act and Rules provide complete policy towards SEZ

The SEZ Act provides for the following -

- **Establishment of SEZ with approval from Board of Approvals (section 3 of SEZ Act).**
- **Notifying an area as SEZ by Central Government (sections 4 and 5 of SEZ Act).**
- **Board of Approval to approve establishment of SEZ (Sections 8 to 10 of SEZ Act).**
- **Development Commissioner for one or more SEZ as administrative authority for the SEZ (sections 11 and 12 of SEZ Act).**
- **Approval Committee to approve setting up an unit in SEZ (sections 13 and 14 of SEZ Act).**
- **Single window clearance by Approval committee for setting up unit in SEZ, OBU (Offshore Banking Unit) or International Finances Service Centre (sections 15 to 20 of SEZ Act).**
- **Appeal against decision of Approval Committee to Board of Approval [section 16(4) of SEZ Act and rules 55 to 69 of SEZ Rules]**

- Enforcement Agency or Enforcement Officer in respect of notified offences committed in SEZ (sections 21 and 22 of SEZ Act - Not brought into effect).
- Special Civil Courts for SEZ and criminal courts to try notified offences in SEZ and appeal to High Court [sections 23 and 24- Not brought into force].
- Reliefs from Income Tax, customs duty, service tax, central sales tax and excise duty and duty drawback on goods brought or services provided from DTA to SEZ developer or SEZ Unit (sections 26 to 29 of SEZ Act).
- Exemption from taxes as specified in First Schedule to SEZ Act (sections 7 and 26 of SEZ Act).
- Customs duty on goods supplied from SEZ unit to DTA (section 30 of SEZ Act).
- Establishment of SEZ Authority (sections 31 to 41 - these sections have not been brought into force).
- Compulsory reference of dispute to arbitration (sections 42 and 43 of SEZ Act).
- Exemptions and relaxations from provisions of certain Central Acts (sections 49 and 54 of SEZ Act).

6.4.2 Highlights of SEZ Rules

SEZ Rules, 2006 provide for the following :

- Procedure for establishment of SEZ (Rules 3 to 16).
- Procedure for establishment of a Unit in SEZ (Rules 17 to 21).
- Terms and conditions for entitlement of exemptions, drawbacks and concessions (Rules 22 to 46 - Chapter IV).
- Conditions for removal of goods from SEZ to DTA (Chapter V - Rules 47 to 50).
- Requirements and monitoring of Foreign Exchange Earnings (Chapter VI - Rules 53 to 54).
- Procedures for appeal to Board of Approval from order of Approval Committee (Chapter VII - Rules 55 to 69).
- Provisions relating to Identity Card, foreign exchange remittances, revival of sick unit, exit of unit and self declaration.
- Prescribed Forms A to K

SEZ Rules provide for-

- Simplification of procedures for development, operation, and maintenance of the Special Economic Zones and for setting up and conducting business in SEZs.
- Single window clearance for setting up of an SEZ.
- Single window clearance for setting up a unit in a Special Economic Zone.
- Single Window clearance on matters relating to Central as well as State Governments.
- Simplified compliance procedures and documentation with an emphasis on self certification; and
- A wide range of services can be rendered from SEZs.
- Documentation for various activities of the units has been reduced to the barest minimum with an emphasis on self-certification.
- No requirement for providing bank guarantees, thereby reducing transaction costs.
- Contract manufacturing for foreign principals allowed.
- Option to obtain sub-contracting permission at the initial approval stage.
- Import - Export of all items, through personal baggage has been allowed.

6.4.3 Policy to set up SEZ

Central Government has liberal policy for setting up such zones. SEZ can be set up in public, private, joint sector or by Central Government or State Government, jointly or severally [section 3(1) of Act]. Developer of such SEZ can allocate fully developed plots to entrepreneurs on purely commercial basis. Developer of SEZ can provide services like water, electricity, security, restaurants, recreation etc. He can also develop township adjacent to SEZ.

Proposal to establish a SEZ will be approved by Board of Approvals (BOA). Procedure to be followed for establishment of SEZ is given in Rules 3 to 16 of SEZ Rules, 2006.

6.4.4 Conditions relating to area and its utilisation

SEZ should have minimum specified area. In respect of non-processing areas, developer cannot lease vacant lands.

Area requirements of SEZ **- Minimum area of land and other terms and conditions of approval shall be prescribed by Central Government [section 3(8) of SEZ Act]. Minimum area requirements stipulated for various categories of SEZs are as follows.**

As per press report dated 5-4-2007, maximum area of SEZ can be 5,000 hectares. Minimum processing area shall be 50%. State Government shall not undertake any compulsory acquisition of land for such SEZ. Comprehensive resettlement and rehabilitation policy will be worked out ensuring livelihood of displaced persons.

Multi-product SEZ - Multi-product SEZs should have an area of 1,000 hectares or more [rule 5(2)(a) of SEZ Rules]. "Special Economic Zone for multi-product" means a Special Economic Zone where Units may be set up for manufacture of two or more goods in a sector or goods falling in two or more sectors or for trading and warehousing or rendering of two or more services in a sector or rendering of services falling in two or more sectors [rule 2(za) of SEZ Rules]

Minimum 35% area shall be earmarked for processing. This can be relaxed to 25% by Central Government on recommendation from Board of Approvals. Thus, remaining 65%/75% area will be available for developing residential and commercial areas.

Service Sector SEZ - Services-Sector SEZs should have an area of 100 hectares or more [first proviso to rule 5(2)(a) of SEZ Rules].

Minimum 35% area shall be earmarked for processing. This can be relaxed to 25% by Central Government on recommendation from Board of Approvals. Thus, remaining 65%/75% area will be available for developing residential and commercial areas.

SEZ in port or airport - In case of SEZ in port or airport, the area must be at least 100 hectares [rule 5(2)(b) of SEZ Rules]. "Special Economic Zone in a port or airport" means a Special Economic Zone in an existing port or airport for manufacture of goods in two or more goods in a sector or goods falling in two or more sectors or for trading and warehousing or rendering of services [rule 2(zc) of SEZ Rules].

Sector Specific SEZ **-** In some sectors where India has a competitive advantage, such as gems and jewellery, information technology, electronic hardware and software, bio-technology, sector-Specific SEZs can be set up over an area of 10 hectares or more Similarly, in case of SEZ in non-conventional energy, solar energy, the area shall be 10 hectares or more [first and second proviso to rule 5(2)(b) of SEZ Rules]

In case of SEZ for specific sectors, at least 50% of the area shall be earmarked for developing processing area. Thus, remaining 50% area will be available for developing residential and commercial areas.

6.5 ADVANCE AUTHORISATION

Inputs required to manufacture export products can be imported without payment of customs duty under Advance Authorisation. Advance Authorisation can be granted to merchant exporter or manufacturer exporter to import raw materials. Since the raw materials can be imported before exports of final products, the authorisation issued for this purpose is called '**advance Authorisation**'. [This was termed as 'Advance License' upto 1-4-2006]. Paras 4.1.3 to 4.1.14 of FTP and paras 4.4 to 4.30 of HOP (Vol. 1) make provisions in respect of 'advance authorisation'.

Advance authorisation is issued to allow duty free import of inputs with normal allowance for wastage. In addition, fuel, oil, energy, catalysts etc. required can also be allowed. Duty free import of mandatory spares upto 10% of CIF Value of Authorisation, which are required to be exported with resultant products may also be allowed. However, prohibited items of imports cannot be imported [paras 4.1.3 of FTP].

Advance authorisation will indicate name and description and of items to be imported and exported/supplied, aggregate CIF value of imports, FOB/FOR value and quantity of exports/supplies. If quantity cannot be indicated, value shall be indicated. Goods can be exported in anticipation of advance authorisation, after submission of application to licensing authority.

The advance authorisation will be for Actual User only. It is not transferable. The material imported under advance authorisation is also not transferable even after completion of export obligation. However, goods manufactured out of such imported material can be disposed of, after export obligation is fulfilled [para 4.1.5 of FTP].

There must be positive value addition [para 4.1.6].

Export Obligation - Export should be within 24 months from date of issuance of authorisation. In case of projects, export obligation shall be fulfilled within duration of execution of project. In case of Advance Authorisation for drugs issued against specific order, export obligation shall be fulfilled within 6 months from date of import of first consignment (para 4.22 of HOP Vol. I).

Advance authorisation can be revalidated for 6 months if export obligation was fulfilled, on payment of composition fee of 2% of duty saved on all unutilised imported items, by submitting application in 'Aayat Niryat Form'. Further extension of 6 months can be obtained on payment of 5% of duty saved on all unutilised imported items as composition fee (para 4.22.1 of HOP Vol. 1).

There is no extension beyond 36 months (24+12 months) – MF(DR) circular N. 16/2006-Cus dated 9-5-2006.

If it is not possible to fulfil export obligation in time, extension has to be obtained from licensing authority (i.e. DGFT). If there is marginal shortfall upto 5%, it can be regularised. If shortfall is higher (upto 50%), extension upto one year can be obtained on submission of bank guarantee of full amount of duty saved. Shortfall in exports can be regularised on payment of duty along with interest @ 15%.

Application for advance authorisation - Application for authorisation shall be made in duplicate in '*Aayat Niryat Form*' given in Handbook of Procedures (HOP) [para 4.4 of HOP (Vol. 1).

SION - The imports of raw materials is on the basis of standard input–output norms (SION). The SION are finalised and quantity allowed to be imported will be based on quantity exported. The price of inputs will be as declared by applicant. However, there must be positive value addition.

SION is fixed by 'Norms Committee'. Advance authorisation can be issued on basis of self declaration, subject to final adjustment as per SION fixed by NC (Norms Committee). (para 4.7 of HOP Vol. 1).

Exports in anticipation of authorisation – Exports in anticipation of Advance Authorisation is permissible, if procedure as specified in para 4.12 of HOP (Vol. 1) is followed. Advance authorisation after exports can be issued on basis of actual proof of exports. In such case, BG/LUT [Bank Guarantee/Letter of Undertaking] is not necessary (para 4.18(a) of HOP Vol. 1). In *CC* v. *Hindustan Tobacco* 2006 (193) ELT 190 (CESTAT), it was confirmed that export can be made in anticipation of license (now authorisation w.e.f. 1-4-2006).

EOU / SEZ / EHTP / BTP / STP can supply goods against advance authorisation – EOU / SEZ / EHTP / DTP/STP units can supply goods against advance authorisation. It is not necessary to convert advance authorisation into advance release order. The supplier will be entitled to benefits of deemed exports [amendment dated 17-5-2005 to FTP.].

Advance release order - Goods can be procured from indigenous manufacturer against advance release order (ARO) to be issued by RA (Regional Authority) (earlier known as Regional Licensing Authority upto 31-3-2006). The ARO can be denominated in foreign exchange/Indian Rupees [para 4.1.11 of FTP]. Alternatively, exporter can obtain goods from indigenous sources on basis of back to back Inland Letter of Credit (LC) from bank [para 4.1.12 of FTP and para 4.15 of HOP (Vol. 1)]. The value of Advance Authorisation will be reduced to that extent. - - Goods can be obtained from EOU/EHTP/SEZ/STP/BTP unit on basis of Advance Authorisation or DFRC. It is not necessary to convert Advance Authorisation into ARO (Advance Release Order) [para 4.1.11 of FTP].

Advance authorisation for intermediate supplies - In respect of supplies made against advance authorisation/ DFRC/DFIA against 'deemed export', the supplier is entitled to Advance Authorisation/DFRC/DFIA for intermediate supplies – para 8.4.1(i) of FTP.

Import and Export from specified port – Export and import under advance authorisation can be through sea ports, airports, ICDs and LCS specified in para 4.19 of HOP Volume I. Export shipments can be effected from any of SEZs.

Advance authorisation for annual requirements to exporters – Annual Advance authorisation would be issued to exporters having past export performance to enable them to import their requirements of inputs on annual basis. Annual Advance Authorisation will be granted upto 300% of FOB value of exports in preceding financial year. There should be positive value addition [para 4.1.10 of FTP]. Customs Notification No. 94/2004-Cus dated 10-9-2004 make provisions for such annual authorisation.

6.6 DUTY ENTITLEMENT PASS BOOK SCHEME (DEPB SCHEME)

The scheme is easy to administer and more transparent. The scheme is similar to Cenvat credit scheme. The exporter gets credit when he exports the goods. The credit is on basis of rates prescribed. This credit can be utilised for payment of customs duty on imported goods.

As per para 4.3 of FTP, DEPB scheme will continue to be in operation until it is replaced by a new scheme, which will be drawn up in consultation with exporters. DEPB scheme has been extended upto 31-3-2008 by customs notification No. 48/2007-Cus dated 29-3-2007. Same provision in amendment to Foreign Trade Policy, announced on 18-4-2007.

The scheme is proposed to be replaced by a new scheme, since it is said that existing scheme is not WTO compliant.

The objective of the scheme is to neutralise incidence of customs duty on the import content of export product. The neutralisation shall be provided by way of grant of duty credit against the export product [para 4.3 of FTP].

Exporter can have either DEPB or duty drawback and not both.

Exports under DEPB scheme are allowed only when DEPB rate for the concerned export product is finalised.

Under this scheme, exporters will be granted duty credit on the basis of notified entitlement rates. The entitlement rates will be notified by DGFT. The entitlement rates will be a percentage of FOB made in free foreign currency. The entitlement rate will be fixed on basis of SION (Standard Input Output Norms) and deemed import content. Value addition achieved in export product will also be taken into account [para 4.3.1 of FTP].

DEPB is a post export duty remission scheme, which allows neutralization of deemed import duty charges on inputs used in the export product as per SION and the basic customs duty payable on such deemed imports. Value addition is also taken into account – para 4.37 of HOP (Vol. 1).

Credit can be utilised for payment of customs duty on *any item* which is freely importable [para 4.3.1 of FTP and para 4.42 of HOP Vol. 1]. [Till 1-4-2006, the credit could not be used for payment of customs duty on capital goods].

Credit can be used for payment of basic customs duty as well as CVD. The importer has option to pay CVD by cash [para 4.3.2 of FTP].

The credit can also be used for payment of special CVD of 4%. If the CVD is paid by debit to DEPB, Cenvat credit/brand rate of duty drawback is available - MF(DR) circular No. 18/2006-Cus dated 5-6-2006.

The credit can be transferred to another person, but the transfer will be valid for imports within the same port from where exports were made. Import from other port will be available under TRA facility [para 4.3.4 of FTP].

DEPB is valid for 24 months for import [para 2.12 of HOP Vol. 1]. The DEPB and/or the items imported are freely transferable. However, DEPB can be transferred only after realisation of export proceeds.

The scheme is available to both manufacturer exporters as well as merchant exporters. DEPB has to be registered with customs house.

Application for DEPB - Filing of applications for DEPB and Advance Authorisation through DGFT website is compulsory w.e.f. 16-1-2006. The application should be digitally signed and fees shall be paid electronically. The procedure is prescribed in DGFT policy circular No. 44 (RE-2005)/2004-09 dated 10-1-2006.

Actual import content in export product not required – DEPB credit to be granted is not related to actual content of imported goods in export products, but deemed import content – *Anjani International* v. *CC* 2005 (186) ELT 512 (CESTAT).

No All India rate of duty drawback if goods exported under DEPB – If goods are exported under DEPB, All Industry Rate of duty drawback will not be available - para 2(g) of customs Notification No. 8/2005-Cus(NT) dated 18-1-2005.

Duty drawback and CVD credit available even if duty paid through DEPB, w.e.f. 17-9-2004 – Earlier, it was clarified that Cenvat of CVD can be availed only if CVD is paid in cash. Similarly, duty drawback was allowed only if CVD was paid in cash. However, para (vi) of notification No. 96/2004-Cus dated 17-9-2004 now specifically provides that drawback or Cenvat credit of CVD can be availed against amount debited in DEPB. The benefit is available only in respect of DEPB issued under Foreign Trade Policy i.e. on or after 1-9-2004 – confirmed in MF(DR) circular No. 59/2004-Cus dated 21-10-2004.

Para 4.3.5 of Foreign Trade Policy (FTP) reads as follows – 'Normally, the exports made under the DEPB scheme shall not be entitled for drawback. However, the additional customs duty/excise duty paid in cash or through debit under DEPB shall be adjusted as Cenvat credit or duty drawback as per rules framed by Department of Revenue'. Thus, Cenvat credit is available whether CVD is paid in cash or by debit to DEPB.

Duty drawback of CVD is available even when CVD is paid through DEPB credit – MF(DR) circular No. 41/2005-Cus dated 28-10-2005.

Customs can check PMV – In *Om Prakash Bhatia* v. *CC* 2003 AIR SCW 3452 = 155 ELT 423 (SC), it was held that over invoicing is an offence. To such goods, section 113(d) would apply and they can be confiscated. - - If margin of profit appears unreasonable, it is for the exporter to establish that it was a true export value stated in the shipping bill. [view held in *Om Prakash Bhatia* v. *CC* 2001(127) ELT 81 (CEGAT 5 member bench) confirmed].

Who cannot avail DEPB ? – Following cannot avail DEPB – (a) Goods manufactured in customs bonded warehouse (b) Goods exported against discharge of export obligation under Advance Authorisation (c) EOU, SEZ, STP, BTP or EHTP units (d) Export of goods of foreign origin, unless there is manufacture or processing (e) Exports made under specified paras of FTP.

Sales tax on sale of DEPB – DEPB (Duty Entitlement Passbook Scheme) is freely tradable. It is right to claim back credit. It is freely tradable and is 'goods'. It is taxable under sales tax. It is not actionable claim. – *Philco Exports* v. *STO* (2001) 124 STC 503 (Del HC DB). However, Haryana Tax Tribunal in case of *Sadhu Overseas*, has held that DEPB is a sort of money which can be used either by dealer or anybody else. Hence it is not 'goods' [CS September 2004 – page 1333].

6.7 DUTY FREE IMPORT AUTHORISATION (DFIA)

'Duty Free Import Authorisation' (DFIA) has been introduced w.e.f. 1-5-2006 as per para 4.4 of Foreign Trade Policy. Corresponding customs notification No. 40/2006-Cus dated 1-5-2006 has been issued. The scheme is said to contain features of Advance Authorisation and DFRC scheme.

'Advance Authorisation' is not transferable, while material imported under DFIA will be transferable after fulfillment of export obligation. In case of Advance Authorisation, positive value addition is sufficient, while in case of DFIA, 20% value addition is required, except in case of gem and jewellery sector.

DFIA is issued to allow duty free import of inputs used in manufacture of export product (with normal allowances for wastages), and fuel, energy, catalyst etc. Duty free import of mandatory spares upto 10% value of authorisation, which are required to be exported/supplied with resultant product is also allowed.

DFIA is issued on basis of SION. Import Authorisation will be limited to quantity mentioned in SION. DFIA is issued to manufacturer-exporter or merchant-exporter for following – (i) Physical exports including supplies to SEZ (b) Intermediate supplies and (c) Main contractors for supply of goods under Deemed Exports (except supply against Advance Authorisation and marine containers). In case of some deemed exports, DFIA is available to sub-contractors also [para 4.4.2 of FTP].

DFIA is initially issued with 'actual user condition'. Imports will be exempted from payment of basic customs duty, additional customs duty, education cess, anti-dumping duty and safeguard duty, if any [para 4.4.2 of FTP].

After export obligation is fulfilled, the scrip can be made transferable by Regional Authority. After endorsement of transferability, duty free inputs (except fuel) can be transferred. However, where SION is subject to 'actual user' norm, transferability is not allowed. In case of fuel, import entitlement can be transferred only to companies which have been granted authorisation to market fuel by Ministry of Petroleum and Natural Gas [para 4.4.6].

Cenvat credit will not be available in respect of inputs [para 4.4.7]. Drawback will be available only in respect of duty paid material used in goods exported as per drawback rate fixed by Ministry of Finance [para 4.4.8 of FTP].

Duty free procurement from domestic market is permissible against ARO/invalidation letter/back to back inland LC [para 4.4.3 of FTP]

Value addition should be minimum 20%, except in case of gem and jewellery sector and items for which higher value addition has been prescribed under Advance Authorisation Scheme [para 4.4.4 of FTP].

In respect of supplies made against advance authorisation/DFRC/DFIA against 'deemed export', the supplier is entitled to Advance Authorisation/DFRC/DFIA for intermediate supplies – para 8.4.1(i) of FTP.

In respect of sensitive items mentioned in para 4.55.3 of Handbook, exporter will have to furnish declaration with regard to technical characteristics, quality and specification in shipping bill – MF(DR) circular No. 16/2006-Cus dated 9-5-2006.

Customs procedures as prescribed in customs notification No. 40/2006-Cus dated 1-5-2006.

6.8 EPCG AUTHORISATION

Under Export Promotion Capital Goods (EPCG) scheme, an authorisation holder can import capital goods (i.e. plant, machinery, equipment, components and spare parts of the machinery) at concessional rate of customs duty of 5%. Capital goods can be imported for pre-production, production and post production (including CKD/SKD of capital goods and computer software systems) – para 5.1 of FTP.

Capital goods which can be imported under 'project imports' can be imported under EPCG scheme. The export obligation will be 8 times the duty saved i.e. difference between concessional rate under project imports and rate applicable under EPCG – para 5.1B of FTP.

Capital goods required for retailers having minimum area of 1,000n SqM is permissible – para 5.1C of FTP.

Importer will be issued 'EPCG Authorisation' for this purpose.

Conditions for EPCG are contained in chapter 5 of FTP.

Importer can either claim exemption of CVD or pay CVD in cash. If he pays CVD in cash, that amount will not be considered for purpose of fixation of export obligation. However, in that case, he cannot avail Cenvat credit of the CVD paid (Amendment w.e.f. 2-3-2005. Till now, importer could pay CVD in cash and avail Cenvat credit. Now, if he pays CVD in cash, his export obligation will get correspondingly reduced, but he cannot avail Cenvat of CVD paid in cash).

Computer software systems are also eligible. Import of spares of capital goods is permitted, without any limit. Jigs, fixtures, dies, moulds will be allowed to the extent of 100% of CIF value of authorisation. Spares for existing plant and machinery can also be imported. Second hand capital goods can also be imported under EPCG scheme

However, second hand capital goods of Indian origin are not permitted under EPCG scheme – DGFT Policy circular No. 16 (RE-2005)/2004-09 dated 15-7-2005.

Hotel equipment (window cleaning equipment in this case) can be imported under EPCG scheme – *CC* v. *Hotel Leela Venture Ltd.* 2003 (158) ELT 777 (CESTAT).

Authorisation will be issued on the basis of certificate of Chartered Engineer in respect of imported capital goods and exported final product.

Merchant Exporters can also import capital goods under EPCG scheme, if the capital goods are installed in the factory of their supporting manufacturer. The name and address of supporting manufacturer should be endorsed on EPCG authorisation and bond with Bank guarantee has to be executed jointly and severally by merchant exporter and his supporting manufacturer.

The import is permitted only through specified port of registration. If EPCG is registered at one place but import is from other customs house, the import shall be permitted against TRA (Telegraphic Release Order) which will be issued by customs house at port of registration – MF(DR) circular No. 88/2003-Cus dated 6-10-2003.

Clubbing of EPCG authorisations - All EPCG authorisations issued under one notification in one financial year and for export of same product/s or services will be clubbed for reducing paper work and easy monitoring – para 5.18 of HOP.

Export obligation - Importer has to fulfil export obligation equal to eight times duty saved on imported capital goods to be fulfilled over a period of 8 years. In respect of capital goods imported for technological upgradation, export obligation will be six times the duty saved. 50% export obligation should be fulfilled in first block of 6 years and balance 50% in next block of two years. SSI units will have export obligation equal to 6 times duty saved on capital goods imported, to be fulfilled over a period of 8 years. Agro units will have export obligation of 6 times the duty saved, to be fulfilled over period of 12 years [para 5.1 of FTP]

Extension of export obligation beyond 8+2 years can be considered for a further period of two years with condition that 50% of duty payable in proportion to unfulfilled export obligation is paid to customs – para 5.11 of HOP — MF(DR) circular No. 16/2006-Cus dated 9-5-2006.

In respect of EPCG authorisation for Rs 100 crore or more, the export obligation shall be required to be fulfilled over a period of 12 years. Similarly, sick companies under BIFR and units in Agri Export Zones can fulfil export obligation in 12 years. Export obligation for every block has been specified. Extension for fulfilling export obligation upto two years can be obtained. – MF(DR) circular No. 25/2003-Cus dated 1-4-2003 [para 5.1 of FTP].

If 75% export obligation is completed in half or less than half the prescribed period, companies can be freed from their obligations in remaining period (para 5.11 of FTP).

The export obligation shall be fulfilled by export of goods capable of being manufactured or produced by the capital goods imported under the scheme. However, goods can be manufactured in other unit of authorisation holder also. The export obligation will be over and above the average level of exports achieved during preceding three licensing years. — Export obligation can also be fulfilled by export of other goods manufactured by the importer. Exports of goods/services by group companies will also be considered towards fulfilment of export obligation. However, in such case, additional export obligation will be over and above the average exports achieved by unit/group company/managed hotel in preceding three years – para 5.4(i) of FTP.

Exports shall be physical exports, but some deemed exports are eligible. Royalty payments and payments for R&D services received in free foreign exchange will be considered towards fulfilment of export obligation – para 5.4(iv) of FTP.

EPCG authorisations can be clubbed for discharge of export obligation.

6.9 ILLUSTRATIONS

Illustration 1 :

Discuss whether any duty drawback is admissible under section 75 in the following cases and if yes, what is the quantum of such duty drawback—

	FOB value of exported goods (₹)	Rate or amount of drawback	Market price of goods (₹)	Value of imported material used in goods (₹)
(a)	1,00,000	0.75% of FOB value	80,000	50,000
(b)	49,000	1% of FOB value	50,000	30,000
(c)	60,000	0.8% of FOB value	70,000	35,000
(d)	3,000	1.5%	3,100	2,500
(e)	2,00,000	40% of FOB value	1,50,000	1,20,000
(f)	1,00,000 (2,000 kgs.)	₹ 30 per kg.	55,000	40,00
(g)	4,00,000	3.5% of FOB value	4,60,000	4,50,000
(h)	4,20,000	4% of FOB value	4,10,000	3,00,00**

**** In this case, the Central Government has specified that the export value should be 40% more than the value of the imported material used therein.**

Answer : The admissibility or otherwise of duty drawback in the aforesaid cases in discussed hereunder—

(a) **Drawback Admissible ₹ 750 :** Even inf the rate of drawback is less than 1% of FOB value of goods, drawback will be admissible because the amount of drawback i.e. 0.75% of 1,00,000 i.e. ₹ 750/- exceeds ₹ 500.

(b) **Drawback Admissible ₹ 490 :** Even if the amount of drawback is less than ₹ 500, drawback will be admissible because it is 1% or mor of the FOB value of the goods,

(c) **Drawback Inadmissible :** The drawback will n ot be admissible because it is less than 1% of the FOB value of the goods and its maount (0.8% of 60,000 i.e. 480) is less than ₹ 500.

(d) **Drawback Inadmissible :** Even if the drawback is 1.5% of FOB value, drawback will be inadmissible as the amount thereof is 1.5% of 3,000 i.e. ₹ 45, which is less ₹ 50.

(e) **Drawback Admissible ₹ 50,000 :** The amount of drawback i.e. 40% of 2,00,000 i.e. ₹ 80,000 shall be restricted to 1/3rd of the Market price of the goods i.e. 1/3rd of 1,50,000. Hence, the amount of drawback admissible shall be ₹ 50,000.

(f) **Drawback Inadmissible :** In this case the market price of the goods ₹ 55,000 is less than the amount of drawback i.e. 2,000 kgs. × ₹ 30 i.e. ₹ 60,000. Hence, no drawback shall be allowed.

(g) **Drawback Inadmissible :** No drawback shall be allowed in this case, as the export value i.e. FOB value of the goods is less the value of imported material used therein.

(h) **Drawback Inadmissible :** The value 40% more than value of imported materials is ₹ 3,00,000 + 40% of 3,00,000 i.e. ₹ 4,20,000. Since, the export value is not more than ₹ 4,20,000, no drawback shall be admissible.

Comparison of section 74 and 75 of the Customs Act, 1962 relating to duty drawback.

Basis	Drawback allowable on re-export of duty paid goods—Section 74	Drawback on materials used in the manufacture of exported goods — Section 75
6. Period for export of goods	The goods should be exported within two year from the date of payment of duty or such extended time as the Board may allow.	No such restrictions.
7. Criteria of Value addition	There is no criterion of minimum value addition, which is to be fulfilled before export for claim of drawback.	It has been specifically provided that there should not be negative value addition and in specified the same should be achieved for claim of drawback.
8. Rules framed	The drawback is governed by the Re-export of Imported goods (Drawback of Customs Duties) Rules, 1995. The Rules cover only the customs duty.	The drawback, in this case, is governed by the Customs Central Excise Duties and Service tax Drawback Rules, 1995. The rules cover customs duty, central excise duty and service tax.
1. Scope of drawback	Drawback, in relation to any goods exported out of India, means refund of duty paid on importation of such goods in terms of section 74. Thus, drawback is allowed only of import duties of customs.	"Drawback" in relation to any goods manufactured in India and exported, means the rebate of duty or tax, as the case may be, chargeable on any imported materials or excisable materials used or taxable services used as input services in the manufacture of such goods.
2. Identity of goods exported	The identity of the goods exported should be established as the one, which was imported on payment of duty.	The goods exported under this Section are different from the inputs as the inputs are manufactured, processed or any operations are carried on them before their export.
3. Goods eligible for drawback	Drawback under this Section is available on all goods (identification is the only criterion).	Drawback under this Section is available only on notified goods.
4. Nature of goods exported	The exported goods should have been imported and customs duty be paid thereon.	The goods to be exported may be manufactured or processed from imported or indigenous inputs or by utilising input services.
5. Rate of drawback	The rate of drawback is 98% in case the goods are exported without use.	The rate of drawback on goods taken into use is separately notified depending upon the period of us, depreciation in value and other relevant factors. Rate per unit of final article to be exported is fixed by taking into account — (a) mode of manufacture (b) input-output ratio (c) standardisation of the products etc.

Illustration 2 :

As per proviso to section 3 of Central Excise Act, excise duty payable is equal to customs duty on like articles imported into India. As per Sr No. 2 of Notification No. 23/2003-CE dated 31.3.2003 (as amended), the duty payable is to be calculated as if (a) customs duty is reduced to 50% and (b) Special duty of 4% u/s 3(5) of Customs Tariff Act is not payable. However, if goods cleared in DTA are exempt from VAT, this special additional duty will be payable.

Answer :

If assessable value = ₹ 10,000, Basic customs duty = 10%; basic excise duty = 14%, education cess is 2%, secondary and higher education cess is 1%, the duty calculation will be as follows—

		Duty %	Amount (₹)	Total Duty
(1)	Assesable Value		10,000.00	
(2)	Basic Customs Duty	5	500.00	500.00
(3)	Sub-Total for calculating CVD (1+2)		10,500.00	
(4)	CVD 'C' × Excise Duty rate	14	1,470.00	
(5)	Education Cess of Excise - 2% of '4'	2	29.40	
(6)	SAH Eduction cess of excise - 1% of '4'	1	14.70	
(7)	Total CVD (4+5+7)		1,514.10	1,514.10
(8)	Sub-total for educational cess on customs (2+4+5+7)		2,014.10	
(9)	Education Cess of Customs - 2% of '8'	2	40.28	40.28
(10)	SAH Education Cess of Customs - 1% of '8'	1	20.14	20.14
(11)	Sub-total for Spl CVD (3+4+5+7+9+10)		12,074.52	
(12)	Special CVD u/s 3(5) - 4% of '11'	0	0.00	0.00
(13)	Total Basic Duty as per section 3 of CE Act		2,074.52	
(14)	Education cess of excise - 2% of '13'	2	41.49	
(15)	SAH Education Cess of Excise - 1% of 'L'	1	20.75	
(16)	Total duty (Basic+Ed Cess+SAH Ed Cess)			**2,136.76**

Cenvat Credit will be available to DTA unit on basis of formula.

Note : The general objection to above mode of calculations is that education cess and SAH education cess is calculated thrice which is incorrect. However, what has to be remembered is that first we have to calculate duty under section 3 of CEA, which is equal to customs duty with reduced rate of 25% and then calculate education cess and SAH education cess of excise duty as usual).

STUDY NOTE - 7
CENTRAL SALES TAX ACT, 1956

This Study Note includes

7.1 INTRODUCTION

- Central Sales Tax is an indirect tax which is levied by the Central Government.
- In this case, the taxable event is **'sale of goods inter-state'.**
- CST applies to the whole of India including the state of Jammu & Kashmir.
- CST is payable in the state in which the movement of goods commences.
- Though it is called CST, it is actually assessed, collected & administered by the local (i.e. State) sales tax authorities only.
- Also, the tax collected under CST is actually retained by the state (in which it is collected).

7.2 CONSTITUTIONAL PROVISIONS & NEXUS THEORY

(A) Constitutional Provisions :

- The power to levy tax is given through the constitution of India. (Entry No.92A and 92B of List I, called the Union List, in the Seventh Schedule to the Constitution of India, as per Article 246(1).
- Article 265 of the Constitution of India states that no tax shall be levied or collected except by authority of law.
- Article 269 (1)(G) empowers the Central Government to levy taxes on sale or purchase of goods other than newspapers, which takes place in the course of inter-state trade or commerce.(Entry No.92A and 92B)
- Article 269(2) assigns the levy of such tax to the States.
- Article 269(3) empowers the Parliament to formulate principles for determining when a sale or purchase takes place in the course of interstate trade or commerce.
- Article 286 prohibits the States to levy tax on transactions which are covered by the CST Act.

(B) Nexus Theory :

Sales tax is levied on the transaction of sale of goods. A sale of goods has various elements such as goods, agreement to sell, transfer of property, valuable consideration, seller, buyer etc.

It is possible that each such element of sale may be distributed over more than one state.

For e.g. : the seller is in one state, the buyer is in another state, transfer takes place in the third state, consideration may pass in the fourth state etc.

Earlier, each such state tried to subject a single sale transaction to its own sales tax under the 'Nexus doctrine'. 'Nexus' means connection or link.

Under the guise of having a territorial nexus each state brought a single sale transaction to its own sales tax.

This consequently resulted in the same sale transaction being subject to multiple taxation.

To put an end to this unfair multiple taxation on a single sale transaction, Article 286 of the Constitution of India was amended.

Article 286 provides that no law of a State shall impose, or authorize the imposition, of a tax on the sale or purchase of goods where such sale or purchase takes place

(a) Outside the State, or

(b) In the course of the import of the goods into, or export out of, the territory of India.

7.3 PRINCIPLES & OBJECTS OF CST ACT, 1956

(A) Principles of Central Sales Tax Act :

Entry 92 (a) of the List-I (Union List) to the Seventh Schedule of the Constitution of India empowers the Union Government to levy tax on the sale or purchase of goods, which takes place in the inter-state trade or commerce. Accordingly, the Central Sales Tax Act was enacted.

(B) Objects of the CST Act:

The objects of the Central Sales Tax Act, 1956 as given in the Preamble of the Act are as follows :

1. To formulate principles for determining when a sale or purchase of goods takes place :
   - (a) In the course of interstate trade or commerce (Sec 3)
   - (b) Outside a state (Sec 4)
   - (c) In the course of import into or export from India (Sec 5).
2. To provide for the levy, collection and distribution of taxes on the sale of goods in the course of interstate trade or commerce (Sec 9).
3. To declare certain goods to be of special importance in inter-state trade or commerce (Sec 14).
4. To specify the restrictions and conditions on the State laws imposing taxes on the sale or purchase of such goods of special importance (Sec 15).
5. To provide for collection of taxes from companies under liquidation (Sec 16 - 18).

7.4 DEFINITIONS (SEC 2)

Sec 2(a) -'Appropriate State' means :

(a) in relation to a dealer who has one or more places of business situated in the same state, that state.

(b) In relation to a dealer who has places of business situated in different states, every such state with respect to the place or places of business situated within its territory.

Significance of 'Appropriate State'.

1. Administration, levy and collection of tax have been delegated to Appropriate State (Sec 9).
2. Registration should be made with the authorities of the Appropriate State.
3. Monthly returns, appeals, reviews, references, refunds and compounding of penalties are to be dealt with by the Appropriate State.
4. Appropriate state is equally significant in the application of :
   - Sec 8(2) (rate of tax on sales not covered by C Form);
   - Sec 8(1) and Sec 8(2)(c) (extension of tax concessions on intra state sales to inter-state sales) and
   - Sec 9(2A) (offences under General Sales Tax Acts are offences under CST Act too in the respective states).

Sec 2(aa) -'Business' includes :

(a) Any trade, commerce or manufacture, or any adventure or concern in the nature of trade, commerce or manufacture,
   - whether or not such trade, commerce, manufacture, adventure or concern is carried on with a motive to make gain or profit and
   - whether or not any gain or profit accrues from such trade, commerce, manufacture, adventure or concern;

(b) Any transaction in connection with, or incidental or ancillary to, such trade, commerce, manufacture, adventure or concern.

Analysis of the definition :

1. The meaning of **'business'** is significant since dealer u/s 2(b) is a person who carries on the business of buying, selling, supplying or distributing goods.
2. The definition of business is inclusive and not exhaustive.
3. For determining whether a transaction is in the nature of business, frequency regularity and volume of such transaction has to be looked into.
4. It is not necessary that the business is carried on with a profit motive. Even an activity suffering a loss may be called a business.
5. Business may be legal or illegal. It may be carried on regularly or otherwise.
6. If the main activity of a dealer is business under clause (a) above - only then incidental or ancillary activities under clause (b) above will also be business.

Examples :

- Temples sell prasadam which is an ancillary activity. However, the main activity of temples is not business. Hence, sale of prasadams cannot be taxed. (**Tirumala Tirupathi Devasthanam Case).**
- The sale of assets by bank for realisation of loans (an ancillary activity) cannot be taxed as the main activity of bank is not business (trade, commerce, manufacture etc.) **(Canara Bank Case).**

Sec 2(ab) -'Crossing the customs frontiers of India' means crossing the limits of the area of a customs station in which imported goods or export goods are ordinarily kept before clearance bycustorns authorities.

Customs station means a customs port, customs airport or a land customs station as defined under the Customs Act, 1962.

Sec 2(b) -'Dealer' means any person

- who carries on (whether regularly or otherwise), the business of
- buying, selling, supplying or distributing goods, directly or indirectly,
- for cash or for deferred payment, or for commission, remuneration or other valuable consideration.

Dealer includes the following :

(a) A local authority, a body corporate, a company, any co-operative society or other society, club, firm, HUF or other association of persons which carries on such business.

(b) A factor, broker, commission agent, del credre agent, or any other mercantile agent, by whatever name called, and whether of the same description as herein before mentioned or not, who carries on the business of buying, selling, supplying or distributing, goods belonging to any principal whether disclosed or not, and

(c) An auctioneer who carries on the business of selling or auctioning goods belonging to any principal, whether disclosed or not and whether the offer of the intending purchaser is accepted by him or by the principal or a nominee of the principal.

Deemed Dealers :

Explanation 1 : Every person who acts as an agent, in any State, of a dealer residing outside that state and buys, sells, supplies, or distributes, goods in the State or acts on behalf of such dealers as —

(a) A mercantile agent as defined in the Sale of Goods Act, 1930, or

(b) An agent for handling of goods or documents of title relating to goods, or

(c) An agent for the collection or the payment of the sale price of goods or as a guarantor for such collection or payment, and every local branch or office in a state of a firm registered outside that State or a company or other body corporate, the principal office or headquarters whereof is outside that state, shall be deemed to be a dealer for the purposes of this Act.

Explanation 2 : A Government which, whether or not the course of business buys, sells, supplies or distributes goods, directly or otherwise, for cash or for deferred payment or for commission, remuneration or other valuable consideration, shall except in relation to any sale, supply or distribution of surplus, un-serviceable or old stores or materials or waste products or obsolete or discarded machinery or parts or accessories thereof, be deemed to be a dealer for the purposes of the CST Act.

'Central Government can become a dealer, but the state government cannot-is the statement correct? Give reasons.

Answer :

- The statement is not correct. According to Explanation 2 under Sec 2(b), "a **Government** which, whether or not the course of business buys, sells, supplies or distributes goods……shall….. be deemed to be a dealer for the purposes of CST Act'
- The word used is 'Government' and not Central Government.
- No distinction is sought to be made between Central Government and State Government.
- Hence every government, be it central or state, buying /selling goods will be deemed to be a dealer.

Sec 2(c) - 'Declared goods' means goods declared under Section 14 to be of special importance in interstate trade or commerce.

Sec 2(d) -'Goods' includes all materials, articles, commodities and all other kinds of movable property, but does not include newspapers, actionable claims, stocks, shares & securities.

Analysis of definition :

The definition of 'goods' is inclusive definition. It does not bring out the essential characteristics of goods, but declares that all materials, articles commodities and all other kinds of movable property are goods and excludes some specified items. Article 366(12) of the Constitution of India, defines the term 'goods' to include all materials, commodities and articles. But this definition is very wide, when compared with the definition of goods under the CST Act.

Held to be 'Goods'	**Held not to be 'Goods'**
Electricity and electric meters	Labour
Animals or birds in captivity and livestock	Money (Cash/Currency/Cheque/DD)
Copyrights, branded software programmes of floppies or discs	Oil Tanker embedded in earth
Lottery tickets, incomplete films, steam etc.	Claim for loss or damages

Goods include all movable property :

- The immovable property is excluded from the definition of Goods. Immovable property includes land, benefits arising out of land and things attached to earth or permanently fastened to anything that is attached to the earth.
- However, goods include standing crop, grass and things attached to and forming part of land, which is agreed to be severed before sale or under contract of sale. But standing trees are not goods and not taxable, unless timber is identified, contract is unconditional and the timber is in deliverable state.
- The securities like shares, debentures, stocks or money certificates are not goods and hence not taxable.

Examples :

(1) Arun sells his land along with the standing crops and trees for ₹20 lakhs. Sales tax officer wants to assess for sales tax the value of standing crops and trees. Comment.

Answer :

- What is sold is land along with standing crops and trees.

- The sale does not pertain to the latter alone in which case they are uprooted and removed. Consequently, they become goods.
- In the instant case, the standing crops and trees are immovable.
- They are not goods and hence do not attract sales tax.

(2) Are sale of bundles of old newspapers as waste papers exempt from CST?

Answer :

As per section 2(d), goods do not include 'news paper'.

In **Sait Rikhaji Furtarnal Vs State of AP**, the Supreme Court held that when old newspapers are sold as newspapers, they are only in the character of newspapers and they are not goods.

However, when the newspapers are sold as waste papers, they are not newspapers and hence they are goods. Therefore, sale of bundles of old newspapers as waste papers is taxable**. (The Hindu vs. State of Tamil Nadu)**

Sec 2(dd) -'Place of Business' includes :

(a) In any case, where a dealer carries on business through an agent (by whatever name called), the place of business of such agent;

(b) A warehouse, godown or other place where a dealer stores his goods; and

(c) A place where a dealer keeps his books of account.

Significance of 'Place of Business'

- The 'Place of Business' has significance in the context of registration of dealers for Sec 7, 8 & 9 of the CST Act, 1956.
- A dealer having a place of business in more than one state - has to get himself registered under each state.
- If a dealer has different places of business in one state, then he can apply for registration through a single application for that state.

Sec 2(g) -'Sale' means any transfer of property in goods by one person to another for cash or for deferred payment or for any other valuable consideration, but does not include a mortgage or hypothecation of or a charge or pledge on goods.

Deemed Sale :

Pursuant to amendment of **Article 366** of the Constitution, the following deemed transactions are also covered :

1. A transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;
2. A transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;
3. A delivery of goods on hire-purchase or any system of payment by instalments;
4. A transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;
5. A supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;
6. A supply, by way of or as part of any service of goods, being food or any other article for human consumption or any drink (whether or not intoxication), where such supply or service is for cash, deferred payment or other valuable consideration.

Essential ingredients of a sale :

- There must be two parties to the contract of sate (i.e.) the buyer & the seller.

- There must be valid consent of both the above parties.
- There must be an actual transfer of property in goods (i.e. agreement to sell is not a sale)
- There must be a consideration in cash or in deferred payment or any other valuable consideration in money or moneys worth.
- Sale includes deemed sales.
- Sale does not include a mortgage or hypothecation of or a charge or pledge on goods.

Examples :

(1) Is transfer of property in goods without consideration chargeable to CST?

Answer : Sale u/s 2(g) means transfer of property for cash or deferred payment or for any other valuable consideration. Where there is transfer of property in goods without consideration, it does not amount to sale within the meaning of the definition under the act and therefore CST is not attracted.

(2) Is transfer by way of mortgage chargeable to CST?

Answer : the definition of 'sale' u/s 2(g) specifically excluded mortgage, hypothecation of goods, charge or pledge on goods. Hence, CST cannot be charged when there is transfer by way or mortgage.

Sec 2(h) -'Sale price' means the amount payable to a dealer as consideration for the sale of any goods, less, any sum allowed as cash discount according to the practice normally prevailing in the trade, but inclusive of any sum charged for anything done by the dealer in respect of the goods at the time of or before the delivery thereof, other than the cost of freight or delivery or the cost of installation in cases where such cost is separately charged.

Inclusions in Sale Price :

- **Central Sales Tax**-whether or not shown separately in invoice (then back calculations are made)
- **Excise Duty**- the excise duty payable is includible in 'sale price'. *Hindustan Sugar Mills vs. State of Rajasthan(1979); Ramco Cement Distribution Co.(P) Ltd. V. State of Tamilnadu* Sales tax is also payable on excise duty whether or not shown separately in invoice and even if paid directly by purchaser. However, this is so only when liability to pay duty is on seller.-*McDowell and Co.Ltd v. CTO.*

  Excise duty is a part of turnover, even in that case, the duty was payable by the purchaser, as primary liability to pay duty is of the manufacturer-*Mohan Breweries & Distilleries Ltd v.CTO(1997), State of Kerala V.MRF(1997)*-the judgement was in case of 'cess' payable.
- **Packing material and packing charges**-sales tax is leviable on packing material as well as packing charges (i.e. labour charges for packing goods). Sales tax is leviable on packing charges, even if shown separately-CST v. Rai Bharat Das (1988); *Ramco Cement Distribution Co .(P) Ltd. V. State of Tamilnadu; Dalmia Cement (Bharat)Ltd. V. State of Tamilnadu(1991). Cost of packing material is includible in sale price-HPCL v .State of Kerala(1993)*
- **Bonus discount or incentive bonus-** for additional sales affected by the distributor/dealer.
- **Insurance charges-**if the goods are insured by the seller.
- **Freight and delivery charges incidental to sale only are deductible-** if the goods are sold from depot, transport charges from factory to the depot cannot be allowed as deduction-*Dyer Meakin Breweries Ltd.V. State of Kerala(1970)*
- **Design charges-** in case of goods includible if charged separately in respect of goods manufactured as per design and sold to buyer,as it is a pre-sale expense and forms part of manufacturing cost-*American Refrigerator Co.Ltd.v.State of Tamilnadu(1994)*
- **Compulsory warranty charges-**includible if a manufacturer sales goods with service warranty on which customer has no option, the charges for warranty are includible as there is no sale without it-*State of AP V. Hyderabad Allwyn Ltd(1970)*

- **Weighment charges paid for goods-**includible in the sale price.
- **Subsidy/incentive paid to supplier –** these are not post sale expense, hence includible. *EID Parry V.ACCT(1997)*
- **Tax paid by buyer when liability is of seller.** However, if the liability to pay tax/cess/duty is in the buyer, the same cannot be considered for purpose of 'sale price'-*P.V.Beedies(P)Ltd v. State of Mysore (1963); G M S Prakash Rice Mills v. State of Punjab(1993).* Market cess collected by dealer from buyer and paid to Government is not part of consideration for sale and hence is not taxable-*State of AP v. T. Siddaiah Naidu (1997)*
- **Any sum charged for anything done by the dealer-***in respect of goods at the time of or before delivery of such goods.*

Exclusions from Sale Price :

The following items shall not be a part of sale price for the calculation of sales tax liability :

- **Freight / transport charges for delivery of goods**- CST is not payable on freight and transport charges. However, CST is payable on freight charges if (a)Freight Charges are not shown separately in invoice or (b) contract is for FOR destination.

  Supreme Court envisaged three situations: (1) Price at the factory gate, i.e. ex-works price. Here tax is not payable on freight (2) Contract for sale is FOR destination (3) the price is FOR destination, but contract does not have all ingredients of FOR destination railway contract. *Hindustan Sugar Mills Ltd. V. State of Rajasthan(SC);Kurkunta and Seram Stones (P)Ltd. V.State of Karnataka; Black Diamond Beverages v.CTO, Hyderabad Asbestos Cement Products Ltd v.State of AP; CST v. Ballarpur Industries Ltd(1995).*
- **Cost of installation if charged separately**- is not to be includible.
- **Cash discount** for making timely payments- is not includible.
- **Trade discounts**-is deduction from list price to wholesalers/dealers, cannot be considered for calculation of CST. *Dy.CST v .Advani Oerlikons (P) Ltd (SC); State of Tamilnadu V.Alkali Chemical Corporation (1994); Dy.CST v.Kerala Rubber and Allied Products (1993); Dy.CST v.Motor Industries Co (SC).*
- **Insurance on transit if incurred at the request of buyer**-are not chargeable to CST.
- **Goods returned within 6 months of the date of sale**-Sec 8A (b) provides that if goods are returned by buyer within six months, its sale price will be deducted from 'aggregate sale price', if satisfactory evidence is produced before sales tax authority in respect of the same. *Dy.CST v.Motor Industries Co (SC); State of Maharashtra v.BASF (India) Ltd (SC).*
- **Goods rejected**-in such case, the period of six months is not applicable, as in case of rejected goods, there is no 'complete sale' at all within the meaning of CST Act or Sale of Goods Act, as the purchasing party has not accepted the goods. Return of goods is a bilateral transaction brought about by consent of seller and purchaser, while rejection of goods is a unilateral transaction, open only to purchaser. It means that sale has not taken place to attract tax. *Metal Alloy Co.(P) Ltd. V. CTO, Bhavanipur Charge Calcutta(1977); State of Tamilnadu v. General Engineering Stores(1993)*
- **Government subsidy & other subsidy**-is excludible from the sale price for CST.
- **Deposits for returnable containers**-Deposits taken for returnable bottles or tin containers are not sales. Even if the customer does not return the container for long time and security deposit is transferred to profit and loss account that will convert the deposits as part of sale proceeds. There is no intention to sale the container. If the container is not returned the deposit is retained as liquidated damages for loss of bottle. *United Breweries Ltd. V.State of AP (SC); State of Tamilnadu V McDowell (SC); Kalyani Breweries v.State of West Bengal.*
- **Customs duty paid by Buyer-**when sale is by transfer of documents-*Gujarat Export Corporation Ltd.V. State of Maharashtra(1990)*
- **Taxes and fees statutorily recoverable from Buyer-***Anand Swarup Mahesh Kumar v.CST(SC); State of AP v. T Siddaiah Naidu*

Sec. 2 (i) : Sales tax law and general sales tax law

'Sales tax law' means any law for the time being in force in any state or part thereof which provides for the levy of taxes on the sale or purchases of goods generally or on any specified goods expressly mentioned in that behalf.	'General sales tax law' means the law for the time being in force in any state or part thereof which provides for the levy of tax on the sale or purchase of goods generally.

Sec 2 (j) -'Turnover' means the aggregate of the sale prices received and receivable by him in respect of sales of any goods in the course of interstate trade or commerce made during any prescribed period and determined in accordance with the provisions of the CST Act and the Rules made there under.

Sec 2(k) -'Year' in relation to a dealer means the year applicable in relation to him under the General sales tax law of the appropriate State and where there is no such year applicable, the financial year.

7.5 SALE OR PURCHASE IN THE COURSE OF INTERSTATE SALE (SECTION 3)

According to Section 3 of the Central Sales Tax Act, 1956, a sale or purchase of goods shall be deemed to take place in the course of inter-state trade or commerce if the sale or purchase :

(a) Occasions the movement of goods from one state to another; or

(b) Is effected by a transfer of documents of title to goods during their movement from one state to another.

The essential ingredients of interstate sale are as follows :

1. The transaction should be a complete sale.
2. There should be movement of goods from one state to another state by virtue of agreement to sale.
3. The completed sale must take place in a state different from the state in which movement of goods commences.
4. It is not necessary that completed sale precedes the movement of goods. Sale can be either before or after the movement of goods.
5. There must be physical movement of goods from one state to another state.
6. Where the movement of goods commences and terminates in the same state, it shall not be deemed to be a movement of goods from one state to another by reason merely of the fact that in the course of such movement the goods pass through the territory of any other state.
7. The movement of goods shall commence when the goods are delivered to the carrier or other bailee for transmission and the movement of the goods shall end when the delivery is taken from such carrier or bailee. Thus, the transfer of documents to the title of the goods (Lorry receipt/ Railway Receipt, Bill of Lading, Airway Bill) shall be made during the movement of the goods from one state to another.

Case Laws :

In **Union of India Vs K.G. Khosla Co. Ltd** it was held that a sale can be 'interstate sale' even if the contract of sale does not itself provide for the movement of goods from one state to another. However, such movement should be the result of a covenant of sale or an incidence of that contract.

In **East India Corporation Ltd. Vs State of Tamil Nadu**, the assessee and the customer were from the same state (i.e. Tamil Nadu). However, it was held as an interstate sale u/s 3(b) since goods had moved in from a state outside Tamil Nadu.

In **Mewalal Kawal Kishore v CST,** it was held that there can well be an interstate sale between the two persons belonging to the same state, if the goods move from one state to another, as a result of a contract of sale or the goods are sold, while they are in transit by transfer of documents.

Exceptions to Section 3 :

- Generally, CST is leviable on interstate sale transactions which cover movement of goods from one state to another.
- However, all dispatches of goods from one state to another state do not ipso facto result in interstate sale u/s. 3 of the CST Act.
- Only when the movement is on account of a covenant or the sale effected by a transfer of document of title to the goods during their movement from one state to another, it will be an interstate sale U/s 3.
- The following are the instances where goods move from one state to another but do not amount to interstate sales :
  - (a) A movement of goods from one state to another will not amount to interstate sales unless the seller had the responsibility to deliver the goods outside that state or the movement was as a result of a covenant or incident of contract of sale.
  - (b) Stock transfer between head office & branch office will not amount to interstate sales as the basic elements of sale i.e., the presence of a buyer & seller; consideration & transfer of ownership etc. are not present.
  - (c) Sale or purchase in the course of export/ import does not attract levy of CST since these have been specifically covered u/s 5 of the CST Act, 1956.
  - (d) Sale through commission agent / on account sales will not amount to interstate sales as the agent only acts on behalf of the seller and he does not acquire any ownership of the goods. The agent is only entitled to receive commission on the sales effected by him and will also get re-imbursement of the expenses incurred by him.

Is sale by VPP liable to Central Sales Tax?

Answer :

- In order to be an interstate sale, there must be movement of goods in connection with the sale as stipulated in Section 3.
- In a sale by VPP, both the requirements of Section 3 are satisfied. In a sale by VPP, there is an order by the buyer on the seller.
- The seller dispatches the goods by post parcel and the goods are to be delivered by postal authorities to the buyer on payment of price.
- The sale takes place in the state where the parcel is received and its value is paid to the post office.

7.6 SALE OR PURCHASE OUTSIDE A STATE (SECTION 4)

1. Section 4(1) provides that subject to the provisions of Section 3, if a sale or purchase of goods is said to take place inside a state, then, such sale or purchase shall be deemed to have taken place outside all other states.
2. According to Section 4(2), a sale or purchase of goods shall be deemed to take place inside a state, if :

In case of ascertained or specific goods	If the goods are within the State at the time of contract of sale
In case of unascertained or future goods	If the goods are within the State at the time of their appropriation to the contract of sale by the seller or by the buyer, whether assent of the other party is prior or subsequent to such appropriation

3. Where there is a single contract for sale or purchase of goods situated at more than one place, it shall be treated as separate contracts in respect of goods at each such place.

7.7 SALE IN THE COURSE OF EXPORT /IMPORT (SECTION 5)

(A) Sale in the course of export : [Section 5(1)]

1. Section 5(1) provides that a sale or purchase of goods shall be deemed to take place in the course of export only if :
   (a) The sale or purchase occasions such export, or
   (b) It is effected by a transfer of documents of title to the goods **after** the goods have crossed the customs frontiers of India.
2. The requisites of an export sale are :
   (a) There is a contract of sale between an Indian exporter and a foreign buyer.
   (b) There must be an obligation to export as a result of the above foreign contract.
   (c) There must be an actual export of goods to a foreign destination.
3. An export sale can also be effected by transferring documents of title to the goods to a foreign buyer after the goods have crossed the customs frontiers of India.

(B) Sale in the course of Import : [Section 5(2)]

1. Section 5(2) provides that a sale or purchase of goods shall be deemed to take place in the course of import only if :
   (a) The sale or purchase occasions such import, or
   (b) It is effected by a transfer of documents of title to the goods **before** the goods have crossed the customs frontiers of India.
2. The requisites of an import sale are :
   (a) There is a contract of sale between an Indian importer and a foreign seller.
   (b) There must be an obligation to import as a result of the above foreign contract.
   (c) There must be an actual import of goods from a foreign destination.
3. An import sale can also be effected by transferring documents of title to the goods in favour of an Indian buyer before the goods have crossed the customs frontiers of India.

(C) Penultimate sale for export of goods : [Section 5(3)]

1. Penultimate sale is the last sale immediately prior to the original export.
2. According to Section 5(3) of the CST Act, the last sale or purchase of any goods preceding the sale or purchase occasioning the export of those goods out of the territory of India shall also be deemed to be in the course of such export if the following conditions are satisfied :
   (a) There must have been pre-existing agreement or order to sell the specific goods to a foreign buyer.
   (b) The last purchase as referred above, must have taken place after that agreement with the foreign buyer was entered into.
   (c) The last purchase must have been made for the purpose of complying with the pre-existing agreement or order.
   (d) The same goods, which are purchased in the penultimate sale, must be exported.
   (e) The dealer should obtain proof of export from the original exporter.
   (f) The original exporter should give Form H to the dealer and only on that basis the dealer can claim exemption of deemed export.

7.8 PERSON LIABLE TO PAY CST [SECTION 6(1) & 6(1A)]

- Section 6(1) of the CST Act provides that subject to the other provisions contained in this Act, every dealer shall, with effect from such date as the Central Government may, by notification in the Official Gazette, appoint, not being earlier than thirty days from the date of such notification, be liable to pay tax under this Act on all sales of goods other than electrical energy effected by him in the course of interstate trade or commerce during any year on and from the date so notified.

  However, a dealer shall not be liable to pay tax under this Act on any sale of goods which, in accordance with the provisions of section 5(3), is a sale in the course of export of those goods out of the territory of India.

Analysis of Section 6(1) :

Section 6(1) is the charging Section. It reveals the following ingredients :

(a) The taxability under this Section is subject to other provisions of the Act.

(b) A sale under this Section shall be taxed only if it comes within the scope of section 3 of the Act, to be determined as Interstate Sale.

(c) An assessee, to become liable to pay tax, should be dealer within the meaning of section 2(b) of the Act.

(d) The liability to tax shall arise in respect of all goods, except electrical energy.

(e) The penultimate sales in the course of export of goods outside the territory of India are exempt from tax liability.

- Section 6(1A) provides that a dealer shall be liable to pay tax under the CST Act on sale of any goods effected in the course of interstate trade or commerce notwithstanding that no tax would have been leviable under the Local Sales Tax Act of the appropriate state if such sale had taken place inside that State.
- Thus, the absence of levy in intra state sales has no bearing on the levy in respect of interstate sale

7.9 EXEMPTION IN RESPECT OF SUBSEQUENT SALE [SEC 6(2)]

1. According to Section 6(2) of the Central Sales tax Act, 1956, any sale effected during the movement of goods from one state to another by transfer of document of title is known as subsequent sale.
2. Such subsequent sale shall be exempted from CST when the following conditions are fulfilled :

   (a) The first sale should be an interstate sale.

   (b) A sale subsequent to the sale mentioned here in above should take place.

   (c) The subsequent sale should be during the course of movement of goods from one state to another.

   (d) Such subsequent sale shall be effected by a transfer of documents of title to such goods.

   (e) The subsequent sale shall be made to the government or a registered dealer other than the government.

   (f) Where the subsequent sale is made to a registered dealer other than the government, the goods are of the description referred to in Section 8(3).

   (g) The dealer effecting the subsequent sale furnishes the prescribed certificate or declaration to the appropriate authority.

   (h) The entire transaction of sale shall be supported by the following supporting documents :

Nature of Sales	Form to be issued by the Buyer*	Form to be issued by the Seller
Original Inter State Sale [Section 3(1)]	Form C	Form E-I
Next Inter State sale by transfer of documents of title to goods	Form C	Form E-II
Subsequent sale u/s 6 (2)	Form C	Form E-II
Second subsequent sale during same transit	Form C	Form E-II

* If the sale is made to Government, Form D will be issued.

3. In case of subsequent sale in the course of Interstate sale, the dealer effecting subsequent sale can avail exemption by submitting Form C/D issued by his customer and by submitting Form E-I, issued by his seller.
4. Form, E-I, E-II & E-III etc. are printed by the Sales Tax department and are supplied to the registered dealer for their use. Form E-I & E-III will have to be issued, in case there are more than one subsequent sale.
5. Thus, it should be noted that Form E-I can be issued by the first seller alone. Form E-II & E-III will have to be submitted by those selling dealer (other than the first dealer) to their purchaser, who can avail of the exemption under section 6(2), subject to the condition that Form C is submitted as well.
6. Where a Government Department has submitted Form D there cannot be subsequent resale by it.

Thus, any number of subsequent sales effected in the course of such single interstate movement of the goods from one state to another by transfer of documents of title to the goods by one dealer to another shall be exempt provided that the above conditions are fulfilled and relevant f6rms are obtained and filed.

7.10 TAXABILITY OF TRANSFER OF GOODS MADE OTHER-WISE THAN BY WAY OF SALE (SEC 6A)

1. Where any dealer claims that he is not liable to pay tax under the CST Act, in respect of any goods, on the ground that the movement of such goods from one State to another was occasioned by reason of transfer of such goods by him to any other place of his business or to his agent or principal and not by reason of sale, the burden of proving that the movement of those goods was so occasioned shall be on that dealer.
2. The dealer may furnish to the assessing authority, within the prescribed time a declaration, duly filled and signed by the principal officer of the other place of business, or his agent or principal, containing the prescribed particulars in the prescribed form (Form F) obtained from the prescribed authority, along with the evidence of dispatch of such goods.
3. If the dealer fails to furnish such declaration, then, the movement of such goods shall be deemed to have been occasioned as a result of sale.
4. If the assessing authority is satisfied after making such inquiry as he may deem necessary that the particulars contained in the declaration furnished by a dealer are true, he may make an order to that effect.
5. Thereupon, the movement of goods to which the declaration relates shall be deemed to have been occasioned otherwise than as a result of sale.

7.11 REGISTRATION OF DEALER

Section 7 of the CST Act lays down the provisions for registration of Dealers as under:

(A) Compulsory Registration : [Section 7(1)]

Section 7(1) provides that every dealer liable to pay tax under the CST Act shall, within such time as may be prescribed for the purpose, make an application for registration to such authority in the appropriate Stale as the Central Government may, by general or special order, specify, and every such application shall contain such particulars as may be prescribed.

(B) Voluntary Registration : [Section 7(2)]

1. Section 7(2) provides that any dealer liable to pay tax under the sales tax law of the appropriate State, or where there is no such law in force in the appropriate State or any part thereof, any dealer having a place of business in that State or part, as the case may be, may, notwithstanding that he is not liable to pay tax under the CST Act, apply for registration to the authority referred to in Section 7(1), and every such application shall contain such particulars as may be prescribed.
2. A dealer shall be deemed to be liable to pay tax under the sales tax law of the appropriate State notwithstanding that under such law a sale or purchase made by him is exempt from tax or a refund or rebate of tax is admissible in respect thereof.

(C) Issue of Certificate of Registration : [Section 7(2A) & 7(3)]

1. Section 7(2A) provides that where it appears necessary to the authority to whom an application is made for registration, he may for the proper realisation of the tax payable under the CST Act or for the proper custody and use of the forms impose as a condition for the issue of a certificate of registration, by an order in writing and for reasons to be recorded therein, a requirement that the dealer shall furnish in the prescribed manner and within such time as may be specified in the order specified security for all or any of the aforesaid purposes.
2. Section 7(3) provides that if the authority is satisfied that the application is in conformity with the provisions of the CST Act and the rules made thereunder and the condition, if any, imposed, has been complied with, he shall register the applicant and grant to him a certificate of registration in the prescribed form which shall specify the class or classes of goods for the purposes of Section 8(1).

(D) Security for Registration : [Section 7(3A), 7(3B), 7(3BB) & 7(3C)]

1. Section 7(3A) provides that where it appears necessary to the authority granting a certificate of registration he may for the proper realisation of tax payable under the CST Act or for the proper custody and use of the forms require, at any time while such certificate is in force, by an order in writing and for reasons to be recorded therein, require from the dealer, to whom the certificate has been granted, to furnish within such time as may be specified in the order and in the prescribed manner such security, or, if the dealer has already furnished any security, such additional security, as may be specified in the order, for all or any of the aforesaid purposes.
2. Section 7(3B) provides that no dealer shall be required to furnish any security or additional security unless he has been given an opportunity of being heard.
3. Section 7 (3BB) provides that the amount of security which a dealer may be required to furnish or the aggregate of the amount of such security and the amount of additional security which he may be required to furnish by the authority referred to therein, shall not exceed :
   (a) in the case of a dealer other than a dealer who has made an application, or who has been registered in pursuance of an application, a sum equal to the tax payable under this Act, in accordance with the estimate of such authority on the turnover of such dealer for the year in which such security or as the case may be, additional security is required to be furnished; and
   (b) in the case of a dealer who has made an application, or who has been registered in pursuance of an application a sum equal to the tax leviable under this Act, in accordance with the estimate of such authority on the sales to such dealer in the course of inter-State trade or commerce in the year in which such security or, as the case may be, additional security is required to be furnished, had such dealer been not registered under the CST Act.
4. Section 7(3C) provides that where the security furnished by a dealer is in the form of a surety bond and the surety becomes insolvent or dies, the dealer shall, within thirty days of the occurrence of any of the aforesaid events, inform the authority granting the certificate of registration and shall within ninety days of such occurrence furnish a fresh surety bond or furnish in the prescribed manner other security for the amount of the bond.

(E) Forfeiture of Security : [Section 7(3D) & 7(3E)]

1. Section 7(3D) provides that the authority granting the certificate of registration may by order and for good and sufficient cause forfeit the whole or any part of the security furnished by a dealer :
   (a) for realising any amount of tax or penalty payable by the dealer;
   (b) if the dealer is found to have misused any of the forms or to have failed to keep them in proper custody :
2. However, no order shall be passed under this sub-section without giving the dealer an opportunity of being heard.
3. Section 7(3E) provides that where by reason of an order, the security furnished by any dealer is rendered insufficient; he shall make up the deficiency in such manner and within such time as may be prescribed.

(G) Refund of Security : [Section 7(3G)]

Section 7(3G) provides that the authority granting a certificate of registration may, on application by the dealer to whom it has been granted, order the refund of any amount or part thereof deposited by the dealer by way of security under Section 7, if it is not required for the purposes of the CST Act.

(H) Refusal to issue forms : [Section 7(3F)]

Section 7(3F) provides that the authority issuing the forms may refuse to issue such forms to a dealer who has failed to comply with an order or with the provisions of, until the dealer has complied with such order or such provisions, as the case may be.

(I) Appeal against the order : [Section 7(3H), 7(31) & 7(3J)]

1. Section 7(3H) provides that any person aggrieved by an order may, within thirty days of the service of the order on him, but afterfurnishing the security, prefer, in prescribed form and manner, an appeal against such order to the prescribed appellate authority
2. However, the appellate authority may, for sufficient cause, permit such person to present the appeal :
   (a) after the expiry of the said period of 30 days; or
   (b) without furnishing the whole or any part of such security.
3. Section 7(3I) provides the procedure to be followed in hearing any appeal and the fees payable in respect of such appeals. This shall be such as may be prescribed.
4. Section 7(3J) provides that the order passed by the appellate authority in any appeal shall be final.

(J) Cancellation of Registration : [Section 7(4) & 7(5)]

1. Section 7(4) provides that a certificate of registration granted under Section 7 may :
   (a) Either on the application of the dealer to whom it has been granted, or, where no such application has been made, after due notice to the dealer, be amended by the authority granting it if he is satisfied that by reason of the registered dealer having changed the name, place or nature of his business or the class or classes of goods in which he carries on business or for any other reason the certificate of registration granted to him requires to be amended; or
   (b) Be cancelled by the authority granting it where he is satisfied, after due notice to the dealer to whom it has been granted, that he has ceased to carry on business or has ceased to exist or has failed without sufficient cause, to comply with an order or with the provisions or has failed to pay any tax or penalty payable under the CST Act, or in the case of a dealer registered has ceased to be liable to pay tax under the sales tax law of the appropriate State or for any other sufficient reason.
2. Section 7(5) provides that a registered dealer may apply in the prescribed manner not later than six months before the end of a year to the authority which granted his certificate of registration for the cancellation of such registration, and the authority shall, unless the dealer is liable to pay tax under this Act, cancel the registration accordingly, and where he does so, the cancellation shall take effect from the end of the year.

(K) Amendment in Certificate :

1. A certificate of registration can be amended in any of the following cases :
   (a) Where the dealer changes his place of business;
   (b) Where there is a change in the goods dealt with by the dealer;
   (c) Where there is change in the constitution of the firm.
2. The dealer should get his Certificate of Registration modified in the above cases, in order to avoid penalty.

(L) Benefits of Certificate of Registration :

1. A certificate of registration provides the following benefits to the dealer :
   (a) By obtaining the requisite declaration forms from the department and using them, he can make interstate purchase @ 4%.
   (b) The dealer can also obtain form, which will enable him to claim total exemption in respect of subsequent sales, as laid down by section 6(2).
2. Failure to get registered under the CST Act prevents a dealer from effecting interstate sale, even where the turnover is only ₹ 1.

7.12 RATES OF TAX IN THE COURSE OF INTERSTATE TRADE OR COMMERCE [SECTION 8(1) & 8(2)]

Vat (Sales tax) rate for sale within the State	CST rate in case of sale to registered dealers (applicable to declared goods as well as other goods)	CST rate in case of sale to unregistered dealers (applicable to declared goods as well as other goods)
Nil	Nil	Nil
1%	1%	1%
2%	2%	2%
3%	2%	3%
4%	2%	4%
8%	2%	8%
10%	2%	10%
12.5%	2%	12.5%
20%	2%	20%

Note :

Local Rate means the basic rate, surcharge and additional tax payable by dealer under the Local Sales Tax Act.

7.13 PURCHASE OF GOODS BY A REGISTERED DEALER [SECTION 8(3)]

Under section 8(3), a registered dealer can purchase goods as under:

1. Goods of the class or classes specified in the certificate of registration of the registered dealer purchasing the goods as being intended:
   (a) for re-sale by him or subject to any rules made by the Central Government in this behalf, or
   (b) for use by him in the manufacture of processing of ‘goods for sale, or
   (c) in mining or
   (d) in the generation or distribution of ‘electricity or any other form of power.
2. Containers or other materials specified in the certificate of registration of the registered dealer purchasing the goods, being containers or materials intended for being used for the packing of goods for sale or in the telecommunications network.

3. Containers or other materials used for the packing of any goods or classes of goods specified in the certificate of registration referred to above or for the packing of any containers or other materials specified in the certificate of registration referred to above.

Thus, the purpose for which the dealer purchases goods will have to conform to the purpose for which he was registered under the CST Act.

7.14 FURNISHING OF DECLARATION [SECTION 8(4)]

1. Section 8(4) provides that the provisions of Section 8(1) shall not apply to any sale in the course of interstate trade or commerce, unless the dealer selling the goods furnishes to the prescribed authority in the prescribed manner :
   (a) a declaration duly filled and signed by the registered dealer to whom the goods are sold containing the prescribed particulars in a prescribed form obtained from the prescribed authority; or
   (b) if the goods are sold to the Government, not being a registered dealer, a certificate in the prescribed form duly filled and signed by a duly authorised officer of the Government.
2. However the declaration in prescribed Form, is required to be furnished within the prescribed time or within such further time as that authority may, for sufficient cause, permit.

7.15 POWER TO EXEMPT OR IMPOSE TAX AT CONCESSIONAL RATES [SECTION 8(5)]

Section 8(5) provides that 'the State Government' may, on the fulfilment of the requirements laid down in Section 8(4) by the dealer, if it is satisfied that it is necessary so to do in the public interest, by notification in the Official Gazette and subject to such conditions as may be specified therein, direct that :

(a) No tax under this Act shall be payable by any dealer having his place of business in the State in respect of the sales by him, in the course of interstate trade or commerce to a registered dealer or the Government, from any such place of business of any such goods or classes of goods as may be specified in the notification, or that the tax on such sales shall be calculated at such lower rates than those specified in Section 8(1) or Section 8(2), as may be mentioned in the notification;

(b) In respect of all sales of goods or sales of such classes of goods, as may be specified in the notification, which are made, in the course of interstate trade or commerce to a registered dealer or the Government, by any dealer having his place of business in the State or by any class of such dealers as may be specified in the notification to any person orto such class of persons as may be specified in the notification, no tax under the CST Act shall be payable or specified the tax on such sales shall be calculated at such lower rates than those specified in Section 8(1) or Section 8(2), as may be mentioned in the notification.

7.16 SALE FOR UNITS LOCATED IN SPECIAL ECONOMIC ZONE [SECTION 8(6)]

1. Section 8(6) provides that sale made by a dealer in the course of interstate trade or commerce to a registered dealer in any Special Economic Zone is not liable for tax subject to the following conditions:
2. The sale should be to a registered dealer in Special Economic Zone.
3. The registered dealer has been purchasing the goods for the purpose of setting up operation, maintenance, manufacture, trading, production, processing, assembling, repairing, reconditioning, reengineering, packaging or for use as packing material or packing accessories in an unit located in any special -economic zone.
4. The establishment of such unit is authorized by the authority specified by the Central Government.
5. The goods or class of goods shall be specified in the certificate of registration of such dealer.
6. The dealer selling the goods should obtain a declaration in the prescribed form duly filled and signed by the dealer in Special Economic Zone to whom such goods are sold.
7. The above declaration should be furnished, by the dealer, who sold the goods to the prescribed authority.

7.17DETERMINATION OF TAXABLE TURNOVER (SECTION 8A)

(A) Deduction from Aggregate of the Sale Prices : [Section 8A(l)]

The following deductions are permitted for the aggregate of sales prices, in determining the turnover :

1. The amount arrived at by applying the following formula :

   $$\frac{\text{Rate of Tax} \times \text{Aggregate of Sale Prices}}{100 + \text{Rate of Tax}}$$

   No deduction on the basis of the above formula shall be made if the amount by way of tax collected by a registered dealer has been otherwise deducted from the aggregate of sale prices.

   Where the turnover of a dealer is taxable at different rates, the aforesaid formula shall be applied separately in respect of each part of the turnover liable to a different rate of tax.

2. The sale price of all goods returned to the dealer by the purchasers of such goods within a period of 6 months from the date of delivery of the goods.

   However, satisfactory evidence of such return of goods and of refund or adjustment in accounts of the sale price thereof is produced before the authority competent to assess or, as the case may be, reassess the tax payable by the dealer under the CST Act; and

3. Such other deductions as the Central Government may prescribe, having regard to the prevalent market conditions, facility of trade and interests of consumers.

(B) No Other Deduction from Aggregate Sale Prices : [Section 8A(2)]

No other deductions are allowed from the aggregate of the sale prices except which are provided in Section 8A(2).

To determine the turnover from the Turnover inclusive of CST (as calculated above), following formula shall be applied:

$$\text{Turnover} = \frac{(\text{Turnover inclusive of CST}) \times 100}{(1100 + \text{Rate of Tax})}$$

$$\text{CST} = \frac{(\text{Turnover Inclusive of CST}) \times (\text{Rate of Tax})}{(100 + \text{Rate of Tax})}$$

7.18 LEVY & COLLECTION OF TAX (SECTION 9)

1. Section 9(1) :

Nature of Transaction	State empowered to levy tax
Interstate sale transaction whether covered by Section 3(a) or 3(b)	State in which movement of goods commenced
Subsequent sale not'exempt'u/s 6(2) effected by a registered dealer	State from which the registered dealer obtained the relevant forms for claiming exemption
Subsequent sale not'exempt'u/s 6(2) effected by an uregistered dealer	State from which such subsequent sale has been effected by the unregistered dealer.

2. Section 9(2): Powers of Authorities of the Appropriate State under CST Act-

1. The authorities of the appropriate state are empowered to assess, re-assess, collect and enforce payment of any tax, including any penalty payable by a dealer under the CST Act as if it is a tax or penalty payable under the local sales tax law.

2. For the aforementioned purpose, the authorities may exercise all or any of the powers they have under the general sales tax law of the State.
3. All the provisions of the local sales tax law in relation to offences, penalties and penalties in lieu of prosecution shall, with necessary modifications, apply to offences under CST Act, except for the provisions of Section 10 and 1 0A of the Act.

3. Section 9A: Collection of Tax to be only by Registered Dealers-

Section 9A provides that no person who is not a registered dealer shall collect in respect of any sale by him of goods in the course of interstate trade or commerce any amount by way of tax under the CST Act, and no registered dealer shall make any such collection except in accordance with the CST Act and the rules made thereunder.

7.19 PENAL PROVISIONS UNDER CST ACT (SECTION 10)

Section 10 of the CST Act, 1956 provides for levy of penalty as provided below:

Sec.	Offence	Penalty
10(a)	Issue of false certificate under Sections 6 (2) or 6A (1) or 8 (4)	Simple imprisonment, which may extened to six months, or with fine or with both
10 (aa)	Failure to get registered under Section 7	Fine of Rs. 50 per day till the offence continues.
10(b)	Falsely represents that to purchase of goods of such class which are not covered by his registration certificate	1.5 times of the tax due.
10 (c)	Purchase of goods without having a registration certificate	1.5 times of the tax due.
10 (d)	Purchase of goods for the purpose mentioned in Section 8 (3) but failure to make use of goods for any such specified purpose.	1.5 times of the tax due.
10 (e)	Having possession of any prescribed form, which has not been obtained as per prescribed procedure	1.5 times of the tax due.
10 (f)	Collecting any amount of tax in contravention of the provision of Section 9A 1.5 times of the tax due.	

7.20 IMPOSITION OF PENALTY IN LIEU OF PROSECUTION (SECTION 10A)

1. Section 1 OA(1) provides that if any person purchasing goods is guilty of an offence under section -10(b), (c) or (d), the authority who granted to him or, as the case may be, is competent to giant to him a certificate of registration may, after giving him a reasonable opportunity of being heard, by order in writing, impose upon him by way of penalty a sum not exceeding one and a half times the tax which would have been levied under Section 8(2) in respect of the sale to him of the goods, if the sale had been one falling under that provision.
2. No prosecution for an offence under section 10 shall be instituted in respect of the same facts on which a penalty has been imposed under Section 10A.
3. Section 10A(2) provides that the penalty imposed upon any dealer shall be collected by the Government of India in the manner provided in Section 9(2) :

Nature of offence	Manner of collection
Offence u/s 10 (b) or 10 (d)	Collected in the State in which the dealer purchasing the goods obtained in form prescribed u/s 8(4) (a) in connection with the purchase of such goods
Ofence u/s 10 (c)	Collected in the State in which the person purchasing the goods should have registred himself if the offence had not been committed.

7.21 COGNIZANCE OF OFFENCES (SECTION 11 & 12)

1. No Court shall take cognizance of any offence punishable under the CST Act or the rules made thereunder except with the previous sanction of : (a) The Government within the local limits of whose jurisdiction the offence has been committed or (b) Such officer of that Government as it may, by general or special order, specify in this behalf.
2. No Court inferior to that of a Presidency Magistrate or a Magistrate of the first class shall try any such offence.
3. All offences punishable under the Act shall be cognizable and bailable.
4. However, no suit, prosecution or other legal proceeding shall lie against any officer of Government for anything which is in good faith done or intended to be done under the Act or the rules made thereunder.

7.22 GOODS OF SPECIAL IMPORTANCE (SECTION 14)

The following categories of goods are declared as goods of special importance in interstate trade or commerce :

(a) Cereals (paddy, rice, wheat, maize, barley etc.)
(b) Coal (including coke in all its forms but excluding charcoal)
(c) Cotton of all kinds, cotton fabrics, cotton yarn
(d) Crude oil (including crude petroleum oils and mineral oils)
(e) Hides and skins (whether in a raw or dressed state)
(f) Jute
(g) Oilseeds (Peanut, Til, Cotton seed, Soyabean, etc)
(h) Pulses (Black gram, Green gram etc.)
(i) Man-made fabrics
(j) Sugars
(k) Tobacco (including unmanufactured tobacco, cigars, cigarettes etc.)
(l) Woven fabrics of wool
(m) Iron and steel (including pig & cast iron, steel semis, bars, plates, discs, rings, forgings and castings etc)

Restrictions and Conditions with reference to Declared Goods :

1. Section 15 provides that every sales tax law of a State shall, insofar as it imposes or authorises the imposition of a tax on the sale or purchase of declared goods, be subject to the following restrictions and conditions:
2. The tax payable under the Sales tax law in respect of sales inside the State shall not exceed 4%. Thus, the maximum rate of tax on declared goods for interstate or local sales shall be only 4%.
3. Where local sales tax has been levied in respect of the sale or purchase inside the State of any declared goods and such goods are sold in the course of interstate trade or commerce, and CST having been paid thereupon, the local sales tax paid shall be reimbursed to the seller making the interstate sale.
4. Where a tax has been levied under the State law in respect of the sale or purchase inside the State of any paddy, the tax leviable on rice procured out of such paddy shall be reduced by the amount of tax levied on such paddy.

5. Where a tax on sale or purchase of paddy is leviable under that law and the rice procured out of such paddy is exported out of India, then, for the purposes of section 5(3), the paddy and rice shall be treated as a single commodity.
6. Each of the pulses referred to in Section 14, whether whole or separated, and whether with or without husk, shall be treated as a single commodity for the purposes of levy of tax under State law.

Analysis of section 14 & 15

- While section 14 declares certain goods to be of special importance, Section 15 places restriction on the tax that can be levied on such declared goods.
- One of the primary conditions laid down by section 15 is that on the declared goods the sales tax shall not be levied in excess of 4%. Further, Sales tax will not be levied at more than one stage.
- Secondly where under the local sales tax law tax has been levied on sale or purchase of goods within a state and where such goods are subsequently sold in the course of interstate sale and sales tax has been paid on such a sale, the local sales tax paid will have to be refunded to the dealer, making the Interstate sale.
- Also, where there are more than one enactments levying tax like sales tax, surcharge, turnover, additional tax etc. on the sale of goods, the aggregate of the multiple rates shall not exceed 4%.
- When declared goods are sold in the same condition in which they are purchased without any further manufacture or processing, the subsequent sale will be exempted from tax. "Single point Sales Tax" exemptions can be claimed only if the declared goods purchased, are sold subsequently in the same form.

7.23 LIABILITY OF LIQUIDATOR OF COMPANY IN LIQUIDATION (SECTION 17)

1. Notice of Appointment of Liquidator/Receiver : Every person-
   (a) Who is the liquidator of any company, which is being wound up, whether under the orders of a Court or otherwise; or
   (b) Who has been appointed the receiver of any assets of a company, shall, within thirty days after he has become such liquidator, give notice of his appointment as such to the appropriate authority.
2. Notification by Appropriate Authority : On receipt of notice from the Liquidator
   (a) The appropriate authority should notify to the liquidator the amount, which in the opinion of the appropriate authority would be sufficient to provide for any tax which is then or is likely thereafter to become payable by the company.
   (b) The above intimation should be made within 3 months of the receipt of notice of appointment.
   (c) The appropriate authority is empowered to make such inquiry or call for such information, as it may deem fit, for arriving at the tax liability.
   (d) The Company's liability under the CST Act, upto the date of winding up, shall be notified to the liquidator, in writing.
3. Duties of Liquidator : The liquidator shall not part with any of the assets of the company or the properties in his hands until he has been notified by the appropriate authority. On being so notified, he shall set aside an amount equal to the amount notified and, until he so sets aside such amount, shall not part with any of the assets of the company or the properties in his hands.
4. However, the Liquidator can part with such assets or properties of the Company for the following purposes :
   (a) Compliance with any order of a Court
   (b) Payment of the tax payable by the Company under the CST Act
   (c) Payment to secured creditors whose debts are entitled under law to priority of payment over debts due to Government on the date of liquidation
   (d) Meeting reasonable costs and expenses of the winding up.

5. Personal Liability of Liquidator: The liquidator shall be personally liable for the payment of the tax, which the company would be liable to pay, if he: (a) fails to give the notice, as provided or (b) fails to set aside the amount as required by, or (c) parts with any of the assets of the company or the properties in his hands in contravention of the provisions

6. Where there are more liquidators than one, the obligations and liabilities attached to the liquidator under this section shall attach to all the liquidators jointly and severally.

7. Effect of these Provisions : The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other law for the time being in force.

7.24 LIABILITY OF DIRECTORS OF PRIVATE COMPANY IN LIQUIDATION (SECTION 18)

1. Directors of a private company are personally aointly & severally) liable for tax due under the CST Act if the following conditions are fulfilled :

   (a) The private company is wound up after the commencement of the CST Act.

   (b) Any tax assessed on the Company under the CST Act for any period, whether before or in the course of or after its liquidation, cannot be recovered.

   (c) The person was a director of the private company at anytime during the period for which the taxis due.

2. The Director shall not be jointly and severally liable for the payment of such tax if he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

7.25 APPEALS

Constitution of Central Sales Tax Appellate Authority : (Section 19)

1. Section 19 provides that the Central Government shall constitute an Authority, to be known as"the Central Sales Tax Appellate Authority," which would settle inter-State disputes failing under Section 6A read with Section 9 of the CST Act.

2. Composition of Authority: The Authority shall consist of the following Members appointed by the Central Government :

Member	Qualification
A Chairman	Retired Judge of the Supreme Court, or a retired Chief Justice of a High Court
An officer of the Indian Legal Service	Is or qualified to be, an Additional Secretary to the Government of India
An officer of a State Government	Not below the rank of Secretary or an officer of the Central Government not below the rank of Aditional Secretary, who is an expert in sales tax matters.

3. Staff & Officers: The Central Government shall provide the Authority with such officers and staff as may be necessary for the efficient exercise of the powers of the Authority under this Act.

4. Terms & Conditions : The salaries and allowances payable to, and the terms and conditions of service of, the Chairman and Members shall be such as may be prescribed.

7.26 ORDERS APPEALABLE AND PROCEDURE FOR FILING APPEAL (SECTION 20)

1. This section shall apply to appeals filed by the aggrieved dealer against any order of the assessing authority made under Section 6A or Section 9 of the CST Act.
2. The appeal shall be filed by the aggrieved dealer within 45 days from the date on which the order is served on him.
3. However, the Authority may entertain any appeal after the expiry of 45 days, but not later than 60 days from the date of such service, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal in time.
4. The application shall be made in quadruplicate and be accompanied by a fees of ₹ 5,000.

7.27 PROCEDURE ON RECEIPT OF APPEAL (SECTION 21)

1. On receipt of an appeal, the Authority shall cause a copy thereof to be forwarded to the Assessing Authority concerned as well as to each State Government concerned with the appeal and to call upon them to furnish the relevant records.
2. The Authority shall adjudicate and decide upon the appeal filed against an order of the assessing authority.
3. The Authority, after examining the appeal and the records called for either allow or reject the appeal.
4. The appeal shall not be rejected without giving the appellant dealer a reasonable opportunity of being heard.
5. Whether an appeal is rejected or accepted, reasons for such rejection or acceptance shall be given in the order.
6. The order shall be passed by the Authority within 6 months from the receipt of the appeal.
7. A copy of every order shall be sent to the appellant and to the assessing authority.

7.28 POWERS OF THE CST APPELLATE AUTHORITY (SECTION 22 & 23)

Section 22 :

1. The Authority shall have the same powers as are vested in a court under the Code of Civil Procedure, 1908 in respect of the following matters, namely :
   (a) Enforcing the attendance of any person, examining him on oath or affirmation;
   (b) Compelling the production of accounts and documents;
   (c) Issuing commission for the examination of witnesses;
   (d) The reception of evidence on affidavits;
   (e) Any other matter which may be prescribed.
2. Every proceeding before the Authority shall be deemed to be a judicial proceeding within the meaning of the Indian Penal Code.

Section 23 :

The Authority shall have the power to regulate its own procedure in all matters arising out of the exercise of power under the CST Act.

7.29 AUTHORITY FOR ADVANCE RULINGS (SECTION 24)

The Authority for Advance Rulings constituted under section 245-0 of the Income-tax Act, 1961 shall be the authority under the CST Act till such time an authority is constituted under Section 19.

On and from the date of the constitution of the Authority in under the CST Act, the proceedings pending with the Authority for Advance Rulings under Section 245-0 shall be transferred to the Authority under Section 19.

7.30 TRANSFER OF PENDING PROCEEDINGS (SECTION 25)

Section 25 provides that on and from the date when the Authority is constituted under Section 19, every appeal arising out of the provisions contained in Chapter VI :

(a) Which is pending immediately before the constitution of such Authority before the appellate authority constituted under the general sales tax law of a State or of the Union territory, as the case may be; or

(b) Which would have been required to be taken before such appellate Authority; shall stand transferred to such Authority on the date on which it is established.

7.31 APPLICABILITY OF ORDER PASSED (SECTION 26)

An order passed by the Authority shall bt, binding on each State Government concerned, the assessing authorities and other authorities created by or under any law relating to general sales tax, in force for the time being in any State or Union territory.

7.32 FORMS UNDER CST

Form A	This form is prescribed for application to get registered u/s 7 of CST Act. Details such as name status, place of business, warehouses, nature of business, nature and purpose of goods to be dealt, goods to be bought from outside the state etc., are required to be furnished. Care should be taken to list the goods sought to be bought from outside the state and the purposes for which they are proposed to be utilized as the benefit of Form C is restricted to the goods and end uses listed only.
Form B	Certificate of registration shall be issued by the authority in this form. The certificate of registration should be kept in the principal place of business an copies thereof in the branches inside the appropriate state
Form C	Registered dealers are entitled to certain exemptions under CST Act, 1956 Form C is used by a purchasing dealer to get the goods at confessional rate of duty and is issued in favour of the dealer who effects interstate sale. It is obtained from the sales tax authorities in the state in which the purchasing dealer is registered. It contains particulars such as name of purchasing dealer, sales tax registration no., its validity, details of goods obtained (whether for resale, manufacture, processing or as packing material), name and address of the seller etc.
Form D	Now Abolished
Form EI & E II	In case of subsequent sale in the course of Interstate sale, the dealer effecting subsequent sale can avail exemption by submitting Form C issued by his customer and by submitting Form E-1, issued by his seller. Form, E-I, E-II & E-III etc. are printed by the Sales Tax department and are supplied to the registered dealer for their use. Form E-II & E-III will have to be issued, in case there are more than one subsequent sale.

Form F	Thus, it should be noted that Form E-I can be issued by the first seller alone. Form E-II & E-III will have to be submitted by those selling dealer (other than the first dealer) to their purchaser, who can avail of the exemption under section 6(2), subject to the condition that Form C is submitted as well. Contents of Form E-I: Declaration contains the name of the issuing state, date of issue, name of selling dealer, name of purchasing dealer name and place of state in which movement of goods commence, quantity, weight, value, number and date of declaration in Form C received by the purchasing dealer. Contents of Form E-II: the. Declaration contains the name of the issuing state, date of issue, name and address of dealer effecting sate by transfer of documents to the title name of purchasing dealer, name and place of state in which movement of goods commence, quantity, weight, value, invoice, number and date of declaration in Form C received by the purchasing dealer.
Form G	This form is used by registered dealer for making a declaration to the effect that the transfer of goods from one state to another by him is done otherwise than by way of sale as per the provisions of Section 6A of the CST Act, 1956. These forms are issued by the sales tax authorities of the concerned state where the goods are received. It contains the name of the issuing state, date of issue, name and address of consignee and his registration no., name and registration no. of the transferor, description of goods, quantity, weight value etc. The declaration shall be signed by the authorized signatory.
Form H	Form G relates to the indemnity which is required to be furnished by the dealer in regard to matters of security deposit (section 7A). The value of the stamp duty on which this should be executed has to be determined at the time of furnishing the indemnity after discussing with the Officer concerned. This form is used by the exporters who purchase the goods for the purpose of export. The actual exporter shall issue a certificate to the penultimate seller in Form H. These forms are obtained from the sales tax authorities by the exporter. Form H contains the name of the issuing state, date of issue name and address of exporter and his registration no., name and registration no. of the selling dealer, description of goods, quantity, weight, value details of export etc. It also contains an undertaking by the exporter that if the goods are re-imported they will inform the sales tax authorities about the re-import within 1 month of such re-import.

7.33 ILLUSTRATIONS

Illustration 1.

Determine the central sales tax liability from the folowing data when a sale is effected from Faridabad to Lucknow :

- **(a) Invoice no. : 00708374**
- **(b) Basic price : ₹ 3,00,000**
- **(c) Excise duty : 10% ad valorem**
- **(d) CST : as applicable under 'C' forms**
- **(e) Trade discount : 8%**

(f) **Cash discount : 2%**

(g) **Quantity supplied : 10,000 kgs**

(h) **Quantity rejected by buyer within 3 days of delivery : 1000 kgs**

(i) **Quantity returned by buyer after 6 months of despatch : 1000 kgs.**

Solution :

Computation of CST

Particulars	Amount ₹
Basic Price @ ₹ 30/kg	3,00,000
Less : Goods rejected/returned by buyer within 6 months	30,000
Balance	2,70,000
Less : Trade Discount @ 8%	21,600
Balance	2,48,400
Less : Cash Discount @ 2%	5,400
Net Sales	2,43,000
Add : Excise Duty @ 10%	24,300
Total	2,67,300
CST @ 2% (under 'C' Form)	5,346

Illustration 2.

Vishal is a dealer. His sales during the first quarter of 2009-10 (April to June) are :

Date	Invoice No.	Amount (₹)
05.04.2010	**101**	**10,000 plus tax @ 2%**
12.04.2010	**102**	**80,000 plus tax @ 2%**
05.04.2010	**102**	**62,400 (inclusive of tax)**
05.04.2010	**104**	**14,000 plus tax @ 2%**
05.04.2010	**105**	**18,000 plus tax @ 2%**

(i) **Goods worth ₹ 7,000 (excel of tax) against Invoice No. 104 were returned on 29.06.10.**

(ii) **Goods worth ₹ 13,000 (incl of tax) sold on 26.12.09 were returned on 30.06.10.**

(iii) **Goods worth ₹ 6,500 (incl of tax) sold on 27.12.09 were returned on 30.06.10.**

All the above sales were made in the course of inter-State trade. Calculate the turnover and sales tax payable if the rate of tax is 2%.

Solution : **Computation of Turnover (Inclusive of Sales Tax)**

Invoice No.	Computation	Amount ₹
101	(10000 + 2%)	10,200
102	(80000 + 2%)	81,600
103	—	62,400
104	(14000 + 2%)	14,280
105	(18000 + 2%)	18,360
		1,86,840
Less : Sales return within 6 months		**7,280**
Aggregate sale value		**1,79,560**

$$\text{Turnover} = \frac{100 \times 1,79,560}{100+2} = 1,76,039$$

$$\text{Sales tax payable} = 1,76,039 \times \frac{2}{100} = 3,521$$

Note : Goods returned beyond 6 months are not deductible. Hence ₹ 13,000 and ₹ 6,500 are not deductible.

Illustration 3.

A dealer effected the following sales during the first quarter of 20010-11 (April to June) —

(i) Invoice No 1171 dt. 2.4.10 for ₹ 26,000 plus tax @ 2%

(ii) Invoice No 1172 dt. 19.4.10 for ₹ 70,000 plus tax @ 2%

(iii) Invoice No 1173 dt. 2.5.10 for ₹ 52,000 (inclusive of tax)

(iv) Invoice No 1174 dt. 4.6.10 for ₹ 12,200 plus tax @ 2%

(v) Invoice No 1175 dt. 25.6.10 for ₹ 20,000 plus tax @ 2%

(vi) Good worth ₹ 6,100 (exclusive of tax) against invoice No 1174 were returned on 28.6.2010

(vii) Goods worth ₹ 5,200 (inclusive of tax) sold on 25.12. 2009 were returned on 30.6.2010.

All the goods were made in the course of inter state trade. Calculate the turnover and sales tax payable if the rate of local tax is 4%.

Solution :

Computation of Turnover (Inclusive of Sales Tax)

Invoice No.	Computation	Amount ₹
1171	(26400 + 2%)	26,928
1172	(70000 + 2%)	71,400
1173	—	52,000
1174	(12200 + 2%)	12,444
1175	(20000 + 2%)	20,400
		1,83,172
Less : Sales return within 6 months		**6,344**
Aggregate sale value		**1,76,828**

$$\text{Turnover} = \frac{100 \times 1,76,828}{100+2} = 1,73,361$$

$$\text{Sales tax payable} = 1,73,361 \times \frac{2}{100} = 3,467$$

Note : Goods returned beyond 6 months are not deductible. Hence ₹ 5,200 is not deductible.

Illustration 4.

A registered dealer of Bikaner (Rajasthan) sold goods worth ₹ 4,36,000 (including tax @ 9%) to an unregistered dealer or Gujarat. Calculate the amount of central sales tax payable, if the sales tax rate on such goods in Rajasthan is 9% and surcharge @ 15% is also paybale on it.

Solution :

As per Section 8(2) of CST Act, 1956 in case of sale to unregistered dealers, the rate of CST in respect of goods other than declared goods shall be calculated at the rate as applicable for sale inside the State 2%. Even if the dealer had collected tax at lower rates, he will have to pay the correct tax. The word 'Tax' includes 'Surcharge' on tax also.

$$\text{Taxable Turnover} = \frac{(\text{Sales Turnover} \times 100)}{100 + \text{Rates}}$$

$$= \frac{(\text{Rs. } 4{,}36{,}000 \times 100)}{(100 + 9)} = ₹\ 4{,}00{,}000.$$

As the State tax 10.35% (i.e. 9% +1.35%, 15% Surcharge on 9%), therefore, tax is payable @ 10.35%.
Amount of Central Sales Tax payable = ₹ 4,00,000 × 10.35% = ₹ 41,400

Illustration 5.

Sales tax paybale on product 'A' is sold within State of Punjab is 10%. If the product is sold in inter-State sale, what will be the Central Sales Tax payable if :

(a) Buyer furnish C form

(b) Buyer does not furnish any form

(c) Buyer furnish H form

(d) Buyer furnish J form?

Solution :

S. No	Particulars	Rate of Tax
(A)	Buyer furnish C form	2%
(B)	Buyer does not furnish any form	10%
(C)	Buyer furnish H form	Nil
(D)	Buyer furnish J form	Nil

Illustration 6.

Adwell Co. of Indore (Madhya Pradesh) has supplied the following statement of sales :

(i) Sales of cloth ₹ 12,00,000 of which ₹ 7,50,000 sold in Madhya Pradesh and rst in Rajasthan.

(ii) Sales to a registered dealer of Gujarat for sale on Form C of such goods which are given in his registration certificate : ₹ 4,68,000.

(iii) Sale of declared goods to unregistered dealer of Maharashtra : ₹ 9,45,000 (The rate of sales-tax on such goods is 2% in the State and the customer returned goods worth ₹ 46,500 within 6 months.)

(iv) Sale to a registered dealer of Gujarat of such undeclared goods which have not been given in his registration certificate : ₹ 3,63,000. (Sales tax on such goods in the State is 7%.)

(v) Sale of goods to Bangladesh : ₹ 6,00,000. (Rate of sales tax in the State is 4%.)

(vi) Subsequent sale during inter-State trade : ₹ 1,20,000. (Rate of tax in the State is 10%).

Compute the taxable turnover under the CST Act, 1956. Sales includes the sales tax.

Solution :

Computation of Taxable turnover

	Particulars	Amount (₹)	Taxable Amount (₹)
(I)	Sales of cloth (Exempt from Tax)	—	—
(II)	Sales to a registered dealer of Gujarat for sale on form C	4,68,000	
	Less : Sales Tax @ 2% i.e. 4,68,000 × 2/102	**9,147**	4,58,853
(III)	Sale of declared goods to unregistered dealer of Maharastra	9,45,000	
	Less : Sales return within 6 months	46,500	
	Less : Sales Tax double the state rate @ 2% i.e. 8,98,500		
	(9,45,000 – 46,500) × 2/102	**17,618**	8,80,882
(IV)	Sale to a registered dealer of Gujarat of undeclared goods		
	which are ot given in the registration certificate	3,63,000	
	Less : Sales Tax at state rate or 6% whichever		
	is higher i.e. 3,63,000 × 6/106	**10,572**	3,52,428
(V)	Sale of goods to Bangladesh. Exempt since it is export		
	from India	6,00,000	—
(VI)	Subsequent sale during Inter-state trade (assumed to a		
	registered dealer) is exempt under Sec 6(2)	—	—
	Taxable Turnover		**16,92,163**

Illustration 7.

Calculate the CST payable from the following data —

(1) Invoice No. 1011 dated 01.04.2010 for ₹ 1,78,967 inclusive of CST @ 2%.

(2) Invoice No. 1012 dated on 02.04.2010 for ₹ 1,87,697 exclusive of CST @ 2%.

(3) Invoice No. 1013 dated 03.04.2010 for ₹ 1,75,000 inclusive of local Sales Tax @ 10%.

(4) Invoice No. 1014 dated 04.04.2010 for ₹ 2,50,000 exclusive of local Sales Tax @ 8%.

(5) 50% of the goods sold on 01.04.2010 on inter-state trade was rejected and returned on 31.07.2010.

(6) 20% of the goods sold on 04.04.2010 on local sale was returned on 30.06.2010.

(7) 30% of the goods sold on 02.04.2010 on inter-state trade returned on 02.06.2010.

(8) 10% of goods sold on 03.04.2010 on local sale was rejected on 03.10.2010.

(9) Goods of ₹ 1,50,000 recorded as stock transferred from Bangalore to Indore on 05.04.2010 excludes CST element of 2%.

(10) Export of goods worth 10 million Yens to Japan on 06.04.2010 of which 50% were rejected and returned on 01.11.2009 (1 Yen = Re. 0.35).

(11) Export through Canalising Agency for value of 100 thousands Dollars (Export order with Canalising Agency) (1 dollar = ₹ 48).

(12) **Purchased goods for ₹ 3,00,000 from the market on 09.01.2010 and exported to Singapore on 14.01.11 to the Agent for further sale (The goods attracted local sales tax of 10%).**

Give reasons for inclusion/non-inclusion of the above.

Solution :

Calculation of CST

Invoice No. and date	**Aggregate Sale Price (100+2%) Col. No. 1**	**Turnover (₹) Col. No. 1×100/102 Col. No. 2**	**CST (₹) Col. No. 1-2 Col. No. 3**
1011 Dt. 01.04.10	1,78,967	1,75,458	3,509
1012 Dt. 02.04.10	1,95,205	1,91,377	3,828
Total	3,74,172	3,66,835	7,337
Less -			
(a) Rejected & returned goods sold on 01.04.10	89,484	87,729	1,755
(b) Returned goods sold on 02.04.10	58,561	57,413	1,148
Net Amount	**2,26,127**	**2,21,693**	**4,434**

Hence, total CST payable is ₹ 4,434.

Working Notes :

(1) Since CST payable is required to be calculated, local sale as given at Sr. No's 3, 4, 6 and 8 are not considered.

(2) Any rejections are excludable without restriction that these must be returned within sixe months.

(3) Direct exports and export through canalising agency are exempted from CST. Hence, sales given in Sr. No's. 10, 11 and 12 are ignored.

(4) No tax is payable on stock transfer and hence transfer as shown at Sr. No. 9 is not taxable.

Thus, we consider only Sr. No's 1, 2, 5 and 7 for calculation of CST.

Illustration 8.

M/s. Menoka Enterprise placed orders for import of sucgar from various exporters abroad. All import documents were in the name of M/s. Menoka Enterprises. After import, M/s. Menoka Enterprises alloted the imported sugar to various buyer in Indian. No Sales Tax was charged as the sales were treated as "in the course of import". Is this in order? Discuss.

Solution :

If the contract between the foreign supplier and importer on one hand and importer, and Indian buyer on the other hand, are independent of each other, the sale within India cannot be termed as 'sale in the course of import'.

In the present case, M/s Menoka Enterprises has first imported the goods independently in its own name. The said import order is independent of subsequent sale to Indian buyers and cannot be termed as sale in the course of import. Hence, sales tax is payable on the sale to Indian buyers.

Illustration 9.

From the following details, compute the Central sales-tax payable by a dealer carrying on business in New Delhi :

Particulars	**Amount (₹)**
Total turnover for the year which included central sales tax and the followings:	**16,00,000**
Trade commission for which credit notes have to be issued separately	**48,000**
Installation charges	**25,000**
Excise duty	**80,000**
Freight, insurance and transport charges recovered separately in the invoices	**60,000**
Goods returned by dealer within six month of sale, but after the end of financial year	**40,000**
Buyer have issued C Form for all purchases.	

Solution :

Computation of Central sales-tax

Particulars	**Amount (₹)**
Gross turnover	16,00,000
Less :	
Trade Commission	48,000
Installation charges (assumed shown separately)	25,000
Excise Duty	60,000
Freight shown separately	40,000
Aggregate of Sale Price	14,27,000
CST rate	2%
CST (= 1/2 x 14,27,000)	27,980

Illustration 10.

During 2010-11, the gross inter-State sales made by Strend Fast Ltd. of Jodhpur is ₹ 71,79,000. Although the central sales tax is not shown separately, the following information is available from the records of the company —

(i) The company sells machinery which makes copper wire rods. If is sold in the Rajasthan State, sales tax rate is 7 per cent [plus additional tax 10 per cent of sales tax]

(ii) Information regarding sales with and without C Form is as follows —

Particulars	Inter-State sale with C Form	Inter-State sale without C Form
Gross sales	**44,25,000**	**27,54,000**
It includes the following —		
Excise duty	**19,12,500**	**6,15,00**
Freight [not being shown separately]	**55,500**	**72,000**
Freight [shown separately]	**1,05,000**	**25,500**
Packing charges	**22,815**	**29,550**
Cost of installation [shown separately]	**1,38,000**	**1,59,000**
Insurance charge to cover the risk of the seller	**15,750**	**22,800**
Insurance charges for covering the risk of Buyer at the request of the buyer	**22,500**	**1,26,000**

The following items have not been deducted to calculate gross sales turnover

Particulars	Inter-State sale with C Form	Inter-State sale without C Form
Trade discount [given by way of credit note on March 31, 2011]	27,000	30,000
Goods returned within 6 months	3,00,000	1,50,000
Incentives bonus for additional sale	37,500	30,000

Ascertain the sales turnover and Central Sales Tax payable.

Solution :

Computation of Sales Turnover & Central Sales Tax

Particulars	Inter-State sale with C Form	Inter-State sale without C Form
Gross Sales	44,25,000	27,54,00
Less :		
Excise duty [not to be deducted]	—	—
Freight not being shown separately [not to be deducted]	—	—
Freight shown separately	1,05,000	22,500
Packing charges [not to be deducted]	—	—
Cost of installation shown separately	1,38,000	1,59,000
Insurance charges to cover the risk of the seller [not to be deducted]	—	—
Insurance charges for covering the risk of buyer at the request of the buyer	22,500	1,26,000
Trade discount [as it is not deducted from gross turnover, it shall be deducted]	27,000	30,00
Goods returned within 6 months	3,00,000	1,50,000
Incentives bonus for additional sale	—	—
[not to be deducted from sale price]		
Aggregate sale price [Total : ₹ 60,96,000] [a]	38,32,500	22,63,500
Local sales tax rate [7% + 10% of 7%]	7.70%	7.70%
Central sales tax	2%	2%
Central sales tax [i.e., 2/102 of ₹ 38,32,500; $\frac{7.70}{107.70}$ of ₹ 22,63,500] [b]	75,147	1,61,829
Sales turnover [a+b] [Total : ₹ 58,59,024]	37,57,353	21,01,671

STUDY NOTE - 8

STATE LEVEL VAT

This Study Note includes

- Background of State VAT
- Basic Principle of VAT
- Disadvantages and Pitfalls in VAT
- Overview of State VAT
- Procedural Provisions relating to VAT
- Impact of VAT on CST
- Illustrations

8.1 BACKGROUND OF STATE VAT

Tax on sale within the State is a State subject. Over the period, many distortions had come in taxation. Following were some of the problems -

- Unhealthy competition among States by giving sales tax incentives to new industries. When one State gave incentives, others also had to give. This ruined State finances.
- 'Tax rate war' started to attract more revenue to State. Often, goods from the State were sent to another State on stock transfer basis and brought back in the same State to show as Inter-State Sale.
- States introduced 'first point sale' to avoid cascading effect of State sales tax. This made tax evasion easy.
- Cascading effect of tax due to Central Sales Tax.

Discussions with State Governments - Central Government initiated discussions with State Governments in 1995. After lot of persuasion by Central Government, all States ultimately agreed to introduce State Level Vat at the conference of Chief Ministers all States at Delhi in November, 1999.

'Empowered Committee' of State Governments - A high power committee consisting of senior representatives of all 29 States was constituted under Chairmanship of Dr. Asim Dasgupta, Finance Minister, West Bengal. After deliberations and many meetings, it was announced that all States have agreed to introduce VAT w.e.f. 1-4-2005. A 'White paper' was released by Dr. Asim Dasgupta, Chairman of Empowered Committee, on 17-1-2005. The White Paper is a policy document indicating basic policies of State Sales Tax VAT.

CST is proposed to be abolished – VAT is consumption based tax while CST is production based tax. Thus, CST is against principles of VAT. CST has been reduced to 3% w.e.f. 1-4-2007. CST rate is proposed to be reduced by 1% every year and made Nil by 1-4-2010.

Revenue loss if CST rate is reduced - If CST rate is reduced, State finances will suffer, since revenue of Central Sales Tax goes to respective State Government. It is proposed to authorise State Governments to levy tax on some services like medical, legal and education.

8.1.1 State-wise position of VAT

Haryana was the only State to introduce VAT w.e.f. 1-4-2003. 20 States introduced VAT w.e.f. 1-5-2005. These include Assam, Andhra Pradesh, Bihar, Delhi, Goa, Karnataka, Kerala, Maharashtra, Punjab and West Bengal.

States like Gujarat, Chhatisgarh, Jharkhand, Madhya Pradesh and Rajasthan introduced VAT w.e.f. 1-4-2006. Tamilnadu has introduced VAT on 1-1-2007.

Uttaranchal has not introduced VAT till November, 2007. UP has introduced Vat w.e.f. 1-1-2008. J&K is not in the jurisdiction due to constitutional issues.

VAT system not same in all States - *The VAT system as introduced is result of deliberations of committee of representatives from 29 States. Each State has its own views and peculiarities. Hence, having uniform nationwide VAT is very difficult and some compromises/adjustments are inevitable.*

VAT law not uniform in all States - *Each State has made changes as per their needs. Though basic concepts are same in VAT Acts of all States, provisions in respect of credit allowable, credit of tax on capital goods, credit when goods are sold inter-state are not uniform. Even definitions of terms like 'business', 'sale', 'sale price', 'goods', 'dealer', 'turnover', 'input tax' etc. are not uniform. Schedules indicating tax rates on various articles are also not uniform, though broadly, the schedules are expected to be same.*

8.1.2 *State VAT is diluted version of VAT*

The VAT as introduced, is a diluted version of VAT and some compromises have been made. There is no credit of Central Sales Tax paid on inter-state purchases. This problem will not arise if CST rate is reduced to 0% on 1-4-2010, as planned and inter-state sale is made 'zero rated'.

If goods are sent outside State on stock transfer basis, credit (set off) of tax paid on inputs is available only to the extent of tax paid in excess of 4%. Thus, credit (set off) to the extent of 4% tax on inputs is lost. It is not clear what will be position when CST rate is brought down to Nil. Thus, the VAT as introduced is State Vat and not a national Vat.

8.1.3 World scenario in respect of Development of 'VAT'

Concept of VAT was developed to avoid cascading effect of taxes. VAT was found to be a very good and transparent tax collection system, which reduces tax evasion, ensures better tax compliance and increases tax revenue.

First introduced in France - Concept of VAT was first conceived by Mr. Maurice Laure, Joint Director of French Tax Authority. VAT (termed as TVA in France) was introduced for the first time in France on 10-4-1954.

VAT in Europe - VAT system got real impetus when European Union (EU) made adopting VAT regime as condition precedent to joining European Common Market. Members of EU (that time it was European Common Market) were required to introduce common system of VAT *vide* Sixth Council Directive No. 77/388/EEC dated 17-5-1977. This is most important document so far as VAT is Europe is concerned.

VAT is imposed in Europe on both goods and services. VAT rate varies in various member countries of European Union. Minimum is 15% and maximum is 25%. General Vat rate in UK is 17.5%, but there is lower rate of 5% in case of some goods and some goods are exempt.

General VAT rate in some other countries is as follows – Sweden – 25%, Germany – 19%, France – 19.6%.

If goods or services are exported to another EU member country or other country, VAT is not imposed. VAT paid on inputs is granted as refund.

European Union was formed on 1-11-1993. Many countries joined EU later. As in July 2007, 27 countries are part of EU.

Development in other countries - Many countries in Asia, Central America and other parts of Europe have introduced VAT. So far, about 135 countries have introduced VAT.

VAT in China - China introduced in VAT on 24 items in 1984. Later, regulations for VAT Tax were made effective on 1-1-1994 and VAT was extended to all goods and services. The general VAT rate is 17%. VAT rate is reduced to 13% in some cases. There is no VAT on exports.

Consumption tax in Japan – Japan has system of consumption tax, which is levied @ 5%.

No Vat in USA - USA has not introduced VAT. In USA, tax is levied by State Governments on retail sale. The rate varies between 0% to 8.8%. There is no tax on services in USA.

Development in India - In India, VAT was introduced at manufacturing stage under Central Excise in 1986, termed as Modvat (modified value added tax). Modvat was re-named as Cenvat w.e.f. 1-4-2000. System of Vat was introduced in service tax w.e.f. 16-8-2002. Credit of excise duty and service tax was made inter-changeable w.e.f. 10-9-2004. Thus, partial integration of goods and service tax has been achieved. Presently, full integration is not possible since power to levy sales tax is with State Government.

8.2 BASIC PRINCIPLE OF VAT

VAT (Value Added Tax) is a tax on final consumption of goods and services.

VAT works on the principle that when raw material passes through various manufacturing stages and manufactured product passes through various distribution stages, tax should be levied on the 'Value Added' at each stage and not on the gross sales price. This ensures that same commodity does not get taxed again and again and there is no cascading effect. In simple terms, 'value added' means difference between selling price and purchase price. VAT avoids cascading effect of a tax.

Basically, VAT is multi-point tax, with provision for granting set off (credit) of the tax paid at the earlier stage. Thus, tax burden is passed on when goods are sold. This process continues till goods are finally consumed. Hence, VAT is termed as 'consumption based' tax. It is tax on consumption of goods and services. VAT works on the principle of 'tax credit system'.

Distinction between sales tax and VAT - Basic distinction between VAT and sales tax is that sales tax is payable on total value of goods while VAT is payable only on 'value addition' at each stage.

8.2.1 Cascading effect of tax

Generally, any tax is related to selling price of product. In modern production technology, raw material passes through various stages and processes till it reaches the ultimate stage e.g., steel ingots are made in a steel mill. These are rolled into plates by a re-rolling unit, while third manufacturer makes furniture from these plates. Thus, output of the first manufacturer becomes input for second manufacturer, who carries out further processing and supply it to third manufacturer. This process continues till a final product emerges.

This product then goes to distributor/wholesaler, who sells it to retailer and then it reaches the ultimate consumer. If a tax is based on selling price of a product, the tax burden goes on increasing as raw material and final product passes from one stage to other, as illustrated below, where A sales to B and B sales to C.

Details	A	B	C
Purchase	–	110	165
Value Added	100	40	35
Sub-Total	100	150	200
Add Tax 10%	10	15	20
Total	110	165	220

You will find that B is paying tax not only on his contribution of ₹ 40 but also on ₹ 100 and ₹ 10. Thus, same material gets taxed again and again and there is also tax on tax. As stages of production and/or sales continue, each subsequent purchaser has to pay tax again and again on the material which has already suffered tax. Tax is also paid on tax. This is called *cascading effect*.

8.2.2 Disadvantages of cascading effect of taxes

A tax purely based on selling price of a product has cascading effect, which has the following disadvantages :

- Real tax content in the price of a product cannot be known, as a product passes through various stages and tax is levied at each stage.
- Tax burden on any commodity will vary widely depending on the number of stages through which it passes in the chain from first producer to the ultimate consumer.
- Ancillarisation is discouraged and manufacturer tries to manufacture all parts and do all processes in his plant itself. This increases manufacturing costs.
- End use based exemptions and concessions (e.g. exports or goods consumed by poor) cannot be given since it is not known what were taxes paid in earlier states.
- Exports cannot be made fully tax free.

8.2.3 VAT avoids cascading effect of tax

System of VAT works on tax credit method. In Tax Credit Method of VAT, the tax is levied on full sale price, but credit is given of tax paid on purchases. Thus, effectively, tax is levied only on 'Value Added'. Most of the countries have adopted 'tax credit' method for implementation of VAT.

The aforesaid illustration will work out as follows under VAT system.

'B' will purchase goods from 'A' @ ₹ 110, which is inclusive of duty of ₹ 10. Since 'B' is going to get credit of duty of ₹ 10, he will not consider this amount for his costing. He will charge conversion charges of ₹ 40.00 and sell his goods at ₹ 140. Following example will illustrate the tax credit method of VAT.

	Transaction without VAT		Transaction with VAT	
Details	A	B	A	B
Purchases	–	110	–	100
Value Added	100	40	100	40
Sub-Total	100	150	100	140
Add Tax 10%	10	15	10	14
Total	110	165	110	154

Note - 'B' is purchasing goods from 'A'. In second case, his purchase price is ₹ 100/- as he is entitled to VAT credit of ₹ 10/- i.e. tax paid on purchases. His invoice shows tax paid as ₹ 14. However, since he has got credit of ₹ 10/-, effectively is paying only ₹ 4/- as tax, which is 10% of ₹ 40/-, i.e. 10% of 'value added' by him.

Meaning of 'Value added' - *In the above illustration, the 'value' of inputs is ₹110, while 'value' of output is ₹150. Thus, the manufacturer has made 'value addition' of ₹40 to the product. Simply put, 'value added' is the difference between selling price and the purchase price.*

8.2.4 Revenue Neutral Rate (RNR)

Government was earlier getting tax revenue of ₹ 25. In above example, Government gets revenue of only ₹ 14. To avoid loss of revenue, rate of tax will have to be suitably increased such that Government gets same revenue as per previous system. This is termed as 'RNR' (Revenue Neutral Rate'). In aforesaid example, RNR will be high i.e. 17.86%.

Practically, since most State Governments had single point sales tax at first level, RNR is not high. In fact, RNR is lower than the earlier sales tax rate since under Vat, tax is realised on final selling price and not the price at the first level.

For example, if earlier sales tax rate was 15% on wholesale price of ₹ 100; under VAT system, tax will be collected at consumption stage i.e. on retail price of (say) ₹ 140.

It has been decided to levy sales tax at RNR of 12.5% for most of commodities.

What is meant by consumption Types of 'VAT? - 'Consumption based tax' means tax is actually levied only when goods are finally consumed/utilised. Till then, the tax burden is passed on to next buyer.

8.2.5 Advantages of VAT over conventional system of taxation

Advantages of VAT are as follows :

- Tax burden is only at the last i.e. consumption stage. This is useful for taxation structure based on 'destination principle'.
- It becomes easier to give tax concessions to goods used by common man or goods used for manufacture of capital goods or exported goods.

- Exports can be freed from domestic trade taxes.
- It provides an instrument of taxing consumption of goods and services.
- Interference in market forces is minimum.
- Simplicity and transparency.
- Aids tax enforcement by providing audit trail through different stages of production and trade.
- Thus, it acts as a self-policing mechanism resulting in lower tax evasion.
- Tax rates can be lower as tax is levied on retail price and not on wholesale price.

8.3 DISADVANTAGES AND PITFALLS IN VAT

One major disadvantage of VAT is tremendous paper work and record keeping. VAT system can work only if record keeping is proper and reliable. The elaborate record keeping is not possible to small businesses. Hence, exemption is granted to tiny businesses whose turnover is below prescribed limits. In case of small businesses, a composition scheme is provided where tax is paid on gross value of sales at a fixed rate.

Some major problems in VAT are –

- Bogus Invoices on which tax credit is availed, i.e. invoice without actual purchase of goods.
- Acquisition fraud (missing trader fraud).
- Carousel Fraud (missing trader fraud).

Acquisition fraud - The acquisition fraud is based on the fact that goods imported are tax free. A dealer imports goods and makes sale within the country. The dealer either has his own VAT registration number or he hijacks other's VAT number. He collects the tax from buyer and then disappears without paying the collected tax to Government. The buyer is usually innocent and is not aware that the seller is not going to pay tax to Government. This is 'missing trader fraud' of one type.

In Indian context, this fraud is possible when CST rate is Nil or is reduced to 1%. A dealer can purchase goods inter-state and make sale within the State. He will collect tax and then disappear. He may use someone else's vat number in his invoices or may himself get registered with address of some temporary rented premises.

8.3.1 'Carousel fraud' in VAT

'Carousel' means 'merry-go-around' or' roundabout' (Concise Oxford Dictionary). This is 'missing trader fraud' of another type. It is much more involved and difficult to trace. The fraud works as follows –

One dealer 'A' imports goods without tax. He sells goods to 'B' and charges VAT. 'B' avails credit of tax shown by 'A' in his Invoice. 'B' sells the goods to 'C' and charges VAT. Actually, 'B' has to pay only differential amount as tax. 'C' avails credit of tax shown by 'B' in his Invoice. 'C' sells goods to 'D' by charging VAT. Since 'C' has availed credit of VAT paid by 'B', he has to pay only differential amount, which is small. 'D' exports the goods and claims refund of input tax i.e. entire tax shown by 'C' in his Invoice.

This is a legitimate transaction. The missing link is that 'A' actually does not deposit tax to Government. 'A' either has his own VAT registration number or he hijacks other's VAT number. He collects tax and then disappears. Thus, 'D' gets refund of tax which is actually not paid by 'A'!. By the time Government traces the transaction to 'A', he i.e. 'A' has disappeared.

The same goods are used again and again for 'imports' and 'exports'. That is why the fraud is termed as 'carousel' fraud. The high value goods like microchips and mobile phones are generally used for such deals.

UK is said to be main victim of such fraud. It is reported that UK has lost 12.6 billion Euro in such frauds. It is said that fraudsters prefer UK since it has weak and time consuming legal system!

In UK, reverse charge has been introduced in 2006 on tax payable on wholesale sales of mobile phones and microchips to combat the fraud. In 'reverse charge', buyer himself is liable to pay VAT on goods purchased.

Can the fraud work in Indian context? – In Indian context, the fraud can work in inter-state purchases and sales in the same way in which it works in European countries in imports/exports. The person finally selling the goods outside the State can either claim refund of tax paid on his purchases or can adjust the credit for paying taxes on sales made within the States.

In fact, it is possible that actually, goods may not move. Only documents may move from one State to another!.

What happens if 'D' is innocent and had entered into genuine transaction? - If 'D' is innocent, he cannot be penalised for default of 'A'. One such case has been decided by Court of Justice of European Communities, which is the highest Court of European Union. In *Optigen Ltd* v. *Commissioners of Customs and Excise* 2006 EUECJ C-354/03 (decided on 12-1-2006), it has been held that Government cannot refuse refund in such cases.

In India also, Tribunal has held that a buyer cannot be penalised for default of the seller.

In *Prachi Poly Products* v. *CCE* 2005 (186) ELT 100 (CESTAT SMB), it was held that a genuine buyer is eligible for Cenvat credit, even if the seller-manufacturer did not pay duty.

In *R S Industries* v. *CCE* 2003(153) ELT 114 (CEGAT), the manufacturer supplied goods to buyer on duty paying document. The manufacturer had availed Cenvat credit on inputs fraudulently. It was held that the buyer is not responsible for fraud of supplier and he is entitled to Cenvat credit on basis of a valid duty paying document.

Precautions being taken by State Governments under Vat - State Governments have put up or are in process of putting up check posts at State borders to ensure that all goods entering and leaving State are properly recorded. Though the purpose is sound, it is experience everywhere that such physical barriers increase harassment of honest tax payers while dishonest taxpayers can devise their own ways to hoodwink the system.

8.4 OVERVIEW OF STATE VAT

A 'White paper' was released by Dr. Asim Dasgupta, Chairman of Empowered Committee, on 17-1-2005. The White Paper is a policy document indicating basic policies of State Sales Tax VAT.

The white paper gives background of problems in present system of sales tax, principles of Vat and its advantages. It also gives basic design of State level VAT proposed to be implemented. States have generally followed the principles as given in the White Paper. Of course, there are variations.

Highlights of policy regarding State VAT as contained in White Paper are given below.

Tax Credit - Manufacturer will be entitled to credit of tax paid on inputs used by him in manufacture. A trader (dealer) will be entitled to get credit of tax on goods which he has purchased for re-sale [*para 2.3 of White Paper on State-Level VAT*].

Input Tax Credit - Credit will be available of tax paid on inputs purchased within the State. Credit will ***not*** be available of certain goods purchased like petroleum products, liquor, petrol, diesel, motor spirit (position of furnace oil is not clear in white paper, but many States do not give credit).

No credit is available in case of Inter-State purchases.

Credit of tax paid on capital goods - Credit will be available of tax paid on capital goods purchased within the State. Credit will be available only in respect of capital goods used in manufacture or processing. The credit will be spread over three financial years and not in first year itself. There will be a negative list of capital goods [*para 2.4 of White Paper on State-Level VAT*]

States has deviated from these provisions. In West Bengal and Kerala, it is available in 36 monthly instalments. In Karnataka, it is available in 12 monthly instalments, but value of capital goods should be minimum ₹ 10 lakhs. Capital goods of value less than ₹ 10 lakhs will be 'inputs' and immediate credit will be available. In Maharashtra, entire credit is available immediately.

Instant credit – Credit will be available as soon as inputs are purchased. It is not necessary to wait till these are utilised or sold [*para 2.3 of White Paper on State-Level VAT*].

No credit of CST paid - Credit of Central Sales Tax (CST) paid on inputs and capital goods purchased from other States will not be available [*para 2.6 of White Paper on State-Level VAT*]. This appears to be discriminatory and violative of Articles 303 and 304(a) of Constitution.

Transitional Credit of stock as at the beginning of VAT Act - Input tax as already paid on goods lying in stock as on the day when VAT was introduced (which are purchased within one year prior to that date) was available to dealer. For example, if VAT was introduced on 1-4-2005, credit of tax paid on stock lying as on 31-3-2005 was allowed if the goods were purchased on or after 1-4-2004.

Detailed stock statement were required to be submitted to sales tax authorities. This credit will be available over a period of six months after an interval of 3 months need for verification [*para 2.7 of White Paper on State-Level VAT*].

States have deviated from these provisions.

Very few sales tax forms – Most of present sales tax forms will disappear. [*para 2.14 of White Paper on State-Level VAT*] However, forms relating to EOU/SEZ may continue. Forms under CST Act will continue.

One to one correlation not required – VAT does not require one to one i.e. Bill to Bill correlation between input and output. Credit is available as soon as inputs/capital goods are purchased. The credit can be utilised for payment of VAT on any final product. It is not necessary to wait till the input is actually consumed/sold.

Entry tax/Octroi will continue - There is no proposal to extend VAT to entry tax (in lieu of octroi) or Octroi levied by local authorities. These will continue.

8.4.1 Purchase tax in VAT or 'reverse charge'

Though white paper makes no mention of purchase tax, some States like Kerala and Andhra Pradesh have made provision for imposition of purchase tax when purchase is from unregistered dealers. Its credit will be available where vat credit on purchases is available. Thus, in effect, in respect of purchases where VAT credit is not available, purchase tax will be payable.

This is termed as 'reverse charge'.

In UK, reverse charge has been introduced in 2006, on tax payable on sale of mobile phones and microchips.

Reverse charge - Normally, Vat is payable by seller of goods. However, in some cases, the liability is cast on the purchaser of goods. This is termed as 'reverse charge'.

This concept is used in service tax also. In reverse charge, the service receiver also acts as service provider. He pays tax on services received by him. He can avail Cenvat credit of tax paid by him, since the service is actually his 'input service'.

There is provision of 'tax collection at source' under section 206C of Income Tax Act. Here, seller of liquor is liable to pay tax at source. The buyer has no liability. Tax deduction at source (TDS) under Income tax is really not 'reverse charge', since basic responsibility of payment of income tax continues to be that of person earning income.

Mode of 'reverse charge' is used when it is administratively difficult to collect tax from seller of goods or service provider or income earner.

8.4.2 Tax rates under VAT

Ideally, VAT should have only one rate. Though this is not possible, it is certain that there should be minimum varieties of rates. Broadly, following VAT rates are proposed [*para 2.18 and 2.19 of White Paper on State-Level VAT*]

- 0% on natural and un-processed produces in unorganised sector, goods having social implications and items which are legally barred from taxation (e.g. newspapers, national flag). This will contain 46 commodities, out of which 10 will be chosen by individual States which are of local or social importance. Other commodities will be common for all States. Certain specified life saving medicines have been exempted from VAT tax.

- No VAT on Additional Excise Duty items (textile, sugar and tobacco) in first year. Position will be reviewed later. Vat has been imposed by State Governments @ 12.5% on tobacco products w.e.f. 1-4-2007.
- 1% floor rate for gold and silver ornaments, precious and semi-precious stones.
- 4% for goods of basic necessities (including medicines and drugs), all industrial and agricultural inputs, declared goods & capital goods. This will consist of about 270 commodities.
- 12.5% RNR (Revenue Neutral Rate) on other goods.
- Aviation turbine fuel (ATF) and petroleum products (petrol, diesel and motor spirit) will be out of VAT regime. Liquor, cigarettes, lottery tickets, will also be taxed at a higher rate. These will have uniform floor rates for all States (generally 20%). Tax paid on these will not be eligible for input tax credit.

Broadly, VAT rates of all States follow this pattern, but still there are many variations.

For example, in some States, Vat rate on gold and silver ornaments has been reduced to 0.25%, as traders were facing competition from neighboring States. Kerala State has imposed tax @ 20% on some luxury goods, though tax on such goods should be @ 12.5% as per the white paper.

In some States, hand tools are taxed at 4%, while in some States, these are taxed at 12.5%.

Policy about turnover tax, surcharge, additional tax etc. imposed by State Governments - States were levying turnover tax, surcharge etc. on sales tax,. Those taxes on sale will go. However, Octroi and Entry tax (which is in lieu of octroi) will continue. Other type of Entry Tax will either be discontinued or will be made Vatable [*para 2.16 of White Paper on State-Level VAT*] .

8.4.3 Concessions for small dealers

VAT tax will be payable only by those dealers whose turnover exceeds ₹ five lakhs per annum. The dealers whose turnover is less than ₹ five lakhs can register on optional basis. Dealers having turnover exceeding 5 lakhs should register within 30 days from date of liability to get registered [*para 2.9 of White Paper on State-Level VAT*]

In case of Karnataka, the limit is only ₹ two lakhs. Most of States have kept the limit as ₹ five lakhs.

Composition scheme for dealers with turnover upto ₹ 50 lakhs - Small dealers having gross turnover exceeding ₹ five lakhs but less than ₹ 50 lakhs have option of composition scheme. They will have to pay a small percentage of gross turnover. They will not be entitled to any input tax credit [*para 2.9 of White Paper on State-Level VAT*]

The percentage has not been announced in white paper, but earlier, it was announced as 1%. This rate has been prescribed in West Bengal VAT Act, AP VAT Act, Delhi VAT Act, Kerala VAT Act and Karnataka VAT Act.

In case of Karnataka, composition scheme is available only to a dealer whose turnover in a period of four consecutive quarters does not exceed ₹ 15 lakhs.

In Maharashtra, tax payable under composition scheme is 8% of difference between value of turnover of sales less value of turnover of purchases including tax (other than excluded goods) (in short, it is 8% of gross margin of trader). Second hand car dealer is required to pay sales tax @ 4%. In case of works contract, tax can be paid @ 8% of total contract value after deducting amount payable towards sub-contracts to the sub-contractors.

Dealers who make inter-State purchases are not eligible for the composition scheme. This provision applies to VAT law of almost all States.

The scheme is optional. They can opt to pay normal VAT tax and avail credit of input tax.

Composition scheme is a practical scheme considering ground realities, though it dilutes the basic concept of vat that tax is payable at consumption stage. Of course, such schemes are provided in almost all Vat regimes prevailing in Europe and elsewhere, considering practical difficulties in assessing and collecting tax from small traders.

8.4.4 Where input credit will not be available

Credit of tax paid on inputs will be denied in following situations -

No credit if final product is exempt - Credit of tax paid on inputs is available only if tax is paid on final products. Thus, when final product is exempt from tax, credit will not be availed. If availed, it will have to be reversed on *pro-rata* basis.

Restricted credit if output goods are transferred to another State - If the final products are transferred to another State as stock transfer or branch transfer, input credit availed will have to be reversed on *pro-rata* basis, which is in excess of 2%. In other words, in case of goods sent on stock transfer/branch transfer out of State, 2% tax on inputs will become payable e.g. if tax paid on inputs is 12.5%, credit of 10.5% is available. If tax paid on inputs is 2%, no credit is available (This is termed as 'retention'). Thus, the VAT as introduced is State Vat and not a national Vat (In case of some States, even if CST is reduced to 2%, retention has been kept @ 4% only).

No input credit in certain cases - In following cases, the dealer is not entitled to input credit —

(a) Final product is exempted from Vat.

(b) Inter-state purchases i.e. goods purchased from outside the State

(c) Goods imported (obvious, since there will be no Vat invoice)

(d) Goods purchased from unregistered dealer (as he cannot charge Vat)

(e) Goods purchased from dealer who is paying Vat under composition scheme (as he cannot charge Vat separately in invoice)

(f) Purchase where final goods sold are exempt from Vat

(g) Final product is given free i.e. goods not sold

(h) Inputs stolen/lost/damaged before use/sale as there is no sale

(i) Proper Tax Invoice showing Vat separately is not available

(j) Ineligible purchases like automobiles, fuel, certain capital goods etc. as specified in relevant State Vat law i.e. items in negative list.

No credit on certain purchases – Generally, in following cases, credit is not available – (a) Purchase of automobiles (except in case of purchase of automobiles by automobile dealers for re-sale) (b) fuel.

There are variations between provisions of different States.

8.4.5 Distinction between 'Zero rated sale' and 'exempt sale'

Certain sales are 'zero rated' i.e. tax is not payable on final product in certain specified circumstances. In such cases, credit will be available on the inputs i.e. credit will not have to be reversed. Distinction between 'zero rated sale' and 'exempt sale' is that in case of 'zero rated sale', credit is available on tax paid on inputs, while in case of exempt goods, credit of tax paid on inputs is not available.

As per para 2.5 of White Paper on State-Level VAT, export sales are zero rated, i.e. though sales tax is not payable on export sales, credit will be available of tax paid on inputs.

In respect of sale to EOU/SEZ, there will be either exemption of input tax or tax paid will be refunded to them within three months. If supplies to EOU/SEZ are exempt from sales tax, then the question will arise whether these are 'zero rated' or 'exempt goods'.

In case of stock transfer to another State, CST is not payable, but input credit will have to be reversed to the extent of 3%. Thus, stock transfer of goods to another State is 'exempt' and not 'zero rated'.

It is not clear what will be the policy after CST is reduced to 2% or when CST is reduced to zero. As per basic concept of Vat, inter-state transactions should be 'zero rated' and not 'exempt'.

8.4.6 Refund if VAT credit of input tax available cannot be utilised for any reason

Entire input tax will be refundable within three months, when final product is exported. In respect of sale to EOU/SEZ, there will be either exemption of input tax or tax paid will be refunded within three months [*para 2.5 of White Paper on State-Level VAT*].

If tax credit exceeds tax payable on sales, the excess credit will be carried to end of next financial year. Excess unadjusted credit at end of second year will be eligible for refund [*para 2.4 of White Paper on State-Level VAT*]

Such excess credit can arise when purchases of inputs are made locally, but final product is mainly exported or stock transferred to another State.

8.4.7 Exemptions and incentives to new industries already granted to continue

All State Governments were offering sales tax incentives to new industries set up in the State. The incentives were broadly of three types - (a) Exemption - Don't charge tax and don't pay (b) Deferral - Charge sales tax in invoice but pay after long period of (say) 12 to 18 years (c) Remission - Charge in the invoice but retain and do not pay to Government. - - State Governments have stopped giving incentives to new industries after January, 2000. However, there are commitments in respect of industries set up prior to January, 2000. State Governments to continue with the incentives which were already granted [*para 2.15 of White Paper on State-Level VAT*). [Some States may allow industries under exemption scheme to convert to deferral scheme so that such industries can pass on benefit of VAT to their buyers].

8.5 PROCEDURAL PROVISIONS RELATING TO VAT

A system of audit checks will have to be established to keep check on bogus invoices. One essential requirement is to give TIN (Tax Identification Number) to all registered dealers, so that a check is maintained that (a) The tax as shown in the invoice has indeed been paid (b) There is no double credit on basis of same invoice. TIN will have to be indicated on each invoice issued. It will be a 11 digit numerical code. First two digits will indicate State Code [*para 2.10 of White Paper on State-Level VAT*] .

Thus, State level computer network with check based on TIN will be established. Otherwise, misuse will be rampant.

Documentation required to avail credit of tax paid on inputs and capital goods - Tax credit will be given on basis of document, which will be a 'Tax Invoice', cash memo or bill. Such invoice can be issued only by a registered dealer, who is liable to pay sales tax. The invoice should be serially numbered and duly signed, containing prescribed details. The tax payable should be shown separately in the Invoice. The dealer should keep counterfoil/duplicate of such invoice duly signed and dated [*para 2.8 of White Paper on State-Level VAT*]

In case of manufacturer, Invoice issued under Central Excise Rules should serve purpose of VAT also, if the invoice contains required particulars.

Dealers availing composition scheme shall not show any tax in their invoice. They are not entitled to any credit of tax paid on their purchases.

Debit note and credit note - If sale price is increased/reduced subsequent to sale, the transaction will be recorded through proper debit/credit note. The buyer will adjust the input credit available to him accordingly.

8.5.1 Records and Accounts

Each State has prescribed records to be maintained. Broadly, following records will be required.

- Records of purchases of Inputs.
- Record of debit notes and credit notes.
- Quantity record of inputs.

- Record of credit notes received from supplier.
- Record of capital goods.
- Sale register and tax charged on sales.

Record of Tax credit available - Monthly/quarterly totals of the following should be taken - (a) Input credit available (b) Credit available on capital goods (c) Credit notes from suppliers.

Carry forward/refund of tax credit - If input tax credit cannot be utilised in a particular month/year, the credit can be carried forward and used in subsequent months/year. Refund of such excess credit is permitted only if goods were exported out of India. If credit is not utilised in two years, refund will be granted.

Preservation of records - Since assessment can be opened for prescribed period (usually five to eight years), it is necessary to preserve all relevant records for prescribed period from close of the financial year. The records can be audited by departmental audit party.

8.5.2 Payment of VAT Tax and filing of returns

Every dealer is required to file returns on monthly/quarterly basis. If the records are kept properly, filing the return will be very easy and mistakes will be minimum.

Net Tax payable - Net tax payable will have to be calculated as follows - (a) Output tax *plus* (b) Reversal of Credit (On exempted goods, stock transfers, free samples, lost inputs) - *Less* - (c) Input tax credit available.

This net amount is required to be paid through prescribed challan on or before due date.

8.5.3 Accounting treatment of VAT

ICAI has issued Guidance Note on Accounting for State level VAT on 15-4-2005. The guidance note is based on principles of VAT as contained in White paper released on 17-1-2005. However, there are variations in respect of each State. Hence, accounting policies will have to be adopted to suit provisions of VAT law of the particular State. Following broad principles should be kept in mind -

- As per AS-2, cost of purchase for purpose of inventory valuation should not include tax, if credit of tax paid is available.
- For purpose of income tax, inventory valuation should be inclusive of taxes, even if its credit is available, as per section 145A of Income Tax Act.
- Purchase account should be debited with net amount. VAT credit receivable on purchases should go to 'VAT Credit receivable (Input) Account.
- Account of each rate i.e. 0%, 1%, 4%, 12.5% etc. is required to be kept separately.
- In case of capital goods, as per AS-10, cost of fixed assets should include only non-refundable duties or taxes.
- If entire credit of tax on capital goods is not available immediately, the credit that is available immediately should be debited to VAT Credit Receivable (Capital Goods) Account and credit which is not available immediately should be taken to 'VAT Credit Deferred Account'.
- In case of sales, the sales account should be credited only with net amount (i.e. exclusive of VAT). Tax payable should be credited to separate account 'VAT Payable Account' [This is 'exclusion method'. Interestingly, in case of excise duty paid on final product, 'inclusive method' is permitted, i.e. sale account is credited inclusive of excise duty on final product].
- If any VAT is payable at the end of period (after adjusting VAT credit available), the balance is to be shown as 'current liability'.

8.5.4 Assessment of TAX

Dealer is required to assess his tax and pay himself. It will be basically self assessment. There will be no compulsory assessment at end of the year. If notice is not issued within prescribed time, dealer will be deemed to have been self assessed [*para 2.12 of White Paper on State-Level VAT*]

Returns will be filed monthly/quarterly, as prescribed, along with challans. Returns will be scrutinised and if there is technical mistake, it will have to be rectified by dealer [*para 2.11 of White Paper on State-Level VAT*]

As per West Bengal VAT Act, if dealer does not receive any intimation within two years from end of the accounting year, it is deemed that his return has been accepted by sales tax authority. In case of Andhra Pradesh, the time limit is four years from date of filing of return.

Audit of records - There will be audit wing in department and certain percentage of dealers will be taken up for audit every year on scientific basis. The audit wing will be independent of tax collection wing, to remove bias. There will be cross verification with Central Excise and Income Tax also. [*para 2.13 of White Paper on State-Level VAT*]

Audit by outside Agencies – VAT laws of some States provide for audit by outside agencies. AP Vat Act provides for audit by CA, cost Auditor or Sales tax Practitioner (STP), if audit is ordered by Commissioner.

In Karnataka, audit report is required if turnover exceeds ₹ 25 lakhs.

In Delhi, the dealer is required to submit copy of audit report u/s 44AB of Income Tax Act (This report is required when turnover exceeds ₹ 40 lakhs per annum) No separate audit is prescribed, unless special audit is ordered by department.

In Maharashtra, audit report from Chartered Accountant or Cost Accountant is required if sales turnover exceeds ₹ 40 lakhs.

8.6 IMPACT OF VAT ON CST

The provisions in respect of Central Sales Tax are summarised below –

- Para 4.3 of White Paper on State-Level VAT had stated that present CST rate (that time it was 4%) will continue for some time. CST may go after decision in respect of loss of revenue to States is taken and comprehensive Taxation information System is put in place. Accordingly, CST rate has been reduced to 3% w.e.f. 1-4-2007.
- Present CST forms i.e. C, D, E-I/E-II, F, H, I and J will also continue.
- There will be no credit of CST paid on inter-state purchases [para 2.6 of White Paper on State-Level VAT].
- If goods are sent on stock transfer outside the State, input tax paid in excess of 4% will be allowed as credit. In other words, input tax to the extent of 4% will not be allowed as credit if goods are sent inter-state (The CST rates has been reduced to 3% w.e.f. 1-4-2007. The dis-allowance should also be reduced to 3%. It is not known whether all State Governments are reducing the dis-allowance i.e. 'retention').

Unfortunately, the way sales tax VAT is to be implemented by States, it is only local (i.e. State) VAT and not national VAT. This is because –

(a) If goods are purchased from another State, credit (set off) of CST paid in other State will not be granted by the State where the goods are consumed/used/sold.

(b) If goods are sent to another State on stock transfer basis, only restricted input credit will be given, i.e. there will be no credit on first 4% tax paid on inputs.

Obviously, this is against basic concept of VAT. Thus, the State Level VAT is a truncated version of VAT. It can at the most be termed as 'Local Sales Tax VAT' and not 'National Sales Tax VAT'.

8.6.1 Discriminatory treatment to CST

Provision of not granting credit of CST seems discriminatory. Article 303 of Constitution of India provides as follows, 'Neither Parliament nor the Legislature of State shall have power to make any law giving any preference to one State over another, or making any discrimination between one State and another'.

As per Article 304(a), State Government can impose tax on goods imported from other States, but cannot discriminate between goods imported from other States and goods manufactured within the State.

Kelkar Committee in para 7.2 of its final report submitted in December 2002, has expressed apprehensions about legal implications of Article 304(a) in State Level VAT. The Kelkar Committee has expressed apprehension that investment decisions will tend towards States where the market within the State is larger than outside.

Giving credit only for locally purchased goods appears to be discriminatory and it appears that this will discourage inter-state purchases.

States indirectly taxing inter-state transaction - If goods sent on stock transfer basis, credit will be granted only in excess of 4% tax paid on inputs. Thus, indirectly, tax will be levied on stock transfers.

As per Article 286, State Government cannot impose tax on sale or purchase during imports or exports; or tax on sale outside the State. It means that State Government can impose sales tax only on sale within the State.

12.6.2 Will inter-state sale be zero rated?

The Vat system will be Vat compliant if inter-state sale or stock transfer is 'zero rated' i.e. no tax will be payable on inter-state sale or stock transfers, but entire credit of taxes paid on inputs and capital goods is available. If CST is reduced to Nil, but restricted credit of tax paid inputs is available, then the inter-state sales will be 'exempt' and not 'zero rated'. Then the Vat system will not be as per principles of Vat.

The intention seems to be to make inter-state sales 'zero rated' and not merely 'exempt'. However, white paper issued by Empowered Committee does not categorically say so.

8.7 ILLUSTRATIONS

Illustration 1 :

Aloke, a registered dealer in the State of Orissa, furnishes the following details relating to its sales for the month of March, 2011.

		₹
1.	**Sale of exempted goods (*Schedule* A goods)**	**75,000**
2.	**Sale of goods of zero rate (*Schedule* AA goods)**	**50,000**
3.	**Sale of goods taxable at 4% (*Schedule* C goods)**	**4,00,000**
4.	**Sale of goods taxable at 12.5% (*Schedule* CA goods)**	**1,20,000**

On buyer of *Schedule C* goods (taxable at 4%) returned goods worth ₹ 20,000 on 20th April, 2011.

Tax on maximum retail price has been paid at the time of purchase of *Schedule CA goods*, taxable at 12.5%.

Determine turnover of sales and taxable turnover of the dealer.

Solution :

Computation of Turnover of Sales and Taxable Turnover of Mr. Alok for the month of March, 2011.

	₹	₹
Aggregate Sale Price ₹ (75,000 + 50,000 + 4,00,000 + 1,20,000		6,45,000
Less : (i) Sales return of *Schedule C* goods within 6 months from the date of sale		
(ii) Sale price of goods, tax on which has been paid on the Maximum Retail Price (MRP) at the time of purchase	1,20,000	1,40,000
Turnover of Sales [Section 2(55)]		5,05,000
Less : (i) Sale of Exempted Goods (Schedule A goods)	75,000	
(ii) Sale of Zero-rated Goods (Schedule AA goods)	50,000	1,25,000
Taxable Turnover (on which tax is payable)		3,80,000

Illustration 2 :

M/s. Vijoy Traders, a registered dealer in the State of Bihar, furnishes the following details relating to it's sales and purchases during the month of March, 2011 :

Details of sales :

Invoice No. 301 dated	**5.3.2011**	**₹**	**10,500**	**(inclusive of 12.5% tax)**
Invoice No. 302 dated	**10.3.2011**	**₹**	**15,000**	**(inclusive of 12.5% tax)**
Invoice No. 303 dated	**12.3.2011**	**₹**	**12,500**	**(inclusive of 4% tax)**
Invoice No. 304 dated	**18.3.2011**	**₹**	**14,700**	**(inclusive of 12.5% tax)**
Invoice No. 305 dated	**22.3.2011**	**₹**	**16,750**	**(inclusive of 4% tax)**
Invoice No. 306 dated	**25.3.2011**	**₹**	**9,750**	**(inclusive of 12.5% tax)**
Invoice No. 307 dated	**31.3.2011**	**₹**	**10,000**	**(inclusive of 4% tax)**

Details of Purchase :

Within Bihar on	**4.3.2011**	**₹**	**7,000**	**(inclusive of 12.5% tax)**
From Other State (CST)	**8.3.2011**	**₹**	**3,500**	**(inclusive of 4% tax)**
Within Bihar on	**12.3.2011**	**₹**	**9,500**	**(inclusive of 4% tax)**
Within Bihar on	**15.3.2011**	**₹**	**10,000**	**(inclusive of 12.5% tax)**
Within Bihar on	**18.3.2011**	**₹**	**7,500**	**(inclusive of 12.5% tax)**
Within Bihar on	**22.3.2011**	**₹**	**12,000**	**(inclusive of 4% tax)**

Out of sale against Invoice No. 302, Goods worth ₹ 2,000 has been returned on 15.4.2011.
Compute the amount of VAT liability for the month of March, 2011.

Solution :

Computation of Net VAT Liability of M/s. Vijoy Traders for the month of March, 2011.

Output Tax Liability :	Output Tax ₹
1. On Turnover of ₹ 10,500 inclusive of 12.5% tax	
$₹\ 10{,}500 \times \frac{12.5}{112.5}$	1,167
2. On Turnover of ₹ 13,000 inclusive of 12.5% tax (Net Sales = ₹ 15,000 – ₹ 2,000 = ₹ 13,000 since goods returned within six months	1,444
3. On Turnover of ₹ 12,500 inclusive of 4% tax	
$₹\ 12{,}500 \times \frac{12.5}{112.5}$	481
4. On Turnover of ₹ 14,700 inclusive of 12.5% tax	
$₹\ 14{,}700 \times \frac{12.5}{112.5}$	1,633
5. On Turnover of ₹ 16,750 inclusive of 4% tax	
$₹\ 16{,}750 \times \frac{4}{104}$	644
6. On Turnover of ₹ 9,750 inclusive of 12.5% tax	
$₹\ 9{,}750 \times \frac{12.5}{112.5}$	1,083
7. On Turnover of ₹ 10,000 inclusive of 4% tax	
$₹\ 10{,}000 \times \frac{4}{104}$	385
Total Output Tax [A]	6,837
Input Tax Credit on Purchase :	
1. On Turnover of ₹ 7,000 inclusive of 12.5% tax	
$₹\ 7{,}000 \times \frac{12.5}{112.5}$	778
2. On Purchase of ₹ 9,500 inclusive of 4% tax	
$₹\ 9{,}500 \times \frac{4}{104}$	365
3. On Purchase of ₹ 10,000 inclusive of 12.5% tax	
$₹\ 10{,}000 \times \frac{12.5}{112.5}$	1,111
4. On Turnover of ₹ 7,500 inclusive of 12.5% tax	
$₹\ 7{,}500 \times \frac{12.5}{112.5}$	833
5. On Purchase of ₹ 12,000 inclusive of 4% tax	
$₹\ 7{,}000 \times \frac{4}{104}$	462
Total Input Tax Credit [B]	3,549
Net VAT Payable [A–B]	3,288

Note : No input tax credit is available in respect of purchases from other states, i.e., inter-State purchase.

Illustration 3 :

M/s Ashok Engg. Co. Ltd., a registered dealer in the State of Punjab, furnishes the following details relating to it's sales and purchases during the quarter ended 31st March, 2011 :

Sales :

Invoice No. 101 dated	**4.3.2011**	**₹**	**20,000**	**(inclusive of 12.5% tax)**
Invoice No. 102 dated	**8.3.2011**	**₹**	**17,000**	**(inclusive of 4% tax)**
Invoice No. 103 dated	**12.3.2011**	**₹**	**16,000**	**(inter-State sale inclusive of 4% tax)**
Invoice No. 104 dated	**18.3.2011**	**₹**	**19,700**	**(inclusive of 12.5% tax)**
Invoice No. 105 dated	**26.3.2011**	**₹**	**20,100**	**(inclusive of 4% tax)**
Invoice No. 106 dated	**27.3.2011**	**₹**	**22,750**	**(inclusive of 12.5% tax)**

Goods sent to Patna branch of the company on 15.3.2011 for ₹ 12,000.

Purchases :

From dealer in Punjab on	**2.3.2011**	**₹**	**10,000**	**(inclusive of 4% tax)**
From dealer in Punjab on	**4.3.2011**	**₹**	**15,000**	**(inclusive of 12.5% tax)**
From dealer in Delhi (CST) on	**6.3.2011**	**₹**	**7,500**	**(inclusive of 4% tax)**
From dealer in Punjab on	**12.3.2011**	**₹**	**8,500**	**(inclusive of 12.5% tax)**
From dealer in Punjab on	**18.3.2011**	**₹**	**18,000**	**(inclusive of 12.5% tax)**
From dealer in Punjab on	**22.3.2011**	**₹**	**14,000**	**(inclusive of 4% tax)**

Goods purchased on 2.3.2011, was sent to Patna branch of the company.

Compute the amount of VAT liability for the month of March, 2011.

Solution :

Computation of Net VAT Liability of M/s. Ashok Engg. Co. Ltd. for the month of March, 2011.

Output Tax Liability :	Output Tax ₹
1. On Turnover of ₹ 20,000 inclusive of 12.5% tax	
₹ 10,500 × $\frac{12.5}{112.5}$	2,222
2. On Turnover of ₹ 17,000 inclusive of 4% tax	
₹ 17,000 × $\frac{4}{104}$	654
3. On Turnover of ₹ 19,700 inclusive of 12.5% tax	
₹ 19,700 × $\frac{12.5}{112.5}$	2,189
4. On Turnover of ₹ 20,100 inclusive of 4% tax	
₹ 20,100 × $\frac{4}{104}$	773
5. On Turnover of ₹ 22,750 inclusive of 12.5% tax	
₹ 22,750 × $\frac{12.5}{112.5}$	2,528
Total Output Tax [A]	8,366

Input Tax Credit on Purchase :	
1. On Turnover of ₹ 9,750 inclusive of 12.5% tax	
₹ 15,000 × $\frac{12.5}{112.5}$	1,667
2. On Turnover of ₹ 8,500 inclusive of 12.5% tax	
₹ 8,500 × $\frac{12.5}{112.5}$	944
3. On Turnover of ₹ 18,000 inclusive of 12.5% tax	
₹ 18,000 × $\frac{12.5}{112.5}$	2,000
4. On Turnover of ₹ 14,000 inclusive of 4% tax	
₹ 14,000 × $\frac{4}{104}$	538
Total Input Tax Credit [B]	5,149
Net VAT Payable [A–B]	3,217

Note : (1) No input tax credit is available in respect of purchases from other states. Hence, inter-State purchase of ₹ 7,500 is not eligible for input tax credit under VAT.

(2) No input tax credit is available in respect of goods purchased in West Bengal and transferred to Patna branch (stock transfer), since the amount of tax on purchase was 4%. If the rate of tax on purchase happens to be more than 4%, the excess amount beyond 4% shall be eligible for input tax credit.

Alternatively,

If the Input Tax Credit in respect of purchase of ₹ 10,000 (inclusive of 4% tax) has beeen considered, in deterimining Total Input Tax Credit should have been :

		₹
	Total Input Tax Credit	5,149
Add :	Input Tax Credit on ₹ 10,000 ₹ 10,000 × $\frac{4}{104}$	385
		5,534

However, since the goods have been transferred to Patna branch on Stock Transfer basis the credit of ₹ 385 shall be reversed. Hence, Credit shall be for ₹ 385 and Net VAT Payable shall be ₹ (8,366 – 5,534 + 385) = ₹ 3,217.

Liability under Central Sales Tax :

Sale of ₹ 16,000 inclusive of 4% CST i.e., ₹ 16,000 × $\frac{4}{104}$ = ₹ 615

Accordingly, Net VAT Payable = ₹ 3,217

Net CST Payable = ₹ 615

Illustration 4 :

BBJ Co. Ltd., a registered dealer under the Central Sales Tax Act and VAT Act in the State of West Bengal. It makes inter-State sale as well as sale within West Bengal of goods specified in *Schedule C* (rate of tax 4%) and *Schedule 3 CA* (tax rate 12.5%).

From the following details, determine the amount of Central Sales Tax and VAT liability of the dealer for the month of March, 2011.

(1) Sale price of *Schedule C* (4%) goods in West Bengal on 12.3.2011 ₹ 5,00,000.

(2) Sale price of *Schedule CA* (12.5%) goods in West Bengal on 18.3.2011 ₹ 3,00,000.

(3) Sale price of *Schedule C* (4%) goods in West Bengal on 20.3.2011 ₹ 7,50,000.

(4) Sale price against *Form C* (4%) goods in West Bengal on 24.3.2011 ₹ 4,00,000.
(All the above sales are exclusive of sales tax)

Purchase of *Schedule C* (4%) Goods in West Bengal ₹ 4,16,000 inclusive of tax.

Purchase of *Schedule CA* (12.5%) Goods in West Bengal ₹ 1,68,750 inclusive of tax.

Purchase from Delhi, against *Form C* (4%) ₹ 52,000 inclusive of CST.

Solution :

Computation of Net VAT liability of M/s BBJ Co. Ltd. for the month of March, 2011.

Output Tax Liability :	Output Tax ₹
1. On Sale price of ₹ 5,00,000	
₹ 5,00,000 × 4%	20,000
2. On Sale price of ₹ 3,00,000	
₹ 3,00,000 × 12.5%	37,500
3. On Sale price of ₹ 7,50,000	
₹ 7,50,000 × 4%	30,000
Total Output VAT Liability [A]	87,500
Input Tax Credit on Purchase :	
1. On Purchase of ₹ 4,16,000 inclusive of 4% tax	
₹ $4,16,000 \times \frac{4}{104}$	16,000
2. On Purchase of ₹ 1,68,750 inclusive of 12.5% tax	
₹ $1,68,750 \times \frac{12.5}{112.5}$	18,750
Total Input Tax Credit [B]	34,750
Net VAT Payable [A – B]	52,750

Note : No input tax credit is available in respect of purchases from other State. Hence inter-State purchase from Delhi of ₹ 52,000 is not eligible for input tax credit under VAT.

Liability under Central Sales Tax :

Sale of ₹ 4,00,000 @ 4% CST (against Form C) = ₹ 16,000

Accordingly, Net VAT Payable = ₹ 52,750

Net CST Payable = ₹ 16,000

Illustration 5 :

M/s Jyoti Industries, a registered dealer of VAT in the State of Rajasthan, furnishes the following details relating to it's sales and purchases during the quarter ended 31st March, 2011 :

Sales :

Sale of *Schedule C* (4%) goods in Rajasthan ₹ 8.32,000 inclusive of tax

Sale of *Schedule CA* (12.5%) goods in Rajasthan ₹ 4,50,000 inclusive of tax

Sale of *Schedule C* (4%) goods in Rajasthan ₹ 4,16,000 inclusive of tax

Sale of *Schedule A* (Exempted) goods in Rajasthan ₹ 85,000.

Sale, return of *Schedule CA* goods in April, 2011 for ₹ 20,000 inclusive of tax.

Freight and delivery charges included in turnover and not separately charged :

For *Schedule A* goods	**₹**	**5,000**
For *Schedule C* goods	**₹**	**30,000**
For *Schedule CA* goods	**₹**	**22,000**

Purchases :

***Schedule C* (4%) goods from dealers in Rajasthan ₹ 9,00,000 inclusive of tax**

***Schedule CA* (12.5%) goods in Rajasthan ₹ 3,50,000 inclusive of tax**

***Schedule A* (exempted) goods in Rajasthanl ₹ 70,000**

Purchase from unregistered dealer in Rajasthan for ₹ 2,000 goods used in regular business of the dealer (*Schedule CA* goods) 12.5%

Determine aggregate sale price, taxable turnover of sales, output tax liability, input tax credit and net VAT liability of the dealer.

Solution :

Computation of Net VAT Liability of M/s. Jyoti Industries Ltd. for the month of March, 2011.

	Output Tax ₹
Output Tax Liability :	
1. On Turnover of ₹ 8,32,000 inclusive of 4% tax	
₹ $8{,}32{,}000 \times \frac{4}{104}$	32,000
Sale Price ₹ 8,32,000 – ₹ 32,000 = ₹ 8,00,000 on which VAT is payable @ 4%	
2. On Turnover of ₹ 4,50,000 *less* returned goods ₹ 20,000 Net turnover of ₹ 4,30,000 @ 12.5%	
₹ $4{,}30{,}000 \times \frac{12.5}{112.5}$	47,778
Sale Price ₹ 4,30,000 – ₹ 47,778 = ₹ 3,82,222 on which VAT is payable @ 12.5%	
3. On Turnover of ₹ 4,16,000 inclusive of 4% tax	
₹ $4{,}16{,}000 \times \frac{4}{104}$	16,000
Sale Price ₹ 4,16,000 – ₹ 16,000 = ₹ 4,00,000 on which VAT is payable @ 4%	
4. Tax on purchase from Unregistered Dealer [*Section 17*] ₹ 2,000 × 12.5%	250
Total Output Tax [A]	96,028
Input Tax Credit :	

1. On Purchase within Rajasthan @ 4% on ₹ 9,00,000	
₹ 9,00,000 $\frac{4}{104}$	34,615
2. On Purchase of ₹ 3,50,000 @ 12.5%	
₹ 3,50,000 $\frac{12.5}{112.5}$	38,889
3. On Purchase from Unregisterd Dealer (No credit is available)	Nil
Total Input Tax Credit [B]	73,504

Computation of Net VAT Liability

			₹
	Total Output Tax	(A)	96,028
Less :	Input Tax Credit	(B)	73,504
	Net VAT Liability		22,524

Notes : (1) No Input Tax Credit is available in purchase of exempted goods.

(2) No Input Tax Credit is available on purchase from unregistered dealer under *Section 22(5)* of the Act.

(3) Freight and delivery charges are included in the definition of 'Sale Price' under *Section 2(41)* of the Act and hence no deduction is allowed.

STUDY NOTE - 9

OVERVIEW OF INCOME TAX

This Study Note includes

- **The Sources of Income Tax Law**
- **Rates of Income Tax Payable : Assessment Year 2011-12**
- **Agricultural Income and Tax Liability**
- **Income from Salaries**
- **Income from House Property**
- **Profits and Gains from Business or Profession**
- **Capital Gains**
- **Income from others sources**
- **Deductions under Chapter VIA**
- **Set Off & Carry Forward of Losses**
- **Tax deducted at source**
- **Interest**
- **Advance Payment of Tax**
- **Return of Income and Assessment Procedure**
- **Clubbing of Income**
- **Refund**

9.1 THE SOURCES OF INCOME TAX LAW

1. The Income Tax Act, 1961

(a) Income tax in India is governed by the Income Tax Act,1961

(b) It came into force w.e.f.1.4.1962

(c) The Act contains 298 sections and XIV Schedules

(d) The Finance Act shall bring amendment to this Act.

(e) The Law provides for determination of taxable income, tax liability and procedure for assessment, appeal, penalties and prosecutions.

2. Finance Act

(a) Finance Minister presents this as Finance Bill in both the Houses of Parliament.

(b) Part A of the Budget contains proposed policies of the Government in fiscal areas.

(c) Part B contains the detailed tax proposals.

(d) Once the Finance Bill is approved by the Parliament and gets the assent of the President, it becomes the Finance Act.

(e) The rate of tax at which income shall be charged is prescribed in the Schedule I of Finance Act.

(f) The Finance Act brings amendments to both the Direct Tax Laws (i.e. Income Tax, Wealth Tax etc.) and Indirect Tax Laws (i.e. law relating to Central Excise, Customs Duty, Service Tax etc.)

3. The Income Tax Rules, 1962

(a) The administration of Direct Taxes is vested with Central Board of Direct Taxes (CBDT).

(b) Under Section 295 of IT Act, CBDT is empowered to frame rules from time to time to carry out the purpose and proper administration of the Act.

(c) All forms, procedures and principles of valuation of perquisites prescribed under the Act are provided in the Rules framed by CBDT.

4. Circulars / Notifications from CBDT

(a) In exercise of the powers u/s 119, CBDT issues circulars and notifications from time to time.
(b) These circulars clarify doubts regarding the scope and meaning of the various provisions of the Act.
(c) These circulars act as guidance for officers and assesses.
(d) These circulars are binding on Assessing Officers but not on assesses and Courts.
(e) The circulars issued by the CBDT shall not be in contrary to the provisions of the Act.

Subordinate Legislation

The Government enacts the law in the Parliament, there e.g. Income Tax Act, Central Excise Act, etc. where is a need for detailed rules and regulations, the enactment is to be done by either CBDT or CBEC. The rules and regulations enacted by CBDT or CBEC i.e. Income Tax Rules, Cenvat Credit Rules, the Notifications and Circulars issued by CBDT, CBEC is called Subordinate Legislation.

5. Supreme Court and High Court Decisions

(a) The Supreme Court and the High Court can give judgment **only on the question of law.**
(b) The Law laid down by the Supreme Court is the law of the land.
(c) The decision of High Court will apply in the respective States, within its jurisdiction.

DETERMINING THE RATES OF TAX UNDER THE INCOME TAX ACT, 1961

1. Income Tax shall be charged at the rates fixed for the year by the Annual Finance Act.

2. The First Schedule to the Finance Act provides the following rates of taxation.

Part I	The tax rates applicable to income of various types of assessees for the assessment year
Part II	Rates of TDS for the current Financial year
Part III	Rates of TDS for salary and advance tax (which becomes Part I of the next assessment year)

9.2. RATES OF INCOME-TAX FOR ASSESSMENT YEAR 2011-12

9.2.1 (A) For woman, resident in India and below the age of 65 years at any time during the previous year:

Upto ₹ 1,90,000	Nil
Rs. 1,90,001 to ₹ 5,00,000	10%
₹ 5,00,000 to ₹ 8,00,000	20%
Above ₹ 8,00,000	30%

(B) For an individual (man or woman), resident in India who is of the age of 65 years or more at any time during the previous year.

Upto ₹ 2,40,000	Nil
₹ 2,40,001 to ₹ 5,00,000	10%
₹ 5,00,000 to ₹ 8,00,000	20%
Above ₹ 8,00,000	30%

(C) Individuals, [other than those mentioned in para 2.2.1(A) and (B) above] HUF, AOP/BOI (other than co-operative societies, whether incorporated or not)

Upto ₹ 1,60,000	Nil
₹ 1,60,001 to ₹ 5,00,000	10%
₹ 5,00,000 to ₹ 8,00,000	20%
Above ₹ 8,00,000	30%

Note : Surcharge Nil. 'Education Cess' @ 2%, and 'Secondary and Higher Education Cess (SHEC)' @ 1% on income tax shall be chargeable.

9.2.2 Other Assessees :

Assessee	Rate of Tax	Surcharge
For Firms (including limited liability partnership)	Total Income × 30% + EC @ 2% + SHEC @ 1%.	Surcharge — NIL
Domestic Companies	Total Income × 30% + EC @ 2% + SHEC @ 1%.	Surcharge @ 7.5% if the total turnover exceeds ₹ 1 crore
Foreign Companies Other Income Royalty received from Indian Government or an Indian concern in pursuance of an agreement made by it with the Indian concern after March 31, 1961, but before April 1, 1976, or fees for rendering technical services in pursuance of an agreement made by it after February 29, 1964 and where such agreement has, in either case been approved by the Central Government	Total Income x 40%+ EC @ 2% + SHEC @ 1%	Surcharge @ 2.5% if the total turnover exceeds ₹1 crore
For Local Authorities	Total Income × 30% + EC @ 2% + SHEC @ 1%.	**(Surcharge is not applicable) Nil**
For Co-operative Societies	For First ₹ 10,000 @ 10% For Next ₹ 10,000 @ 20% For the Balance @ 30% EC @ 2% and SHEC @ 1% are applicable.	**Surcharge is not applicable. Nil**
MAT = Minimum Alternate Tax	18% of Book Profit + EC 2% + SHEC 1%	Surcharge if Book Profits exceed ₹ 1 crore.

9.2.3 Definition

Assessee means: [Section 2(7)]

Any person who is liable to pay any tax or any other sum under the Income Tax Act, 1961, and

Assessee includes

(a) Every person in respect of whom any proceedings has been taken for the assessment of

- **His income** or the income of any other person.
- **Loss** sustained by him or other person.
- **Refund** due to him or such other person.

(b) Every person who is **deemed to be an assessee** under the Act.

(c) Every person who is **deemed to be an assessee in default** under the Act.

Assessment Year [Section 2 (9)]

1. Assessment Year means the **period of twelve months commencing on the 1st day of April every year.**
2. The year for which tax is paid is called Assessment Year.

The present Assessment Year is 2011-12 relating to previous year 2010-11.

Previous Year [Section 3]

1. Previous Year means **Financial Year** immediately preceding the Assessment Year.
2. The year in respect of the income of which tax is levied is called Previous Year.

The present previous year 2010-11 and its Assessment Year is 2011-12.

Note: Previous Year for Newly established business From the date of setting up of the business to the end of the Financial year in which business was set up.

Example : X Ltd. Started business on 1.11.10. So for X Ltd. Previous year will be considered as 1.11.10 to 31.3.11.

Income [Section 2(24)] includes:

1. Profits or gains of business or profession.
2. Dividend.
3. Voluntary Contribution received by a Charitable / Religious Trust or University / Education Institution or Hospital
4. Value of perquisite or profit in lieu of salary taxable u/s 17 and special allowance or benefit specifically granted either to meet personal expenses or for performance of duties of an office or an employment of profit.
5. Export incentives, like Duty Drawback, Cash Compensatory Support, Sale of licences etc.
6. Interest, salary, bonus, commission or remuneration earned by a partner of a Firm from such Firm.
7. Capital Gains chargeable u/s 45.
8. Profits and gains from the business of banking carried on by a cooperative society with its members.
9. Winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.
10. Deemed income u/s 41 or 59.
11. Sums received by an assessee from his employees towards welfare fund contributions such as Provident Fund, Superannuation Fund etc.
12. Amount received under Keyman Insurance Policy including bonus thereon.
13. Amount received under agreement for (a) not carrying out activity in relation to any business, or (b) not sharing any knowhow, patent, copyright etc.
14. Benefit or perquisite received from a Company, by a Director or a person holding substantial interest or a relative of the Director or such person.
15. Gift as defined u/s 56 (2)(vi) (w.e.f. A.Y 2008-2009). Any sum of money exceeding ₹ 50,000, received by an Individual or a HUF from any person during the previous year without consideration on or after 1.4.2007, then the whole of aggregate of such sums will be taxable.

PREVIOUS YEAR & ASSESSMENT YEAR WILL BE SAME in the following cases:

1. **Shipping business of nonresident [Section 172]**
2. **Persons leaving India [Section 174]**
3. **AOP or BOI or Artificial Juridical Person formed for a particular event or purpose [Sec. 174A]**
4. **Persons likely to transfer property to avoid tax [Section 175]**
5. **Discontinued business [Section 176]**

UNDISCLOSED SOURCES OF INCOME

1. **Unexplained Cash Credits u/s 68**
2. **Unexplained investments u/s69**
3. **Unexplained money, bullion or jewel or valuable article u/s 69A**

4. **Undisclosed investments u/s 69B**
5. **Unexplained expenditure u/s 69C**
6. **Amount borrowed or repaid on hundi, other than by way of account payee cheque u/s 69D.**

Application of Income

An obligation to apply income, which has accrued or has arisen or has been received amounts to merely the apportionment of income. Therefore the essentials of the concept of application of income under the provisions of the Income Tax Act are :

1. Income accrues to the assessee
2. Income reaches the assessee
3. Income is applied to discharge an obligation, whether self-imposed or gratuitous.

Diversion of Income

An obligation to apply the income in a particular way before it is received by the assessee or before it has arisen or accrued to the assessee results in diversion of income. The source is charged with an overriding title, which diverts the income. Therefore the essentials are the following :

1. Income is diverted at source,
2. There is an overriding charge or title for such diversion, and
3. The charge / obligation is on the source of income and not on thereceiver.

Examples of diversion by overriding title are -

(a) Right of maintenance of dependants or of coparceners on partition
(b) Right under a statutory provision
(c) A charge created by a decree of a Court of law.

TOTAL INCOME [Sec. 2(45)]

"Total income" means the total amount of income as referred to in sec. 5 and computed in the manner laid down in the Act. Total income constitutes the tax with reference to which income tax is charged.

GROSS TOTAL INCOME [Section 80B]

Gross Total Income means total income computed in accordance with the provisions of the Income Tax Act before making any deduction under Chapter VIA.

ROUNDING OFF TOTAL INCOME AND TAX

Rounding Off Income [Section 288A] : The Total Income computed under this Act, shall be rounded off to the **nearest multiple of ₹ 10**.

Rounding Off Tax [Section 288B] : The amount of Tax including Tax Deducted at Source (TDS) and advance tax, interest, penalty, fine or any other sum payable, and the amount of refund due under the Income Tax Act, shall be rounded off to the **nearest Ten Rupees.**

BOOKS OF ACCOUNT [Sec. 2(12A)]

It includes ledgers, day books, cash books, account-books and other books, whether kept in the written form or as printouts or data stored in a floppy, disc, tape or any other form of electromagnetic data storage device.

DOCUMENT [Sec. 2(22AA)]

It includes an electronic record as defined in clause (t) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000).

RELATIVE [Sec. 2(41)]

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

RESULTING COMPANY [Sec. 2(41A)]

It means one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger.

INSURER [Sec. 2(28BB)]

It means an insurer being an Indian insurance company, as defined under clause (7A) of section 2 of the Insurance Act, 1938 (4 of 1938), which has been granted a certificate of registration under section 3 of that Act.

SUBSTANTIAL INTEREST [Sec. 2 (32)]

Person who has a substantial interest in the company, in relation to a company, means a person who is the beneficial owner of shares, not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits, carrying not less than twenty per cent of the voting power. In the case of a non-corporate entity, a person can be said to have substantial interest if 20% or more share of profit is held.

INFRASTRUCTURAL CAPITAL COMPANY [Sec.2(26A)]

"*Infrastructure capital company*" means such company which makes investments by way of acquiring shares or providing long-term finance to any enterprise or undertaking wholly engaged in the business referred to in sub-section (4) of section 80 –IA or sub-section (1) of section 80-IAB or an undertaking developing and building a housing project referred to in sub-section (10) of section 80- IB or a project for constructing a hospital with at least one hundred beds for patients.[Sec. 2(26A)].

INFRASTRUCTURAL CAPITAL FUND [Sec.2(26B)]

"*Infrastructure capital fund*" means such fund operating under a trust deed registered under the provisions of the Registration Act, 1908 established to raise monies by the trustees for investment by way of acquiring shares or providing long-term finance to any enterprise or undertaking wholly engaged in the business referred to in sub-section (4) of section 80-IA or sub-section (1) of section 80- IAB or an undertaking developing and building a housing project referred to in sub-section (10) of section 80-IB or a project for constructing a hotel of not less than three star category as classified by the Central Government or a project for constructing a hospital with at least one hundred beds for patients. [Sec 2(26B)].

CHARGE OF INCOME TAX [Sec. 4]

According to sec. 4 of the Income-tax, 1961 the following basic principles are followed while charging income-tax—

(i) income-tax is a tax on the annual income of an assessee,

(ii) usually, the income of the Previous Year (PY) is charged to the following Assessment Year (AY) at the prescribed rate fixed by the relevant Financial Act, and

(iii) tax is levied on the total income of every assessee

RECEIPT OF INCOME - DEEMED INCOME [Sec. 7]

The following income shall be deemed to be received in the Previous Year :

(i) Employers contribution to recognized provident fund in excess of 12% of salary and interest credited to the recognized provident fund in excess of 9.5%

(ii) The transfer balance in a recognized provident fund, to the extent provided in sub rule (4) of rule 11 of part A of fourth schedule.

DIVIDEND INCOME [Sec. 8]

Dividend include—

(a) any distribution by a company of accumulated profits whether capitalised or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company ;

(b) any distribution to its shareholders by a company of debentures, debenture-stock, or deposit certificates in any form, whether with or without interest, and any distribution to its preference shareholders of shares by way of bonus, to the extent to which the company possesses accumulated profits, whether capitalised or not ;

(c) any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not ;

(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[85] 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 ;

(e) any payment by a company, not being a company in which the public are substantially interested, of any sum (whether as representing a part of the assets of the company or otherwise) [made after the 31st day of May, 1987, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than ten per cent of the voting power, or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest (hereafter in this clause referred to as the said concern)] or any payment by any such company on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company in either case possesses accumulated profits;

But "dividend" does not include—

(i) a distribution made in accordance with sub-clause (c) or sub-clause (d) in respect of any share issued for full cash consideration, where the holder of the share is not entitled in the event of liquidation to participate in the surplus assets ;

(ia) a distribution made in accordance with sub-clause (c) or sub-clause (d) in so far as such distribution is attributable to the capitalised profits of the company representing bonus shares allotted to its equity shareholders after the 31st day of March, 1964,

(ii) any advance or loan made to a shareholder [or the said concern] by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company ;

(iii) any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (*e*), to the extent to which it is so set off;

(iv) any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956 (1 of 1956);

(v) any distribution of shares pursuant to a demerger by the resulting company to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company)

Explanation 1.—The expression "accumulated profits", wherever it occurs in this clause, shall not include capital gains arising before the 1st day of April, 1946, or after the 31st day of March, 1948, and before the 1st day of April, 1956.

Explanation 2.—The expression "accumulated profits" in sub-clauses (*a*), (*b*), (*d*) and (*e*), shall include all profits of the company up to the date of distribution or payment referred to in those sub-clauses, and in sub-clause (*c*) shall include all profits of the company up to the date of liquidation,[but shall not, where the liquidation is consequent on the compulsory acquisition of its undertaking by the Government or a corporation owned or controlled by the Government under any law for the time being in force, include any profits of the company prior to three successive previous years immediately preceding the previous year in which such acquisition took place].

Explanation 3.—For the purposes of this clause,—

(a) "concern" means a Hindu undivided family, or a firm or an association of persons or a body of individuals or a company ;

(b) a person shall be deemed to have a substantial interest in a concern, other than a company, if he is, at any time during the previous year, beneficially entitled to not less than twenty per cent of the income of such concern;

CAPITAL AND REVENUE RECEIPTS

The objective of the Income-tax Act is to tax only income generally revenue receipts unless specifically exempted. On the other hand capital receipts are not chargeable to tax except when specifically provided in the Act. The distinction between a capital receipt and a revenue receipt should be perceived based on the facts and circumstances of each case. There is no specific provision in the Act to distinguish between a capital receipt and revenue receipt. It may be observed that :

A receipt in substitution of a source of income is a capital receipt while a receipt in substitution of an income is a revenue receipt.

An amount received as a compensation for surrender of certain rights under an agreement is a capital receipt whereas an amount received under an agreement as compensation for loss of future profit is a revenue receipt.

CAPITAL AND REVENUE EXPENDITURE

In computing taxable income normally revenue expenditure incurred for the purpose of earning income is deductible from revenue receipt unless the law provides specific rules to disallow such expenditure wholly or partly. On the other hand capital expenditure is not deductible while computing taxable income unless the law expressly so provides.

Neither the capital expenditure nor revenue expenditure has been defined in the Act. However, from the facts and circumstances of each case and from the judicial decisions the following general principles to be kept in mind :

(i) Capital expenditure is incurred in acquiring, extending or improving a fixed asset whereas revenue expenditure is incurred in the normal course of business as a routine expenditure.

(ii) Capital expenditure incurred for enduring benefits whereas revenue expenditure is consumed within a Previous Year .

(iii) Capital expenditure makes improvement with earning capacity of a business whereas a revenue expenditure maintains the profit making capacity of a business.

(iv) Capital expenditure is a nonrecurring expenditure whereas revenue expenditure is normally a recurring one.

"HEADS OF INCOME" [Sec 14]

Significance of Heads of Income :

1. The income chargeable under a particular head **cannot be charged under any other head.**
2. The Act has **self contained** provisions in respect of each head of income.
3. If any income is **charged under a wrong head** of income, the assessee will **lose the benefit** of deduction available to him under that head.

Relevance of method of accounting for heads of income :

Heads of Income	Relevance of Method of Accounting
Chapter IV-A **Salaries (15 - 17)**	1. Taxable on **due basis or on receipt basis,** whichever is earlier. 2. Method of accounting is **irrelevant.**
Chapter IV-C **House Property** **(22 - 27)**	1. Income from house property is **taxable** only on **accrual basis.** 2. Method of accounting is **not relevant.**
Chapter IV-D **Business Income** **(28-44DB)**	1. U/s 145 assessee may follow either **Cash or Mercantile system** of accounting **regularly employed** by the assessee. **2. Exceptions :** Certain payments are allowable only on actual payment basis. Accrual concept does not hold good - (a) Employer's contribution to PF, ESI, Tax, Duty, Cess, Fees to Government, Interest on loans and advances from banks and financial institutions, provision for leave encashment, bonus or commission etc. (b) Telecommunication Licence Fee is allowable in instalments only from the year of payment. (c) Preliminary Expenses distributed over five years. (d) Amalgamation / Demerger Expenses distributed over five years. (e) Amount paid in connection with Voluntary Retirement Scheme distributed over five years.
Chapter IV-E **Capital Gains** **(45 - 55A)**	1. Income from capital gains shall be taxable during the **previous year Capital Gains in which the Capital Asset is transferred (i.e) year of accrual.** 2. The method of accounting is not relevant for taxing the income under the head capital gains.
Chapter IV-F **OtherSources** **(56 - 59)**	U/s 145 assessee may follow either on **Cash or Mercantile system** of accounting **regularly employed** by the assessee.

9.3 AGRICULTURAL INCOME AND TAX LIABILITY

Article 270 of the Constitution of India empowers Government of India to collect tax on income other than agricultural income. Agricultural income has been placed in the State list and as such the Central Government cannot levy tax on agricultural income.

Sec. 2(1A)provides definition of the term. 'Agricultural income' means –

(a) any rent or revenue derived from land which is situated in India and is used for agricultural purposes.

(b) any income derived from such land by-

 (i) agriculture; or

 (ii) the performance by a cultivator or receiver of rent-in-kind of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market; or

 iii) the sale by a cultivator or receiver of rent in kind of the produce raised or received by him, in respect of which no process has been raised or received by him, in respect of which no process has been performed other than a process of the nature described in para (ii) of the sub-clause:

(c) any income derived from any building owned and occupied by the receiver of rent or revenue of any such land provided the following conditions are satisfied-

 (i) the building should be on or in the immediate vicinity of land and is used for agricultural purposes;

 (ii) the cultivator or receiver of rent-in-kind uses the building as a dwelling house or a store house; and

 (iii) the land is assessed to land revenue or local rate or the land is situated within the jurisdiction of municipality/cantonment having a population of not less than 10,000 persons or within distance of not more than 8 k.m.

It may be pointed out that sec. 10(1) exempts from income-tax 'agricultural income' covered by the aforesaid definition.

However, in case of certain category of assessees e.g. individuals. HUFs having income more than maximum amount not liable for tax, 'agricultural income' is taken into consideration to determine tax on non-agricultural income.

Case Laws:

Essential Conditions :
Agriculture not involving any basic operation like tilling, sowing or dissemination of seeds and planting on land would not constitute agriculture merely because they have relation or connection with land. Term agriculture does not include breeding and rearing of live stock, dairy faming, butter, cheese making, poultry, etc.- CIT v/s Raja Benoy Kumar Sahas Roy 32 ITR 466 (SC).

Agricultural Income :

Where the owner himself performs slaughter tapping and then sells the rubber, the income is agricultural income.- Jacob(K.C.) v Ag. ITO 110 ITR 402.

Lease rent received for leasing out land for grazing of cattle required for agricultural pursuits, is agricultural income.- CIT v Rai Shamsherjang Bahadur 24 ITR 1.

Compensation received from an insurance company on account of damaged caused to the crop is an agricultural income.- CIT v B. Gupta Tea Pvt. Ltd. 74 ITR 337.

Seeds are clearly a product of agriculture and the income derived from the sale of seeds derived on account of cultivation by the assessee is an agricultural income.- CIT v Soundharya Nursury 241 ITR 530.

Miscellaneous income from plantation: Miscellaneous income from plantation should also be agricultural income except in respect of sale of trees of spontaneous growth. Thus, where a state undertaking owing a forest, had received income by sale of firewood, grazing permits and compounding fee for trespasses into the plantation, the same shall be treated as agricultural income.-CIT v Tamil Nadu Forest Plantation Corporation 248 ITR 331.

Non Agricultural Income :

Dividend received from company having only agricultural income is not agricultural income for a shareholder-CIT v/s Mrs. Bacha F. Guzdar 27 ITR 1 (SC).

Conversion of sugarcane into Gur- No Agriculture income - Seth Banarasi Dass Gupta v/s CIT. 106 ITR 804 .

Income from agricultural lands situated outside India is not agricultural income within the meaning of the Indian income-tax. Similarly if there is a figure of loss from agricultural lands, situated outside India, it has got to be deducted while computing the total income of the resident assessee in India - *CIT* v. *Carew & Co. Ltd.* 120 ITR 540.

Compensation for acquisition of land - Where land of assessee-tea company was requisitioned by State Government and same was given to refugees who carried on cultivation thereon and at time of requisition assessee too was carrying on agricultural operations on land, compensation received by assessee was to be treated as agricultural income - *CIT* v. *All India Tea & Trading Co. Ltd.* 85 Taxman 391/219 ITR 544.

Following are certain instances defining the scope of agricultural income.

Rent or revenue should be derived from land:

— Any loan obtained by a shareholder out of accumulated profits of the company having only agricultural income, which is liable to be treated as 'deemed dividend', is not agricultural income in the hands of recipient.

— Interest on arrears of cess or rent payable by a tenant to his landlord is no doubt revenue but it is not revenue derived from land and hence it is not agricultural income.

— Commission earned by a broker for selling agricultural produce of an agriculturist is not agricultural income.

— Any capital gain arising from the transfer of agricultural land is not treated as revenue derived from land and hence it is not agricultural income.

Income held as not derived from land:

— Mutation fees paid by tenant on succession to a holding by inheritance.

— Fees paid by tenants for renewal of leases and fees paid for recognising the distribution of holding on partition would not be income derived from land, since they are payments made for administrative services rendered by the landlord, akin to registration fees.

— Receipts from the supply of water tank in an agricultural land

Use of building or land for agricultural purpose:

— Any income arising from the use of land or building for any purpose (including letting for residential purpose or for the purpose of any business or profession) other than agriculture shall not be agricultural income.

— Any income attributable to farm house situated in urban areas will not be treated as agricultural income unless the land on which the farm house is situated is assessed to land revenue or any local rate. On the other hand, in case of farm house situated in rural areas, the income will be treated as agricultural income even where the land on which farm house is situated is not assessed to land revenue or any local rate.

Agriculture Income and Income-tax :

Agricultural income [Section 10(1)] –

(i) Section 10(1) provides that agricultural income is not to be included in the total income of the assessee. The reason for totally exempting agricultural income from the scope of central income tax is that under the Constitution, the Parliament has no power to levy a tax on agricultural income.

(ii) Indirect way of taxing agricultural income - However, since 1973, a method has been found out to levy tax on agricultural income in an indirect way. This concept is known as partial integration of taxes. It is applicable to individuals, HUF, unregistered firms, AOP, BOI and artificial persons.

Two conditions which need to satisfied for partial integration are:

1. The net agricultural income should exceed ₹5,000 for the year and
2. Non-agricultural income should exceed the maximum amount not chargeable to tax. (e. g. ₹ 2,40,000 for senior citizens, ₹ 1,90,000 for women assessees below 65 years of age, ₹ 1,60,000 for all other individuals and HUFs.)

It may be noted that aggregation provisions do not apply to company, firm assessed as such (FAS), co-operative society and local authority. The object of aggregating the net agricultural income with non-agricultural income is to tax the non-agricultural income at higher rates.

Tax calculation in such cases is as follows :

Step 1: Add non-agricultural income with net agricultural income. Compute tax on the aggregate amount.

Step 2: Add net agricultural income and the maximum exemption limit available to the assessee (e.g. ₹ 1,60,000 / ₹ 1,90,000 / ₹ 2,40,000, etc. as applicable). Compute tax on the aggregate amount.

Step 3: Deduct the amount of income tax calculated in step 2 from the income tax calculated in step 1 i.e. Step 1 – Step 2.

Step 4: Deduct any applicable rebate from the amount of tax obtained in step 3.

Step 5: Add surcharge, if applicable, to the amount obtained in step 4 above.

Step 6: The sum so arrived at shall be increased by education and higher secondary cess.

These steps are applicable whenever tax liability is to be worked out e.g. self-assessment tax, advance tax, tax on regular assessment)

ILLUSTRATION ON AGRICULTURAL INCOME AND TAX LIABILITY

Illustration 1 : Mr X furnishes the return of income for the financial year 2010-2011. His total income (nonagricultural) is ₹ 12,10,000 and net agricultural income is ₹ 2,90,000. Compute the amount of tax payable by Mr X for the assessment year 2011-2012.

Solution : Computation of tax for the assessment year 2011-2012

(a) Income tax on the aggregate of non-agricultural income and net agricultural income (i.e. ₹ 14,00,000) as if it is the total income.

On the first	1,60,000	Nil	Nil
On the next	3,40,000	10%	34,000
On the next	3,00,000	20%	60,000
On the balance	7,00,000	30%	2,10,000
	15,00,000		3,04,000

(b) Income tax on net agricultural income plus the basic exemption limit i.e. ₹ 1,60,000 (i.e. ₹ 3,50,000) as if it is the total income.

On the first	1,60,000	Nil	Nil
On the next	2,90,000	10%	29,000
	4,50,000		29,000

Net income tax : (a) – (b) = ₹ 3,04,000 – 29,000 =	**2,75,000**
Add:	
(i) Education cess @ 2%	5,500
(ii) SHEC @ 1%	2,750
Tax payable	**2,83,250**

Illustration 2 : Mr. Gangaprasad, resident in India, turns out 65 years of age on 31st March 2011. He furnishes the following particulars of his income for the previous year 2010-2011 :

Particulars	**₹**
(i) Rent from agriculture land, located in a village of Jharkhand district	2,50,000
(ii) Rent from building, located in the vicinity of agriculture land, which is assessed to land to revenue and the tenant, cultivating the agricultural land, occupies it for his dwelling and storing purposes	60,000
(iii) Income from business	3,00,000
(iv) Long-term capital gain	1,00,000

He maintains a motor car which is used 70% for business purpose, 10% for collecting rent from building and 20% for collecting rent from agriculture land. He has incurred and expenditure of ₹1,00,000 by way of petrol, repair and salary of the driver. He also claims depreciation on the written down value of the motor car on 1.4.2010. ₹ 2,00,000 @ 15%. He has paid ₹ 2000 as local tax to the village panchayat in respect of the building. He also paid ₹ 30,000 land revenue to the Government on account of agriculture land. He also reported a short term capital loss of Rs. 50,000. Determine his total income and tax liability in the following cases:

(i) Agriculture produce goes under marketing process to fetch better rates in the market,

(ii) Agriculture produce goes under marketing process to make it saleable in the local market.

Solution :

Computation of Total Income for the Assessment Year 2011-2012

(i) Income from house property:			
Gross annual value based on rent		60,000	
Less : Local tax to village panchayat: No deduction is allowed as— it is not a municipal tax		Nil	
Net annual value		**60,000**	
Less: (i) Statutory deduction @ 30% of NAV		18,000	
Income from House Property			42,000
Income from house property to be treated as agriculture income provided the agriculture produce is not subjected to marketing produce to fetch better rates [Sec. 2(1A)(c)]			
(ii) Income from business			3,00,000
(iii) Long-term capital gain	1,50,000		
Less : Adjustment for Short Term Capital loss	(50,000)		1,00,000
(iv) Income from other sources :			
Rent from agriculture land		2,50,000	
Less: Permissible deduction (Sec. 57) :			
(a) Land revenue		(-) 30,000	
(b) Realisation expenses		(-) 20,000	
(c) Depreciation: Not admissible Sec. 57(ii) see Note below			
Income from agriculture [Sec. 2(1A)(a)]		**2,00,000**	
Total income, subject to increase by ₹ 42,000 when produce is subjected to marketing process to fetch better rates.			**4,42,000**

Computation of tax liability: AY. 2011-2012

Particulars	**Senior citizen**	
	Case I Produce subjected to marketing process for better rates ₹	**Case II** Produce subjected to marketing process to make it saleable ₹
Non-agriculture income	4,42,000	4,00,000
Agriculture income	2,00,000	2,42,000
Total Income	**6,42,000**	**6,42,000**
(a) Tax on non-agriculture income + agriculture income as if it is the total income:		
(i) Tax on long-term capital gain	20,000	20,000
(ii) Tax on balance of total income at slab rates	34,400	34,400
Gross Tax Liability (i) + (ii)	54,400	54,400
(b) Tax on agriculture income + basic exemption limit	20,000	24,200
(c) Tax payable: (a) – (b)	34,400	30,200
Add: Education cess @ 2%	688	604
SHEC @ 1%	344	302
Tax payable	**35,432**	**31,106**
Tax payable to be rounded off to the nearest multiple of ₹ 10 (Sec. 288B)	35,430	31,110

Note :

While computing income under "other sources" depreciation is allowed only in case where plant, machinery or furniture is let out on hire or building along with plant, machinery or furniture is let out on hire [Sec. 57(ii)]

Hence no depreciation is allowed in respect of motor car.

Proportionate depreciation on motor car is permissible under the head "business or profession":

It is assumed it has been allowed as the expression "income from business" refers to taxable income after permissible deductions.

Illustration 3 : RP (HUF), furnishes the following particulars of its income and outgoing for the previous year 2010-2011.

Receipts :	4,00,000
(i) Short-term capital gain	1,00,000
(ii) Gross winning from lottery	12,00,000
(iii) Sale consideration of 3/4th of agriculture produce, derived from land located in India, the balance produce has been kept for family use.	50,000
(iv) Net sale proceeds of wild grass and fruits from trees of spontaneous growth	
Payments:	
(i) Repair of tube-well	60,000
WDV of tuble-well on 1-4-2010	10,00,000
(ii) Wages paid to agriculture labour	6,00,000
(iii) Manuring and spraying charges	50,000
(iv) Rent of the building, used for storing agriculture produce on site	50,000
(v) Petrol, repair, salary of driver and insurance of motor car. WDV of motor car on 1-4-2010	1,50,000 2,00,000
50% use of the motor car is for personal purpose of the family	
(vi) LIP paid to insure members of the family	20,000
(vii) School fees paid for 3 children of the family @ ₹ 15,000 per child	45,000
(viii) Purchase of infrastructure bonds, covered under Sec. 80C(2)(xix)	90,000
(ix) Deposit with LIC for maintenance of a dependant member with disability:	
Unabsorbed losses brought forward:	
AY: 2001-2002	40,000
AY: 2003-2004	5,00,000
AY: 2006-2007	1,00,000

Determine the total income of the HUF and its tax liability for the assessment year 2011-2012.

Solution :

Assessee : R P (HUF)

Computation of Total Income: AY 2010-2011

Particulars	₹	₹
Computation of net agriculture income for the purpose of aggregation to determine the rate of tax applicable to non-agriculture income of the HUF. **Such computation is done under the head business profession**:		
(1) Sale proceeds of agriculture produce		12,00,000
Add: Market value of produce kept for family use:		4,00,000
12,00,000 × (4/3) × (1/4)		16,00,000
Less: Permissible deductions:		
(i) Repair of tube-well	60,000	
(ii) Wages	6,00,000	
(iii) Rent	50,000	
(iv) Petrol, repair, salary of driver— 50%	75,000	
(v) Manuring and spraying	50,000	
(vi) Depreciation on tube-well @ 10% on WDV	1,00,000	
(vii) 50% depreciation on motor car: (15% of 2,00,000) x 50%	15,000	9,50,000
Less: Adjustment for Carry Forward Losses :		
(i) Loss 2001-2002-not allowed	Nil	
(ii) Loss from AY 2003-2004	1,00,000	
(iii) Loss from AY 2006-2007	45,000	1,45,000
Net Agriculture Income		**5,05,000**
(2) Computation of Total Income		
(a) Short-term capital gain		4,00,000
(b) Income from other sources:		
(i) Winnings from lottery	1,00,000	
(ii) Net sale proceeds of non-agriculture produce	50,000	1,50,000
Gross Total Income (excluding Agricultural Income)		**5,50,000**
Less: Contributions paid for approved savings [Sec. 80C(2)]:		
(i) LIP on the life of members	20,000	
(ii) School fees for 3 children of the HUF [Sec. 80(4)(c)]	Nil	
(iv) Purchase of NSC	90,000	
	1,10,000	
But deduction restricted upto a maximum of ₹1,00,000		1,00,000

2. Deposit for maintenance (including medical treatment) of a dependant with disability (Sec. 80DD)		50,000
Total Non-Agricultural Income		**4,00,000**
Computation of Tax Liability		
(i) Income tax on winnings 30% on ₹ 1,00,000		30,000
(ii) Income tax on non-agriculture + agriculture income:		
3,00,000 + 5,05,000 at slab rates		
(Non-agricultural income = 3,00,000 = 5,50,000 – 1,00,000 – 1,00,000 – 50,000)		
(a) Income tax on 8,05,000 as if it is the total income	95,500	
(b) Income tax on agriculture income + exemption limit as if it is the total income: 5,05,000 + 1,60,000 = 6,65,000	67,000	
Income tax on non-agriculture income: (a) – (b)	28,500	28,500
Tax on total income		58,500
Add:		
(i) Education cess @ 2%		1,170
(ii) SHEC @ 1%		585
Tax payable		**60,255**

Illustration 4 : B Ltd. grows sugarcane to manufacture sugar. The data for the financial year 2010-11 is as follows :

Cost of cultivation of sugarcane	₹ 6,00,000
Market value of sugarcane when transferred to factory	₹ 10,00,000
Other manufacturing cost	₹ 6,00,000
Sales of sugar	₹ 25,00,000
Salary of Managing Director who looks after all operations of the Company	₹ 3,00,000

Solution :

(1)	**Business Income :**	
	Sales of Sugar	₹ 25,00,000
	Less: Market value of sugarcane when transferred to factory	₹ 10,00,000
	Other manufacturing cost	₹ 6,00,000
	Salary of Managing Director	₹ 3,00,000
		₹ 6,00,000
(2)	**Agricultural Income :**	
	Market value of sugarcane when transferred to factory	₹ 10,00,000
	Less: Cost of cultivation	₹ 6,00,000
		₹ 4,00,000

Illustration 5 : Mr. P has estates in Rubber, Tea and Coffee. He has also a nursery wherein he grows plants and sells. For the previous year ended 31.3.2011, he furnishes the following particulars of his sources of income from estates and sale of Plants. You are requested to compute the taxable income for the Assessment year 2011-2012:

Manufacture of Rubber	₹ 5,00,000
Manufacture of Coffee grown and cured	₹ 3,50,000
Manufacture of Tea	₹ 7,00,000
Sale of Plants from Nursery	₹ 2,00,000

Solution :

Computation of Taxable Income

Rule	Nature of Business	Agl Inc.	Non-Agl. Inc.
7A	Sale of centrifuged latex or cenex manufactured from rubber	3,25,000	1,75,000
7B	Sale of grown and cured coffee by seller in India	2,62,500	87,500
8	Growing and Manufacturing Tea	4,20,000	2,80,000
	Sale of plants from nursery	2,00,000	—
	Total	**12,07,500**	**5,42,500**

Computation of Tax Liability :

	₹
(a) Total Income (Agricultural Income + Non-agricultural Income)	17,50,000
(b) Tax on (a) above	3,79,000
(c) Total of (Agricultural Income + Basic Exemption Limit)	13,67,500
(d) Tax on (c) above	2,64,250
(e) Tax Payable (b) – (d)	1,14,750
Add: Education Cess @ 2%	2,295
Add: SHEC @ 1%	1,148
Total Tax Liability	1,18,193
Tax payable rounded off u/s 288B	1,18,190

9.4 INCOME FROM SALARY

The meaning of the term 'salary' for purposes of income tax is much wider than what is normally understood. Every payment made by an employer to his employee for service rendered would be chargeable to tax as income from salaries. The term 'salary' for the purposes of Income-Tax Act will include both monetary payments (e.g. basic salary, bonus, commission, allowances etc.) as well as non-monetary facilities (e.g. housing accommodation, medical facility, interest free loans etc).

(1) Employer-employee relationship :

Before an income can become chargeable under the head 'salaries', it is vital that there should exist between the payer and the payee, the relationship of an employer and an employee.

(2) Full-time or part-time employment:

It does not matter whether the employee is a fulltime employee or a part-time one. Once the relationship of employer and employee exists, the income is to be charged under the head "salaries". If, for example, an employee works with more than one employer, salaries received from all the employers should be clubbed and brought to charge for the relevant previous years.

(3) Foregoing or Sacrificing of salary :

Once salary accrues, the subsequent waiver by the employee does not absolve him from liability to income-tax. Such waiver is only an application and hence chargeable.

(4) Surrender of salary :

However, if an employee surrenders his salary to the Central Government u/s 2 of the Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961, the salary so surrendered would be exempt while computing his taxable income.

(5) Salary paid tax-free :

This, in other words, means that the employer bears the burden of the tax on the salary of the employee. In such a case, the income from salaries in the hands of the employee will consist of his salary income and also the tax on this salary paid by the employer. This means both the salary and the tax paid thereon will be taxable in the hands of the employee.

(6) Voluntary payments :

Whether the payment from an employer is based on a contract or not, it constitutes salary in the hands of the employee. However, many employers give personal gifts and testimonials to the employees. For example, employees who complete 20 years of service may be given a wrist watch. The question arises whether the value of the watch can be taxed in the hands of the employee. Courts have taken the view that such gifts are not taxable. However, in these cases it is important that such gifts must be given to employees pursuant to a scheme applicable to employees in general. If gifts are given purely on a selective basis they will become chargeable in the hands of the recipient. However, due to the levy of Fringe Benefit Tax, these gifts will now be exempt in the hands of the recipient, but will be taxable in the hands of the employer.

Sec.15: Year of Chargeability of Salary

- Due or receipt whichever falls earlier: Salary is taxable on due basis or on receipt basis, whichever is earlier. Hence,
  (a) salary due in a previous year is taxable, even if it not received.
  (b) Salary received in a previous year is taxable, even if it is not due.
  (c) Arrears of salary received during the current previous year shall be taxable in the current year if not charged to tax in an earlier previous year.
- No double taxation: once salary is taxed on due/receipt basis, it will not be taxed again on receipt/falling due, as the case may be.
- The assessee can claim relief u/s 89(1) for arrears or advance salary.
- Loan from employer is not salary. Advance salary is taxable, while advance against salary is not taxable.
- For Government employees, the period of chargeability of salary is from March to February. For example, salary from 1st March 2008 to 29th February 2009 is chargeable as Income of the Assessment Year 2009-10.

"Place of accrual of salary"

- The place of accrual of salary is the place of employment.
- Service rendered in India: U/s 9(1)(ii), salary earned in India is deemed to accrue or arise in India even if –
  (a) it is paid outside India,
  (b) it is paid or payable after the contract of employment in India comes to an end.
- If an employee gets pension paid abroad in respect of services in India, the same will be deemed to accrue or arise in India
- Leave salary paid abroad in respect of leave earned in India is deemed to accrue or arise in India.
- Services rendered outside India: Sec.9(1)(iii) provides that income chargeable under the head "Salaries" payable by the Government to a citizen of India for service provided outside India will be deemed to accrue or arise in India.
- U/s 10(7), any allowance or perquisites paid or allowed outside India by the Government to a citizen of India for rendering services outside India will be fully exempted.

Items included under the head Salary u/s 17(1)

Salary includes:

- Wages
- Any annuity or pension
- Any gratuity
- Any fees, commission, perquisite or profits in lieu of or in addition to any salary or wages
- Any advance salary
- Encashment of leave-not-availed
- Interest earned in excess of 9.5% on Recognized Provident Fund(RPF)
- Amount transferred in excess of 12% of Salary to RPF

- Contribution made by Central Government or any other employer (w.e.f. A.Y.2008-09) in the previous year to the account of an employee under Pension Scheme u/s 80 CCD.
- Money embezzled by an employee constitutes his income.

Profits in Lieu of Salary u/s 17(3)

- Compensation due or received from present/former employer in connection with
  (a) termination of employment, or
  (b) modification of terms and conditions of employment.
- Any amount received from an Unrecognized Provident Fund, to the extent of Employer's contributions, along with interest on such contribution.
- Sum received under Keyman Insurance Policy, including Bonus on it.
- Any sum received (either in lump sum or otherwise), either prior to employment or after cessation of employment.

Specified Employee

An Individual will be considered as a Specified Employee if :

- He is a director of a company, or
- He holds 20% or more of equity voting power in the company,
- Monetary salary in excess of ₹ 50,000: His income under the head salaries, (from any employer including a company) excluding non-monetary payments exceeds ₹ 50,000. For the above purpose, salary, should be arrived at after making the following deductions:
  (a) Entertainment Allowance
  (b) Professional Tax

TAXABILITY OF ALLOWANCES

Fully taxable allowances without any exemptions :

1. Basic Salary	9. Fees
2. Dearness Allowance	10. Lunch/Tiffin Allowance
3. Advance Salary	11. Overtime Allowance
4. Arrears of Salary	12. Servant Allowance
5. City Compensatory Allowance	13. Warden Allowance
6. Bonus	14. Non-practicing Allowance
7. Commission as a percentage on turnover	15. Family Allowance
8. Fixed Medical Allowance	16. Leave encashment during service

Specific allowances that are fully exempt in the hands of employees

Allowance	Conditions to claim full exemption
1. Travelling allowance	Should be provided by the employer and spent by the employee to meet the cost of official tour or transfer expenses.Cost of travel or transfer includes payments for transfer, packing and transportation of personal effects.
2. Daily Allowance	Should be spent by the employee for meeting the daily charges incurred on a tour or transfer.

3. Conveyance allowance	Should be used by the employee to meet the expenditure on conveyance in performance of official duties.
4. Helper allowance	Should be used by an employee to meet the expenditure on a helper who assists him in the performance of official duties.
5. Academic allowance	Should be used by the employee for his academic research and training pursuits.
6. Uniform allowance	Should be spent by the employee for purchasing/maintaining office uniform for official duties.
7. Allowances and perks paid by Government of India to an Indian citizen outside India	Fully exempted

Various items of Salary for which exemptions are available subject to limitations :

LEAVE TRAVEL ASSISTANCE (LTA) U/S 10(5) Rule 2B

Conditions for claiming the benefit:

(a) An individual can avail the benefit of LTA offered by his employer, twice in a block of four years.

(b) The present block of four years applicable for A.Y.2008-09 is calendar years 2006-2009.

(c) LTA may be provided by the employer to the employee and his family:

- In connection with his proceeding on leave to any place in India, while in service.
- Proceeding to any place in India after retirement or termination from service.

When Taxable :

- LTA encashed without performing journey is fully taxable
- Expenses reimbursed other than the fare like boarding or lodging is fully taxable.
- Amount received from employer in excess of the cost of traveling on the shortest route.

Family of an Individual means:

- Spouse and children of the individual, and
- Parents, brothers and sisters of the individual or any of them, wholly or mainly dependent on the individual.

HOUSE RENT ALLOWANCE [Sec. 10(13A) Rule 2A]

Conditions for claiming exemption:

- Assessee is in receipt of HRA
- Pays rent
- Rent paid is more than 10% of salary.

Very Important:

- The exemption shall be calculated on the basis of where the accommodation is situated.
- If the place of employment is the same for the whole year, then exemption shall be calculated for the whole year.
- If there is a change in place during the previous year, then it will be calculated on a monthly basis
- Exemption should be calculated in respect of the period during which rental accommodation is occupied by the employee during the previous year.
- Salary for the period during which rental accommodation is not occupied shall not be considered.

Salary for HRA= Basic Pay + DA(considered for retirement benefits) + Commission (if received as a fixed percentage on turnover as per terms of employment)

Taxable HRA:

Particulars	₹	₹
Amount received during the financial year for HRA		xxx
Less: Exemption u/s 10(13A) Rule 2A Least of the followings:		
(a) Actual amount received	xxx	
(b) 50% (for metro cities) / 40% of Salary (for other places)	xxx	
(c) Rent paid less 10% of Salary	xxx	xxx
Taxable HRA		xxx

OTHER ALLOWANCES

Allowances	Exemption u/s 10(14) Rule 2BB
Children Education Allowance	₹ 100 p.m.per child restricted upto 2 children
Children Hostel Expenditure Allowance	₹ 300 p.m.per child restricted upto 2 children
Running Allowance (for transport sector employees for meeting personal expenditure incurred during transport from one place to another)	Least of : (a) 70% of the amount received, or (b) ₹ 10,000 p.m.
Transport allowance (given to meet the employee's expenditure for traveling from his residence to offfice and back)	₹ 800 p.m. (in case of handicapped or blind employees, ₹ 1,600 p.m.)

GRATUITY

1. Government Employee: Fully exempted from tax u/s 10(10)(i).
2. Non-Govt.Employee:
    (a) Employee **covered** by Payment of Gratuity Act,1972
    Computation of Taxable Gratuity:

Particulars	₹	₹
Amount received as Gratuity		xxx
Less: Exemption u/s 10(10)(ii)		
Least of the followings:		
(i) Actual amount received	xxx	
(ii) 15/26 × Last drawn salary × No. of years of completed service or part thereof in excess of 6 months	xxx	
(iii) Maximum Limit	**10,00,000**	xxx
Taxable Gratuity		xxx

Note: Salary = Basic Pay + Dearness Allowance

In case of seasonal employment, instead of 15 days, 7 days shall be considered.

(b) Employee **not covered** by Payment of Gratuity Act,1972

Particulars	₹	₹
Amount received as Gratuity		xxx
Less: Exemption u/s 10(10)(iii)		
Least of the followings:		
(i) Actual amount receive	xxx	
(ii) 1/2 × Average salary × No. of fully completed years of service	xxx	
(iii) Maximum Limit	**10,00,000**	xxx
Taxable Gratuity		xxx

Note: Salary = 10 months average salary preceeding the month of retirement.
= Basic Pay + Dearness Allowance considered for retirement benefits + commission (if received as a fixed percentage on turnover)

Very Important :

- Where an individual receives retirement gratuity from more than one employer, he can claim exemption in respect of both of them.
- However, the maximum amount of exemption should not exceed ₹ 3,50,000
- When gratuity is received from more than one employer during different periods of time, the maximum exemption claimed by an assessee during his entire life should not exceed ₹ 3,50,000.

PENSION

1. Taxability of **Uncommuted Pension** or Monthly Pension:
   (a) Pension is received periodically by the retired employee
   (b) It may be received by Government or non-government employees
   (c) Amount received shall be fully taxable under the head salaries

2. Taxability of **Commuted Pension**:
   (a) Pension is received in lumpsum as per the terms of the employment on retirement or superannuation.
   (b) Full Value of Commuted Pension = Amount received on commutation / percentage of commutation.
   (c) Taxability:

Recipient	**Amount Taxable**
Government employee (Central/State/Local Authority or Statutory Corporation)	Fully exempted u/s 10(10A)(i)
Non-Govt. employee who has also received Gratuity u/s 10(10A)(ii)	Amount Received Less: 1/3 of Full Value of Commuted Pension
Non-Govt. employee who has not received Gratuity u/s 10(10A)(iii)	Amount Received Less:1/2 of Full Value of Commuted Pension

LEAVE ENCASHMENT

1. Leave encashment while in service is fully taxable as income of previous year in which it is encashed.
2. Leave encashment on retirement: if an individual receives leave encashment on his retirement, then the amount received will be eligible for exemption. The amount of exemption is based on his employment:
   (b) Government employee: fully exempted from tax
   (c) Non-Govt. employee: An individual who is not a Government employee is also entitled for exemption in respect of Leave Encashment compensation received by him.

3. Computation of exemption from Leave Encashment:

Step 1 : Computation of Salary = 10 months average salary preceeding the month of retirement.

Step 2 : Salary = Basic Pay + Dearness Allowance (forming a part of salary for retirement benefits) + Commission (if received as a fixed percentage on turnover)

Step3 : This calculation is only applicable where the employer has sanctioned leave to the employee in excess of 30 days for every completed year of service.

Particulars	₹
(i) Leave credit available on the date of retirement	xxx
Less: Excess leave sanctioned by the employer	
(Leave sanctioned by the employer per year – 30 days per year) × No. of completed years of service)	xxx
Leave credit on the basis of 30 days credit for completed years of service	xxx
(ii) Leave salary on the basis of 30 days credit = Step 3(i) x Step 1	xxx

Note: In case the employer sanctioned leave of 30 days or less for completed year of service then the salary for actual leave balance shall be considered and Step 3(i) shall not apply.

4. Taxable Leave Salary on Retirement :

Particulars	₹	₹
Amount Received on Leave Encashment		xxx
Less: Exemption u/s 10(10AA)		
Least of the followings:		
(i) Actual amount of Leave encashment received	xxx	
(ii) Average salary of the individual for the past 10 months ×10 months	xxx	
(iii) Maximum Limit	**3,00,000**	
(iv) Leave at credit at the rate of 30 days p.a. for every Completed year of service as calculated in Step 3(ii)	xxx	xxx
Taxable Value of Leave Encashment		xxx

Notes: (a) If the individual receives leave encashment from more than one employer, the quantum of exemption will be computed independently in respect of each employer.

(b) The total amount of exemption should not exceed ₹ 3,00,000 during his life time.

RETRENCHMENT COMPENSATION

Compensation is received by a workman at the time of:

(i) closing down of the undertaking.

(ii) transfer (irrespective of by agreement/compulsory acquisition) if the following conditions are satisfied:

- service of workmen interrupted by transfer
- terms and conditions of employment after transfer are less favourable
- new employer is not under a legal obligation whether under the terms of transfer or otherwise to pay compensation on the basis that the employee's service has been continuous and has not been interrupted by transfer.

Note:

(a) Retrenchment compensation received in accordance with any scheme, which is approved by the Central Government, is fully exempt from tax.

(b) An individual who receives retrenchment compensation, is entitled for exemption u/s 10(10B).

Computation of Taxable Retrenchment Compensation :

Particulars	₹	₹
Amount received as Retrenchment Compensation		xxx
Less: Exemption u/s 10(10B):		
Least of the followings:		
(i) Actual amount receive	xxx	
(ii) Amount determined under the Industrial Disputes Act,1947	xxx	
(iii) Maximum Limit	**5,00,000**	xxx
Taxable Value		xxx

VOLUNTARY RETIREMENT COMPENSATION

Conditions for claiming exemption:

(i) An individual, who has retired under the Voluntary Retirement scheme, should not be employed in another company of the same management.

(ii) He should not have received any other Voluntary Retirement Compensation before from any other employer and claimed exemption.

(iii) Exemption u/s 10(10C) in respect of Compensation under VRS can be availed by an Individual only once in his lifetime.

Computation of Exemption:

Step 1: Salary = Last drawn salary = Basic Pay + D.A.(considered for retirement benefits

Step 2: Taxable VRS compensation

Particulars	₹	₹
Amount received as VRS Compensation		xxx
Less: Exemption u/s 10(10C):		
Least of the followings:		
(i) Actual amount received	xxx	
(ii) Maximum Limit	**5,00,000**	
(iii) The highest of the following:		
• Last drawn salary ×3×No. of fully completed years of service		xxx
• Last drawn salary×Balance of no. of months of service left.		xxx
Taxable Value		xxx

DEDUCTIONS AGAINST SALARY

1. Entertainment Allowance: **Applicable only for Government Employees [Sec.16(ii)]**

Least of the following will be allowed as a deduction:

(i) Actual amount of entertainment allowance received

(ii) 20% of Basic salary of the Individual

(iii) ₹ 5,000

2. Professional Tax [Sec.16(iii)]

(i) Professional tax or tax on employment paid by an employee, levied under a State Act shall be allowed as deduction

(ii) such deduction is available only on actual payment

(iii) If an employer pays professional tax on behalf of his employee, then it will first be included in the Salary as a perquisite and then, allowed as a deduction.

VALUATION & TAXABILITY OF PERQUISITES

Perquisite: Perquisite includes any amount due to or received in lump sum or otherwise by an assessee from an employer which is usually attached to a position.

Perquisite includes:

(a) value of rent free accommodation given by the employer

(b) value of accommodation given at concessional rate

(c) value of benefit given free of cost or at concessional rate in the following cases:

- given by employer to his Director Employee;
- given by employer to his employee who owns 20% or more of voting power in the company, and
- given by any employer (including company) to his employees whose monetary salary exceeds ₹ 50,000

(d) any sum paid by the employer on behalf of the employees

(e) sum paid/payable by the employer towards insurance on the life of the individual or annuity payments

(f) Value of any other fringe benefit or amenity (excluding the fringe benefits chargeable to tax under Chapter XII-H as may be prescribed. [Sec.17(2)(vi)]

PERQUISITES WHICH ARE FULLY EXEMPTED FROM TAX

The following perquisites are exempt from tax in all cases and hence not includible for the purpose of tax deduction at source under section 192 during the financial year 2008-09:

1. Provision for medical facilities subject to limit
2. Tea or snacks provided during working hours
3. Free meals provided during working hours in a remote area or an offshore installation
4. Perquisites allowed outside India by the Government to a citizen of India for rendering service outside India.
5. Sum payable by an employer through a recognized provident fund or an approved superannuation or deposit-linked insurance fund established under the Coal Mines Provident Fund or the Employees Provident Fund.
6. Employer's contribution to staff group insurance scheme.
7. Leave travel concession subject to Sec.10(5)
8. Payment of annual premium by employer on personal accident policy effected by him on his employee
9. Free educational facility provided in an institute owned/maintained by employer to children of employee provided cost/value does not exceed ₹ 1,000 per month per child (no limit on no. of children)
10. Interest-free/concessional loan of an amount not exceeding ₹ 20,000
11. Computer/laptop given(not transferred) to an employee for official/personal use.
12. Transfer without consideration to an employee of a movable asset (other than computer, electronic items or car) by the employer after using it for a period of 10 years or more.
13. Traveling facility to employees of railways or airlines.
14. Rent-free furnished residence (including maintenance thereof) provided to an Official of Parliament, a Union Minister or a Leader of Opposition in Parliament.
15. Conveyance facility provided to High Court Judges u/s22B of the High Court Judges (Conditions of Service) Act,1954 and Supreme Court Judges u/s 23A of the Supreme Court Judges (Conditions of Service) Act,1958.

16. Conveyance facility provided to an employee to cover the journey between office and residence.
17. Accomodation provided in a remote area to an employee working at a mining site or an onshore oil exploration site, or a project execution site or an accommodation provided in an offshore site of similar nature.
18. Accommodation provided on transfer of an employee in a hotel for not exceeding 15 days in aggregate.
19. Interest free loan for medical treatment of the nature given in Rule 3A.
20. Periodicals and journals required for discharge of work.
21. Tax on perquisite paid by employer [Sec.10(10CC)]
22. Other Exempted Payments:
    - Bonus paid to a football player after the World Cup victory to mark an exceptional event
    - Payment made as a gift in appreciation of the personal qualities of the employee.
    - Payment of proceeds of a benefit cricket match to a great cricket player after he retired from test match.
    - Trust for the benefit of employee's children.

MEDICAL FACILITIES

- Fixed medical allowance is fully taxable
- Medical payments include reimbursements also [circular no.603/6.6.1991]

MEDICAL TREATMENT IN INDIA

1. Local treatment to employee or any member of his family in:
    - Hospital maintained by employer
    - Government Hospital
    - Notified hospital for prescribed diseases [Sec.17(2)(v)]

   Family includes spouse, children (whether dependent or independent) and parents, brothers and sisters wholly dependent on the employee.
2. Group Medical insurance paid u/s 36(1)(ib) & Medical Insurance paid u/s 80D- which are approved by the Central Govt. or IRDA w.e.f. A.Y.2007-08.
3. Any other medical expenditure reimbursed subject to a maximum of ₹ 15,000

MEDICAL TREATMENT ABROAD (for the patient and the attendant)

If the employee underwent medical treatment abroad and the expenditure is met by the employer, the exemption will be subject to the following:

1. Medical treatment and stay expenses abroad(both for the patient and the attendant) is exempt from tax, subject to the maximum amount permitted by the Reserve Bank of India.
2. Travel expenditure of the patient and the attendant:

Gross Total Income, before including reimbursement of Foreign Travel Expenditure	Amount of Exemption
Upto ₹ 2,00,000	Fully exempted
Above ₹ 2,00,000	Fully taxable

3. **Computation of exemption for foreign travel expenditure**

   Step 1: Compute Gross Total Income of the assessee without considering foreign travel reimbursement but after set-off loss and unabsorbed depreciation.

   Step 2: If the Gross Total Income does not exceed ₹ 2 lakhs, Foreign Travel Reimbursement is not taxable otherwise fully taxable.

Step 3: If Foreign Travel reimbursement is taxable as per Step 2, recomputed the income under the head Salary after including foreign travel reimbursement and Gross Total Income must also be recomputed.

ACCOMODATION FACILITIES

1. Value of Unfurnished Accomodation: Explanation 1 to Sec.17(2), Rule 3(1)

Nature of Perquisite	Taxable Value of Perquisite
Provided by Central Govt. or State Govt.	Licence fee determined by the Government Less: Rent recovered from employee

Provided by Employer other than Central or State Government

(a) owned by employer	**In cities having population exceeding 25 lakhs as per 2001 census**: 5% of Salary **Less** Rent actually paid by employee **In cities having population exceeding 10 lakhs but not exceeding 25 lakhs as per 2001 census**: 10% of Salary **Less** Rent actually paid by employee **In other places:** 7.5% of Salary **Less** Rent actually paid by employee
(b) taken on lease by the employer	Rent paid by the employer or 15% of Salary whichever is lower **Less** Rent recovered from employee
(c) Accommodation in a hotel	24% of salary paid/payable or actual charges paid/payable whichever is lower **Less** Amount paid or payable by the employee

Hotel Accommodation : Accommodation provided in a hotel will not be a taxable perquisite if the following two conditions are fulfilled:

- The period of such accommodation does not exceed 15 days
- Such accommodation has been provided on the transfer of the employees from one place to another.

2. Value of Furnished Accommodation

Particulars	₹
Value of unfurnished accommodation as above	xxx
Add : Value of Furniture provided:	
• If owned by employer, 10%p.a. of original cost of such furniture	xxx
• If hired from third party, then Actual hire charges	
Less: Any charges paid or payable by the employee	**(xxx)**
Value of Furnished Accommodation	xxx

Note : Furniture includes Television sets, radio, refrigerator, other household appliance, air-conditioning plant or equipment.

3. Valuation not applicable:

(a) Employees working at mining site, onshore oil exploration site, offshore site, project execution site, dam site, power generation site.

(b) Conditions to be fulfilled:

- The accommodation should be of a temporary nature, and
- Plinth area should not exceed 800 square feet

- Accommodation should be located at least 8 kms away from local limits of municipality/cantonment or located in a remote area

Remote area means area located at least 40 kms away from town having a population not exceeding 20,000 based on latest published All-India census.

4. Valuation of accommodation in case of Employees on transfer :

(a) For the first 90 days of transfer: Where accommodation is provided both at existing place of work and in new place, the accommodation, which has lower value, shall be taxable.

(b) After 90 days : Both accommodations shall be taxable.

5. Salary for Valuation of Accommodation facilities :

Salary includes	Salary excludes
• Basic Salary • D.A. (if considered for retirement benefits) • All taxable allowances • Bonus or commission or ex-gratia • Any other monetary payment	• Other D.A • Employer's contribution to PF • Exempted allowances • Perquisites u/s 17(2) • Perquisites u/s 17(2)(iii) or its provisions

OTHER FACILITIES AND PERQUISITES TO EMPLOYEE AND HIS HOUSEHOLD

Rule	Nature of Perquisite	Taxable Value of Perquisite(TVP)
3(3)	Service of sweeper, gardener or watchman or personal attendant	Actual cost to the employer **Less:** Amount paid by employee
3(4)	Supply of gas, electricity or water for household consumption	**Procured from outside agency** Amount paid to outside agency **Resources owned by employer himself** Manufacturing cost per unit Less: amount paid by the employee
3(5)	Education facilities to members of his household (a) free education to children in the school maintained by the employer or the school sponsored by the employer (b) other schools (c) for other members of the household	**If** the cost of education per child does not exceed ₹ 1,000 p.m.- then not taxable **For points (b) & (c)** In other case, cost to the employer **Less:** amount recovered from employee
3(7)(i)	Housing Loan/Vehicle Loan- for acquiring capital assets and not for repairs. SBI Rate= SBI Rate prevailing on the first day of the previous year	Other Loans Interest charged by employer is equal to or higher than SBI rates. It is not a taxable perquisite Interest charged is lower than SBI rates: Interest charged at SBI rates on maximum outstanding balance **Less:** Interest paid by the employee on that loan Similar treatment as above. **Exceptions :** (a) Medical loan for treatment of diseases specified in Rule 3A except loan reimbursed by medical insurance (b) Loan not exceeding ₹ 20,000 in aggregate **3(7)(vii)**
Use of	any movable asset other than computer or laptops or other assets already mentioned 10% of Actual Cost if owned by the employer; or Actual rental charge paid/payable by the employer	**Less**: Amount recovered from employee

TRANSFER OF MOVABLE ASSETS TO EMPLOYEES [Rule 3(7)(viii)]

Particulars		Computer & Electronic Gadgets	Car	Other Movable Assets
	Method of Depreciation	**WDV**	**WDV**	**SLM**
Rate of Depreciation for every completed year		50%	20%	10%
	Actual Cost	XXXXX	XXXXX	XXXXX
Less :	Depreciation for completed years	(XXXXX)	(XXXXX)	(XXXXX)
	WDV at the end of completed years	XXXXX	XXXXX	XXXXX
Less :	Sale Value taken from Employee	(XXXXX)	(XXXXX)	(XXXXX)
	Taxable Value of Perquisite	XXXXX	XXXXX	XXXXX

Notes :

(a) Electronic gadgets include computer, digital diaries and printers, but excludes washing machines, microwave ovens, hot plates, mixers, ovens, etc.

(b) Transfer of Assets, which are 10 years old, shall not attract tax liability.

(c) Member of household includes: Spouse(s), children and their spouses, parents, servants and dependents.

(d) Completed year means actual completed year from the date of acquisition of the asset to the date of transfer of such asset to the employees.

TAXABILITY OF PERQUISITES PROVIDED BY EMPLOYERS

Taxability of Motor Car Benefits

Owner of Car	Expenses borne by	Purpose	Taxable Value of Perquisite
1(a) Employer	Employer	Fully official	Not a perquisite provided the documents as specified in Rule 3(2)(B) are maintained.
1(b) Employer	Employer	Fully private	**Total of:** (i) Actual expenditure on car (ii) Remuneration to chauffeur (iii) 10% of the cost of car (normal wear & tear) **Less:** Amount charged from employee
1(c)(i) Employer	Employer	Partly official and partly personal	**Cubic Capacity of Car Engine upto 1.6 litres** ₹ 1,800 p.m+ ₹ 900 p.m. for chauffeur **Cubic Capacity of Car Engine above 1.6 litres** ₹ 2,400 p.m. + ₹ 900 p.m. for chauffeur
1(c)(ii) Employer	Employee	Partly for official and partly for personal	**Cubic Capacity of Car Engine upto 1.6 litres** ₹ 600 p.m + ₹ 900 p.m. for chauffeur **Cubic Capacity of Car Engine above 1.6 litres** ₹ 900 p.m. + ₹ 900 p.m. for chauffeur

Owner of Car	Expenses borne by	Purpose	Taxable Value of Perquisite
2(i) Employee	Employer	Fully official use	Not a perquisite provided the documents as specified in Rule 3(2)(B) are maintained.
2(ii) Employee	Employer	Partly official and partly personal	Subject to Rule 3(2)(B) Actual expenditure incurred. **Less:** Car cubic capacity upto 1.6 litres [i.e. value as per 1(c)(i)] **OR** Car cubic capacity upto 1.6 litres above 1.6 litres [i.e. value as per 1(c)(i)
3(i) Employee owns other auto-motive but not car	Employer	Fully official use	Not a perquisite provided the documents as specified in Rule 3(2)(B) are maintained.
3(ii) Employee owns other auto-motive but not car	Employer	Partly for official use	Subject to Rule 3(2)(B) Actual expenditure incurred by employer. **Less:** ₹ 900 p.m.

Note :

1. Using cars from pool of cars owned or hired by Employer:

The employee is permitted to use any or all cars for both official and personal use:

For one car	Valued as per 1(c)(i)
For more than one car	Valued as per 1(b) as if fully used for personal purpose

2. Documents to be maintained for claiming 'not taxable perquisite' or higher deduction wherever applicable [Rule 3(2)(B)]

(a) Employer should maintain complete details of journey undertaken for official purpose, which includes date of journey, destination, mileage and amount of expenditure incurred thereon.

(b) Certificate of supervising authority of the employee, wherever applicable, to the effect that the expenditure incurred for wholly and exclusively for performance of official duties, should be provided.

TAXABILITY OF OTHER BENEFITS

Rule	Nature of Perquisite	Taxable Value of Perquisite (TVP)
3(6)	Transportation of goods or passengers at free or concessional rate provided by the employer engaged in that business (other than railways/ airlines)	Value at which offered to public **Less:** amount recovered from the employee
3(7)(ii)	Traveling, touring, accommodation and other expenses met by the employer other than specified in Rule 2B. (this shall be calculated only for the period of vacation)	Amount recovered by employer or Value at which offered to public **Less:** amount recovered from the employee
3(7)(iii)	Free meals during office hoursFree meal in remote area or offshore installation area is not a taxable perquisite	Actual cost to the employer in excess of ₹ 50 per meal or tea or snacks **Less:** amount recovered from the employee. Tea or non-alcoholic beverages and snacks during working hours is not taxable.

Rule	Nature of Perquisite	Taxable Value of Perquisite (TVP)
3(7)(iv)	Value of any gift or voucher or taken other than gifts made in cash or convertible into money (e.g. gift cheques) on ceremonial occasion	Value of gift In case the aggregate value of gift during the previous year is **less than ₹ 5,000**, then it is not a taxable perquisite
3(7)(v)	Expenditure incurred on credit card or add on card including membership fee and annual fee	Actual expenditure to employer is taxable **Less:** amount recovered from employee If it is incurred for official purpose and supported by necessary documents then it is not taxable.
3(7)(vi)	Expenditure on club other than health club or sports club or similar facilities provided uniformly to all employees	Actual expenditure incurred by the employer **Less:** amount recovered from employee If the expenditure is incurred exclusively for official purposes and supported by necessary documents then it is not taxable. Initial fee of corporate membership of a club is not a taxable perquisite
3(7)(ix)	Any other benefit or amenities or service or right or privilege provided by the employer other than telephone or mobile phone	Cost to the employer **Less:** amount recovered from employee

Note: Members of household includes: spouse(s), children and their spouses, parents, servants and dependents.

PROVIDENT FUNDS

Particulars	Statutory	Recognized	Unrecognized	Public
Constituted under	Provident Funds Act, 1952	EPF and Misc, Provisions Act, 1952 & recognized by the Commissioner of PF and CIT	Not recognized by the Commissioner of Income Tax	Public Provident Fund Act,1968 Account in SBI or Post Offices
Contribution by	Employer and Employee	Employer and Employee	Employer and Employee	All assessees independently
Assessee's Contribution	**Deduction u/s 80C**	**Deduction u/s 80C**	**No Income Tax Benefit**	**Deduction u/s 80C**
Employer's Contribution	Not taxable	Amount exceeding 12% of salary is taxable	Not taxable at the time of contribution	Not applicable
Interest credited	Fully exempted	Exempted upto 9.5% p.a. Any excess is taxable	On **Employee's contribution taxable** under the head "Other Sources" On **Employer's contribution not taxable** at the time of credit	Fully exempt
Withdrawal at the time of retire-ment/ resignation/ termination, etc	Exempted u/s 10(11)	Exempted u/s 10(12) Subject to conditions	**Employee's contribution** and interest thereon is **not taxable.** **Employer's contribution** and interest thereon is **taxable** as Profits in lieu of Salary, under" Salaries"	Exempted u/s 10(11)

Note: Sum received by an Employee under approved Superannuation Fund is also exempt from tax u/s 10(13).

EMPLOYERS CONTRIBUTION TO RPF IS EXCLUDED FROM SALARY

1. If the employee has rendered continuous service with his employer for a period of 5 years or more.
2. If he has not rendered such continuous service of 5 years, then the service has been terminated:
   (a) by reason of such employee's ill health, or
   (b) by the contraction or discontinuance of the employer's business, or
   (c) any other cause beyond the control of the employee
3. If, on the cessation of his employment, the employee obtains employment with another employer, to the extent, the accumulated balance due and becoming payable to him is transferred to his individual account in any recognized fund maintained by such employer.

The period of service rendered under the previous employer(s) should also be included in determining the period of continuous service in (3) above.

TAXABILITY OF PERQUISITES (At a glance)

Perquisites	**Specified Employee**	**Non-specified Employee**
Rent free/concessional accommodation	Taxable	Taxable
Watchman, gardener, sweeper, personal attendan engaged by employee and expenses met by the employer	Taxable	Taxable
The aforesaid mentioned servants provided in any other manner	Taxable	Non-taxable
Gas, electricity, water, etc. for household consumption and the connection in the name of employee but expenses paid by the employer	Taxable	Taxable
Above facilities provided in any other manner	Taxable	Non-taxable
Education expenses, if the bills are in the name of employee, the but met by employer	Taxable	Taxable
Above facilities provided in any other manner	Taxable	Non-taxable
Transport facility provided by transport undertakings Railways and other than Airlines	Taxable	Taxable
Interest free loans or loans provided at concessional rates by the employer to employee	Taxable	Taxable
Holiday home facilities provided	Taxable	Taxable
Club facility provided by employer(other than official purposes)	Taxable	Taxable
Computer/laptop provided by the employer for use by the employee	Non-taxable	Non-taxable
Other movable assets provided by the employer for use by the employees	Taxable	Taxable
Sale/transfer of movable assets to employees	Taxable	Taxable
Magazines, periodicals, journals, etc. for official work	Not taxable	Not taxable
Medical facilities, if the bills are in the name of employee, employer upto but met by ₹ 15,000	Taxable	Taxable
Above facility in any other manner	Taxable	Non-taxable
Leave Travel Concession	Not taxable subject to Sec.10(5)	Not taxable subject to Sec.10(5)
Stock option under approved scheme	Not taxable	Not taxable

SALARY

For the purpose of	Means
1. Deduction for Entertainment Allowance u/s16(ii) in case of Govt.employees	Basic pay
2. Voluntary Retirement Compensation u/s 10(10C) etirement benefits)	Basic Pay + D.A.(forming part of salary for
3. Exemption for Gratuity covered under Payment of Gratuity Act u/s 10(10)(ii)	Basic Pay + D.A
4. Exemption for Gratuity not covered under Payment of Gratuity Act u/s 10(10)(iii) fixed percentage on turnover	Basic Pay + D.A. (forming part of salary for retirement benefits) + Commission as a
5. Exemption for Leave Salary u/s 10(10AA)	Same as above
6. Exemption for House Rent Allowance u/s 10(13A)	Same as above
7. Contribution to Recognized Provident Fund	Same as above
8. Determination of Specified employee u/s 17 including the value of non-monetary	Income under the head salaries without benefits
9. Rent-free accommodation	**Salary includes**
Salary excludes • D.A. (forming part of salary)	• Basic pay • D.A. (not forming part of salary)
• Employer's contribution to PF	• Exempted allowances
• All taxable allowances	
• Bonus or commission or ex-gratia	• Perquisites u/s 17(2) or (2)(iii) or its provisions
• Any other monetary payment	• Any allowance in the nature of medical facility to the extent not taxable.

Illustration 6 : Aniket joined a company on 1.7.2010 and was paid the following emoluments and allowed perquisities as under :

Emoluments : Basic Pay ₹ 35,000 per month; D.A. ₹ 20,000 per month; Bonus ₹ 20,000 per month.

Perquisities :

(i) Furnished accommodation owned by the employer and provided free of cost;

(ii) Value of furniture therein ₹ 3,60,000; Hire charges of Furniture provided ₹ 20,000 p.a.

(iii) Motor car owned by the company (with engine c.c. less than 1.6 litres) along with chauffeur for official and personal use, expenses met by Employer.

(iv) Sweeper salary paid by company ₹ 1,500 per month; amount recovered @ ₹ 200 pm.

(v) Watchman salary paid by company ₹ 1,500 per month; amount recovered @ ₹ 300 pm.

(vi) Educational facility for 2 children provided free of cost. The school is owned and maintained by the company. Elder child studies in class V and younger child in class II. Tuition fee per month ₹ 1,600 & ₹ 900 respectively.

(vii) Loan of ₹ 5,00,000 repayable within 7 years given on 1.10.2010 for purchase of a house. No repayment was made during the year; let charged by employer @ 2% p.a. Interest chargeable as per Income Tax Act @ 10% p.a.

(viii) Interest free loan for purchase of computer ₹ 50,000 given on 1.2.2011. No repayment was made during the year;

(ix) Corporate membership of a club. The initial fee of ₹ 1,00,000 was paid by the company. Aniket paid the bills for his use of club facilities.

You are required to compute the income of Aniket under the head "Salaries" in respect of assessment year 2011-12.

Solution :

Assessee : Mr. Aniket **A.Y. 2011-12**

Computation of Income under the head 'Salaries'

(i)	Basic Pay	(35,000 × 9)	3,15,000
(ii)	D.A.	(20,000 × 9)	1,80,000
(iii)	Bonus	(20,000 × 9)	1,80,000
(iv)	Value of furnished accommodation	Note 1	1,28,250
(v)	Motor car	(1,800+900) × 9 m	24,300
(vi)	Sweeper Salary	(1,500–200) × 9 m	11,700
(vii)	Watchman Salary	(1,500–300) × 9 m	10,800
(viii)	Education facility	Note 2	5,400
(ix)	Interest free housing loan	Note 3	23,333
(x)	Interest free computer loan	Note 4	1,375
(xi)	Corporate membership fee		1,00,000
	Gross Salary		8,80,158
	Taxable Salary		**8,80,158**

Value of Furnished Accommodation

Note 1.

Particulars		**Amount**
Salary for this purpose -		
Basic Salary	(35,000 × 9)	3,15,000
D.A	(20,000 × 9)	1,80,000
Bonus	(20,000 × 9)	1,80,000
Total		6,75,000

Assuming, Mr. Ankit stays in a city where population is more than 25,00,000 as per 2001 census,

Value of unfurnished accommodation	= 15% of salary
	= 15% of 6,75,000
	= ₹ 1,01,250
Value of furniture provided	= 10% p.a. of actual cost
	= 10% of 3,60,000 × 9/12
	= ₹ 27,000

(Assuming, value of furniture given in the problem represents actual cost.)

Value ofrent free furnished accommodation	= 1,01,250 (+) 27,000
	= ₹ 1,28,250

Assumption: DA is included as a part of retirement benefits.

Note 2.

Value of Educational Facility

Where the school is owned and maintained by employer, if the cost of education provided is less than ₹ 1,000 p.m. then the value of perquisite is NIL. If the cost of education exceeds ₹ 1,000 p.m. then the value of perquisite will be equal to the actual cost of education provided in excess of ₹ 1,000 pm. per child maximum for two children.

Value of perquisite for elder child = ₹ (16,000 – 1,000) × 9 m = 5,400

Valu of perquisite for younger child = NIL, since tuition fee per month is less than ₹ 1,000.

Assuming, cost of education provided to Babu's children is less than ₹ 1,000 p.m. value of perquisite provided is NIL.

Note 3.

Interest free housing loan

Value of perquisite	= Interest @ 10% p.a. *less* Actual interest charged
	= (10% – 2%) × 5,00,000 × 7/12 = ₹ 23,333.

Note 4.

Interest free computer loan

Value of perquisite	= Interest @ 16.50% p.a. *less* Actual interest charged
	= (16.50% – 0%) × 50,000 × 2/12 = ₹ 1,375.

Illustration 7 : A was employed with Z Ltd. He retired w.e.f. 1.2.2011 after completing a service of 24 years and 5 months. He submits the following information :

Basic Salary	₹ 5,000 per month (at the time of retirement)
Dearness Allowance	100% of Basic Salary (60% of which forms part of salary for retirement benefits).
Last increment	₹ 500 w.e.f. 1.7.2010

His pension was determined at ₹ 3,000 per month. He got 50% of the pension commuted w.e.f. 1.3.2011 and received a sum of ₹ 1,20,000 as commuted pension. In addition to this, he received a gratuity of ₹ 1,50,000 and leave encashment amounting to ₹ 56,000 on account of accumulated leave of 240 days. He was entitled to 40 days leave for every year of service.

Compute his Gross Salary for assessment year 2011-12 assuming that he is not covered under Payment of Gratuity Act.

Solution :

Computation of Gross Salary for the Assessment Year 2011-12

		₹	₹
Basic Pay : April '10 to June '10 = 3 months @ ₹ 4,500 pm		13,500	
July 10 to June '11 = 7 months @ ₹ 5,000 pm		35,000	48,500
Dearness Allowance @ 100% of Basic Pay			48,500
Uncommuted Pension			
February @ ₹ 3,000 pm		3,000	
March @ ₹ 1,500 pm		1,500	4,500
(Since 50% cmmuted)			
Commuted Value of Pension			
Amount Received		1,20,000	
Less : Exemption u/s 10(10A)			
1/3 of Value of Commuted Pension $\left(\frac{1}{3}\times 2,40,000\right)$		80,000	40,000
Full value of Commuted Pension $= \frac{\text{Amount Received}}{\text{\% Commuted}}$			
$= \frac{1,20,000}{50\%} = 2,40,000$			
Gratuity :			
Amount received		1,50,000	
Less : Exempt (*See* note No. 1)		93,120	56,880
Leave of the followings :			
(i) Actual Amount Received	1,50,000		
(ii) Maximum limit	10,00,000		
(ii) 1/2 months average slary for each years of completed Service $\left(\frac{1}{2}\times 7,760\times 24\right)$	93,120		

Salary for Gratuity (not covered by Payment of Gratuity Act)

= Basic Pay + D/A (Forming part for retirement benefit)

$$\text{Average Salary} = \frac{\text{Total Salary of 10 months preceeding the month of retirement}}{10}$$

$$= \frac{48,500 + 50\% \text{ of } 48,500}{10} = \frac{48,500 + 29,100}{10} = 7,760$$

Leave Encashment			
Amount received		56,000	
Less : Exemption u/s 10(10AA)			
Least of the followings :			
(i) Actual Average Salary	56,000		
(ii) 10 months average salary (10×7760)	77,600		
(iii) Maximum limit	3,00,000		
(iv) Leave Credit as per Note	NIL	NIL	56,000

Notes :

Calculation of Leave Credit

	Total leave entitlement (24 yrs × 40 days p.a.	= 960 days
Less :	Leave Availed during service	720 days
	= Total leave entitlement – Leave encashment	
	= (960 – 240)	240 days
Less :	Excess Leave in excess of 30 days p.a.	240 days
	(24 (40 – 30)	
	Leave credit	NIL

Illustration 8 : Vineet had been working with M Ltd., in a tribal area since 1-10-1996. He was entitled to the following emoluments:

1. Basic salary w.e.f. 1-1-2010 ₹ 6,000 p.m.
2. Dearness allowancc 50% of basic salary (40% of which forms part of salary for retirement benefits)
3. Medical allowance ₹ 1500 p.m ., (entire amount is spent on his own medical treatment).
4. Entertainment allowance ₹ 400 p.m.
5. Children education allowance ₹ 80 p.m. per child for three children.
6. Hostel expenditure allowance ₹ 100 p.m. per child for three children.
7. Uniform allowance ₹ 250 p.m. (He spends ₹ 1,500 on the purchase and maintenance of uniform)
8. House rent allowance ₹ 750 per month. He pays ₹ 1,000 per month as rent.
9. He contributes ₹ 900 per month to a recognised provident fund to which his employer contributes an equal amount.

He retired from his job on 1.1.2011 and shifted to Delhi. He was entitled to the following benefits at the time of his retirement :

(a) Gratuity ₹ 1,35,000
(b) Pension from 1.1.2011 ₹ 3,000 p.m.
(c) Payment from recognised provident fund ₹ 3,00,000
(d) Encashment of earned leave for 150 days ₹ 36,000

He was entitled to 40 days leave for every completed year of service. He got 50% of his pension commuted in lumpsum w.e.f. 1.3.2011 and received ₹ 1,20,000 as commuted pcnsion.

He joined K Ltd. at Mumbai w.ef 1-2-2011 and was entitled to the following emoluments:

(1) Basic salary ₹ 5,000 p.m.

(2) Dearness allowance (forming part of salary) 20% of basic salary

(3) Rent-free unfurnished accommodation in Delhi which is owned by the employer and whose fair rental value is ₹ 48,000 p.a.

He was also given the following facilities by the employer :

(a) Motor car (1.4 ltr. engine capacity) with driver, which he uses partly for official and partly for personal purposes.

(b) The monthly expenses incurred by 'A' on gas and electricity were ₹ 500 which were reimbursed by the employer.

(c) Reimbursement of educational expenses of his two children which amounted to ₹ 350 p.m.

(d) On 4.3.2010 his wife fell ill and the employer reimbursed the expenditure of medical treatment amounting to ₹ 17,500.

(e) A watchman, a sweeper, a cook and a gradner have been provided to whom the company pays a salary of ₹ 400 p.m. each.

(f) Loan of ₹ 1,00,000 @ 8% p.a. for construction of his house was given by the company. SBI rate of interest is 7% p.a.

He made the following payments during the previous year :

(1) Professional tax ₹ 500

(2) LIP on his life policy of ₹ 1,00,000 – ₹ 15,000.

(3) Deposit in PPF account ₹ 50,000.

Compute his total income and tax liability for the assessment year 2011-12.

Solution :

Mr. Vineet

Assessment Year 2011-12 **Previous Year : 2010-11**

Computation of Total Income and Tax Liability

		₹	₹
Employer – M Ltd.			
Basic salary 6,000 × 9			54,000
DA @ 50% of Basic Salary			27,000
Medical allowance @ ₹ 1,500 pm × 9 months			13,500
Entertainment allowance @ ₹ 400 pm × 9 months			3,600
Children education allowance 80 × 3 × 9		2,160	
Less : Exempt u/s 10(14) = 80 × 2 × 9		440	720
Hostel expenditure allowance 100 × 3 × 9		2,700	
Less : Exempt u/s 10(14) = 100 × 2 × 9		1,800	900
Uncommuted pension (2,000 × 2 + 1,000 × 1)			5,000
Uniform allowance (250 ×9 – 1500)			750
HRA (750 × 9)		6,750	
Less : Exemption u/s 10(13A) Rule 2A		2,520	4,230
House Rent Allowance			
Amount Received 750 × 9		6,750	
Less : Exemption u/s 10(13A) Rule 2A			
Lease of the followings :			
(i) Amount Received	6,750		
(ii) 40% of Salary	25,920		
(iii) Rent paid – 10% of Salary	2,520	2,520	4,230
(1000 × 9 – 6,480)			

Salary for HRA = Basic Pay + Dearness Allowance (forming part of salary) + Commission (if received at a fixed per centage on turnover)			
= 54,000 + (40% of 27,000) = 54,000 + 10,800 = 64,800			
Employer's Contribution to RPF @ ₹ 900 pm × 9 months		8,100	
Less : Exemption u/s 10(14) upto 12% of salary			
Salary = Basic Pay + D.A (forming part)			
= 54,000 + 40% of 27,000 = 64,800			
∴ 12% of 64,800 =		7,776	324
Gratuity — (from A Ltd.)			
Actual Amount Received		1,25,000	
Less : Exemption u/s 10(10)			
Least of the followings :			
(i) Actual Amount Received	1,25,000		
(ii) Max. limit	10,00,000		
(iii) 1/2 months average salary for each years of completed service	50,400	50,400	74,600
[1/2 × 7,200 × 14]			
Salary for Gratuity (not covered by Payment of Graguity Act)			
= Basic Pay + D/A (forming part for retirement benefits) + Commission (if received at a fixed percentage on turnover)			
Again, Average Salary = Salary for 10 months preceeding the month of retirement			
B/P = 6,000 × 10 =	60,000		
D/A (forming part) = 40% × 50% × 6,000 =	12,000		
	72,000		
∴ Average Salary per month $= \frac{72,000}{10} = 7,200$			
Commuted Value of Pension			
Amount Received		1,20,000	
Less : Exemption u/s 10(10A)			
1/3 of Full Value of Commuted Pension $[\frac{1}{3} \times 2,40,000]$		80,000	40,000
Full Value of Commuted Pension $= \frac{\text{Amount Received}}{\text{\% Commuted}}$			
$= \frac{1,20,000}{50\%} = 2,40,000$			
Payment from RPF (Exempt)			—
Leave encashment – Actual amount		36,000	
Less : Exemption u/s 10(10AA)		4,800	31,200
			2,55,824

List of the followings:		
(a) Actual encashment		₹ 36,000
(b) Eligible encashment (7,200/30 × 20)		₹ 4,800
(c) 10 months average salary (7,200 × 10)		₹ 72,000
(d) Amount specified		₹ 3,00,000
Leave encashment shall be exempt as under :		
Completed years of service		13 years
Number of days leave allowed every year		40
Total leave allowable		520 days
Leave encashed		150 days
Therefore leave availed (520 – 150)		370 days
Leave available on basis of 30 days (30 ×13)		390 days
Less : Leave availed		370 days
Therefore encashment eligible for exemption (390 – 370)		20 days
Employer — S Ltd.		
Basic salary 5,000 ×2		10,000
Dearness Allowance @ 20% of B/Pay		2,000
Motor Car facility (1,800 + 900) × 2 months		5,400
Free Gas/Electricity (500 × 2)		1,000
Education Re-imbursement (350 × 2)		700
Medical Re-imbursement (17,500 – 15,000)		2,500
Watchment (400 × 2)		800
Sweeper (400 × 2)		800
Cook (400 ×2)		800
Gardener (400 × 2)		800
Interest on Loan (not taxable as interest charged is more than the rate of SBI)		—
Perquisite for Value ofRent-free unfurnished accommodation		2,250
		27,050
Valuation of unfurnished rent-free accommodation :		
15% of salary which includes the following:		
Basic (5,000 × 2)		₹ 10,000
DA		₹ 2,000
Uncommuted pension from R Ltd. (2,000 + 1,000)		₹ 3,000
		₹ 15,000
Value of the unfurnished accommodation 15% of ₹ 15,000 = ₹ 2,250		
Aggregate salary from M Ltd. and S Ltd.		2,82,874
Less : (i) Entertainment allowance u/s 16(ii)	Nil	
(ii) Professional-tax u/s 16(iii)	500	500
Income from salary		2,82,374
Other Income		Nil
Gross Total Income		2,82,374
Less : Deduction u/s 80C		
RPF (900 × 9)	8,100	
LIP	15,000	
PPF	50,000	73,100
Total income (rounded off)		2,09,274

Total Income (Rounded of u/s 288)		1,09,270
Tax on ₹ 2,09,270		
upto ₹ 1,60,000 = Nil		
@ 10% on (209270 – 1,60,000) = 10% of 49270 = 4927		4,927
Add : Education cess @ 2%		98
Add : SHEC @ 1%		49
Total tax liability		5,074
Tax Payable (Rounded off u/s 288A)		= ₹ 5070

Since he has received lump sum payment on account of gratuity, commuted pension and leave encashment, he can claim relief u/s 89 if the same is beneficial to him.

Illustration 9 : Ramesh retired as General Manager of XYZ Co. Ltd. on 30.11.2010 after rendering service for 20 years and 10 months. He ₹ 9,00,000 as gratuity from the employer. (He is not covered by Gratuity Act, 1972). His Salary details as below -

Basic Pay	₹ 30,000 p.m. upto 30.06.2010
Basic Pay	₹ 32,000 p.m. from 01.07.2010
Dearnes Allowance (Eligible for Retirement Benefits)	50% of Basic Pay
Transport Allowance	₹ 4,500 p.m.

Ramesh resides in his own house. Interest on monies borrowed for the self-occupied house is ₹ 84,000 for the year 31.3.2011.
From a Fixed Deposit with a Bank, he earned Interest Income of ₹ 18,000 for the year ending 31.3.2011. He also invested ₹ 30,000 in long-term infrastructure Bond and ₹ 80,000 in PPF.
Compute Taxable Income of Ramesh for the year ended 31.03.2011.

Assessee : Mr. Ramesh **Previous Year: 2010-2011** **Assessment Year : 2011-12**

Computation of Total Income

Particulars		₹	₹	₹
(A) Salaries : Salary from XYZ Co. Ltd				
1. Basic Salary	(₹ 30,000 × 3 + ₹ 32,000 × 5)			2.50,000
2. Dearness Allowance	(50% of Basic Salary =		1,25,000	
3. Transport Allowance	(₹ 4,500 × 8)		36,000	
Less: Exempt u/s 10(14)	(₹ 800 × 8 Months)		(6,400)	29,600
4. Gratuity Received	(Not covered under Payment of Gratuity Act)		9,00,000	
Less: Exemption u/s 10(10) = Least of the following —				
• Actual Amount received 9,00,000				
• ½ months average salary for each years of completed service = ½ × 30,800 × 20 years		3,08,000		
• Maximum Limit		10,00,000	3,08,000	5,92,000
Average Salary for Gratuity = $\dfrac{\text{Basic Pay + DA (forming part) for the last 10 months preceeding the moth of retirement}}{10}$				
$= \dfrac{32{,}000 \times 4 + 30{,}000 \times 6}{10} = \dfrac{3{,}08{,}000}{10} = 30{,}800$				

Gross Salary			**9,96,600**
Less: Deduction u/s 16			Nil
Income under the head Salary			**9,96,600**
(B) Income from House Property			
Self Occupied — Annual Value		Nil	
Less : Deduction u/s 24 — Interest on Borrowed Capital		(84,000)	**(84,000)**
(C) Income from Other Sources : Bank Interest₹			**18,000**
(D) Gross Total Income			**9,30,600**
Less : Deduction under Chapter VIA u/s 80C – Deposit in PPF ₹ 80,000 (Maximum amount allowed as deduction)			70,000
u/s 80 CCF – Subscription to Long-term Infrastructure Boned – Amount deposited ₹ 30,000 remitted upto			20,000
(E) Total Income			**8,40,600**

Illustration 10 : Mr. Ganesh retires on 31.10.2010 voluntarily from XYZ (P) Ltd as per the scheme u/s (10C) of the Income-tax Act, 1961. He furnishes the following particulars :

(a) Basic Pay ₹ 20,000 pm.
(b) Pension ₹ 8,000 pm.
(c) D.A. forming part of Salary for retirement benefits ₹ 6,000 pm.
(d) Compensation of voluntary retirement ₹ 6,00,000
(e) Gratuity ₹ 1,50,000
(f) Leave Salary ₹ 40,000
(g) He gets 60% of his pension commuted for ₹ 90,000 on 31.1.2010. Completed years of service 18 years and 7 months. Leave availed while in service 19 months. But for the voluntary retirement, Mr. Ganesh would have retired only after 45 months. The last increment he received was on 1.11.2009.

Compute his taxable salary income for the A.Y. 2011-12.

Solution :

Assessee : Mr. Ganesh **Previous Year: 2010-2011** **Assessment Year : 2011-12**

Computation of Total Income

Particulars		**₹**
Basic salary	(₹ 20,000 × 7)	1,40,000
Dearness Allowance	(₹ 6,000 × 7)	42,000
Gratuity	(W.N. 1)	NIL
Pension	(W.N.2)	70,400
Voluntary Retirement Compensation	(W.N.3)	1,00,000
Leave Encashment	(W.N.4)	90,000
Income under the head "Salaries"		**4,42,400**

Working Notes :

(a) Taxable Gratuity

Particulars	₹	₹
Gratuity received (assumed as not covered by Payment of Gratuity Act, 1972)		1,50,000
Less : Exempt u/s 10(10) :		
Least of the following —		
(i) Actual Amount of Gratuity Received	1,50,000	
(ii) Maximum Limit	10,00,000	
(iii) ½ months average salary for each years of completed service (½ × 18 × 26,000)	2,34,000	(1,50,000)
Average Salary = $\frac{26,000 \times 10}{10} = 26,000$		
Taxable Gratuity		**NIL**

(b) Taxable Pension

Particulars		₹	₹
(a) **Uncommuted Pension**			
• Period: November 2010 - January 2011	(₹ 8,000×3 Months)	24,000	
• Period: February 2011 - March 2011	(₹ 8,000×40%×2 Months)	6,400	
• Total			30,400
(b) **Commuted Pension**			
Amount Received		90,000	
Less : Exempt u/s 10(10A)			
1/3rd of Full Value of Commuted Pension			
(Since Gratuity received)			
[1/3rd of (90,000/60) x 100] (Note 1)	(50,000)	40,000	
Taxable Pension			**70,400**

(c) Computation of Taxable VRS Compensation

Particulars	₹	₹
Amount of VRS Compensation Received		6,00,000
Less: Exempt u/s 10(10C):		
Least of the following —		
• Actual Amount Received	6,00,000	
• Maximum Limit	5,00,000	
• The above shall not exceed higher of :		
(i) Last Drawn Salary x 3 x No. of completed years of service (26,000 x 3 x 18 Years)	14,04,000	
(ii) Last drawn Salary x balance of months of service left (26,000 x 45 Months)	5,40,000	(5,00,000)
Taxable Value of VRS Compensation		**1,00,000**

(d) Computation of Taxable Leave Encashment

Particulars	₹	₹
Amount of Leave Encashment Received		90,000
Less : Exemption u/s 10(l0AA) :		
Least of the following :		
(i) Amount Received	90,000	
(ii) Notified Amount	3,00,000	
(iii) Average salary of past 10 months Salary x 10 months (12,000 × 10)	1,20,000	
(iv) Leave Encashment based on 30 days credit for every completed year of service (Note)	Nil	Nil
Taxable Leave Encashment		**90,000**

Note :

Total Leave Eligible on basis of 30 days credit for every completed years of service of 18 years	18 Months
Total Leave Taken	19 Months
Leave to his credit	Nil

Illustration 11 : M Ltd. has sold the following assets to its employee, Mr. Raghu. Compute taxable perquisite.

Assets	Date of purchase	Purchase value	Date of sale	Sale price
Computer	1-7-07	2,00,000	18-8-2010	20,000
Car	1-4-08	3,00,000	1-3-2011	50,000
Television	1-4-05	50,000	1-4-2010	2,000
Sofa set	1-4-95	80,000	1-7-2010	5,000

Solution :

Computation of taxable value of perquisite in hands of Mr. Amit for the A.Y. 2011-12.

Assets	Written down value	Sale value	Taxable perquisite
Computer	25000 (Note 1)	2,000	5,000
Car	192000 (Note 2)	50,000	1,42,000
Television	25000 (Note 3)	2,000	23,000
Sofa set	Nil[4]	5,000	Nil
Taxable Perquisite		**1,70,000**	

1. Calculation of WDV of Computer

Particulars	Amount
Purchase value	2,00,000
Less : Depreciation from 1-7-07 to 30-6-08 @ 50%	1,00,000
WDV as on 1-7-08	1,00,000
Less : Depreciation from 1-7-08 to 30-6-09 @ 50%	50,000
WDV as on 1-7-09	50,000
Less : Depreciation from 1-7-09 to 30-6-10 @ 50%	25,000
WDV as on 1-7-10	25,000
Less : Depreciation from 1-7-10 to 18-8-10 (as year not completd)	Nil
WDV as on the date of sale	25,000

2. Calculation of WDV of Car

Particulars	Amount
Purchase value	3,00,000
Less : Depreciation from 1-4-08 to 31-3-09 @ 20%	60,000
WDV as on 1-4-09	2,40,000
Less : Depreciation from 1-4-09 to 31-3-10 @ 20%	48,000
WDV as on 1-4-10	1,92,000
Less : Depreciation from 1-4-10 to 1-3-11 @ (as year not completd)	Nil
WDV as on date of sale	1,92,000

3. Calculation of WDV of Television

Particulars	Amount
Purchase value	50,000
Less : Depreciation from 1-4-05 to 31-3-10 @ 10%	25,000
WDV as on date of sale	25,000

4. Depreciation on sofa set is charged @ 10% as per straight-line method. Since the asset is used for more than 10 years, hence its WDV will be Nil.

Illustration 12 : Ms. Hema, aged about 66 years is a Finance Manager of Udyog Pvt. Ltd. based at Mumbai. She is in continuous service since 1969 and received the following from the Company during the year ended 31.3.2011.

(a) Basic Pay (50,000 × 12) = ₹ 6,00,000

(b) D.A (20,000 × 12) = ₹ 2,40,000

(c) Bonus 2 months Basic Pay

(d) Commission — 0.1% of Company's Turnover. Turnover for financial year 2010-2011 was ₹ 15 Crores.

(e) Contribution of the Employer and Employee to the PF Account ₹ 3,00,000 each

(f) Interest credited to P.F Account at 10% ₹ 60,000

(g) Rent Free Unfurnished Accommodation provided by the Company (Company pays ₹ 70,000 p.a. rent)

(h) Entertainment Allowance ₹ 30,000

(i) Children's Education Allowance to meet the hostel expenditure of three children ₹ 5,000 each.

Hema makes the following payments and Investments :

(a) Premium paid to insure the life of her major son ₹ 15,000

(b) Medical Insurance Premium for Self — ₹ 15,000, Spouse ₹ 15,000 (Aged 70 yrs.)

(c) Donation to Public Charitable Institution registered under Section 80G ₹ 2,00,000

(d) LIC Pension Fund ₹ 12,000

(e) Long-term Infrastructure Bond —₹ 25,000

Determine the tax liability for the Assessment Year 2011-12.

Assessee : Mr. Hema **Previous Year: 2010-2011** **Assessment Year : 2011-12**

Computation of Total Income

Particulars	**₹**	**₹**
Basic Salary (₹ 50,000×12)		6,00,000
Dearness Allowance (₹ 20,000×12)		2,40,000
Bonus (₹ 50,000×2)		1,00,000
Commission (₹ 15 Crores×0.1%)		1,50,000
Employer's Contribution to Providend Fund	3,00,000	
Less : Exemption u/s 10(14) upto 12% of Salary (12% × 9,90,000) **(WN 1)**	(1,18,800)	1,81,200
Interest credited to Providend Fund Account at 10%	60,000	
Less : Exempted u/s 10(14) upto 9.5%	57,000	3,000
Entertainment Allowances		30,000
Children Education Allowance (₹ 5,000×3)	15,000	
Less : Exempt u/s 10(14) [₹ 300 p.m.×12 months × 2 Children (maximum)]	(7,200)	7,800
Taxable Salary before Perquisites		**13,12,000**
Value of Perquisites		
Rent Free Unfurnished Accommodation		
Least of the following—		
Rent paid by the Employer 70,000		
15% of Salary [15% of ₹ 11,27,800] **(WN 2)** (assumed that Mumbai population > 25 Lakhs as per latest census)	1,69,170	70,000
Gross Salary		**13,82,000**
Less : Deduction u/s 16		
Entertainment Allowance		
u/s 16(ii) [Not a Govt. Employee]		Nil
Income under the head Salary		**13,82,000**
Gross Total Income		**13,82,000**
Less : Deduction Under Chapter VI-A		
U/s 80C LIC Premium paid 15,000		
Contribution to PF Account 3,00,000		
U/s 80CCC Contribution to Pension Fund 12,000		
[The maximum amount along with deduction 1,00,000 u/s 80CCC and 80CCC or u/s 80C, restricted to ₹ 1,00,000]		
U/s 80CCF Subscription to long term Infrastructure Bond 20,000		
U/s 80D Medical Insurance Premium paid	20,000	
U/s 80G **(WN 3)**	63,450	**(2,03,450)**
Total Income		**11,78,550**

Computation of Tax Liability

Particulars		₹	₹
Total Income			**11,78,550**
Upto ₹ 1,90,000			NIL
1,90,000 – 5,00,000	= @ 10% of 3,10,000		31,000
5,00,000 – 8,00,000	= @ 20% of 3,00,000		60,000
8,00,000 – 11,78,550	= @ 30% of 3,78,550		1,13,565
			2,04,565
(+) Deduction Cess @ 2%		4,091	
(+) SHEC @ 1%			2,046
			2,10,702
Rounded off u/s 288A			**2,10,700**

Working Notes :

1. Salary for the purpose of computation of Taxable Portion of Employer's Contribution to Provident Fund
   = Basic Salary + DA considered for Retirement Benefits + Commission
   = ₹ 6,00,000 + ₹ 2,40,000 + ₹ 1,50,000 = ₹ 9,90,000

2. Salary for the purpose of computation of Taxable Value of Rent Free Unfurnished Accommodation
   = Basic Pay (+) D.A (forming part of Salary) (+) All other Taxable Allowances (+) Any other monetary benefits
   = 6,00,000 + 2,40,000 + 1,00,000 + 1,50,000 + 30,000 + 7,870 = 11,27,800

3. **Computation of deduction u/s 80G :**

		₹
50% of least of the followings :		
(a) Amount Donated		2,00,000
(b) 10% of Adjusted Gross Total Income		
Gross Total Income	13,82,000	
Less : Deduction under Chapter VI-A excluding sec. 80G		
u/s 80C 80CCC	1,10,000	
(retired u/s 80CCF)		
u/s 80CCF	20,000	
u/s 80D	20,000	

9.5 INCOME FROM HOUSE PROPERTY

9.5.1 Chargeability [Section 22]

1. The basis of chargeability under the head income from house property is **Annual Value.**
2. The property must consist of Building or Lands Appurtenant thereto.
3. The assessee must be the owner of such property.
4. The property may be used for any purpose other than the assessee's business or profession.

9.5.2 Deemed Owner [Section 27]

1. **Owner:** An Individual shall be considered as owner of a property when the document of title to the property is registered in his name.

2. **Deemed Owner:** Under the following circumstances, Income from House Property is taxable in the hands of the Individual, even if the property is not registered in his name —

   (a) Where the Property has been transferred to **spouse for inadequate consideration** other than in pursuance of an agreement to live apart.

   (b) Where the Property is transferred to a **minor child for inadequate consideration (except a transfer** to minor married daughter)

   (c) Where the Individual holds an **impartible estate.**

   (d) Where the Individual is a **member** of Co-operative Society, Company, or other Association and has been allotted a house property by virtue of his being a member, even though the property is registered in the name of the Society / Company / Association.

   (e) Where the property has been transferred to the individual's name as part-performance of a contract u/s 53A of the Transfer of Property Act, 1882. (i.e. Possession of the Property has been transferred to Individual, but the Title Deeds have not yet been transferred).

   (f) Where the Individual is a **holder of a Power of Attorney** enabling the right of possession or enjoyment of the property.

   (g) Where the property has been constructed on a **leasehold land.**

   (h) Where the **ownership** of the Property is under **dispute.**

   (i) Where the property is taken on a lease for a period of not less than 12 years, then the lessee shall be deemed as the owner of the property.

9.5.3 PROPERTY INCOME IS EXEMPT FROM TAX TO CERTAIN PERSONS

10(19A):	An Ex-Ruler for his occupation (palace)
10(20):	Local Authority.
10(21):	Approved Scientific Research Association.
10(23B):	Institution_for the development of Khadi and Village Industries.
10(23BB):	Khadi and Village Industries Boards.
10(23BBA):	A body or authority for administering religious or charitable Trust or endowments.
10(23C):	Certain Funds, educational institutions, hospitals etc.
10(24):	Registered Trade Union.
10 (26B):	Statutory Corporation or an institution or association financed by the Government for promoting in the interests of members of SC or ST.
10(27) :	Co-operative Society for promoting the interest of the members of SC or ST.
11 :	Charitable Trust.
13A :	Political Party.

9.5.4 RECOVERY OF UNREALISED RENT [SECTION 25AA]

1. **Chargeability:** Recovery of Unrealized Rent is chargeable to tax as "Income from House Property".
2. **Year of Taxability:** Unrealized Rent recovered is taxable in the financial year in which it is recovered.
3. **Non-Subsistence of Ownership:** It will be taxable in the hands of Individual even if he does not own the property to which such rent pertains.
4. **Deduction:** No deduction will be allowed against such receipt.

9.5.5 RECEIPT OF ARREARS OF RENT [SECTION 25B]

1. **Meaning:** Arrears of Rent means the incremental rent relating to earlier financial years which has not been offered to tax in those financial years itself, but received during the current financial year,
2. **Chargeability:** Receipt of Arrears of Rent will be chargeable to tax under the head Income from House Property only.
3. **Year of receipt:** It is taxable as income of the financial year in which he receives the arrears of rent.
4. **Non-subsistence of ownership:** It is taxable in the hands of the Individual even if he does not own the prop" at the time of receipt of arrears of rent.
5. **Deduction:** A standard deduction of 30% of the amount of arrears received will be allowed as deduction.

9.5.6 UNREALIZED RENT (Rule 4)

Unrealized Rent means the rent not paid by the tenant to the owner and the same shall be deducted from the Actual Rent Receivable from the property before computing income from that property, provided the following conditions are satisfied :

1. The tenancy is bonafide
2. The defaulting tenant should have vacated the property
3. The assessee has taken steps to compel the defaulting tenant to vacate the property

4. The defaulting tenant is not in occupation of any other property owned by the assessee
5. The assessee has taken all reasonable steps for recovery of unrealised rent or satisfies the Assessing Officer that such steps would be useless.

9.5.7 MUNICIPAL TAX

1. **Municipal Tax includes** services tax like Water Tax and Sewerage Tax levied by any local authority. It can be claimed as a deduction from the Gross Annual Value of the Property.
2. **Conditions:**
   (a) **Paid by Owner.** The tax shall be borne by the owner and tie same was paid by him during the previous year.
   (b) **Property let out:** Municipal Tax can be claimed as a deduction only in respect of let out or deemed to be let out properties (i.e. more than one property self occupied).
   (c) **Year of payment:** Municipal Tax relating to earlier previous years, but paid during the current previous year can be claimed as deduction only in the year of payment.
   (d) Advance Taxes: Advance Municipal Tax paid shall not be allowed as deduction in the year of payment, but can be claimed in the year in which it falls due.
   (e) **Borne by Tenant:** Municipal taxes met by tenant are not allowed as deduction.
3. **Foreign Property:** For a property situated outside India, Municipal Tax levied by foreign Local Authority can be claimed as a deduction.

9.5.8 DEDUCTION FROM NET ANNUAL VALUE

A. Standard Deduction u/s 24(a)

Standard deduction of 30% of NAV (Net Annual Value) shall be allowed to the assessee.

B. Interest on Loan u/s 24(B)

1. **Purpose of loan:** The loan shall be borrowed for the purpose of **acquisition, construction, repairs, renewal or reconstruction of the house property.**
2. **Accrual basis:** The interest will be allowed as a deduction on accrual basis, even though it is not paid during the financial year.
3. **Interest on interest:** Interest on unpaid interest shall **not be allowed as a deduction.**
4. **Brokerage:** Any brokerage or commission paid for acquiring the loan **will not be allowed as a deduction.**
5. **Prior period interest:** Prior Period Interest shall be allowed in **five equal installments commencing from the financial year in which the property was acquired or construction was completed.**

   Note : Prior period interest means the interest from the date of borrowal of the loan upto the end of the financial year immediately preceding the financial year in which acquisition was made or construction was completed.
6. **Interest on fresh loan to repay existing loan:** Interest on any fresh loan taken to repay the existing loan **shall be allowed as a deduction. [Circular 28 / 20.9.1969]**
7. **Inadmissible interest:** Interest payable outside India without deduction of tax at source and in respect of which no person in India is treated as an agent u/s *163* shall NOT be an allowable **expenditure. [Section25]**
8. **Certificate:** The assessee should furnish a **certificate from the person from whom the amount is borrowed.**

9.5.9 COMPUTATION OF PRIOR PERIOD INTEREST

Let us illustrate the steps with an example :

Loan taken on 1.7.07 ₹ 8,0,000 @ 9% p.a. Date of completion of construction 31.5.10. Loan amount remains outstanding till date. Determine Prior Preiod and Interest u/s 24(b)

Step 1:	Identify the Date of Borrowal of Loan	1.7.07 (P.Y : 07-08)
Step 2:	Identify the Date of Completion / Acquisition	31.5.10 (P.Y : 10-11)
Step 3:	Identify Last Date of the Financial Year immediately preceding the date of Completion / Acquisition.	31.3.10 (P.Y : 09-10)
Step 4:	Prior Period = Calculated Period from Step 1 to Step 3	= 1.7.07-31.3.10 = 33 months
Step 5:	Prior Period Interest = Prior Period as per Step 4 × Rate of interest × Amount of Loan	$= \frac{33}{12} \times \frac{9}{100} \times 8{,}00{,}000 = 1{,}98{,}000$
Step 6:	Allowable Prior Period Interest = Prior Period Interest as per Step 5/ 5	= 39,600

Current Year Interest = 8,00,000 × 9% × 12 months = 72,000

∴ Interest allowable u/s 24(b) = CYI + 1/5 PCPI

$$= 72{,}000 + \frac{1}{5} \times 1{,}98{,}000$$

$$= 72{,}000 + 39{,}600$$

$$= 1{,}11{,}600$$

COMPUTATION OF INCOME FROM HOUSE PROPERTY

PROPERTY USED FOR	ANNUAL VALUE	Deductions Allowed	Section
1. Self occupied House Property or self occupied property kept vacant	**Nil**	u/s 24(b), subject to the fulfillment of conditions	23(2)
2. Property let out for the whole year	To be computed	All deductions	23(1)(a)/(b)
3. Let out property kept vacant for the whole year	**Nil**	All deductions except Sec. 24(a)	23(1)(c)
4. Let out property kept vacant for the part of the year	To be computed	All deductions	23(1)(c)
5. Two or more self-occupied House Property. Compute as if they are let-out property. Take the combination which will minimize total income from house property. • One property at the option of the assessee to be treated as self-occupied • Other property/(ies) shall be deemed to have been let out	**Nil**	To be computed Sec.24(b), subject to the fulfillment of conditions All Deductions 23(4)	23(1)(a)/(b)

COMPUTATION OF INCOME FROM HOUSE PROPERTY

GROSS ANNUAL VALUE	xx
Less: Municipal Taxes paid during the year	xx
NET ANNUAL VALUE	xx
Less: Standard Deduction @ 30% of NAV u/s 24(a)	xx
Less: Interest on Loan u/s 24(b)	xx
Add: Recovery of Unrealized Rent u/s 25 AA	xx
Income from House Property before considering Arrears of Rent	xx
Add: Arrears of Rent Received	xx
Less: Deduction u/s 25B: 30% of Arrears Received	xx
NET INCOME FROM HOUSE PROPERTY	**xx**

COMPUTATION OF GROSS ANNUAL VALUE

1. Municipal Value	xx
2. Fair Rental Value or Notional Rental Value	xx
3. Higher of (1) and (2)	xx
4. Standard Rent (if applicable)	xx
5. **Reasonable Expected Rent**= Lower of Step (3) and (4)	xx
6. Annual Rent (total rent assuming the property to be let out throughout	xx
the previous year)	
7. **Deduct:** Unrealized Rent as per Rule 4	xx
8. **Actual Rent= Step (6) – (7)**	xx
9. **Higher of Reasonable Expected Rent (Step 5) & Actual Rent (Step 8)**	xx
10. **Deduct:** Vacancy Allowance (proportionately on the basis of Annual Rent in Step 6)	xx
11. **GROSS ANNUAL VALUE**	**xx**

TERMINOLOGIES USED

(a) Municipal Value : It is the value that the municipal authorities deem as the value of the property for the purpose of assessment of property taxes. We shall have to ascertain the Gross Municipal Value. If Net Municipal Value is given, we shall have to determine the Gross Municipal Value = [Net Municipal Value + 1/9th of Net Municipal Value]

In case of Metro cities, Municipal Tax is calculated on the Net Municipal Value = [Gross Municipal Value – 10% of Gross Municipal Value].

Net Municipal Value is also known as **Net Rateable Value**.

If the information is silent regarding Municipal value, whether gross or net, we shall always consider it to be Gross Municipal Value, so as to give the maximum benefit to the Assessee.

(b) Fair Rent: It is the rent of the property fetched by a similar property in the same or similar locality with the same facilities.

(c) Standard Rent: It is the maximum rent which a person can recover from the tenant under the Rent Control Act.

CONDITIONS FOR ADMISSIBILITY OF INTEREST ON LOAN TAKEN FOR SELF-OCCUPIED PROPERTY

1. Loan taken for acquisition or construction of house property on or after 01.04.99 and the same was completed within 3 years from the end of the financial year in which capital was borrowed, interest paid or payable, subject to a maximum of **₹ 1,50,000 (= Current year + 1/5th of prior-period interest)**
2. Loan taken **prior to 1.4.99** for acquisition or construction or loan taken for repair, renovation or reconstruction at any point of time, interest paid or payable subject to a maximum of **₹ 30,000 (= Current year + 1/5th of prior-period interest)**
3. Loan taken **on or after 1.4.99** for acquisition or construction of house property, and the **same was not completed within 3 years** from the end of the financial year in which capital was borrowed, interest paid or payable, subject to a maximum of ₹ 30,000 **(= Current year + 1/5th of prior-period interest)**

Illustration 13 : Mr.Ashis discloses the following particulars of the property owned by him during the PY 2010-2011.

Particulars	House self-occupied	Flat alloted by HB Society let out ₹	Shops & godwons let out ₹
Municipal value	5,00,000	2,00,000	4,00,000
Fair rent	4,00,000	2,50,000	5,00,000
Municipal taxes payable	60,000	80,000	80,000
(a) Paid by Ashis	60,000	30,000	-
(b) Paid by tenant	-	50,000	80,000
Annual rent	-	3,60,000	7,00,000
Expenses incurred by Ashis :	-		
Maintenance charges	-	12,000	-
Repairs	-	-	2,60,000
Collection charges	-	-	6,000
Electricity bills paid	-		Nil
Insurance premium	20,000	-	6,000
Ground rent	5,000	2,000	6,00
Depreciation	1,000	2,000	20,000

Other information :

(i) He has taken the loan on 1 July 2008 to purchase the house in self-occupancy. However, he could purchase the house on 1 May 2008. He repaid ₹ 6,30,000 on 1 July 2010. This includes a charge of ₹ 1,20,000 on account of interest from the date of borrowing.

(ii) The flat has been purchased under EMI scheme of the Gujarat Apartment Cooperative House Building Society Ltd. He has to pay 120 EMI of ₹ 10,000 each, which includes 50% charge on account of interest. He has defaulted in payment of the last 20 EMI. To repay the outstanding EMI and penal interest of Rs, 20,000, he borrowed ₹ 2,20,000 on 1 October 2010 © 15% p.a.

The flat remained vacant for 1.5 months and rent of 3/4th month could not be realised. Conditions of Rule 4 have been satisfied,

(iii) Shops and godowns are held as stock-in-trade. However, till a suitable buyer is found, these are let out. P claims that income from letting should be computed under the head "profits and gains of business of profession".

He has borrowed money to construct/repair the godowns/shops. He paid ₹ 20,000 on account of brokerage for arranging the loan.

Interest is payable outside India, in two equal instalments of ₹ 50,000 each. The first instalment was paid net of tax at ₹ 40,000. However, the second instalment was paid without deducting tax at sources as the recipient had given an undertaking in the prescribed form to pay the tax. Compute income from house property for the assessment year 2011-2012.

Computation of Income from House Property for the Assessment Year 2011-12

Particulars	House self-occupied ₹	Flat let-out ₹	Shops and godowns let out ₹
Gross Annual Value	Nil	2,92,500	7,00,000
Less: Municipal taxes paid by the assessee	—	30,000	—
Net Annual Value	Nil	2,62,500	7,00,000
Less: Deductions u/s 24			
Statutory deduction u/s 24(a) @ 30% of NAV	—	78,750	2,10,000
Interest on Loan u/s 24(b)	24,000	37,500	50,000
Income from House Property	(24,000)	1,46,250	4,40,000

Workings :

1. Gross Annual Value:

ALV	2,50,000
Annual Rent	3,60,000
Less: Vacancy Allowance	45,000
Unrealised rent	22,500
	2,92,500

The higher of ALV and Annual rent, is the Gross Annual Value ₹2,92,500

2. Interest on loan taken for self- occupied:

(i) Amount of interest = ₹1,20,000
(ii) Period of interest = 01.07.2007 to 01.07.2009 = 2 years
(iii) Pre-acquisition period = 01.07.2007 to 31.3.2009 = 9 months
(iv) Interest for pre-acquisition period = 1,20,000 × 9/24
(v) Interest for 2007-2008 = ₹ 1,20,000/2 =₹60,000
(vi) Interest for 2008-2009 for 3 months = 1,20,000 × 3/24 = 15,000
(vii) Interest deductible during PY 2009-2010 = (45,000/ 5) + (15,000) = 24,000

3. Interest for the flat:

(i) Interest included in EMI from 01.04.2010 to 30.09.2010:
₹ (10,000 × 6/2) = ₹ 30,000

(ii) Interest on money borrowed to repay original loan interest
₹ (10,000 × 20/2) = (1,00,000 × 15% × 1/2) = 7,500

(iii) Total interest = ₹ (30,000 + 7,500) = ₹ 37,500

(iv) No deduction is allowed for penal interest.

4. Letting out of shops and godowns, held as stock-in-trade:

Section 22 excludes from its charge only such building as is occupied by the assessee for his business or profession, profits of which are chargeable to tax.

In the instant case, as letting out is not the business of the assessee, so, it cannot be said that he has occupied shop and godown for his business. Accordingly, income from letting out shop and building, held as stock-in-trade is assessable under the head "income from house property".

Where an assessee is not holding shops and godowns as stock-in-trade but engaged in the business of letting them on hire, the income is again chargeable under the head "house property" as it is a specific head of income dealing with letting out of buildings only.

5. Deduction in respect of other expenses: Section 24 does not allow any deduction in respect of (i) maintenance charges, (ii) repairs, (iii) collection charges, (iv) electricity, (v) fire insurance premium, (vi) ground rent, and (vii) depreciation.

Illustration 14 : Puja has occupied three houses for his self-occupancy. Their particulars for the previous year 2010-2011 are given below:

Particulars	House X ₹	House Y ₹	House Z ₹
Municipal value	3,60,000	9,60,000	9,50,000
Municipal taxes paid	40,000	80,000	90,000
Fair rent	5,40,000	8,00,000	10,00,000
Standard rent	4,50,000	6,00,000	9,00,000
Repairs	1,50,000	2,50,000	3,00,000
Ground rent paid	20,000	25,000	30,000
Insurance premium paid	5,000	6,000	7,000
Interest on loantaken for purchase of H.P.	75,000	1,20,000	2,00,000
Year of the loan	1997-98	2000-2001	2005-06

She has suffered loss in his business, amounting ₹ 3,00,000

Compute her total income, advising her which house should be specified for self-occupancy concession:

Solution : Computation of income from house property under different options :

(a) Assuming all the properties are self-occupied (SO)	House X (SO) ₹	House Y (SO) ₹	House Z (SO) ₹
Annual value	Nil	Nil	Nil
Less: Interest on loan	30,000	30,000	1,50,000
Loss from house property	30,000	30,000	1,50,000

(b) Assuming all the properties as Deemed Let Out (DLO)	House X (DLO) ₹	House Y (DLO) ₹	House Z (DLO) ₹
Gross annual value	4,50,000	6,00,000	9,00,000
Less: Municipal taxes paid	40,000	80,000	90,000
Net annual value	4,10,000	5,20,000	8,10,000
Less: Statutory deduction u/s 24(a) @ 30% of net annual value	1,23,000	1,56,000	2,43,000
Interest on Loan u/s 24(b)	(-) 75,000	(-) 1,20,000	(-) 2,00,000
Income from house property	2,12,000	2,44,000	3,67,000

(c) Total Income under different options for self-occupancy:

Particulars	Option 1 House X ₹	Option 2 House Y ₹	Option 3 House Z ₹
House X	(-) 30,000	2,12,000	2,12,000
	(SO)	(DLO)	(DLO)
House Y	2,44,000	(-) 30,000	2,44,000
	(DLO)	(SO)	(DLO)
House Z	3,67,000	3,67,000	(-) 1,50,000
	(DLO)	(DLO)	(SO)
Income from house property:	5,81,000	5,49,000	3,06,000
Loss from business	(-) 3,00,000	(-) 3,00,000	(-) 3,00,000
Total income	2,81,000	2,49,000	(-) 6,000

Conclusion: A house with minimum income/maximum loss should be opted for self-occupancy concession to minimise the tax liability.

The option can be changed from year to year.

In the instant case, House Z should be treated as self-occupied. There will be no tax-liability, and the assessee will carry forward the unabsorbed business loss of ₹ 94,000 for next 8 assessment years.

Illustration 15 : Mr. Pradipto completed construction of a residential house on 1.4.2010. Interest paid on loans borrowed for purpose of construction during the 2 years prior to completion was ₹ 40,000. The house was let-out on a monthly rent of ₹ 4,000. Annual Corporation Tax paid is ₹ 2,000. Interest paid during the year is ₹ 16,000. Amount spent on repairs is ₹ 2,000. Fire Insurance Premium paid is ₹ 1,500 p.a. Property was vacant for 3 months. Annual letting value as per corporation records is ₹ 30,000. Compute the income under the head "Income from House Property" for the A.Y. 2011-12.

Solution :

Assessee : Mr. Pradipto **Previous Year : 2010-2011** **Assessment Year : 2011-12**

Computation of Income from House Property

	Particulars			₹	₹
	Gross Annual Value u/s 23(1)(c)	**(Note 1)**			36,000
Less :	Municipal Taxes Paid				(2,000)
	Net Annual Value (NAV)				**34,000**
Less :	Deduction u/s 24 —				
	(a) 30% of Net Annual Value	(₹ 30,000 × 30%)		9,000	
	(b) Interest on Borrowed Capital :				
	Interest for Current Year		₹ 16,000		
	Interest of Prior Period	(₹ 40,000 × 1/5)	₹ 8,000	24,000	(33,000)
	Income from House Property				**1,000**

Note :

Computation of Gross Annual Value

Municipal Value	30,000
Annual Rent (4,000 × 12)	48,000
(–) Unrealised Rent	Nil
Annual Rent	**48,000**
Higher of MV & Actual Rent	48,000
Less : Vacancy Allowance	
$\frac{48{,}000}{12} \times 3$	12,000
Gross Annual Value	**36,000**

Illustration 16 : Mr. Suman owned a house property at Chennai which was occupied by him for his residence. He was transferred to Mumbai in June 2010 and therefore he let-out the property with effect from 1.7.2010 on a monthly rent of ₹ 5,000. The corporation tax payable in respect of the property was ₹ 10,000 of which 50% was paid by him before 31.3.2011. Interest on money borrowed for the construction amounted to ₹ 20,000. Compute the income from house property for the A.Y. 2011-12.

Solution :

Assessee : Mr. Suman **Previous Year : 2010-2011** **Assessment Year : 2011-12**

Computation of Income from House Property

	Particulars		**₹**	**₹**
	Annual Value u/s 23(1)(a)/(b) – Rent receivable for the whole year			60,000
Less :	Municipal Taxes paid	₹ 10,000 × 50%		(5,000)
	Net Annual Value			**55,000**
Less :	**Deduction u/s 24**			
	(a) 30% of Net Annual Value	₹ 55,000 × 30%	16,500	
	(b) Interest on borrowed Capital		20,000	(33,500)
	Income from House Property			**21,500**

Illustration 17 : Mr. G and N constructed their houses on a piece of land purchased by them at Kolkata. The built-up area of each house was 1,000 sq ft. Ground floor and an equal area in the First floor. Mr. G started construction on 1.7.2009. Mr. G occupied the entire house on 1.4.2010. Mr. N occupied the Ground floor on 1.7.2010 and let-out the first floor for a rent of ₹ 20,000 p.m. However, the tenant vacated the house on 31.12.2010 and Mr. N occupied entire house during 1.1.2011 to 31.3.2011.

Following are the other information :

(i)	Fair Rental Value of each unit (Ground floor/First floor)	₹ 2,00,000 p.a.
(ii)	Municipal Value of each unit (Grount floor/First floor)	₹ 90,000 p.a.
(iii)	Municipal taxes paid by	G – ₹ 12,000
		N – ₹ 12,000
(iv)	Repair and Maintenance charges paid by	G – ₹ 40,000
		N – ₹ 50,000

Mr. G has availed a housing loan of ₹ 16.00 Lakhs @ 12% p.a. on 1.4.2009. N has availed a housing loan of ₹ 18.00 Lakhs @ 10% p.a. on 1.7.2009. No repayment was made by either of them till 31.3.2011. Compute Income from House Property for G and N for the A.Y. 2011-12.

Solution :

Assessee : Mr. G **Previous Year : 2010-2011** **Assessment Year : 2011-12**

Computation of Income from House Property

	Particulars	₹
	Nature : Self Occupied – Annual Value u/s 23(2)	NIL
Less :	**Deduction u/s 24 :** Interest – ₹ 16 Lakhs × 12% = ₹ 1,92,000	1,50,000
	(Restricted to ₹ 1,50,000)	
	Loss from House Property	**(1,50,000)**

Note : Since construction of property is completed in the year of borrowal of loan itself, prior period interest does not arise.

Assessee : Mr. N **Previous Year : 2010-2011** **Assessment Year : 2011-12**

Computation of Income from House Property

	Particulars	₹	₹	₹
Ground Floor	**Nature : Self Occupied**			NIL
	Annual Value u/s 23(2)			
Less :	**Deduction u/s 24 :** Interest on Borrowed Capital			
	Current Year : ₹ 18,00,000 × 10% × 50%	90,000		
	Prior Period : ₹ 18,00,000 × 10% × 9/12 × 50% ×1/5	13,500	(1,03,500)	(1,03,500)
First Floor	**Nature : Let-Out**			
	Annual Value u/s 23(1)(a)/(b)			
	Higher of Fair Rent vs. Municipal Rent **[See Note 1]**	1,50,000		
	Higher of Rent selected above vs. Acual Rent received **[See Note 2]**	1,80,000	1,80,000	
Less :	Municipal Taxes – (₹ 12,000 × 50%)		(6,000)	
	Net Annual Value		**1,74,000**	
Less :	Deduction u/s 24			
	(a) 30% of Net Annual Value	52,200		
	(b) Interest on borrowed Capital			
	Current Period Interest – (₹ 18,00,000 × 10% × 50%)	90,000		
	Prior Period Interest – (₹ 18,00,000×10% ×9/12×50% ×1/5)	13,500	(1,55,700)	18,300
	Net Income from House Property			**(85,200)**

Notes:

1. Since the construction of property was completed on 1.7.2009, Fair rent, Municipal Rent and Actual Rent receivable are to be considered only for a period of **9 months**.

   Fair Rent $= 2,00,000 \times \frac{9}{12} = 1,50,000$

   Municipal Value $= 90,000 \times \frac{9}{12} = 67,500$

2. Since the house is self occupied for part of the year and let out for part of the year, income from house property shall be calculated for the whole year as deemed let out property. Therefore Rent receivable is ₹ 1,80,000 (₹ 20,000 × 9).

Illustration 18 : Mr. L is the owner of a commercial property let out at ₹ 30,000 p.m. The municipal tax on the property is ₹ 15,000 annually, 60% of which is payable by the tenant. This tax was actually paid on 15.4.2011. He had borrowed a sum of ₹ 10 Lakhs from his cousin, resident in USA (in dollars) for the construction of the property on which interest at 18% is payable. He has also received arrears of rent of ₹ 40,000 during the year, which was not charged to tax in the earlier years. What is the Property Income of X for A.Y. 2011-12?

Solution :

Assessee : Mr. L **Previous Year : 2010-2011** **Assessment Year : 2011-12**

Computation of Income from House Property

	Particulars		₹	₹
	Let Out : So, Annual Value u/s 23(1)(a)/(b) = Actual Rent = ₹ 30,000×12		3,60,000	
Less :	Municipal Taxes Paid during the F.Y. 2010-11			NIL
	Net Annual Value			**3,60,000**
Less :	**Deduction u/s 24**			
	– 30% of NAV –	₹ 3,60,000 × 30%	1,08,000	
	– Interest on Housing Loan (Note)	₹ 20,00,000 × 8%	1,60,000	(2,68,000)
	Income from House Property before considering Arrears of Rent			**92,000**
	Arrears of Rent Received		40,000	
Less :	Deduction u/s 25B – 30% of Arrears received – ₹ 40,000 × 30%		(12,000)	28,000
	Net Income from House Property			**64,000**

Note : It is presumed that the tax has been deducted at source on the amount of interest payable outside India.

9.6 PROFITS AND GAINS FROM BUSINESS AND PROFESSION

BUSINESS [Sec. 2(13)]

Definition of "Business" includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.

Certain terms used in the definition can be understood as follows:

"Trade" is the activity of purchase and sale of goods with an object of making profit.

"Commerce" means trade repeated on a large scale.

"Manufacture" is said to have taken place when as a result of certain process(es) applied on a product, a new and commercially different product comes into existence which is known to the market as different from the raw material.

"Adventure or concern in the nature of trade, commerce or manufacture" has to be decided on the basis of cumulative effect of the facts and circumstances of each case i.e. scale of activity, time period covered by it, nature of the commodity etc. in order to decide whether the act is an adventure or concern.

Business necessarily means a continuous activity with a profit motive by the application of labour and skill.

Under certain circumstances a single and isolated transaction may also constitute business provided it bears clear indications of trade or is an adventure in the nature of trade.

PROFESSION [Sec. 2(36)]

Profession involves an exercise of intellect and skill based on learning and experience. It includes "vocation".

Vocation refers to any work performed on the strength of ones natural ability for that work. Regularity and profit-motive are not necessary for an activity to be called a vocation.

CHARGEABILITY [Sec. 28]

The following incomes shall be chargeable under this head :-

U/s 28, the following income shall be chargeable to income-tax under the head "Profits and gains of business or profession",—

(i) the profits and gain of any business or profession which was carried on by the assessee at any time during the previous year;

(ii) any compensation or other payment due to or received by, —

  (a) any person, by whatever name called, managing the whole or substantially the whole of the affairs of an Indian company, at or in connection with the termination of his management or the modification of the terms and conditions relating thereto;

  (b) any person, by whatever name called, managing the whole or substantially the whole of the affairs in India of any other company, at or in connection with the termination of his office or the modification of the terms and conditions relating thereto ;

  (c) any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person, at or in connection with the termination of the agency or the modification of the terms and conditions relating thereto ;

  (d) any person, for or in connection with the vesting in the Government, or in any corporation owned or controlled by the Government, under any law for the time being in force, of the management of any property or business ;

(iii) income derived by a trade, professional or similar association from specific services performed for its members ;

(a) profits on sale of a licence granted under the Imports (Control) Order, 1955, made under the Imports and Exports (Control) Act, 1947 (18 of 1947) ;]

(b) cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India ;]

(c) any duty of customs or excise re-paid or re-payable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1971 ;]

(d) any profit on the transfer of the Duty Entitlement Pass Book Scheme, being the Duty Remission Scheme under the export and import policy formulated and announced under section 5 of the Foreign Trade (Development and Regulation) Act, 1992 (22 of 1992);]

(e) any profit on the transfer of the Duty Free Replenishment Certificate, being the Duty Remission Scheme under the export and import policy formulated and announced under section 5 of the Foreign Trade (Development and Regulation) Act, 1992 (22 of 1992) ;]

(iv) the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession ;]

(v) any interest, salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from such firm :

Exception :

where any interest, salary, bonus, commission or remuneration, by whatever name called, or any part thereof has not been allowed to be deducted under clause (b) of section 40, the income under this clause shall be adjusted to the extent of the amount not so allowed to be deducted ;

(va) any sum, whether received or receivable, in cash or kind, under an agreement for—

(a) not carrying out any activity in relation to any business; or

(b) not sharing any know-how, patent, copyright, trade-mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services :

Exception : this sub-clause (a) shall not apply to—

(i) any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any business, which is chargeable under the head "Capital gains";

(ii) any sum received as compensation, from the multilateral fund of the Montreal Protocol on Substances that Deplete the Ozone layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India.

Explanation : For the purposes of this clause,—

(i) "agreement" includes any arrangement or understanding or action in concert,—

(A) whether or not such arrangement, understanding or action is formal or in writing; or

(B) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings;

(ii) "service" means service of any description which is made available to potential users and includes the provision of services in connection with business of any industrial or commercial nature such as accounting, banking, communication, conveying of news or information, advertising, entertainment, amusement, education, financing, insurance, chit funds, real estate, construction, transport, storage, processing, supply of electrical or other energy, boarding and lodging;

(vi) any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.

Explanation : For the purposes of this clause, the expression "Keyman insurance policy" shall have the meaning assigned to it in clause (10D) of section 10;

(vii) any sum, whether received or receivable, in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD.

Speculative Business :

Where speculative transactions carried on by an assessee are of such a nature as to constitute a business, the business (hereinafter referred to as "speculation business") shall be deemed to be distinct and separate from any other business.

In the context of computation of income under the head profits and gains of Business or Profession, the following points may be noted :

(a) Profits chargeable to tax are computed on the basis of commercial principles including generally accepted accounting principles and practices.

(b) Only profits or gains are liable to income-tax and not mere gross receipts. Capital receipts and Capital expenditures are not generally to be taken into account while computing profits under this section unless it expressly provides in the provisions of the Income Tax Act.

(c) Taxable profits or gains should be real and not notional. Anticipated losses are not provided for and unrealized gains are not considered except in case of stock valuation which is valued at lower of cost or market price.

(d) Profits and gains arises to Business or Profession carried on by the assessee are computed in relation to a time period which is covered by a previous year.

It is not necessary that Business or Profession should be carried on throughout the Previous Year. However, as an exception, the following incomes are taxable by virtue of express provisions under the Act even if no business was carried on during the Previous Year.

(i) Recovery against any loss, expenditure or trading liability earlier allowed as deduction. [sec. 41(1)]

(ii) Balancing charge i.e. profits or gains from sale of a building, machinery, plant or furniture owned by a power undertaking. [Sec. 41(2)]

(iii) Profits and gains from sale of capital asset used for scientific research. [Sec. 41(3)]

(iv) Recovery against bad debt. [Sec. 41(4)]

(v) Amount withdrawn from special reserve. [Sec. 41(4A)]

(vi) Profits and gains from transfer of the Business or interest in the petroleum and natural gas business. [Sec. 42(2)]

(vii) Any sum received after the discontinuance of a business. [Sec. 176(3A), Sec. 176(4)]

(e) Profits and gains can not arise by trading with oneself.

(f) Taxability of an income depends on its source. Thus, profits and gains that arise to an assessee during the Previous Year may not be taxed under the head Business or Profession, its taxability depends on source.

For example :

(i) Profits from activity of purchasing and selling real estate properties is taxable under the head "Profits and gains of Business or Profession". However, rental income from any of such properties is taxable under the head "Income from House Property".

(ii) Interest on securities held as investment is charged to tax under the head "Income from Other Sources". However, interest on securities held as stock-in-trade is charged under the head "Profits and gains of Business or Profession".

(g) Profits and gains from illegal business are also chargeable to Income-tax under this head.

(h) Income from letting or exploiting of commercial assets is charged under the head Business or Profession but the intention of the assessee should be to treat the asset as commercial asset.

COMPUTATION OF INCOME FROM BUSINESS OR PROFESSION (Sec. 29)

Format for Computation of Business or Profession Income :

Computation of Income from Business

Net Profit as per Profit & Loss Account	xxx
Add : Expenses disallowed/Inadmissible Expenses [i.e. items already debited in P/L A/c but not eligible for deduction]	xxx
Less : Incomes Credited in P/L A/c to be treated separately under difference heads of income	(xxx)
Less : Expenses allowed as per Provisions	(xxx)
Income from Business	**xxx**

Computation of Income from Profession

Receipts relating to Profession (on Cash Basis)	xxx
Less : Payment relating to profession (both cash and accrual basis)	(xxx)
Income from Profession	**xxx**

Expenses which are allowed as deduction [Sections 30 to 37]

RENT, RATES, TAXES, REPAIRS AND INSURANCE FOR BUILDINGS [Sec. 30]

In respect of rent, rates, taxes, repairs and insurance for premises, used for the purposes of the business or profession, the following deductions shall be allowed—

(a) where the premises are occupied by the assessee—

(i) as a tenant, the rent paid for such premises ; and further if he has undertaken to bear the cost of repairs to the premises, the amount paid on account of such repairs;

(ii) otherwise than as a tenant, the amount paid by him on account of current repairs to the premises ;

(b) any sums paid on account of land revenue, local rates or municipal taxes ;

(c) the amount of any premium paid in respect of insurance against risk of damage or destruction of the premises.

REPAIRS AND INSURANCE OF MACHINERY, PLANT AND FURNITURE [Sec. 31]

In respect of repairs and insurance of machinery, plant or furniture used for the purposes of the business or profession, the following deductions shall be allowed—

(i) the amount paid on account of current repairs thereto ;

(ii) the amount of any premium paid in respect of insurance against risk of damage or destruction thereof

DEPRECIATION [Sec. 32]

Depreciation is the diminution in the value of an asset due to normal wear and tear or due to obsolescence. In order to allow depreciation as notional expenses in computing profits and gains of Business or Profession, the following conditions are to be fulfilled;

(i) **There must be assets :** It may be classified into two types.

 (a) **Tangible assets :** Buildings, machinery plant or furniture.

 (b) **Intangible assets :** Know-how, patents, copy rights, trademarks, licences, franchise or any other business or commercial right of similar nature acquired on or after 1st April, 1998.

(ii) **Such asset should be owned, wholly or partly, by the assessee :** Ownership does not necessarily mean legal ownership. Assessee will be treated as owner if he is capable of enjoying the right of the owner in respect of asset in his own right and not on behalf of the owner in whom title vests even though a formal deed of title has not been executed and registered (Mysore minerals, Ltd. vs. CIT[(1999) 239 ITR 775(SC)]. In case of a building in which Business or Profession is carried on is not owned by the assessee but he holds a lease or other right of occupancy though he is not entitled to depreciation on the building, depreciation is allowed on the capital expenditure incurred for the purposes of Business or Profession on construction of any structure or renovation etc.

(iii) **Such asset should be used for purposes of Business or Profession**

Depreciation Statement as per Income Tax Act, 1961

Particular of Asset	WDV as on 01.4.....	Additions at Actual Cost	Deductions	Net Value of Block	Depreciation for Current Year	WDV as on 31.03.....
1	2	3	4	5	6	7

BLOCK OF ASSETS [Sec. 2(11) AND EXPLANATION 3 TO SECTION 32] :

It means a group of assets falling within a class of assets comprising,

(i) **Tangible assets :** Buildings, machinery, plant or furniture;

(ii) **Intangible assets :** Know-how, patents, copyright, trademarks, licences, franchises or any other business or commercial rights of similar nature in respect of which same percentage of depreciation has been prescribed.

Aligning the definition of 'Block of Asset" [Explanation 3 to section 32(1)] [W.e.f. A.Y. 2010-11]

The term "block of assets" has been defined in section 2(11) and in *Explanation*3 to section 32(1) of the Income-tax Act. However, these definitions are not identical and therefore they are subject to misuse. Accordingly, *Explanation* of section 32(1) has been amended so as to delete the definition of "block of assets" provided therein. Consequently, "block of assets" will derive its meaning only from section 2(11) and *Explanation* 3 shall contain the meaning of assets which shall be applicable for electricity undertaking only.

WRITTEN DOWN VALUE [Sec. 43(6)]

(i) In case of assets acquired in the Previous Year, written down value is the actual cost to the assessee.

(ii) In case of assets acquired before the Previous Year :- Written down value is the actual cost of the asset to the assessee as reduced by depreciation actually allowed to him in respect of such asset under this Act.

(iii) In case of any block of assets :- Written down value of the block of asset is computed as per the following mechanism.

	₹
Written down value of the block of assets at the beginning of the current Previous Year.	***
Add: Actual cost of assets falling within that block, acquired during the Previous Year.	***
Less: Moneys payable and scrap value if any, in respect of asset sold/discarded/demolished destroyed during the Previous Year	***
Written down value	***

(iv) In case of block of assets when there is a slump sale:– In accordance with section 2(42C), "slump sale" means the transfer of one or more undertakings as a result of the sale for lump sum consideration without values being assigned to the individual assets and liabilities in such sales.

Written down value in case of slump sale is computed as per the following mechanism.

	₹
Written down value of the entire block at the beginning of the relevant Previous Year.	***
Add: Actual cost of assets falling within that block, acquired during the Previous Year.	***
	***
Less: Moneys payable and scrap value if any, in respect of asset sold/discarded/demolished/destroyed during the Previous Year	***
	***
Less: Actual cost of the asset falling within that block as reduced by amount of depreciation actually allowed to such asset, but it should not exceed the written down value of the block as at the end of the Previous Year in it cannot be negative.	***
Written down value in case of slump sale.	***

(v) Written down value in case of demerged company [Explanation 2A of Sec. 43(6)]:

Written down value of resulting company =	Written down value of assets prior to demerger shall be reduced by the written down value of assets transferred pursuant to demerger.

(vi) Written down value in case of resulting company [Explanation 2B to Sec. 43(6)]

Written down value of resulting company =	Written down value of assets as appearing in the books of the demerged company before the demerger.

(vii) Written down value in case of corporatisation [Explanation Sec. 5 to Sec. 43(6)]

Written down value of a company under a =	Written down value of the transferred asset by a scheme of corporatisation approved by SEBI recognised stock exchange in India immediately before such transfer.

Note : Written down value cannot be negative i.e. it shall be reduced to 'nil' in the following situations :

(a) Where the block of assets ceases to exist i.e., all the assets of the block are transferred.

(b) Where a part of the block is sold and the sale consideration of the assets sold exceeds the value of the block.

Written down value where the assessee was not required to compute his total income of any earlier previous year [*Explanation* 6* to section 43(6) inserted by the Finance Act, 2008, w.r.e.f assessment year 2003-2004]

Where an assessee was not required to compute his total income for the purposes of this Act for any previous year or years preceding the previous year relevant to the assessment year under consideration,—

(a) the actual cost of an asset shall be adjusted by the amount attributable to the revaluation of such asset, if any, in the books of account;

(b) the total amount of depreciation on such asset, provided in the books of account of the assessee in respect of such previous year or years preceding the previous year relevant to the assessment year under consideration shall be deemed to be the depreciation actually allowed under this Act for the purposes of this clause; and

(c) the depreciation actually allowed under clause (b) shall be adjusted by teh amount of depreciation attributable to such revaluation of the asset.

Computation of written down value where income of an asscsscc is derived in part from agriculture and in part from business chargeable to income-tax under the head "Profits and gains of business or profession" [Explanation 1 to Section 43(6)] [W.e.f. A.Y. 2010-11]

Section 32(l)(iii) provides that depreciation is to be allowed and computed at the prescribed percentage on the written down value (WDV) of any block of assets. Sub-clause (b) of clause (6) of section 43 provides that WDV in the case of assets acquired before the previous year shall be computed by taking the actual cost to the assessee less all depreciation "actually allowed" to him under the Income-tax Act.

Rules 7A, 7B and 8 of the Income tax Rules, 1962, deal with the computation of composite income where income is derived in part from agricultural operations and in part from business chargeable to tax under the Income tax Act, 1961 under the head "Profits & Gains of Business". These rules prescribe the method of computation in the case of manufacture of rubber, coffee and tea. In such cases, the income which is brought to tax as "business income" is a prescribed fixed percentage of the composite income.

The Hon'ble Supreme Court in the case of C1T *vs*. Doom Dooma India Ltd 222 CTR 105 (SC) has held that in view of the language employed in sub-clause (b) of clause (6) of section 43 regarding depreciation "actually allowed", where any income is partially agricultural and partially chargeable to tax under the Income-tax Act, 1961 under the head "Profits & Gains of Business", the depreciation deducted in arriving at the taxable income alone can be taken into account for computing the WDV in the subsequent year.

For instance, Rule 8 prescribes the taxability of income from the manufacture of tea. Under the said rule, income derived from the sale of tea grown and manufactured by seller shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax. As a result of the Court decision, the resultant computation of depreciation is as per the following :

Illustration 19 :

	₹
Sale proceeds of tea	5,000
Less: Expenses:	
Depreciation - (10% of ₹ 5,000)	(500)
Others expenses	(1,500)
Composite income	3,000
Income subject to charge under the Income-tax Act, 1961 by application of rule 8 (40% of 3,000)	1,200
Income not chargeable to income-tax (60% of 3,000)	1,800

According to the interpretation of the Court, the W.D.V. of the fixed asset for the immediately succeeding year is to be taken at ₹ 4,800 (₹ 5,000 minus ₹ 200 being depreciation allocated for business income) and not ₹ 4,500 (₹ 5,000 minus depreciation of ₹ 500 allowed for determining composite income). Thus the depreciation for which deduction is allowed to the assessee while computing its agricultural income is to be ignored for computing the W.D.V. of the asset according to the Court ruling.

The above interpretation is not in accordance with the legislative intent. WDV is required to be computed by deducting the full depreciation attributable to composite income. Hence in the above illustration, the WDV of the fixed asset for the immediately succeeding year is to be taken at ₹ 4,500 and not 4,800 as held by the Supreme Court. The ambiguity in this case has arisen on account of the interpretation of the meaning of the phrase "actually allowed" in sub-clause (b) of clause (6) of section 43.

Therefore Explanation 7 has been inserted in section 43(6) to provide that where the income of an assessee is derived, in part from agriculture and in part from business chargeable to income-tax under the head "Profits and gains of business or profession", for computing the written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire income is derived from the business of the assessee under the head "Profits and gains of business or profession" and the depreciation so computed shall be deemed to be the depreciation actually allowed under this Act.

MONEYS PAYABLE [EXPLANATION TO SEC. 41]

Moneys payable in respect of any building, machinery, plant and furniture includes

(a) any insurance, salvage or compensation moneys payable in respect thereof;

(b) where the building, machinery plant or furniture is sold, the price for which it is sold.

DEPRECIATION MANDATORY

Explanation 5 to Sec. 32 inserted by the Finance Act, 2001 w.e.f. 1.4.2002, it is clarified that the depreciation provisions shall apply, whether or not the assessee has claimed the deduction in respect of depreciation in computing his total income.

ADDITIONAL DEPRECIATION :

Sec. 32(1)(iia) has been inserted by the Finance Act, 2002 w.e.f. from Assessment Year 2003-04 to provide additional depreciation @20% of the actual cost of new machinery and plant (other than ships and air craft) which has been acquired and installed after the 31.3.2002 by an assessee engaged in the business of manufacture or production of any article or thing provided that such further deduction of 20% shall be allowed to :

(i) a new industrial undertaking during any Previous Year in which such undertaking begins to manufacture or produce any article or thing on or after 1.4.2002. or

(ii) any industrial undertaking existing before the 1.4.2002, during any Previous Year in which it achieves the substantial expansion by way of increase in installed capacity by not less than 25% provided further that no deduction shall be allowed in respect of :

    (a) any machinery or plant which, before its installation by the assessee was used either within or outside India by any other person; or

    (b) any machinery or plant installed in office premises for any residential accommodation including accommodation in the nature of a guest house; or

    (c) any office appliances or road transport vehicles; or

    (d) any machinery or plant, the whole of the actual cost which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of Business or Profession" of any one Previous Year.

Additional depreciation as per section 32(1)(iia) is available on furnishing the details of machinery or plant and increase in the installed capacity of production in the prescribed form along with the returned income and the report of an accountant as defined in the explanation below subsection (2) of section 288 certify that the deduction has been correctly cleaned in accordance with the provisions of this clause.

Illustration 20 : The WDV of plant and machinery on 1.4.2010 of Z Ltd. engaged in manufacturing of PVC granules is ₹ 2000 lacs. Company purchased additional plant and machinery for ₹ 1,600 lacs on 18.4.2010 inclusive of second-hand machine imported from Ireland of ₹ 400 lacs to increase its installed capacity of production from 1000 TPA to 1500 TPA. The production from new machine commenced w.e.f 1.12.2010. Work out by giving reasons the amount of allowable depreciation.

Assessee : Z Ltd. **Previous Year : 2010-11** **Assessment Year : 2011-12**

Computation of Depreciation

Particulars		**Lakhs**	
		₹	₹
	Opening WDV		2,000
Add :	Additions During the year		1,600
	Net Value for the purpose of Depreciation		3,600
Less :	**Depreciation of the Year**		
—	On Opening Block – ₹ 2,000 Lakhs × 15%	300	
—	On Additions (Period of usage less than 180 days) — ₹ 1,600 lakhs × 15% × 50%	120	
—	Additional Depreciation on Eligible Assets (Notes)	120	540
	Closing WDV		**3,060**

Notes :

1. Second hand machinery imported from China is not an eligible asset for the purpose of Additional Depreciation computation. Therefore, cost of eligible assets = ₹ 1,600 lakhs – ₹ 400 lakhs = ₹ 1,200 lakhs.
2. Period of usage of new machine is less than 180 days. Therefore, they are entitled to only 50% of additional depreciation rate of 20%.

DEPRECIATION AT REDUCED RATE

Where an asset referred in clause (i) or clause (iii) as the case may be, is acquired by the assessee during the Previous Year and is put to use for the purposes of Business or Profession for less than 180 days in that Previous Year, the depreciation allowable in respect of such asset shall be restricted to 50% of the normal rate.

Illustration 21 : Depreciation at Reduced Rate

W.D.V. of Machinery (Rate of Depreciation @15%) = ₹ 5,00,000

New Machinery Purchased (on 31.12.10) = ₹ 1,00,000, having same rate of depreciation.

Calculate : Depreciation u/s 32

Block A : Machinery

(Rate of Depreciation = 15%)

W.D.V. of the Machinery		5,00,000
Add :	Cost of New Asset Purchased (relating to the Block) [Put to Use > 180 Days]	Nil
Less :	Government Subsidy Received for Purchase/Acquisition Asset	Nil
Less :	Adjustment for CENVAT Credit	Nil
Less :	Sale of Asset from the Block	Nil
	W.D.V for Charging Depreciation	5,00,000
Less :	Depreciation @ 15%	75,000
	Closing WDV	**4,25,000**

Block B : Machinery

(Rate of Depreciation = 7.5% of 15%, since Acquired & Put to Use for less than 180 Days)

	Cost	1,00,000
Less :	Depreciation @ 7.5%	7,500
	Closing WDV	**92,500**

Total Depreciation u/s 32 = 75,000

7,500

82,500

TERMINAL DEPRECIATION [Sec. 32(1)(iii)]

Terminal Depreciation (i.e. Loss on Transfer) & Balancing Charge (i.e. Gain on Transfer)

(a) Applicable for any undertaking engaged in generation or generation and distribution of power;

(b) It must be a depreciable asset, on which depreciation is claimed on straight line basis;

(c) Such depreciable asset, is sold, discarded, demolished or destroyed in a previous year

If there arises:

(i) Loss on Sale = Terminal Depreciation;

(ii) Gain on Sale= Balancing Charge.

Calculation of Terminal Depreciation:

1. Calculate Written Down Value of the depreciable asset on the first day of the previous year in which such asset is sold, discarded, demolished or destroyed.
2. Ascertain Net Sale Consideration.

If value as per (1) > value as per (2) = Loss= Terminal Depreciation

Notes:

(i) Sale Consideration is money payable to the tax payer in respect of such depreciable asset (+) Scrap Value, if any

(ii) Net Sale Consideration = Sale Consideration (-) Expenses on Transfer;

(iii) Sale consideration is the actual money, received or receivable in cash or by cheque or draft;

(iv) It excludes any other thing or benefit which can be measured and converted in terms of money;

(v) If the asset is sold or discarded, etc, in the previous year in which it is first put to use, any loss on transfer of that asset shall be treated as capital loss and not as terminal depreciation;

(vi) The asset must be used by the assessee for the purpose of business or profession, at least for some considerable time period during the previous year, in which the transfer/sale takes place;

(vii) Terminal depreciation can only be allowed, if the asset is completely written off from the books of accounts.

Balancing Charge u/s 41(2) and Capital Gain u/s 50A:

If value as per (2) > value as per (1) = Gain = Balancing Charge

NC > WDV = Balancing Charge

NC > OC
= Capital Gain

OC < WDV
= Balancing Charge

Where,

NC = Net Sale Consideration

OC = Original Cost

WDV = Written Down Value

Illustration 22 :

Kalpataru power Projects is a power generating unit. On 1.4.2008, it purchased a plant of ₹ 50,00,000, eligible for depreciation @15% on SLM. Compute balancing charge or terminal deprecation assuming the plant is sold on 21.4.2010 for : (a) ₹ 8,50,000 (b) ₹ 32,00,000 (c) ₹ 45,00,000 (d) ₹ 52,00,000

Solution :

Computation of Terminal depreciation or balancing charge, capital gain.

Particulars	A	B	C	D
W.D.V. as on 1.4.2010	35,00,000	35,00,000	35,00,000	35,00,000
Less: Sale Proceeds	8,50,000	32,00,000	45,00,000	52,00,000
Balance	26,50,000	30,00,000	(10,00,000)	(17,00,000)
Terminal depreciation	26,50,000	3,00,000	NIL	NIL
Balancing charge	NIL	NIL	10,00,000	15,00,000
Short term capital Gain	NIL	NIL	NIL	2,00,000
Computation of Depreciation:				
Original cost	50,00,000			
Less: Depreciation	7,50,000			
WDV as on 1.4.2009	42,50,000			
Less: Depreciation for the year 2009-2010	7,50,000			
WDV as on 1.4.2010	35,00,000			

SECTION 43(1) — ACTUAL COST

Actual Cost [Sec. 43 (1)] for the purpose of determination of Depreciation

Explanation	Nature of Acquisition	Actual Cost
1	Assets used in scientific research subsequently put into use for the business	NIL
2	Asset received under gift, will or inheritance	WDV to the previous owner
3	Acquisition of asset to claim depreciation on enhanced cost to reduce tax liability	Cost as determined by the Assessing Officer with the prior approval of Joint Commissioner of Income Tax
4	Transfer and re-acquisition of the same asset	Least of the followings: (i) WDV at the time of original transfer (ii) Re-purchase price
4A	Sale and Lease Back	WDV to the transferor
5	Building previously used for private purpose	Cost of Acquisition or construction *Less* : Deemed Depreciation Deemed depreciation refers to the total depreciation that would have been allowable had the building been used for business purpose since its acquisition
	Succession of business	WDV to the previous owner

6	Transfer by Parent company to its wholly owned Indian subsidiary company	WDV to Parent company
	Transfer by wholly owned Indian subsidiary company to its Indian Parent company	WDV to Indian Subsidiary company
7	Amalgamation (amalgamated company must be an Indian company)"	WDV to the amalgamating company
7A	Demerger : In the hands of the Demerged Company after demerger	WDV of Demerged Co. before Demerger *Less* : WDV of assets transferred to Resulting Co.
7A	Demerger: In the hands of the Resulting Company	WDV to Demerged Company
8,9,10	Asset acquired by the Assessee	Cost of Acquisition *Add* : (i) Interest on loan for the period upto the date of usage of the asset (ii) Freight & Insurance (iii) Loading, Unloading Charges (iv) Installation Charges *Less* : (i) Government Subsidy or Grant received related to purchase of asset (ii) CENVAT credit
11	Assets brought into India by a Non-resident	Actual cost of Acquisiton *Less* : Notional depreciation for the period such asset was held outside India
12	Asset acquired by a company under a scheme of Corporatisation of Recognized Stock Exchange	Actual Cost as if there is no such corporatization.

Notes:

The followings are to be considered for determination of Actual Cost

(i) Actual cost refers to the cost of the asset to the assessee;

(ii) Interest on loan after commencement of commercial production should not be included in the Actual cost;

(iii) Trial Run expenses should be included in Actual Cost, after adjusting any income derived during the trial run period;

(iv) All expenses directly attributable (e.g. salaries, guest house for staff engaged in installation activities , travelling expenses incurred) to setting up of plant and machinery, will be included;

(v) Loss arising out of exchange rate differences, should be included in Actual Cost;

(vi) Subsidy received from Government for units in backward areas should not be adjusted against actual cost of project, for computing depreciation;

(vii) Cost of land shall not be considered for claiming depreciation;

(viii) Interest receipts and Hire charges received from Contractors should be reduced from Actual Cost;

(ix) Conversion cost incurred for transforming an asset shall be included in actual cost;

(x) Interest earned on deposits made to open Letter of Credit for purchase of any asset will be adjusted to reduce actual cost.

Illustration 23 :

X Ltd. acquired a printing machine for ₹ 25,00,000. Transport Cost, including loading and unloading charges ₹ 35,000. Expenses incurred during the trial run period ₹ 2,00,000. Output generated during trial run period was sold for ₹ 90,000. Depreciation @ 15% . Compute WDV. Would your answer differ if the output generated during trial run period was ₹ 3,00,000.

Assessee : X Ltd

Previous Year : 2010-11

Computation of Depreciation

Particulars	Amount (₹)	Amount (₹)
Expenses incurred during trial run period	2,00,000	2,00,000
Less : Income from sale of output generated during trial run period	(90,000)	(3,00,000)
Net Cost / Gain	1,10,000	(1,00,000)
Actual Cost of the Machine	25,35,000	25,35,000
Add : Net Cost during trial run	1,10,000	—
Less : Net Gain during trial run		(1,00,000)
Actual Cost of Machine for charging depreciation	26,45,000	24,25,000
Less : Depreciation @ 15%	3,96,750	3,63,750
Written Down Value (W.D.V.)	22,48,250	20,61,250

Illustration 24 :

Z Ltd. purchased machinery (rate of depreciation 15%) from Japan for US$ 2,50,000 on 17. 08.2009 (US $ = 43.25) by borrowing from Hero Bank Ltd. Z Ltd. took a forward contract on 11.07.2009, when the exchange rate was ₹ 45.70 per US$. This was put to use from 23.11.2009. Compute Depreciation for the previous years 2009-10 and 2010-11.

Assessee: Z Ltd

Previous Year: 2009-10 & 2010-11

Computation of Depreciation and Written Down Value

Particulars	Amount (₹)
Cost of the Asset (US$ 2,50,000 × ₹ 43.25)	1,08,12,500
Less : Depreciation @ 50% of 15% (since Put to Use < 180 days) for previous year 2009-10 (₹ 1,08,12,500 × 50% × 15%)	(8,10,938)
WDV as on 01.04.2010	1,00,01,562
Add : Exchange Rate Difference [US$ 2,50,000 × ₹ (45.70 – 43.25)]	6,12,500
WDV for claiming depreciation	1,06,14,062
Less : Depreciation @ 15% for the previous year 2010-11 (₹ 1,06,14,062 × 15%)	15,92,109
WDV as on 01.04.2011	90,21,953

Illustration 25 :

Pharma Ltd. imported machinery from Germany on 27.8.10 at a cost of ₹ 40 crores. Customs Duty paid @ 20%. Government granted subsidy of ₹ 25 crores. The entire logisitics was supported by Nexgen Courier Ltd., an Indian Company. Total Service charges paid to them ₹20 lacs including service tax of ₹ 2,20,000.

Compute Actual Cost, if assessee, avail CENVAT credit adjustment.

Assessee : Pharma Ltd **Previous Year : 2010-11**

Computation of Depreciation and Written Down Value

Particulars	**Amount** (₹ crores)
Cost of Purchase	40.00
Add: Customs Duty @ 20% on ₹ 40 crores	8.00
Less: Government subsidy granted	25.00
Less: CENVAT Credit (Service Tax paid included in the payment made to Nexgen Courier Ltd.)	0.22
Actual Cost for the purpose of charging depreciation	22.78

Illustration 26 :

ZED Ltd. imported machinery from South Korea on 12.5.2010 for US$ 50,000. Exchange rate on that date : US$ = ₹ 44. 70. Customs Duty paid @ 20%. Government granted subsidy of ₹ 15,00,000. The assessee had a forward contract on 2.4.2010 at US$ 45.30. Logistics services was provided by Carrywell Courier Ltd. Service Charges paid ₹ 2,00,000 including service tax of ₹ 25,000. Engineers and labourers were engaged at site for installation of the machinery. Salary and wages paid for site engineers and labourers including their travelling expenses amounted to ₹ 4,60,000. Expenses incurred during trial run period ₹ 1,50,000. Sale of output produced during trial run period ₹ 90,000. Interest earned on deposits made to open Letter of Credit for purchase of this machinery ₹ 15,000 . The machine was put to use from 05.10.10. Depreciation @ 15%. Compute Actual Cost and Written Down Value.

Assessee: ZED Ltd. **Previous Year: 2010-11**

Computation of Actual Cost and Written Down Value

Particulars	**Amount** (₹ crores)
Cost of the Asset (US$ 50,000 × ₹ 44.70)	22,35,000
Add : Customs Duty paid @ 20% on ₹ 22,35,000	4,47,000
Less : Government Subsidy granted	(15,00,000)
Add : Exchange Rate Difference [US$ 50,000 × ₹ (45.30 - 44.70)]	30,000
Add : Transportation charges paid ₹ 2,00,000 (including Service Tax ₹ 25,000)	2,00,000
Less : CENVAT credit adjustment (credit for Service tax included in service charges paid to Carrywell Courier Ltd.)	(25,000)
Add : Installation expenses incurred for payment of site engineers & labourers including travelling expenses	4,60,000
Add : Expenses incurred during trial run period	1,50,000
Less : Sale of output generated during trial run period	(90,000)
Less : Interest earned on deposits made to open Letter of Credit for purchase of this machinery	(15,000)
Actual Cost for the purpose of determining depreciation	18,92,000
Less : Depreciation @ 50% of 15% (since Put to Use < 180 days) for previous year 2010-11 (₹ 18,92,000 × 50% x 15%)	1,41,900
WDV as on 01.04.2011	17,50,100

PROPORTIONATE DEPRECIATION

In the following cases, depreciation is allowed on proportionate basis where in any Previous Year, there is :-

(a) Succession of a partnership firm by a company [u/s. 47(xiii)] or
(b) Succession of a proprietary concern by a company [u/s. 47(xiv)]
(c) Succession of any business other than on death [u/s. 170] or
(d) Amalgamation of company [u/s. 2(1B)] or
(e) Demerger of any company [u/s. 2(19AA)]

Illustration 27 :

A Bros., a sole-proprietorship concern, was converted into a A Ltd. on 20.9.2010. Before the conversion, the concern had a block of furniture (rate of depreciation @ 10%), whose WDV as on 01.04.2010 was ₹ 6,50,000. On 01.05.2010, a new furniture of the same block was purchased for ₹ 50,000. A Ltd. purchased another furniture of the same type on 20.12.2010 for ₹ 48,000. Compute depreciation that would be claimed by A Bros. and A Ltd for the previous year 2010-11.

Solution :

(1) Depreciation shall have to be calculated at the prescribed rates, as is applicable for a going concern, without considering the event of amalgamation or demerger.

(2) Depreciation shall have to be apportioned between the predecessor and the successor in the ratio of number of days for which such assets were held for their business purpose and used by them.

Depreciation to be apportioned = [W.D.V. as on 1.4.2010 + New Purchases on 01.05.2010]
= ₹ (6,50,000 + 50,000) = ₹ 7,00,000 × 10% = ₹ 70,000

Apportionment of Depreciation and Allowable Depreciation

Assessee	No. of Days	Depreciation on Assets on the date of succession	Depreciation on Assets acquired after Succession	Total Depreciation for the Previous Year 2010-11
A Bros. (Sole-Proprietorship concern)	01.04.2010 to 30.9.2010 = 173 days	₹ 70,000 × 173/365 = ₹ 33,178	Nil	₹ 33,178
A Ltd. (Company)	21.09.2010 to 31.3.2011	₹ 70,000 × 192 × 365 ₹ 36,822	₹ 48,000 × 50% × 10% = ₹ 2,400 (Put to use < 180 days)	₹ 39,222

Illustration 28 :

P Ltd. was taken over by Q Ltd. with effect from 31.7.2010. This satisfies the conditions of Sec. 2(1B) of the Income Tax Act, 1961. From the following information, compute deductions admissible u/s 32 to P Ltd and Q Ltd. for the previous year 2010-11.

Assets	Rate of Depreciation	WDV in the hands of P Ltd (as on 01.04.2010)	Transfer Value to Q Ltd. (₹)
Building	10%	30,00,000	45,00,000
Plant & Machinery	15%	20,00,000	15,00,000
Motor Car	15%	8,00,000	6,00,000
Computers	60%	5,00,000	2,00,000
Furniture	10%	3,00,000	1,40,000

Solution :

(1) Depreciation shall have to be calculated at the prescribed rates, as is applicable for a going concern, without considering the event of amalgamation or demerger.

(2) Depreciation shall have to be apportioned between the predecessor and the successor in the ratio of number of days for which such assets were held for their business purpose and used by them.

Depreciation to be apportioned = [W.D.V. as on 1.4.2010 + New Purchases on 01.05.2010]

= ₹ (6,50,000 + 50,000) = ₹ 7,00,000 × 10% = ₹ 70,000

Depreciation Statement as per Income Tax Act, 1961

Particulars of Block of Assets	Rate Of Dept.	W.D.V as on 01.04.2010	Additional Actual Cost	Debenture	Net Value of Block	Depreciation for the Current Year	W.D.V. as on 31.3.2011
1	**2**	**3**	**4**	**5**	**6**	**7**	
Block I – Building	10%	30,00,000	**Nil**	**Nil**	30,00,000	**3,00,000**	**27,00,000**
Block – II Plant & Machinery	15%	20,00,000	**Nil**	**Nil**	20,00,000	**3,00,000**	**17,00,000**
Block – III Motor Car	15%	8,00,000	**Nil**	**Nil**	8,00,000	**1,20,000**	**6,80,000**
Block – IV Computers	60%	5,00,000	**Nil**	**Nil**	5,00,000	**3,00,000**	**2,00,000**
Block – V Furniture	10%	3,00,000	**Nil**	**Nil**	3,00,000	**30,000**	**2,70,000**
		56,00,000			**56,00,000**	**10,50,000**	**45,50,000**

TOTAL DEPRECIATION ADMISSIBLE ₹ 10,50,000

Apportionment of Depreciation and Allowable Depreciation

Assessee	No. of Days	Depreciation on Assets on the date of amalgamation	Depreciation on Assets acquired after amalgamation	Total Depreciation for the Previous Year 2010-11
P Ltd.	01.04.2010 to 31.7.2010 = 122 days	₹ 10,50,000 × 173/365 = ₹ 4,97,671	Nil	₹ 4,97,671
Q Ltd.	01.08.2010 to 31.3.2011 = 243 days	₹ 10,50,000 × 243 × 365 = ₹ 6,99,041	Nil	₹ 6,99,041

Illustration 29 :

Mr. Hari purchased a house property on 18.11.2006 for ₹15,00,000. Till 1.7.2010, the same was self-occupied for own residence. Thereafter, the said building was brought into use for the purpose of his profession. Determine the amount of depreciable admissible for the Assessment Year 2011-12, given rate of depreciation @ 10%.

Solution :

(a) Property acquired by the assessee himself: As per Sec. 43(1), if a building/asset used for private purpose of the assessee is subsequently put to use for the purpose of business, the cost of acquisition shall be determined in the following manner:

Assessee: Mr. Hari **Previous Year: 2010-11** **Assessment Year: 2011-12**

	₹
Cost of acquisition of Residential House Property as on 18.11.2006	15,00,000
Less: Deemed depreciation for the Financial year 2006-07 @ 50% of 10% on ₹ 15,00,000 (since period of usage is less than 180 days)	75,000
WDV as on 01.04.2007	14,25,000
Less: Deemed Depreciation for Financial year 2007-08 @ 10% on ₹14,25,000	1,42,500
WDV as on 01.04.2008	12,82,500
Less: Deemed Depreciation for Financial year 2008-09 @ 10% on ₹12,82,500	1,28,250
WDV as on 01.04.2009	11,54,250
Less: Deemed Depreciation for Financial year 2009-10 @ 10% on ₹11,54,250	1,15,425
WDV as on 01.04.2010 = Actual cost for the purpose of charging depreciation	10,38,825
Less: Deemed Depreciation for Financial year 2010-11 @ 10% on ₹10,38,825	1,03,883
WDV as on 01.04.2011	9,34,942

Additional Depreciation :

Applicable	For assesses engaged in the business of manufacture or production of any article or thing
Assets eligible for additional depreciation	Any new plant or machinery acquired and installed after 31.3.2005
Assets not eligible for additional depreciation	(a) Ships and aircrafts; (b) Any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person, or (c) Any machinery or plant installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house, or (d) Any office appliance or road transport vehicle, or (e) Any machinery or plant, the whole of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head " profits and gains from business or profession" of any previous year
Rate of Additional Depreciation	20% of the Actual Cost of Plant or Machinery
Adjusted rate of additional depreciation	If the newly acquired asset is "put to use" for a period of less than 180 days during the previous year, in which it is acquired, the rate of additional depreciation shall be provided at 50% of the normal rate = 50% × 20% = 10%

ASSET IS PARTLY USED FOR BUSINESS, PARTLY FOR PERSONAL PURPOSES [Sec. 38(2)]

If any asset is partly used for business and partly for personal purposes, depreciation u/s. 32(1)(ii) shall be restricted to a fair proportionate part thereof which the Assessing Officer may determine having regard to the user of such assets (building, machinery, plant or furniture) for the purposed of business or profession.

UNABSORBED DEPRECIATION [Sec. 32(2)]

Unabsorbed depreciation shall be treated as part of the current year depreciation such unabsorbed depreciation can be set off not only against income under "Profits and gains of Business or Profession" but also against income under any other head. Unabsorbed depreciation can be carried forward indefinitely and the business need not be continued in order to get the benefit of carry forward of unabsorbed depreciation.

INVESTMENT ALLOWANCE [Sec.32A]

In respect of a ship or an aircraft or machinery or plant specified in sub-section (2), which is owned by the assessee and is wholly used for the purposes of the business carried on by him, there shall, in accordance with and subject to the provisions of this section, be allowed a deduction, in respect of the previous year in which the ship or aircraft was acquired or the machinery or plant was installed or, if the ship, aircraft, machinery or plant is first put to use in the immediately succeeding previous year, then, in respect of that previous year, of a sum by way of investment allowance equal to twenty-five per cent of the actual cost of the ship, aircraft, machinery or plant to the assessee.

TEA/COFFEE/RUBBER DEVELOPMENT ACCOUNT [Sec. 33AB]

Sec.33AB Tea Development Account

Illustration 30 :

X Ltd., is a company engaged in the business of growing, manufacturing and selling of tea.

For the accounting year ended 31st March, 2010, its composite business profits, before an adjustment under section 33AB of the Income-tax Act, were ₹60 lakhs. In the year, it deposited ₹ 25 lakhs with NABARD.

The company has a business loss of ₹10 lakhs brought forward from the previous year.

The company withdrew in February, 2010 ₹20 lakhs from the deposit account to buy a non-depreciable asset for ₹18 lakhs and could not use the balance before the end of the accounting year. The withdrawal and the purchase were under a scheme approved by the Tea Board.

The non-depreciable asset was sold in November, 2010 for ₹29 lakhs.

Indicate clearly the tax consequences of the above transactions and the total income for the relevant years.

Computation of Total Income of X Ltd. for A.Y. 2011-12

Particulars	₹
Net profits before adjusting deduction u/s 33AB	60,00,000
Less: Deduction u/s 33AB	24,00,000
[Lower of	
(i) 40% of ₹60 lakhs = ₹24 lakhs; or	
(ii) actual amount deposited with NABARD = ₹25 lakhs	
Profiits after adjusting deduction u/s 33AB	36,00,000
As per Rule 8 of Income-tax Rules, 40% of this sum is subject to income-tax and the balance 60% is treated as agricultural income.	
Hence, the business income is 40% of ₹36 lakhs	14,40,000
Add: Non-utilisation of amount withdrawn:	
₹ 2 lakhs [i.e. (₹20 lakhs – ₹18 lakhs)]	
40% is taxable as business income (the balance 60% is treated as agricultural income).	80,000
Business income	15,20,000
Less: Business loss brought forward from the previous year	10,00,000
Total income	**5,20,000**

Computation of total income of X Ltd. for A.Y.2011-12

Particulars	₹
Business income **(See Note 2)**	7,20,000
Capital gains (Short-term) **(See Note 1)**	11,00,000
Total Income	**18,20,000**

Note 1 - Computation of capital gains

Particulars	₹
Sale proceeds	29,00,000
Less: Cost of acquisition	18,00,000
Short term capital gains (since the period of holding is less than 36 months)	**11,00,000**

Note 2 -Computation of business income Since the asset is sold within 8 years, the cost of the asset i.e. ₹ 18 lakhs should be treated as income since the same has been allowed as deduction in the assessment year 2010-11.

However, out of this ₹18 lakhs, 60% would be agricultural income and the balance 40% i.e. ₹7.2 lakhs would be business income of P.Y.2010-11. This is because deduction under section 33AB was allowed in P.Y. 2010-11, before disintegration of income into agricultural income and non-agricultural income.

The assessment must satisfy the following conditions :

(i) The assessee must be engaged in the business of tea, coffee or rubber plantation in India

(ii) The amount must be deposited in a "Special Account".

(iii) The deposit should be made within the specified time limit.

(iv) The accounts should be duly audited.

Amount of Deduction :

Least of the followings :

(i) Amount Deposited

(ii) 40% of the Profit of the Business before any adjustment u/s 33AB & Sec. 72.

SITE RESTORATION FUND [Sec. 33ABA]

The amount deposited in site restoration fund including interest thereon or 20% of profits, whichever is less, in case of an assessee carrying on business of prospecting for, or extraction or production of, petroleum or prospecting for, or extraction or production of, petroleum or natural gas or both in India. The accounts are required to be audited and furnish of such report in form 3AD is necessary to avail the deduction.

EXPENDITURE ON SCIENTIFIC RESEARCH [Sec. 35]

"Scientific Research" means any activities for the extension of knowledge in the filed of natural or applied sciences including agriculture, animal husbandry and fisheries. [Sec. 43(4)]

35(1) (i) Revenue Expenditure related to the business —		
incurred for	– Current year	100%
own business	– Prior Period	100% upto 3 years prior to commencement

35(1) (ii)	Any sum paid to approved scientific Research Association or University or College or Institution	For undertaking Scientific research	125% of amount paid
35(1) (iia)	Any sum paid for scientific research, to a company, registered in India, having an object to carry out scientific research and development activities	For undertaking Scientific research	125% of amount paid
35(1) (iii)	Any sum paid to an approved University, College or other Institution	For research in social Science or statistical research	125% of amount paid
35 (2)	Capital expenditure incurred for own business (excluding cost of land)	related to the business Current year Prior Period	100% reduction 100% upto 3 years prior to commencement
35(2AA)	Any sum paid to National Laboratory or University or IIT or a specified person	For undertaking a programme approved by the prescribed autority	125% of amount paid
35(2AB)	In house research and development or Bio-technology in the busines of manufactuer or production of any article or thing, not being an article or thing specified in list of Eleventh Schedule	Bio-technology or in-house research	150% of expense incurred

AMORTISATION OF TELECOM LICENCE FEES [Sec. 35ABB]

Amortization of Telecom Licence Fees [Sec 35ABB]

Expenditure incurred for obtaining licence to operate telecommunication services shall be allowed for deduction/ amortization, if the following conditions are satisfied:

(i) Expenditure should be capital in nature;

(ii) Expenditure should have been incurred for purpose of acquiring any right to operate telecommunication services;

(iii) Payment should have been actually made to obtain a licence;

(iv) Expenditure may be incurred either before commencement of business or at any time during the previous year.

Mode of calculating deduction :

(i) If licence fees is actually paid before commencement of business

= Licence fees actually paid before commencement of business

No. of years from the previous year of commencement of business to the previous year in which licence expires

(ii) If licence fees is paid after commencement of business

= Licence fees actually paid after commencement of business

No. of years from the previous year in which licence fee actually paid to the previous year in which licence expires

In case of transfer :

(a) Calculate Unallowed amount = Actual cost of licence fee paid less amount of deduction already claimed u/s 35ABB

(b) For consideration received on transfer:

(i) If whole licence is transferred and net consideration is less than "Unallowed amount"

Business Expenditure = Unallowed amount less Net consideration

(ii) Where part of licence is transferred and net consideration is less than "Unallowed amount"

$$\text{Amount of deduction} = \frac{\text{Unallowed amount less Net consideration}}{\text{Remaining period of licence}}$$

(iii) Where whole or part of licence is transferred and net consideration is more than "Unallowed amount"

Net consideration **more** than Unallowed amount but **less** than Original Cost of licence	Business Income = Net Consideration less Unallowed amount
Net Consideration is **more** than Original Cost of licence and Un allowed amount	Business Income = Original cost of licence less Unallowed amount Capital Gain = Net Consideration less Original Cost of licence

The following table would explain the various situations

	A	B	C	D
Transfer of licence	**Full**	**In Part**	**Full**	**In part**
Licence period (years)	7	7	7	7
Acquisition cost	140	140	140	140
Deduction claimed so far (4 years)	80	80	80	80
Unamortised value	60	60	60	60
Sale price – current year	140	45	50	30
Amount remaining to be amortised		15		30
Amount deductible U/s.35ABB(3)			10	
Amount chargeable to tax as business income	80			
Amount to be amortised in remaining 3 years		5		10

Illustration 31 :

Free Call Ltd. obtained a telecom licence on 15.6.07 for a period of 8 years ending on 31.3.2015 against a fee of ₹30 crores to be paid in four instalments of ₹12 crores, ₹7 crores, ₹6 crores, ₹5 crores by June 2008, June 2009, June 2010 and June 2011 respectively. Explain how the payment for licence fee shall be dealt under the Income Tax Act, 1961.

Solution :

Assessee : Free Call Ltd. **Previous Year 2010-11** **Assessment Year: 2011-12**

(a) U/s 35ABB, expenditure incurred for the purpose ofacquiring any right to operate telecommunication services is allowed equally as deduction throughout the unexpired life of the licence. Deduction shall be allowed **only for the actual payment made.**

(b) If only part payment is made, amortization is based on the amount paid and not on the basis of total consideration. For any further payments, deduction/amortization is allowed equally for the remaining unexpired useful life.

(c) Computation of amount of eligible deduction u/s 35 ABB:

Previous year	Amount paid (₹ Crores)	Unexpired Period of Licence on the date of actual payment	Amount of Deduction (₹ Crores)
2007-08	12.00	8 years	1.50
2008-09	7.00	7 years	[1.50 + (7.00/7)] = 2.50
2009-10	6.00	6 years	[2.50 + (6.00/6)] = 3.50
2010-11	5.00	5 years	[3.50 + (5.00/5)] = 4.50

Illustration 32 :

Hello International Ltd. incurs an expenditure of ₹ 240 crores for acquiring the right to operate telecommunication services for Assam & Sikkim. The payment was made in November 2009 and the licence to operate the services was valid for 15 years. In December 2010, the company transfers part of the licence, in respect of Assam, to Hi International Ltd. for a sum of ₹56 crores and continue to operate the licence in Sikkim. What is the deduction allowable u/s 35ABB to Hello International Ltd. for the Assessment Year 2011-12?

Solution :

Assessee: Hello International Ltd. **Previous Year: 2010-11** **Assessment Year : 2011-12**

(a) u/s 35ABB, where part of the Telecom Licence is transferred and Net Consideration received on such transfer, is less than the expenditure remaining unallowed, the amount of deduction shall be computed as follows :

(i)	Unallowed amount as on 01.04.2010	= Total Expenditure Less Deduction for Financial Year 2009-10 = ₹240 crores Less (₹240 crores/licence period of 15 years) = ₹240 crores less ₹16 crores = ₹224 crores.
(ii)	Net Consideration received	= ₹60 crores
(iii)	Remaining period of licence	= 14 years (including current previous year)
(iv)	Deduction u/s 35 ABB	= ₹ (224 crores less 56 crores) / 14 years= ₹12 crores.

Illustration 33 :

Jammer International Ltd. incurs an expenditure of ₹300 crores for acquiring the right to operate telecommunication services for Orissa and Jharkhand. The payment was made in August 2009 and the licence to operate the services was valid for 12 years. In December 2010, the company transfers part of the licence, in respect of Orissa to Hammer International Ltd. for a sum of ₹280 crores and continue to operate the licence in Jharkhand . What is the deduction allowable u/s 35ABB to Jammer International Ltd. for the Assessment Year 2011-12?

Solution:

Assessee: Jammer International Ltd. **Previous Year: 2010-11** **Assessment Year : 2011-12**

(a) u/s 35ABB, where part of the Telecom Licence is transferred and Net Consideration received on such transfer, is more than the expenditure remaining unallowed, the amount of deduction shall be computed as follows :

(i)	Unallowed amount as on 01.04.2010	= Total Expenditure Less Deduction for Financial Year 2009-10 = ₹300 crores Less (₹300 crores / licence period of 12 years) = ₹300 crores less ₹25 crores= ₹275 crores.
(ii)	Net Consideration received	= ₹280 crores
(iii)	Remaining period of licence	= 11 years (including current previous year)
(iv)	Deduction u/s 35 ABB	= ₹ (224 crores less 56 crores) / 14 years = ₹12 crores.

Illustration 34 : On Sec.44AF

Ms.Chitralekha, a retail trader of Kolkata furnishesthe following Trading and Profit and Loss Account for the year ending 31st March, 2011 :

Dr. **Trading and Profit and Loss Account for the year ended 31.03.2011** *Cr.*

Particulars	₹	Particulars	₹
To Opening stock	90,000	By Sales	12,11,500
To Purchases	10,04,000	By Income from UTI	2,400
To Gross Profit	3,06,000	By Other business receipts	6,100
		By Closing stock	1,80,000
	14,00,000		14,00,000
To Salary	60,000	By Gross profit b/d	3,06,000
To Rent and rates	36,000		
To Interest on loan	15,000		
To Depreciation	1,05,000		
To Printing & stationery	23,200		
To Postage & telegram	1,640		
To Loss on sale of shares (Short term)	8,100		
To Other general expenses	7,060		
To Net Profit	50,000		
	3,06,000		3,06,000

Additional Information :

(i) It was found that some stocks were omitted to be included in both the Opening and Closing Stock, the values of which were

Opening stock ₹ 9,000

Closing stock ₹ 18,000

(ii) Salary includes ₹10,000 paid to his brother, which is unreasonable to the extent of ₹2,000.

(iii) The whole amount of printing and stationery was paid in cash.

(iv) The depreciation provided in the Profit and Loss Account ₹ 1,05,000 was based on the following information :

The written down value of plant and machinery is ₹4,20,000. A new plant falling under the same Block of depreciation of 25% was bought on 1.7.2010 for ₹70,000. Two old plants were sold on 1.10.2010 for ₹ 50,000.

(v) Rent and rates includes sales tax liability of ₹3,400 paid on 7.4.2010.

(vi) Other business receipts include ₹2,200 received as refund of sales tax relating to 2008-09.

(vii) Other general expenses include ₹2,000 paid as donation to a Public Charitable Trust.

You are required to advise Ms.Chitralekha whether he can offer his business income under section 44AF i.e. presumptive taxation.

Solution:

Let us assume that the facts relate to previous year relevant to assessment year 2011-12 and accordingly compute the income of Ms.Chitralekha.

Previous Year : 2010-11 **Mr. Chitralekha** **Assessment Year : 2011-12**

Computation of Income from Business

	₹	₹
Net Profit as per profit and loss account		50,000
Add : Inadmissible expenses / losses		
Under valuation of closing stock	18,000	
Unreasonable salary paid to brother (section 40A(2)	2,000	
Printing and stationery paid in cash [Section 40A(3)] 100% of ₹23,200	43,200	
Depreciation (considered separately)	1,05,000	
Short term capital loss on shares	8,100	
Donation to public charitable trust	2,000	
		1,78,300
		2,28,300
Less : **Deductions allowable :**		
Under valuation of opening stock	9,000	
Income from UTI	2,400	
Refund of sales tax [Taxable u/s.41(1) – No adjustment necessary]	—	
		11,400
Business income before depreciation		2,16,900
Less : Depreciation (see note 1)		66,000
		1,50,900

Computation of business income as per section 44AF

As per section 44AF, the business income would be 5% of turnover

12,11,500 × 5 /100 = ₹60,575

The business income under section 44AF is **₹ 60,575.**

As the business income under section 44AF is lower than the business income as per the normal provisions of the Act, it is advisable for Mr. Sivam to offer the business income under section 44AF of the Act

Note 1

Calculation of depreciation

WDV of the block of plant & machinery as on the first day of previous year	4,20,000
Add : Cost of new plant & machinery	70,000
	4,90,000
Less : Sale proceeds of assets sold	50,000
WDV of the block of plant & machinery as on the last day of previous year	4,40,000
Depreciation @ 15%	66,000

Note : No additional depreciation is allowable as the assessee is not engaged in manufacture or production of any article.

Note 2

Since sales-tax liability has been paid before the due date of filing return of income under section 139(1), the same is deductible.

Illustration 35 :

Mukund is a person carrying on profession as film artist. His gross receipts from profession are as under :

Financial year	2008-2009	1,25,000
Financial year	2009-2010	1,60,000
Financial year	2010-2011	1,80,000

Is he required to maintain any books of account under Section 44AA of the Income-tax Act? If so, what are these books?

Answer :

Section 44AA requires every person carrying on any profession, notified by the Board of the Official Gazette (in addition to the professions already specified) to maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income-tax Act. The CBDT has notified the profession of film artists as one such profession (S.O. No.17E/12-1-77). Hence section 44AA applies to Mukund.

Sub-section (3) of section 44AA authorizes the Board to prescribe by rules, the books of account and other documents (including inventories) to be kept and maintained under sub-section (1), the particulars to be contained therein etc. The prescribed rule is Rule 6F, under which every person carrying on the specified profession, including a film artist, is required to maintain the books of account and other documents specified in sub-Rule (2).

However, under the proviso to Sub-Rule (1), nothing contained therein shall apply in the case of a person, if his gross receipts do not exceed ₹1,50,000/- in any one of the three years, immediately preceding the previous year.

The significance of this rule is that if the gross receipts from profession do not exceed ₹1,50,000 in any one of the previous 3 years, he is not required to maintain the books of account specified in sub-rule (2) of Rule 6F. Since in one of the three previous years the gross receipts are below ₹1,50,000, the assessee is not required to maintain books of account and other documents as he is not governed by section 44AA.

Illustration 36 :

Discuss the tax implications of the following transactions in the case of a doctor running a nursing home :

		₹
(1)	Amount paid to a scientific research association approved by the Central Government and run by a drug manufacturing company	20,000
(2)	Amounts received from the employees of the nursing home as contributions towards provident fund for the month of March, 2011 paid to the PF Commissioner on 25th April, 2011	25,000
(3)	Repayment made in cash towards purchases of medicines	50,000
(4)	Repayment of loan taken from a bank for doing a post-graduate course in medicine – instalment	50,000
	Interest	10,000

Answer :

(a) Under section 35(ii), 125% of the sums paid to scientific research association, which has as its object the undertaking of scientific research is deductible.

Deduction admissible = 20,000 + (1/4 × 20,000)

= ₹25,000.

(b) Under clause (x) of sub section 24 of section 2, any sum received by an assessee from his employees as contribution to any provident fund is deemed to be his income. Such income is deductible under section 36(1) (va) only if it is credited to the employees' account in the relevant fund by the due date.

Under Employees' Provident Fund Act, the due date for the payment of the contribution is the 15th of the month following the month for which the contribution is due. A grace period of 5 days is also allowed. Hence the payment of the employee's contribution for the P.F. Commissioner should have been made by 20th April. Since the payment has been made on 25th April, the deduction is not available.

(c) Under section 40A(3) payments made in cash exceeding ₹ 20,000 are not allowable in computing the income from business or profession. 20% of such expenditure is liable to be disallowed. Hence ₹ 10,000 will be disallowed. It is assumed that the case is not covered by the exceptions under Rule 6DD.

(d) Under section 80E, a deduction is admissible in the case of an individual towards any amount paid in the previous year by way of interest on loan taken from any financial institution for the purpose of pursuing his higher education. The purpose stated in the question is covered by the section. The deduction is allowable only towards payment of interest. The amount deductible under section 80-E would be ₹10,000.

EXPENDITURE ON ELIGIBLE PROJECTS/SCHEMES [Sec. 35AC]

Where an assessee incurs any expenditure by way of payment of any sum to a public sector company or a local authority or to an association or institution approved by the national committee for carrying out any eligible project or scheme it will be allowed as deduction. In order to avail the deduction under this section the assessee should furnish with return of income a certificate from the chartered accountant to that extent.

National committee can withdraw the approval granted by it to an association or institution on the ground that the project or scheme is not being carried out in accordance with all or any of the conditions subject to which approval was granted or the notification through which a project or scheme was notified after giving reasonable opportunity. The contribution or donation received by the company or authority or association or institution, as the case may be, or the deduction claimed by company in respect of any expenditure incurred directly on the eligible project or scheme, the approval for which is withdrawn by the national committee shall be deemed to be the income of the company or authority or association or institution as the case may be, of the year in which such approval or notification is withdrawn w.e.f. AY 2003-04 and shall be taxed at the maximum marginal rate of tax in force for that year.

EXPENDITURE BY WAY OF PAYMENT TO ASSOCIATION AND INSTITUTION FOR CARRYING OUT RURAL DEVELOPMENT PROGRAMME [Sec. 35CCA]

Where an assessee incurs any expenditure by way of payment of any sum- a) to an association or institution engaged in any programme of rural development, or b) to an association or institution which undertakes training of persons for implementing any programme of rural development or c) to National fund set up for rural development notified in this behalf by the Central Government or to the National urban poverty Eradication fund set up and notified by the Central Government he will be allowed a deduction of the amount of such expenditure incurred during the Previous Year.

Investment-linked tax incentive for specified business - cold chain facilities, warehousing facilities for storage of agricultural produce, and cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities [Section 35AD, 28(vii) and 73A] [W.e.f. A.Y. 2010-11]

The Income tax Act provides for a number of profit-linked exemptions/deductions. Such benefits are inefficient, inequitable, impose higher compliance and administrative burden, result in revenue loss, increase litigations and lead to competitive demand for similar tax benefits. Further, these benefits also encourage diversion of profits from the taxed sector to the exempt/untaxed sector. However, investment-linked incentives are relatively less distortionary in their impact.

AMORTISATION OF CERTAIN PRELIMINARY EXPENSES [Sec. 35D]

The deduction is allowed under this section only in case of an Indian company or a person (other than company) resident in India. The deduction is in respect of the expenditure incurred after 31.3.1970 and expenditure may be of the type which was incurred —

(i) before the commencement of the business, or

(ii) after the commencement of his business, in connection with the extension of existing industrial unit.

The following expenses shall be eligible for deduction u/s 35D(2):

(a) expenditure in connection with-
   (i) preparation of feasibility report;
   (ii) preparation of project report;
   (iii) conducting market survey or any other survey necessary for the business of the assessee;
   (iv) engineering services relating to the business of the assessee.

(b) Legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up or conduct of the business of the assessee.

(c) The following expenses in case of company assessees :
   (i) legal charges for drafting the Memorandum and Articles of Association of the company;
   (ii) on printing of the Memorandum and Articles of association;
   (iii) by way of fees for registering the company under the provision of the Companies Act, 1956;
   (iv) in connection with the issue, for public subscription, of shares in or debentures of the company being underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus.

(d) Such other item of expenditure (not being expenditure eligible for any allowance or deduction under any other provision of this Act) as may be prescribed.

Mode of Deduction :

Deduction of qualified amount is allowed in 5 equal instalements beginning with the Previous Year in which the business is commenced.

Amount of expenditure qualifying for deduction :

The aggregate amount of expenditure referred to clause (a) to (d) above shall not exceed 5% cost of project if such expenditure incurred after 1.4.1998. But in case of an Indian company, 5% of the cost of the project or 5% of the capital employed at the option of the company.

"Capital employed" means the aggregate of issued capital debentures and long term borrowings (repayable during a period of not less that 7 years) as on the last day of relevant Previous Year. The qualifying amount of preliminary expenditure is allowed as deduction over a period of 5 years in equal installments.
In case of an Indian company under amalgamation/demerger, no deduction shall be allowed to amalgamating/ demerged company for the Previous Year in which amalgamation/demerger takes place. Deduction is allowed to the amalgamated company/ resulting company in the same manner as allowable to amalgamating/demerged company. Audit of accounts is necessary for claiming deduction where accounts are not audited under any other law.

Illustration 37 :

Sleepwell Ltd. is an existing Indian Company, which sets up a new industrial unit. It incurs the following expenditure in connection with the new unit:

	₹
Preparation of project report	4,00,000
Market survey	5,00,000
Legal and other charges for issue of additional capital required for the new unit	2,00,000
Total	11,00,000
The following further data is given:	
Cost of project	30,00,000
Capital employed in the new unit	40,00,000

What is the deduction admissible to the company under section 35D for Assessment Year 2011-12?

Solution :

The deduction admissible under section 35D is one-fifth of the expenditure incurred for the project. This works out to ₹2,20,000.

However, such expenditure should not exceed the following limits as prescribed in section (3):

(a) 5% of cost of the project or

(b) 5% of the capital employed in the new industrial undertaking (being a company) — whichever is higher. In this case

(a) 5% of the project cost is ₹1,50,000 and

(b) 5% of the capital employed is ₹2,00,000.

Hence, the expenditure eligible for amortization under section 35D would be ₹ 2,00,000.

And the admissible deduction for the current assessment year is 2,00,000 × 1/5 = ₹ 40,000.

AMORTISATION OF EXPENDITURE IN CASE OF AMALGAMATION OR DEMERGER [Sec. 35DD]

Where an Indian company incurs any expenditure on or after 1.4.1999, wholly and exclusively for the purposes of amalgamation or demerger of an undertaking, the assessee company is allowed deduction in respect of such expenditure over a period of five years equally beginning with the Previous Year in which amalgamation or demerger takes place.

AMORTISATION OF EXPENDITURE INCURRED UNDER VOLUNTARY RETIREMENT SCHEME [Sec. 35DDA]

Where any expenditure is incurred by way of compensation to an employee under VRS in accordance with any scheme is allowed deduction over a period of 5 years equally from the year in which compensation is paid. W.e.f. Assessment Year 2001-02 inserted by the Finance Act, 2002 to provide that where an undertaking of an Indian company, entitled to deduction for amortisation of voluntary retirement expenses, is transferred before the expiry of the period specified to another Indian company in a scheme of amalgamation or demerger, the deduction shall continue to be available to the amalgamated company or the resulting company as if the amalgamation or demerger had not taken place.

In case of reorganisation of certain form of business where by a firm for a proprietary concern is succeeded by a company, the deduction shall continue to be available to the successor company. Deduction is not available to amalgamating company or demerged company or to the firm or proprietary concern, as the case may be, in the year of transfer.

Illustration 38 : Suppose the payment of voluntary retirement is made ot X as under :

Previous year	Amount paid (₹)
2007-08	20,00,000
2008-09	12,00,000
2009-10	14,00,000
	46,00,000

In this case the deduction of expenses incurred under voluntary retirement scheme shall be allowed as under :

Assessment year 2008-09 : ₹ 4,00,000 (1/5th of ₹ 20,00,000) and balance ₹ 16,00,000 in 4 equal instalments in the next four assessment years i.e. assessment years 2009-10 to 2012-13.

Assessment year 2009-10 : ₹ 6,40,000 i.e. ₹ 4,00,000 on account of payment made in previous year 2007-08 and ₹ 2,40,000 (1/5th of ₹ 12,00,000 paid on previous year 2008-09).

Assessment year 2010-11 : ₹ 9,20,000 i.e. ₹ 6,40,000 (₹ 4,00,000 + ₹ 2,40,000 for payment made in previous year 2007-08 and 2008-09 respectively) and ₹ 2,80,000 on account of payment made in previous year 2009-10.

Assessment year 2011-12 : ₹ 9,24,000 (₹ 4,00,000 + ₹ 2,40,000 + ₹ 2,80,000)

Assessment year 2012-13 : ₹ 9,20,000 (₹ 4,00,000 + ₹ 2,40,000 + ₹ 2,80,000)

Assessment year 2013-14 : ₹ 5,20,000 (₹ 2,40,000 + ₹ 2,80,000)

Assessment year 2014-15 : ₹ 2,80,000

Total amount allowed in various assessment years ₹ 46,00,000.

DEDUCTION FOR EXPENDITURE ON PROSPECTING Etc. FOR CERTAIN MINERALS [Sec. 35E]

Where an assessee being a Indian company or a person other than a company who is resident in India, is engaged in any operation relating to prospecting for, extraction or production of any mineral and incurs after 31.3.1970 any expenditure during the period of 5 years ending with the year of commencement of commercial production is allowed as deduction over a period of 10 years in equal installments.

Auditing of Accounts : The accounts of the assessee have got to be audited by a qualified chartered accountant and a copy of the audited report is to be sent as an accompaniment to the return of income. Companies and cooperative societies getting their accounts audited ordinarily need not get them audited specifically for this purpose.

Expenses amortised not deductible : Expenses which are included for amortisation will not be deducted while computing business profit or loss under any other section of this Act.

OTHER DEDUCTIONS [Sec. 36]

The deduction provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in Sec. 28.

INSURANCE PREMIUM FOR STOCK AND STORES [Sec. 36(1)(i)]

The amount of any insurance premium paid in respect of insurance against risk of damage or destruction of stocks or stores used for the purpose of the Business or Profession.

PREMIUM PAID BY FEDERAL MILK COOPERATIVE SOCIETY [Sec. 36(1)(ia)]

A federal milk cooperative will be allowed deduction in respect of any premium paid by it towards an insurance policy in the life of cattle owned by a member of a primary cooperative society, which is engaged in supply of milk (raised by its members) to the federal milk cooperative society.

PREMIUM FOR EMPLOYEES' HEALTH INSURANCE [Sec. 36(1)(ib)]

The amount of any premium paid by any mode of payment other than cash by the assessee as an employer to effect or to keep in force an insurance on the health of his employees under a scheme in this behalf by the General Insurance Corporation of India and approved by the Central Government.

BONUS OR COMMISSION TO EMPLOYEES [Sec. 36(1)(ii)]

Any sum paid to an employee as bonus or commission for services rendered is deductible provided it would not otherwise be payable to him as profits or dividend, before due date subject to section 43B.

INTEREST ON BORROWED CAPITAL [Sec. 36(1)(iii)]

The amount of the interest paid in respect of capital borrowed for the purposes of the business or profession subject to section 43B.

CONTRIBUTION TOWARDS RECOGNISED PROVIDENT FUND OR AN APPROVED SUPERANNUATION FUND [Sec. 36(1)(iv)]

Any sum paid by the assessee as an employer by way of contribution to a recognized provident fund or an approved superannuation fund subject to limits prescribed in this regard in S. 43B.

CONTRIBUTION TOWARDS AN APPROVED GRATUITY FUND [Sec. 36(1)(v)]

Any sum actually paid by an employer by way of contribution towards an approved gratuity fund created by him for the exclusive benefit of his employees under an irrecoverable trust subject to Sec. 43B.

CONTRIBUTIONS RECEIVED FROM EMPLOYEES TO A WELFARE OF THE EMPLOYEES [Sec. 36(1)(va)]

Deductions in respect of any sum received by the assessee a contribution from his employees towards provident fund or any other welfare fund of such employees is allowed only if such sum is credited by [the tax payer] to the employees accounts in the relevant funds on or before due date. If payment is not made within the due date such contribution should be treated as income of the assessee.

However, deduction will be allowed in respect of any such sum received as stated above only if such sum is credited by the assessee to the employee's account in relevant fund on or before the due date, i.e. the date by which the assessee is required as an employer to credit such contribution to the employee's account under the provisions of any law or term of contract of service or otherwise.

DEDUCTION IN RESPECT OF ANIMALS USED FOR BUSINESS WHICH HAVE DIED OR BECOME PERMANENTLY USELESS [Sec. 36(1)(vi)]

In respect of animals used for the purpose of Business or Profession (but not stock in trade) who have died or become permanently useless, the difference between the actual cost to the assessee of the animals and the amount, if any, realised in respect of carcasses or animals, will be allowed as a deduction.

BAD DEBTS [Sec. 36(1)(vii)]

Any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the Previous Year will be allowed as deduction if—

(i) the debt is incidental to business,

(ii) it should have been taken into account in computing income of the assessee, or it should represent money lent in the ordinary course of banking or money lending business,

(iii) it should be written off in the books of account

(iv) the business in respect of which the debt is incurred should be continued during, the Previous Year.

The successor of a business is entitled to claim deduction in respect of debt created by the predecessor CIT Vs. T. Veerabhadra Rao, K. Koteswara Rao & Co. 155 ITR 152.

PROVISION FOR BAD AND DOUBTFUL DEBTS MADE BY [Sec. 36(1)(viia)] :-

(i) Schedule bank (not incorporated outside India) or non-schedule bank or a co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank, upto

7.5% of its total income and an addition at 10% average advances made by the rural branches of such bank. Option has also been given to bank to claim deduction in respect of any provision for doubtful or loss of assets as per RBI guidelines, upto a maximum of 5% of such assets at the end of the relevant Previous Year for the AY 2000-01 to 2002-03 and upto 10% of such assets for AY 2003-04 and 2004-05.

(ii) A bank incorporated outside India upto 5% of its total income.

(iii) A Public Financial Institution on a State Financial Corporation or a state industrial investment corporation, upto 5% of its total income. Option is also given to Financial Institution/Corporation to claim deduction in respect of any provision for doubtful or loss assets as per RBI guidelines, upto a maximum of 10% of such assets at the end of the Previous Year relevant to Assessment Year 2003-04 or 2004-05.

Total income for this purpose means income computed before making any deduction under chapter VIA.

SPECIAL RESERVE CREATED AND MAINTAINED BY A FINANCIAL CORPORATION [Sec.36(1)(viii)

Deduction under this section is allowed in respect of any special reserve created and maintained by :

(a) to a financial corporation which is engaged in providing long time finance for industrial or agricultural or development in India or for development for infrastructure facility in India; or

(b) by a public company formed and registered in India with the main objective of carrying on the business of providing long time finance for construction of purchase of houses in India for residential purposes.

The deduction under this section shall be an amount transferred to reserve account or an amount not exceeding 20 % of the profits derived from such business which ever is less. If the amount of reserve is more than twice the paid up share capital and general reserve, the excess amount is not deducted.

Special deduction under section 36(1)(viii) allowed to National Housing Bank of an amount not exceeding 20% of the profits subject to creation of a reserve [Section 36(l)(1)(viii)[W.e.f. A.Y. 2010-11]

Section 36(l)(viii) provides special deduction to financial corporations and banking companies of an amount not exceeding 20% of the profits subject to creation of a reserve.

National Housing Bank (NHB) is wholly owned by Reserve Bank of India and is engaged in promotion and regulation of housing finance institutions in the country. It provides re-financing support to housing finance institutions, banks, ARDBs, RRBs, etc., for the development of housing in India. It also undertakes financing of slum projects, rural housing projects, housing projects for EWS and LIG categories, etc. NHB is also a notified financial corporation under section 4A of the Companies Act.

A view has been expressed that NHB is not entitled to the benefits of section 36(l)(v/ii) on the ground that it is not engaged in the long-term financing for construction or purchase of houses in India for residential purpose. The amendment has been made in clause (b) of Explanation to section 36(l)(v/ii) to provide that corporations engaged in providing long-term finance (including re-financing) for development of housing in India will be eligible for the benefit under section 36(l)(viii).

EXPENDITURE INCURRED BY COMPANY FOR PROMOTING FAMILY PLANNING AMONGST ITS EMPLOYEES [Sec. 36(1)(ix)]

The company assessee is entitled to claim deduction in respect of bonafide revenue expenditure incurred by it in a Previous Year for the purposes of promoting family planning amongst its employees. In case of expenditure of a capital nature, the deduction is allowed in 5 equal yearly installments commencing from the previous year in which such expenditure is incurred.

The capital expenditure under this section is governed by the same conditions as are applicable to capital expenditure for scientific research. The unabsorbed expenditure under this section can be carried forward and set off in the following years like unabsorbed depreciation allowance.

Commodities Transaction Tax not operationalised (Section 36(1)(xvi)) [W.r.e.f. A.Y. 2009-10]

The provisions for levy of Commodities Transaction Tax were introduced by Chapter VII of Finance Act, 2008. However, the levy has not yet been operationalised. In view of the recommendations of the Prime Minister's Economic Advisory Council, a new section 121A in Chapter VII of Finance Act, 2008 has been inserted to provide that the Chapter relating to levy of Commodities Transaction Tax shall not apply on or after 1-4-2009.

The Act has made it consequential amendment in clause (xvi) in sub-section (1) of section 36 of the Income-tax Act by omitting the said clause, where CTT was allowable as deduction.

GENERAL DEDUCTIONS [Sec. 37]

Any expenditure (not being expenditure of the nature described in sec. 30 to 36), and not being in the nature of capital expenditure or personal expenses of the assessee paid out or expended wholly and exclusively for the purposes of the business profession shall be allowed in computing the income chargeable under the head "Profits and gains of Business or Profession"- Sec. 37(1).

The conditions to be fulfilled for general deductions u/s. 37 are as follows—

(i) It should be in respect of a business carried on by an assessee;

(ii) It should have been paid out or expended wholly and exclusively for the purpose of the business;

(iii) It must have been incurred during the Previous Year; and

(iv) It should not be in the nature of capital expenditure or personal expenses of the assessee.

Thus expenses incurred on the occasion of Dewali or Mahurat subject to being satisfied that the expenses are not expenses of a personal, social or religious nature- allowed deduction u/s.37.

Loss through embezzlement by an employee or recurring expenses incurred on imparting basic training to apprentices under the Apprentices Act, 1961 are general deductions u/s. 37.

Any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure [Explanation to Sec. 37(1)].

ADVERTISEMENT EXPENDITURE [Sec. 37(2B)]

No allowance shall be made in respect of expenditure incurred by an assessee on advertisement in any Souvenir, Brochure, Pamphlet or the like published by a political party.

INADMISSIBLE EXPENDITURE [Sec. 40, 40A, 43B]

SECTION 40(a)

- Interest, salary, royalty, fees for beneficial services or any other sum payable outside India is not deductible unless tax is deducted at source or tax is paid.
- Income Tax and Wealth Tax are not deductible.
- Any tax paid by the employer on the perquisites not provided by way of monetary payment is not deductible in computing business income of the employer w.e.f. Assessment Year 2003-04.

DISALLOWANCE IN THE CASE OF PARTNERSHIP FIRMS (INCLUDING LIMITED LIABILITY PARTNERSHIP) [Sec. 40(b)] [w.e.f. A.Y. 2010-11]

(i) Interest to a partner by a firm is not deductible unless the following conditions are fulfilled:

1. It should be authorised by the partnership deed.
2. It should relate to a period falling after the date of the Partnership deed.
3. It should not exceed 18% p.a. (12% p.a. w.e.f. 1.6.2002) simple rate of interest.

Explanation 1 : If a person is a partner in his representative capacity in the firm and if he receives interest in his individual capacity from the firm such interest should not be disallowed.

Explanation 2 : If a person who is a partner in his individual capacity receives interest for and on behalf of some one else from the firm in which he is a partner such interest should not be disallowed.

(ii) Any amount paid by way of salary, bonus, commission or remuneration by a firm to a partner is not deductible in the computation of income of the firm unless the following conditions are fulfilled :

1. It should be authorised by partnership deed.
2. It should relate to a period falling after the date of the partnership deed.
3. It should be within the prescribed limits as follows :–

The Act has made upward revision of the existing limits of the remuneration. Further, uniform limits have been prescribed for both professional and non-professional firms for simplicity and administrative case. The revised limits are as under :

(a) On the first ₹ 3,00,000 of the book-profit or in case of a loss	₹ 1,50,000 or at the rate of 90% of the book-profit, whichever is more;
(b) On the balance of the book-profit	At the rate of 60%.

4. It should be paid to a working partner.

Explanation 3 : "Book profit" means the net profit, as shown in the profit and loss account for the relevant Previous Year, computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been debited while computing the net profit.

Explanation 4 : "Working partner" means an individual who is actively engaged in conducting the affairs of the Business or Profession of the firm of which he is a partner.

CBDT issued circular no. 739 dt. 25.3.96 stating that disallowance of salary to partners shall be made in the case of a firm if the partnership deed does not specify the amount of remuneration payable to each individual working partner or it does not lay down the manner of quantifying such remuneration.

DISALLOWANCE IN THE CASE OF ASSOCIATION OF PERSONS AND BODY OF INDIVIDUALS [Sec. 40(ba)]

Any payment by way of interest, salary, bonus, commission or remuneration paid by an association of persons or body of individuals to any of its members shall be disallowed.

Explanation 1 : If the member who received interest from the AOP or BOI also pays interest to the AOP or BOI during the same Previous Year only the net excess interest paid by the AOP to such member should be disallowed.

Explanation 2 : If a person is a member in his representative capacity in the AOP or BOI and if he received interest in his individual capacity from the AOP or BOI such interest should not be disallowed.

Explanation 3 : If a person who is a member in his individual capacity received interest for and on behalf of some one else from the AOP or BOI in which he is a member such interest should not be disallowed.

SECTION 40A(1)

Expenses or payment as provided in subsection (2), (3), (7) and (9) of Section 40A are not deductible.

SECTION 40A(2)

Where an assessee incurs any expenditure, in respect of which payment has been made or is to be made to certain specified persons and in the opinion of Assessing Officer such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made, then so much of expenditure which is considered by the Assessing Officer to be excessive or unreasonable, shall not be allowed as deduction.

Assessee	Specified persons
(i) Individual	(a) any relative (i.e., spouse, any brother, sister, lineal ascendant descendant) of such individual; (b) any person in whose business or profession the assessee (i.e. individual) himself or his relative has substantial interest.
(ii) Company, firm, AOP or HUF	(a) any director of the company, partner of the firm, or member of the association, or family, or any relative of such director, partner or member; (b) any person in whose Business or Profession the assessee or director, partner or member of the assessee or any relative of such person has a substantial interest.
(iii) All assessees	(a) any individual who has substantial interest in the Business or Profession of the assessee; (b) a company, firm, AOP or HUF having a substantial interest in Business or Profession of the assessee or any director, partner or member of any such person or any relative of any.

DISALLOWANCE OF CASH EXPENDITURE EXCEEDING ₹ 20,000 [Sec. 40A(3), RULE 6DD]

Where the assessee incurs any expenditure incurred over ₹ 20,000 otherwise than by account payee cheque drawn on a bank or account payee bank draft, 100% deduction will be disallowed in respect of such expenditure.

Enhancement of limit for disallowance of expenditure made otherwise than by an account payee cheque or account payee bank draft for plying, hiring or leasing goods carriages in the case of transporters to ₹ 35,000 from the existing limit of ₹ 20,000 (Section 40A(3) and (3A) (applicable to transactions effected on or after 1-10-2009)

Under the existing provisions of the Income-tax Act, where an assessee incurs any expenditure, in respect of which payment in excess of ₹ 20,000 is made otherwise than by an account payee cheque or account payee bank draft, such expenditure is not allowed as a deduction. Given the special circumstances of transport operators for incurring expenditure on long haul journeys for plying, hiring or leasing goods carriages, the Act has inserted proviso 2 to section 40A(3) and (3A) in order to raise the limit of payment to such transport operators otherwise than by an account payee cheque or account payee bank draft to ₹ 35,000 from the existing limit of ₹ 20,000.

The existing limit for other categories of payments will remain at ₹ 20,000 subject to the exceptions declared in Rule 6DD of the Income-tax Rules.

Exceptions under rule 6DD

(a) Payments made to banks, including cooperative bank or land mortgage bank, Life Insurance Corporation and financial institution like IDBI, UTI, Industrial Development Corporations and State Financial Corporations, primary agricultural credit society.

(b) Payments made to Government, where such payment is required to be made in legal tender e.g. payment of sales-tax, customs duty, excise duty, etc.

(c) Payments under contracts entered into before 1.4.1969.

(d) Payments made by way of any Letter of Credit, telegraphic transfer, transfer from one bank account to another, or through Bill of Exchange payable to a bank.

(e) Where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee.

(f) Payment for purchase of

- (i) agricultural or forest produce,
- (ii) the produce of animal husbandry (including hides and skins), dairy or poultry farming,
- (iii) fish or fish-products, or
- (iv) products of horticulture, or apiculture if the payment is made to the cultivator, grower or producer of such articles, produce or products.

(g) Payment made for purchase of products manufactured or processed without the aid of power in a cottage industry, if the payment is made to the producer of such products.

(h) Where the payment is made in a village or town, which is not served by any bank, to any person who ordinarily resides or is carrying on any business, profession or vocation in any village or town.

(i) Payment by way of gratuity, retrenchment compensation or similar terminal benefits made to an employee or his legal heirs, if the income under the head salary of the employee does not exceed ₹ 7500 for the current year as well as for the immediately preceding Previous Year.

(j) Payment made by way of salary to its employees after deducting the income-tax from the salary, when such an employee is temporarily posted for a continuous period of fifteen days or more in a place other than his normal place of duty or on a ship and the employee does not maintain any account in any bank at such place.

(k) Where the payment is required to be made on a day on which the banks were closed, either on account of holiday or strike.

(l) Payments made by any person to his agent who is required to make payments in cash for goods or services on behalf of such person.

(m) Where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travellers cheques in the normal course of his business. [Notification No. 11476, dated 6.9.2000 applicable retrospectively from 25.7.1995]

PROVISION FOR GRATUITY [Sec. 40A(7)]

No deduction shall be allowed in respect of any provision made by the assessee for the payment of gratuity to his employees on their retirement or on termination of their employment for any reason. However, any provision made by the assessee for the purpose of payment of any contribution towards an approved gratuity fund or for the purpose of payment of any gratuity which has become payable during the Previous Year shall be allowed as deduction.

NON STATUTORY/UNRECOGNISED WELFARE FUND CONTRIBUTIONS [Sec. 40A(9)]

Any contribution made by the assessee to unrecognised or non-statutory welfare fund accounts is not deductible.

Special provision for computing deductions in the case of business reorganization of co-operative banks [Sec. 44DB]

After section 44DA of the Income-tax Act, the following sections shall be inserted with effect from the 1st day of April, 2008, namely :—

44DB. *Special provision for computing deductions in the case of business reorganization of co-operative banks.*— (1) The deduction under section 32, section 35D, section 35DD or section 35DDA shall, in a case where business reorganization of a co-operative bank has taken place during the financial year, be allowed in accordance with the provisions of this section.

(2) The amount of deduction allowable to the predecessor co-operative bank under section 32, section 35D, section 35DD or section 35DDA shall be determined in accordance with the formula—

$$A \times \frac{B}{C}$$

where A = the amount of deduction allowable to the predecessor co-operative bank if the business reorganisation had not taken place;

B = the number of days comprised in the period beginning with the 1st day of the financial year and ending on the day immediately preceding the date of business reorganisation; and

C = the total number of days in the financial year in which the business reorganisation has taken place.

(3) The amount of deduction allowable to the successor co-operative bank under section 32, section 35D, section 35DD or section 35DDA shall be determined in accordance with the formula—

$$A \times \frac{B}{C}$$

where A = the amount of deduction allowable to the predecessor co-operative bank if the business reorganisation had not taken place;

B = the number of days comprised in the period beginning with the date of business reorganisation and ending on the last day of the financial year; and

C = the total number of days in the financial year in which the business reorganisation section is transferred before the expiry of the period specified therein to a successor co-operative bank on account of business reorganisation, apply to the successor co-operative bank in the financial years subsequent to the year of business reorganisation as they would have applied to the predecessor co-operative bank, as if the business reorganisation had not taken place.

DEEMED PROFIT/DEEMED INCOME [Sec 41(1)]

Where deduction has been made in respect of loss, expenditure or trading liability for any year and subsequently the assessee or successor of the business has obtained any amount in respect of such loss expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained or the value of benefit accrued shall be deemed to be income.

The provisions are applicable even to the successor who receives the amount/benefit.

The 'successor in business', for this purpose, means—

(a) Where there has been an amalgamation of a company with another company, the amalgamated company;

(b) Where any person is succeeded by another person in carrying on the Business or Profession, such other person;

(c) Where a firm carrying on a Business or Profession is succeeded by another firm, such other firm.

(d) Where there has been a demerger, the resulting company.

If there is a remission or cessation of a trading liability which was earlier allowed as deduction, it is chargeable to tax. Even if the remission or cessation is effected by a unilateral Act of writing off of such liability by the assessee, the amount so written off is chargeable to tax.

The above mentioned sub-section covers loss, expenditure and trading liability.e.g.

(i) If stock is destroyed by fire and allowed as trading loss but later insurance compensation is received, the same is assessable u/s. 41(1).

(ii) If credit purchase of raw material is made and claimed as deduction but later, a lesser amount is settled to the supplier creditor, the benefit accruing on remission of the trading liability will be deemed as income u/s. 41(1).

SECTION 41(2)

In the case of an undertaking engaged in the generation or generation and distribution of power, option is available to claim depreciation on straight line method with reference to each individual asset. If such option is exercised, block of asset concept does not apply. In the case of such an assessee, where any building, machinery, plant or furniture is transferred for a consideration which is more than the depreciated value, the surplus to the extent of depreciation already allowed shall be assessed as business income. This is normally described as 'balancing charge'.

SECTION 41(3)

Any amount realised on transfer of an asset used for scientific research is taxable as business income to the extent of deduction allowed u/s. 35 in the year in which the transfer takes place.

SECTION 41(4)

Any amount recovered by the assessee against bad debt earlier allowed as deduction shall be taxed as income in the year in which it is received.

SECTION 41(4A)

Under sec. 36(1)(viii) any special reserve created and maintained by a financial corporation or public company specified there under qualifies for deduction subject to the limit prescribed. Sub-section (4A) is introduced in sec. 41 to make it clear that where a deduction has been so allowed, any amount subsequently withdrawn from such special reserve shall be deemed to be the profits of the year of such withdrawal and shall be charged to tax accordingly. The chargeability applies even if the business is no longer in existence during the relevant Previous Year.

SECTION 41(5)

In the case of an assessee who is chargeable to tax in respect of any amount deemed as profit u/s. 41 relating to a discontinued business, any loss incurred in the year in which the business was discontinued shall be allowed to be set off against such profit and only the balance, if any, shall be taxed.

SECTION 176(3A)

Where any business is discontinued in any year, any sum received after discontinuance shall be deemed to be the income of the recipient and charged to tax accordingly in the year of receipt, if such sum would have been included in the total income of the person who carried on the business had such sum been received before such discontinuance.

SECTION 176(4)

Where any profession is discontinued in any year on account of the cessation of the profession by, or the retirement or death of, the person carrying on the profession, any sum received after the discontinuance shall be deemed to be the income of the recipient and charged to tax accordingly in the year of receipt, if such sum would have been included in the total income of the aforesaid person had in been received before such discontinuance.

CASH CREDITS [Sec. 68]

Where any sum is found credited in the books of an assessee, maintained for any Previous Year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that Previous Year.

UNEXPLAINED INVESTMENTS [Sec. 69]

Where in the financial year immediately preceding the Assessment Year, the assessee has made investments which are not recorded in the books of account, if any, maintained by him for any source of income and the assessee offers no explanation about the nature and source of the investments or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the value of the investments may be deemed to be the income of the assessee of such financial year.

UNEXPLAINED MONEY ETC. [Sec. 69A]

Where in any financial year, the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and such money, bullion, jewellery or valuable article is not recorded in the accounts, if any maintained by him for any source of income, and the assessee offers no explanation about the nature and source of acquisition of the money, bullion, jewellery or other valuable article, or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the money and the value of the bullion, jewellery or other valuable articles may be deemed to be the income of the assessee for such Financial Year.

INVESTMENTS, ETC. NOT FULLY DISCLOSED IN BOOKS OF ACCOUNT [Sec. 69B]

Where in any Financial Year, the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article, and the Assessing Officer finds that the amount expended on making such investments or in acquiring such bullion, jewellery or other valuable article exceeds the amount recorded in his behalf in the books of account maintained by the assessee for any source of income and the assessee offers no explanation about such excess amount or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the excess amount may be deemed to be the income of the assessee for such Financial Year.

UNEXPLAINED EXPENDITURE [Sec. 69C]

Where in any Financial Year, an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or part thereof, or the explanation, if any, offered by him is not, in the opinion of the Assessing Officer, satisfactory, the amount covered by such expenditure or part thereof, as the case may be, may be deemed to be the income of the assessee for such Financial Year.

Further, notwithstanding anything contained in any other provision of the Income Tax Act, such unexplained expenditure which is deemed to be the income of the assessee, shall not be allowed as a deduction under any head of income.

UNEXPLAINED AMOUNT BORROWED OR REPAID ON HUNDI [Sec. 69D]

Where any amount is borrowed on a hundi from, or any amount due thereon is repaid to, any person otherwise than through an account payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying the amount aforesaid for the Previous Year, in which the amount was borrowed or repaid, as the case may be, provided that, if in any case any amount borrowed on a hundi has been deemed under the provisions of this Section to be the income of any person, such person shall not be liable to be assessed again in respect of such amount under the provisions of this Section on repayment of such amount.

Explanation : For the purposes of the Section, the amount repaid shall include the amount of interest paid on the amount borrowed.

EXCHANGE RATE FLUCTUATION [Sec. 43A]

Where an assessee acquires an asset from abroad and in consequence of the variation in exchange rate, the liability of the assessee in terms of payment towards the acquisition of that asset increases or decreases, then the actual cost of that asset shall be increased or decreased accordingly. The effect of exchange rate fluctuation shall be taken into consideration for the purpose of deduction u/s. 32, 35, 35A, 36(1)(ix) and for the purpose of computation of capital gains u/s. 48 or u/s. 50 as the case may be.

The increase or decrease in liability due to exchange rate fluctuation shall be taken into account at the time of making payment also.

SECTION 43B

Certain expenses are allowed only on payment basis within a stipulated time period irrespective of method of accounting and the evidence of such payment is furnished alongwith the return of income.

	Nature of Expense	Stipulated time period
1.	Any sum payable by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force.	Due amount should be paid on or before the due date of furnishing the return of income u/s. 139(1) in respect of the Previous Year.
2.	Any sum payable to an employee as bonus or commission for services rendered.	In which the liability to pay such sum was incurred and proof of payment should be attached alongwith the return of income.
3.	Any sum payable by the assessee as interest on any loan or borrowing from any public financial institution or State Financial Corporation or State Industrial Investment Corporation like IDBI, IFCI, UPSIDC, Delhi Financial Corporation, etc. in accordance with the terms and conditions of the agreement governing such loan or borrowing.	However, in cases (1) to (5), if the payment of outstanding liability is made after the due date, deduction can be claimed in the year of payment.
4.	Any sum payable by the assessee as interest on any term loan from a scheduled bank in accordance with the terms and conditions of the agreement governing such loan.	-do-
5.	Any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee (inserted w.e.f. AY 2002-03)	However, if the deduction has already been allowed on due basis before this amendment, the same will not be allowed again when the sum is actually paid.
6.	Any sum payable by the assessee as an employer by way of contribution to any provident fund of superannuation fund or gratuity fund or any other fund for the welfare of employees.	Payments should be made in cash or by issue of a cheque or draft, or by any other mode on or before the due date by which the employer is required to credit an employee's contribution to the employee's account in the relevant fund under the respective Act, rule, order or notification. Where the payment has been made otherwise than in cash, the sum should be realised within fifteen days from the relevant due date

COST OF ACQUISITION OF CERTAIN ASSETS [Sec. 43C]

	Mode of acquisition	Cost of acquisition
1)	Amalgamation	(a) Cost to the amalgamating company (b) Cost of improvement (c) Expenses incurred for transfer
2)	Gift	(a) Cost to the donor, (b) Cost of improvement (c) Expenses incurred for accepting the gift and the gift tax paid by the donor
3)	Partition of HUF	(a) Cost to the HUF (b) Cost of improvement (c) Expenses incurred for partition.
4)	Will	(a) Cost to the previous owner (b) Cost of improvement (c) Expenses incurred for probating the will
5)	Irrevocable trust	(a) Cost to the previous owner (b) Cost of improvement (c) Expenses incurred for establishing the trust.

SPECIAL PROVISIONS FOR DEDUCTION IN CASE OF TRADE, PROFESSIONAL OR SIMILAR ASSOCIATION [Sec.44A]

Amount received from members of trade, professional or similar associations by way of subscription or membership fee falls short of the expenditure incurred, such deficit will be allowed as deduction in computing the income under the head "Profits and gains of Business or Profession". If there is no income under that head or if the income under that head is inadequate to absorb the deficit, it can be set off against the income of the association computed under any other head of income.

In any case any loss or allowance brought forward from earlier assessment year, the deduction permissible under this provision cannot exceed 50% of the total income for that previous year computed before allowing this deduction.

Sec, 44 is applicable only to the trade, professional or similar association the income of which or any part thereof is not distributed to its members except as grants to any association or institution affiliated to it.

Excess over expenditure received by a club from facilities extended to members as part of advantages attached to such membership shall not be chargeable to tax on the principle of mutuality- CIT vs. Bankipur Club Ltd. 226 ITR 97

COMPULSORY MAINTENANCE OF ACCOUNTS [Sec. 44AA, RULE 6F]

Applicability of this section depends on the type of activity carried on by the person. For this purpose. Persons are classified as follows :-

Person

- Specified Profession
  - Legal
  - Medical
  - Engineering
  - Architechtural
  - Accountancy
  - Technical Consultancy
  - Interior Decoration
  - Authorised Representative
  - Film Artist
  - Company Secretary
  - Information Technology
  - or
  - Any Other Notified Profession
  - Producer of a Cinematograph film
- Non-specified Profession
  - Other than Specified Profession

Note : Film Artist Means

- An Actor / Actress;
- A Cameraman;
- A Music Director;
- An Art Director;
- A Dance Director
- An Editor;
- A Story Writer
- A Screen play writer
- A Dialogue writer
- A Dress Designer

Requirement of Compulsory maintenance of Books of Account :

Catagory	Classification	Condition
A	"Specified Person" ↓ Not Required to Maintain any Books of Account.	Gross Receipts ≤ 1,50,000 in any of the three years immediately preceeding the previous year If newly set up in the previous year, then his Gross total receipts in the protection for that year are not likely to exceed the said amount
B	"Specified Person" ↓ Required to maintain such Books of Account as prescribed in Rule 6F.	Gross Receipts ≥ 1,50,000 in all the three years immediately preceeding the previous year If newly set up in the previous year, then his Gross total receipts in the protection for that year are not likely to exceed the said amount
C	"Non-Specified Person" ↓ Not Required to Maintain any Books of Account	Income from such Business or Profession ≤ 1,20,000 or total sale or turnover or Gross receipts there of are less than ₹ 10,00,000 (utpto A.Y. 2010-11) + ₹ 15,00,000 (for A.Y. 2011-12), as applicable in all the three years immediately preceeding the previous year If newly set up in the previous year, then his Gross total receipts in the protection for that year are not likely to exceed the said amount
D	"Non-Specified Person" ↓ Required to maintain such Books of Account as prescribed in Rule 6F. This category includes an assessee covered u/s 44Ad, 44AE, 44AF, 44BB, 44BBB	Income from such Business or Profession ≥ 1,20,000 or total sale or turnover or Gross receipts there of are less than ₹ 10,00,000 (utpto A.Y. 2010-11) + ₹ 15,00,000 (for A.Y. 2011-12), as applicable in all the three years immediately preceeding the previous year If newly set up in the previous year, then his Gross total receipts in the protection for that year are not likely to exceed the said amount

Rule 6F(2) prescribes the books to be maintained are as follows :-

(a) Cash Book

(b) Ledger

(c) Journal (if mercantile system is adopted)

(d) Bills and vouchers in respect of expenses incurred

(e) Copies of bills issued for amounts exceeding ₹ 25.

In case of medical practitioner, the following additional books are to be maintained.

(a) Daily case register (Form 3C)

(b) Inventory as on the first and last day of the Previous Year, showing the stock of medicines (where drugs and medicines are dispensed during the course of practice)

Rule 6F(5) provides that the books of account and documents are required to be kept for eight years from the end of the relevant Assessment Year and for cash book and ledger for a period of 16 years

n case of assessment relating to any Assessment Year reopened u/s. 147 of the I.T. Act within the period specified in section 149 of the Act, the books and documents relating to that year are required to be kept and maintained till the assessment so reopened has been completed.

AUDIT OF ACCOUNTS [Sec. 44AB]

In case of following person carrying on business or profession are required to get his accounts audited before the specified date by an accountant and to furnish such report in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed before the specified date.

- Carrying on business where total sales turnover or gross receipts exceeds ₹60,00,000;
- Carrying on profession where gross receipts exceed ₹ 15,00,000; or
- Carrying on business referred to in section 44AD or 44AE or 44AF and claiming his income to be lower than the income prescribed under the relevant section.

Types of Audit report [Rule 6G]

Form No. 3CA : For the person who carries on Business or Profession and who is required by or under any other law to get his accounts audited.

Form No. 3CB : For the person carrying on Business or Profession who are not required to get his account audited under any other law.

Form No. 3CD : The particulars of which are required to be furnished u/s. 44AB.

SPECIFIED DATE [EXPLANATION TO SEC. 44AB]

"Specified date" in relation to the accounts of the assessee of the Previous Year relevant to the Assessment Year, means the 30th September of the Assessment Year.

It may also be noted that the requirement of Audit u/s. 44AB does not apply to person who derives income referred to in Sec. 44B, 44BB, 44BBA and 44BBB.

In case of an agent who earns only commission income, the audit of accounts is required only if the commission exceeds ₹ 60 lakhs. [CBDT circular No. 452 dt. 17.3.1986]

INCOME PARTLY AGRICULTURE AND PARTLY BUSINESS

Rule 7A :	Income from manufacture of Rubber :- 35% of such income shall be deemed to be business income and liable to tax. 65% of such income shall be deemed to be Agricultural income.
Rule 7B :	Income from the manufacture of coffee :- 40% of such income shall be deemed to be business income and liable to tax. 60% of such income shall be deemed to be agricultural income.
Rule 8 :	Income from the manufacture of tea :- 40% of such income shall be deemed to be business income and liable to tax. 60% of such income shall be deemed to be agricultural income.

PRESUMPTIVE INCOME

PROFITS AND GAINS OF BUSINESS OF CIVIL CONSTRUCTION (SEC.44AD)

Applicable only if the gross receipts paid or payable (to the assessee) does not exceed ₹60 lakhs.

Income : 8% of such gross receipts. However, if the asssessee, declares higher income, that shall be considered.

PROFITS AND GAINS OF BUSINESS OF PLYING, HIRING OR LEASING GOODS CARRIAGES (SEC.44AE)

Applicable to an assessee who owns not more than 10 goods carriages at any time during the previous year and who is engaged in the business of plying, hiring or leasing of such goods carriages:

(I) For heavy goods vehicle- ₹ 5,000 for every month or part of a month during which the heavy vehicle is owned by the assessee in the previous year.

(II) For goods carriage other than heavy goods vehicle- ₹ 4,500 for every month or part of a month during which the goods carriage is owned by the assessee.

PROFITS AND GAINS OF RETAIL BUSINESS (SEC.44AF)

Applicable only if the turnover of such retail trade does not exceed ₹ 60 lakhs in the previous year.

Income : 5% of the turnover. However, if the assessee, declares higher income, that shall be considered.

Presumptive income for truck owners [Section 44AE] [W.e.f A.Y. 2011-12]

Under the existing provisions of section 44AE, a presumptive scheme is available to assesses engaged in business of plying, hiring or leasing goods carriages. The scheme applies to an assessee, who owns not more than 10 goods carriages at any time during the previous year.

The Act has enhanced the presumed income per vehicle for the owners of—

(i) Heavy goods vehicle to ₹ 5,000 p.m.; and

(ii) Other than heavy goods vehicles to ₹ 4,500 p.m.

The Act has further provided an anti-avoidance clause stating that a prescribed fixed sum or a sum higher than the aforsaid sum claimed to have been earned by the assessee shall be deemed to be profits and gains of such business.

Presumptive income scheme for retail business merged with section 44AD [Section 44AF] [W.e.f. A.Y. 2011-12]

SPECIAL PROVISIONS FOR COMPUTING PROFITS & GAINS FOR NON-RESIDENTS

Section	Nature of Business	Profit- % on Turnover
44B	Shipping business in case of non-resident.	7-1/2%
44BBB	Business of providing services or facilities in connection with orsupplying plant and machinery on hire used in the prospecting for or extraction or production of mineral oils in case of non-resident.	10%
44BBA	Business of operation of aircraft in case of non-resident.	5%
44BBB	In case of foreign company engaged in i) Civil construction ii) erection of plant or machinery iii) testing or commissioning thereof in connection with turnkey power project approved by the Central Government, income is determined at 10% of the gross amount.	10% of the gross amount paid or payable in India or out of India.

REQUIREMENT AS TO MODE OF ACCEPTANCE, PAYMENT OR REPAYMENT IN CERTAIN CASES TO COUNTERACT EVASION OF TAX

Mode of taking or accepting certain loans and deposits [Sec. 269SS]

No person shall, after the 30th day of June, 1984, take or accept from any other person (hereafter in this section referred to as the depositor), any loan or deposit otherwise than by an account payee cheque or account payee bank draft if,—

(a) the amount of such loan or deposit or the aggregate amount of such loan and deposit ; or

(b) on the date of taking or accepting such loan or deposit, any loan or deposit taken or accepted earlier by such person from the depositor is remaining unpaid (whether repayment has fallen due or not), the amount or the aggregate amount remaining unpaid ; or

(c) the amount or the aggregate amount referred to in clause (*a*) together with the amount or the aggregate amount referred to in clause (*b*), is twenty thousand rupees or more :

Provided that the provisions of this section shall not apply to any loan or deposit taken or accepted from, or any loan or deposit taken or accepted by,—

(a) Government ;

(b) any banking company, post office savings bank or co-operative bank ;

(c) any corporation established by a Central, State or Provincial Act ;

(d) any Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956) ;

(e) such other institution, association or body or class of institutions, associations or bodies which the Central Government may, for reasons to be recorded in writing, notify in this behalf in the Official Gazette :

Provided further that the provisions of this section shall not apply to any loan or deposit where the person from whom the loan or deposit is taken or accepted and the person by whom the loan or deposit is taken or accepted are both having agricultural income and neither of them has any income chargeable to tax under this Act.

Mode of repayment of certain loans or deposits [Sec. 269T]

No branch of a banking company or a co-operative bank and no other company or co-operative society and no firm or other person shall repay any loan or deposit made with it otherwise than by an account payee cheque or account payee bank draft drawn in the name of the person who has made the loan or deposit if—

(a) the amount of the loan or deposit together with the interest, if any, payable thereon, or

(b) the aggregate amount of the loans or deposits held by such person with the branch of the banking company or co-operative bank or, as the case may be, the other company or co-operative society or the firm, or other person either in his own name or jointly with any other person on the date of such repayment together with the interest, if any, payable on such loans or deposits, is twenty thousand rupees or more :

Provided that where the repayment is by a branch of a banking company or co-operative bank, such repayment may also be made by crediting the amount of such loan or deposit to the savings bank account or the current account (if any) with such branch of the person to whom such loan or deposit has to be repaid :

Provided further that nothing contained in this section shall apply to repayment of any loan or deposit taken or accepted from—

(i) Government;

(ii) any banking company, post office savings bank or co-operative bank;

(iii) any corporation established by a Central, State or Provincial Act;

(iv) any Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956);

(v) such other institution, association or body or class of institutions, associations or bodies which the Central Government may, for reasons to be recorded in writing, notify in this behalf in the Official Gazette.

Mode of repayment of Special Bearer Bonds, 1991 [Sec. 269TT]

Notwithstanding anything contained in any other law for the time being in force, the amount payable on redemption of Special Bearer Bonds, 1991, shall be paid only by an account payee cheque or account payee bank draft drawn in the name of the person to whom such payment is to be made.

Income from business or Profession and Tax Planning

Following are certain measures should be kept in mind for tax planning for income from business or profession.

1. Nature of business: Economic factors such as scope, profitability, feasibility factors, etc. are important for determining the nature of business but the benefits and concessions available to each line of business may also be presumed before expanding an existing line of business.
2. Location of business: Although certain factors such as nearness to the source of raw materials or markets or availability of infrastructure may be useful in taking decision on the location of business, tax consideration is also equally important. If an industry is located in backward area, deduction under section 80-IB is available.
3. Sources of funds: There are different sources of funds depending upon the needs, availability, terms, etc. However for availing the tax benefits, there should be proper debt- equity mix in the capital structure and a clear policy on return on capital employed.
4. Travel Expenses: The travel expenses of spouse were held as inadmissible, if such travel is not for business consideration. She may be made a partner in the firm to claim business expenditure on travel and further the share of profit of the spouse cannot be clubbed with that of the husband as the same is exempt u/s 10(2A).
5. Employee welfare funds: The contribution of the employees' welfare funds should be paid within time limits prescribed under the relevant Acts. It would be better to borrow and pay the tax liability on or before relevant due date. Contribution made to the welfare funds after the due date does not qualify for deduction even in the year of payment. However interest on money borrowed for meeting such liability qualifies as business expenses.

Illustration 39 : Mr Samir Pradhan, resident in India, for the year ended on 31 March 2011. Compute his income from business and his gross total income for the assessment year 2011-2012.

Profit & Loss Account for the year ended 31.3.10

Dr. *Cr.*

Expenditure	₹	Receipts	₹
To purchases	1,90,000	By sales less returns	5,69,300
To salaries and wages	1,40,000	By bad debts recovered, allowed in earlier years by the Assessing Officer	2,000
To trade expenses	1,000		
To purchase of trademarks	50,000		
To registration of trademarks	2,000	By interest on securities (gross)	892
To rent, rates and taxes	5,000	By dharmada, mandir and gaushala receipts	2,000
To discount allowed	1,500		
To household expenses	6,000	By refund on income tax	1,008
To advertisement bill paid in cash	30,000	By proceeds of life insurance policy on maturity	43,500
To income tax	10,000		
To sales tax paid	3,000		
To purchased technical know-how	12,000		
To expenses incurred on income tax and sales tax proceedings	15,100		
To contribution paid to a trust for staff welfare	1,000		
To staff welfare expenses incurred	700		
To OYT deposit	5,000		
To postage and telegrams	1,300		
To donation to National Defence Fund	2,500		
To life insurance premium on the life of the assessee	2,000		
To interest on capital	5,000		
To interest on loan taken to pay income tax	500		
To wealth tax	500		
To audit fee	1,000		
To entertainment expenditure	30,000		
To gifts and present to five customers, costing ₹ 3,000 each	15,000		
To expenses on apprentice training	4,000		
To emergency risk insurance	200		
To fire insurance premium for stock	200		
To provision for bad and doubtful debts	3,000		
To reserve for pecuniary losses	5,000		
To net profit	76,000		
Total	**6,18,700**		**6,18,700**

Solution :

Previous Year : 2010-11 **Assessment Year : 2011-12**

Computation of Gross Total Income

Particulars	₹	₹
Income from Business		
Net profit as per profit and loss account		76,000
Add: Expenses inadmissible in computing profits and gains from business or profession:		
Purchase of trademarks	50,000	
Household expenses [Sec. 37(1)]	2,500	
Advertisement bills paid in cash [Sec. 37(1) r.w. Sec. 40A(3)] @ 100% of ₹ 30,000	30,000	
Income tax [Sec. 40(a)(ii)]	10,000	
Purchase of technical know-how	12,000	
Contribution to a Trust for staff welfare fund [Sec. 40A(9)]	1,000	
Donation for National Fund [Sec. 37(1)]	2,500	
Life Insurance premium [Sec. 37(1)]	2,000	
Interest on capital [Sec. 36(1)(iii)]	5,000	
Interest on loan to pay income tax [Sec. 37(1) r.w. 40{a)(ii)]	500	
Wealth tax [Sec. 40(a)(iii)]	500	
Provision for bad and doubtful debts [Sec. 37(1) r.w. 36(1)(vii)(2)]	2,000	
Reserve for pecuniary losses [Sec. 37(1)]	6,000	
	1,24,000	1,24,000
		2,00,000
Less:		
(a) Income not relating to business or profession: [Sec. 28(i)] Interest on government securities	892	
(b) Dharada, mandir and gaushala receipts	2,000	
(c) Refund of income tax	1,008	
(d) Proceeds of L.I.P.: It is not a business receipt and exempt [Sec. 10(10)]	43,500	
(e) Depreciation on trademarks; 25% of ₹ 50,000	12,500	
(f) Depreciation on know-how: 25% of ₹ 12,000	3,000	59,400
Income from business		**1,40,600**
Statement of Gross Total Income for the Assessment Year 2010-2011		
1. Income from business		1,40,600
2. Income from other sources— Interest on securities		892
Gross Total Income		**1,41,492**

Note :

1) Bad debts deducted in earlier years and now recovered, has been rightly included in the profit and loss account as business income [Sec. 41(4)].
2) Since payment of income tax is not deductible, its refund cannot be taxed as deemed profits [Sec. 41(1)].
3) OYT (own your telephone) deposit is an allowable deduction in the year in which it is paid.

4) "Dharmada", "mandir" and "gaushala" receipts are customarily levies by trader for charitable purposes. Amount received under these heads are not trading receipts. The fact that the amount collected under these heads are spent for other purposes would amount to breach of trust but it would not affect the initial nature and character of the receipt. Such receipts are not taxable.
5) The assessee is entitled to the deduction in respect of donation to National Defence Fund under Sec. 80G.
6) Life insurance paid by assessee on his life is allowed to be deducted in imputing total income under Sec. 80C.
7) Any payment on advertisement exceeding ₹ 20,000 should be made by on account payee cheque or account payee bank draft. Since the payment has been made in cash, 100% of advertisement has been disallowed [Sec. 37(1) r.w. Sec. 40A(3)]. 'Crossed cheque' requirement has been amended by 'account payee' cheque. It is operative from 13-07-2008.
8) From the assessment year 2001-2002, intangible assets also fall within the scheme of depreciation. Hence, depreciation has been allowed on trademarks and know-how.
9) Registration expense of trademarks is revenue expenditure, allowed under Sec. 37(1).

Illustration 40 : Dr L.Kochagaway is a renowned medical practitioner. He furnishes his receipts and payments account for the financial year 2010-2011:

Dr. *Cr.*

Receipts	₹	Payments	₹
To balance b/d	35,000	By rent of clinics:	
To consultation fees :		2008-2009 13,600	
2007-2008 25,000		2009-2010 44,800	
2008-2009 1,80,000		2010-2011 <u>26,600</u>	85,000
2009-2010 <u>2,62,000</u>	4,67,000	By electricity and water	12,000
To visiting fees	1,30,000	By purchase of professional books	18,000
To loan from bank for professional purposes	2,25,000	By household expenses	97,800
		By municipal taxes paid in respect of property	12,000
To sale of medicines	1,73,000		
To gift/presents from patients	15,000	By purchase of motor car	2,45,000
To remuneration from articles published in professional magazines	26,000	By Telephone Charges	10,000
		By fire insurance in respect of property	3,200
To rent from house property	96,000	By surgical equipment	44,700
To interest on Post Office National Savings Certificates	17,000	By advance income tax	43,000
		By salary and perquisite to compounder	72,000
		By entertainment expenses	16,000
		By purchase of X-ray machine	2,00,000
		By expenses of income-tax proceedings	15,000
		By life insurance premium	25,000
		By gifts to wife	25,000
		By interest on loan	12,000
		By loan a/c—instalment paid	25,000
		By donation to Political Party	2,500
		By car expenses	36,000
		By purchase of medicines	1,05,000
		By balance c/d	79,800
	11,84,000		**11,84,000**

Compute his income from profession and gross total income for the assessment year 2011-2012 after taking into account the following additional information:

1. One-third of the car expenses are in connection with personal use.
2. Depreciation on motor car is allowed at the rate of 15%.
3. The construction of the house property was completed in March 2006. It was let out for residential purposes.
4. Expenses on income tax proceeding include ₹ 1,000 paid for the preparation of return of income.
5. Receipts outstanding from patients for 2010-2011, amount to ₹ 8,000.
6. Closing stock of medicines is ₹ 8,000 but its current market price is ₹ 12,000.
7. Books purchased include annual publications of ₹ 12,000, purchased in December 2010.

Solution : **Dr. L. Kochagaway**

Previous Year : 2010-11 **Computation of Income from Profession** **Assessment Year : 2011-12**

Particulars		₹	₹
Income from Profession :			
(a) Receipt from profession:			
1. Consultation fees: [Sec. 28(i)]: (₹ 25,000 + ₹ 1,80,000 + ₹ 2,62,000)		4,67,000	
2. Visiting fees [Sec. 28(i)]		1,30,000	
3. Sale of medicines [Sec. 28(i)]		1,73,000	
4. Gifts and presents from patients [Sec. 28(iv)]		15,000	
5. Remuneration from articles published in professional magazines [Sec, 28(i)]		26,000	8,11,000
(b) Closing stock of medicines			8,000
Total receipts and closing stock			8,19,000
Less: Expenses allowable:			
1) Rent of clinic [Sec. 30]		85,000	
2) Electricity and water [Sec. 37(1)]		12,000	
3) Salary of compounder [Sec. 37(1)]		72,000	
4) Entertainment expenses [Sec. 37(1)]		16,000	
5) Expenses on income-tax proceedings [Sec. 37(1)]		15,000	
6) Interest on loan [Sec. 37(1)(iii)]		12,000	
7) Purchase of medicines [Sec. 37(1)]		1,05,000	
8) Car expenses [Sec. 37(1)] (2/3 x ₹ 36,000)		12,000	
9) Depreciation on professional books :			
(i) Annual publications: 12,000 × 100% × 50%		6,000	
(ii) Other books: 6,000 × 60%		3,600	
10) Depreciation on car [Sec. 32 r.w. Sec. 38] : 15% of 2,45,000 × 2/3		24,500	
11) Depreciation on plant and machinery:			
(i) X-ray machine	2,00,000		
(ii) Surgical equipment	44,700		
Depreciation @ 15% of	2,44,700	36,705	
12) Telephone Charges		10,000	4,09,805
Income from Profession			**4,09,195**

B/F		4,09,195
Computation of Income from House Property :		
Gross annual value on the basis of rental valuation	96,000	
Less: Full municipal taxes paid by the owner	12,000	
Net annual value	84,000	
Less: Statutory deduction: 30% of net annual value	25,200	
	58,800	
Income from House Property		58,800
Gross Total Income		**4,67,995**
Less: Deduction u/s 80C (LIC premium paid)		**25,000**
Less: Deduction u/s 80GGC		**2,500**
Actual amount of donation to political party		
Total Income		**4,40,495**
Total Income rounded off u/s 288A		**4,40,490**

Notes :

1. Purchase of motor car is capital expenditure. Hence, it is not deductible. Depreciation has been allowed on motor car.
2. Plant includes books and surgical equipment. Depreciation on professional books is allowed @ 60% but annual publications are written off @ 100%. However, as annual publications have been put to use for less than 180 days during the year, depreciation has been allowed @ 50%. The assessee can claim depreciation on surgical equipment at general rate.
3. Contribution of articles to periodicals and magazines constitutes income from vocation of the assessee.
4. Expenses in income-tax proceedings are wholly deductible [Sec. 37(1)].
5. One-third of car expenses and proportionate deprecation in respect of motor car have been disallowed as they are in connection with the personal use of the assessee.
6. Interest on Post Office National Saving Certificates is exempt from income tax [Sec. 10(15)].
7. Profits and gains of the business or profession are computed according to the method of the accounting regularly followed by the assessee (Sec. 145). Since the assessee has adopted cash system of accounting. “Income” is taxable on receipt basis and “expenditure” is allowed to be deducted on payment basis, irrespective of the previous year to which the receipt of payment belongs. Receipts outstanding for the previous year 2010-2011 will not be taken into consideration.
8. Profits and gains of business profession is required to be computed according to the system of accounting regularly followed by the assessee but if the income cannot be properly deduced therefrom, the Assessing Officer may compute the income on such basis and in such manner as he may deem fit [Proviso to Sec. 145(1)].

   In view of this, the Assessing Officer may take into account the value of closing stock while determining profits even under cash system of accounting
9. Donation to Political Party is allowed to be deducted from gross total income under Sec. 80GGC.

Illustration 41 : The Profit and Loss Account of RAI & Co. for the previous year 2010-2011 is given as follows :

Particulars	₹	Particulars	₹
Purchases of goods	10,00,000	Sale of goods	26,00,000
Salaries, bonus and commission	8,00,000	Closing stock	50,000
Rent, rates and taxes	60,000	Interest on drawings	7,000
Depreciation @ 16% on WDV	20,000	Interest on securities	20,000
Travelling expenses	1,50,000		
Interest on capital	25,000		
Advertisement	1,20,000		
Entertainment expenses	60,000		
Expenditure on neon-sign board	50,000		
New telephone deposit under OYT scheme	5,000		
Compensation for cancelling purchase order of an outdated machine	10,000		
Expenses for promoting family planning among employees	20,000		
Net profit	3,57,000		
	26,77,000		**26,77,000**

Additional Information :

(i) Salaries, bonus and commission include: ₹

(a) Salary to the proprietor 1,50,000

(b) Bonus paid to employees on 15-10-2011 75,000

(c) Salary of ₹ 1,20,000 was paid in India to B, a non-resident employee but neither any tax was deducted at source nor paid thereon. However, B is a PAN holder and has cleared his tax liability.

(d) Advertisement includes:

(i) a hoarding bill paid in cash, ₹ 38,000

(ii) advertisement published in souvenir, published by a political party ₹10,000

(e) Depreciation has been charged on plants and machinery and furniture and fittings in proportion of 3:2.

Depreciation @ 15% on plant and @10% on furniture.

(f) Purchases include goods of ₹1,00,000, imported without a licence and confiscated by the customs authorities.

(g) Travelling expenses include a sum of ₹1,00,000 on foreign travel to purchase a machine. Negotiations have not been finalized.

(h) Annual stock taking revealed a theft of goods, costing ₹30,000.

(i) This year stock valuation was deviated from the market price to cost price which is 20% less than its market price.

Compute taxable business profits for the Assessment year 2011-12.

Solution :

Previous Year : 2010-11 **Rai & Co.** **Assessment Year : 2011-12**

Computation of Taxable Business Profits

Particulars	₹	₹
Income from Business		
Net profit as per profit and loss account		3,57,000
Add: Inadmissible Expenses		
(a) Salary paid to Proprietor	1,50,000	
(b) Bonus paid to employees: Deduction will be allowed in Previous Year 2011-12 (Sec.43B, being disallowance of unpaid liability)	75,000	
(c) Salary paid to non-resident employee, without deducting or paying TDS[Sec.40(a)(iii)]	1,20,000	
(d) Advertisement bills paid in cash [Sec. 37(1) r.w. Sec. 40A(3)] @100% of ₹ 38,000	38,000	
(e) Advertisement in sourvenir published by political party [Sec.37(2B)]	10,000	
(f) Depreciation to be treated separately	20,000	
(g) Expenses on family planning: allowable only to a company assessee [Sec.36(1)(ix)]	20,000	
(h) Foreign travel to acquire a new machine, (being capital in nature, deal not yet finalized. It may be added to the cost of the asset when such asset is actually procured)	1,00,000	
(i) Interest on capital [Sec. 36(1)(iii)] [There is no borrowings]	25,000	
(j) Expenditure on neon sign board, being a capital expenditure on advertisement, hence disallowed.	50,000	
(k) Compensation paid to cancel a capital liability, capital in nature, hence disallowed u/s 37(1)	10,000	
(l) Under valuation of closing stock:[50,000/80% - 50,000]	12,500	
	12,500	6,30,550
Less: Expenses allowed :		9,87,500
Interest on Drawings		7,000
Depreciation u/s 32:		
(a) Plant and machinery:		
WDV on 01.04.2010 : 20,000 × 4/5 × 100/16	1,00,000	
Add: Cost of neon-sign board	50,000	
	1,50,000	
Less: Depreciation @15%	22,500	22,500
WDV as on 31.3.11	1,27,500	
(b) Furniture and Fittings:		
WDV on 01/04/10: 20,000 × 1/5 × 100/16	25,000	
Less: Depreciation @10%	2,500	2,500
WDV on 31.3.2011	22,500	
Less: Incomes credited to Profit and Loss A/c to be treated under separate Head of Income		
Interest on Government Securities		20,000
Taxable Business Profits		**9,35,500**

Notes:

(1) Loss due to theft of stock-in-trade is allowable in computing business profits u/s 29. Such loss is incidental to business operation. Since purchase of goods have already been debited to profit and loss account, no separate adjustment is required.

(2) Loss in illegal business may be allowed u/s 29. Explanation to Sec.37(1) does not apply to Sec. 29.

(3) Deposit for new telephone connection is allowable u/s 37(1). Hence, no adjustment is required.

Illustration 42 : The Profit & Loss Account of Mr. Suraj Ranade for the previous year 2010-2011 is given below :

Dr. *Cr.*

Particulars	₹	Particulars	₹
Cost of goods sold	16,00,000	Sales	34,70,000
Salaries wages	9,00,000	Rent of staff quarters	3,00,000
Rent of business premises, owned by the assessee	2,50,000	Sale price of machinery block on 31-03-2011	5,00,000
Repairs and renewals	1,40,000		
Income tax paid	60,000		
Excise duty paid	1,00,000		
Sales tax payable	2,00,000		
Legal expenses	3,00,000		
Municipal taxes payable for staff quarters	10,000		
Provision for bad debts	60,000		
Contingency reserve	1,00,000		
Employees contribution to recognised fund	50,000		
Net profit	5,00,000		
	42,70,000		**42,70,000**

Additional Information :

(i) Salaries include:

(a) ₹ 1,20,000 was paid outside India to an employee, "resident" in India but neither tax was deducted nor tax has been paid thereon,

(b) ₹ 90,000 was paid in India to an employee "resident" in India but neither tax deducted therefrom nor paid thereon.

(ii) Excise duty of ₹ 50,000 for the assessment year 2010-2011 was paid on 1 January 2011 but it was not included in the profit and loss a/c.

(iii) Sales tax amounting ₹ 1,30,000 was paid on 31 July 2011 and the balance was paid on 1 August 2011, the due date of furnishing return of income is 31 July 2011.

(iv) Repairs/renewals include remodelling and renovation costing ₹ 80,000.

(v) Legal expenses include:

(a) Lawyer fee of ₹ 50,000 paid by bearer cheque to K, nephew of the proprietor. The Assessing Officer disallowed a sum of ₹ 10,000, being found in excess of the desired qualifications;

(b) Gift of ₹ 1,20,000, made to wife, a tax-advisor, but disallowed by the A.O.

(vi) Employees contribution include:

(a) ₹ 30,000 credited to their account on due date under Provident Fund rules,

(b) ₹ 20,000 credited to their account in November 2011.

(vii) Commission receipts of ₹ 2,00,000 have not been credited to the profit and loss account as their recovery seems to be doubtful.

(viii) WDV of machinery on 01-04-2010 was ₹ 6,50,000.

(ix) WDV of business premises and staff quarters as on 01-04-2010 : ₹ 10,00,000 and ₹ 30,00,000, respectively. Depreciation @ 10% on Business Premises and @ 5% on staff quarters.

Compute taxable profits for the previous year 2010-2011.

Solution :

Previous Year : 2010-11 **Mr. Suraj Ranade** **Assessment Year : 2011-12**

Computation of Taxable Business Profits

Particulars	₹	₹
Net profit as per profits and loss a/c		5,00,000
Add: Inadmissible Expenses:		
(i) Rent of business premises owned by the assessee (Sec. 30)	2,50,000	
(ii) Remodelling and renovation, being repairs of capital nature	60,000	
(iii) Income tax paid [Sec. 40(a)(ii)l	60,000	
(iv) Sales tax remaining unpaid up to due date of furnishing return of income	70,000	
(v) Legal expense includes:		
(a) Gift made to wife, Sec. 37(1)	1,00,000	
(b) Fees paid to lawyer (being a relative) Sec. 40A(2)	10,000	
(vi) Salaries paid outside India to a "resident" employee TDS [Sec. 40(a)(iii)]	1,20,000	
(vii) Salaries paid in India to a resident employer without TDS	—	
(viii) Municipal tax payable for staff quarters [Sec. 43B]	10,000	
(ix) Provision for bad debts [Sec. 36]	60,000	
(x) Contingency reserve [Sec. 37(1)]	1,00,000	
(xi) Employees' contribution credited to their account after due date	20,000	
(xii) Commission receipts which have accrued during the year but recovery seems doubtful seems doubtful	1,00,000	
(xiii) Employees' contribution not credited to—profit and loss a/c	50,000	10,30,000
		15,30,000
Less: Inadmissible receipts/ admissible claims:		
(i) Excise duty (Sec. 43B)	50,000	
(iii) Sale price of machine, being capital receipts	5,00,000	
(iv) Depreciation: (a) Staff quarters: 5% of 30,00,000	1,50,000	
(b) Business Premises: 10% of 10,00,000	1,00,000	8,00,000
Taxable Business Profits		**7,30,000**

Notes :

Sale of machinery block: Sale of machinery block results into short-term capital loss of ₹ 1,50,000 (₹ 6,50,000 - ₹ 1,00,000) under Sec. 50.

No capital loss, whether short-term or long term, can be set- off against any income. It is to be carried forward for next 8 assessment years.

Illustration 43 : The firm of M/s Amal & Associates is engaged in the business of growing and manufacturing tea. The Profit & Loss Account for the year 2010-2011 is given as follows:

Dr. *Cr.*

Particulars	₹	Particulars	₹
Cost of growing and manufacturing tea	40,00,000	Sales	95,00,000
Salaries and wages	15,00,000	Stock	13,50,000
Advertising	5,00,000		
Entertainment expenses	1,00,000		
Travelling expenses	3,00,000		
Fine and penalties	50,000		
Cost of patent rights	6,00,000		
Expenses on scientific research	6,00,000		
General and sundry expenses	2,00,000		
Net profit	30,00,000		
	1,08,50,000		**1,08,50,000**

You are further informed :

(i) Advertising includes payment of ₹ 2,00,000 made to a political party for insertion of advertisement in party's journal. The payment has been made by bearer cheque,

(ii) Travelling expenses include a visit of the director to UK for 10 days (including 2 days for travelling). Five days were utilized for business purpose. Permission for foreign exchange was granted for ₹ 50,000. Total expenditure on the visit is ₹ 1,00,000 (including air fare of ₹ 40,000).

(iii) Expenses on scientific research include:

(a) Purchase of land ₹ 1,50,000

(b) Contribution to Agricultural Research Institute, New Delhi which is a National Laboratory ₹ 20,000.

(c) Contribution to Bhaba Atomic Research Centre (an approved research association)for statistical research, which is not related to business ₹ 30,000.

(iv) Refund of custom duty, deducted in the previous year, 2008-2009, amounting to ₹ 50,000, has not been credited to the profit and loss account.

(v) Sundry expenses include a contribution of ₹ 60,000 to Kolkata Municipal Corporation for undertaking a Drinking Water Project for slum-dwellers. The Project has been approved by National Committee but KMC has not issued any certificate indicating the progress of the project.

(vi) A deposit of ₹ 12,00,000 was made in instalments with National Bank for Agriculture and Rural Development (a) ₹ 4,00,000 in September 2010, (b) ₹ 6,00,000 in July 2011 and (c) ₹ 2,00,000 in December 2011. It has not been included in the profit and loss account. Date of submitting return of income 30/09/2011.

(vii) (a) W.D.V. of machinery on 01-04-2010 (Rate of depreciation 15%) ₹15,00,000

(b) Machinery purchased in December 2010 for scientific research ₹ 5,00,000

(c) Purchase of five small drier machine, each costing ₹10,000

(d) Sale price of an old machinery (Rate of depreciation 15%) ₹ 6,00,000

(viii) Lump sum payment of ₹ 5,00,000 was made to acquire a licence regarding technical information to improve tea-flavour. It has not been charged to P/L a/c.

Compute the taxable business profits for the assessment year 2011-2012.

Solution :

Previous Year : 2010-11 **Mr. Amal & Associates** **Assessment Year : 2011-12**

Computation of Taxable Business Profits

Particulars	₹	₹
Net profit		30,00,000
Add: Inadmissible Expenses:		
1. Advertisement payment to a political party [Sec. 37(2B)]	2,00,000	
2. Travelling outside India [Sec. 37(1)]. Proportionate expenses of foreign travel, (excluding air fare) not relating to business: 60,000 × 3/8	22,500	
3. Fine and penalties	50,000	
4. Cost of patent rights	6,00,000	
5. Expenditure on scientific research (Sec. 35): Purchase of land	1,50,000	
6. Contribution to Bombay Municipal Committee (Sec. 35 AC):	60,000	10,82,500
Since the Certificate indicating progress in the prescribed form has not been issued, no deduction is allowed.		40,82,500
Add: Deemed profit: Refund of Customs Duty, deducted in earlier years, not credited in the profit and loss a/c [Sec.41(1)]		50,000
Less: Admissible expenses:		
Capital expenditure on scientific research [Sec.35(1)(iv)(2)]	4,00,000	
Depreciation on Patent rights @ 25% of ₹ 6,00,000	1,50,000	
Depreciation on know-how: @ 25% of ₹ 5,00,000	1,25,000	
Depreciation on Machinery:		
WDV as on 01/04/2010: 15,00,000		
Add: Purchase of driers 50,000		
15,50,000		
Less: Sale of Old Machinery 5,00,000		
WDV as on 31/3/2011 **10,50,000**		
Depreciation @ 15% on ₹ 10,50,000		
Weighted Deduction for scientific research:	1,57,500	
(i) National Laboratory: @ 125% of ₹ 20,000= ₹ 25,000 – ₹ 20,000 = ₹ 5,000		
(ii) Bhaba Atomic Research Laboratory: @ 125% of ₹ 30,000 = ₹ 37,500 – ₹ 30,000 = ₹ 7,500		
Therefore, total deduction ₹(5,000 + 7,500)	12,500	8,45,000
Composite Profits before making deduction u/s 33AB		**32,87,500**
Less: Deposit with NABARD (Sec.33AB)		
Least of the followings:		
(i) Deposit of ₹ 10,00,000 (within the due date of submission of return)		
(ii) 40% of Business Profits: 40% of ₹ 32,87,500 = ₹ 13,15,000		10,00,000
Composite Profits after deduction u/s 33AB		22,87,500
Apportionment of profits into agricultural income and business income (As per Rule 8)[since the assessee is engaged in the business of growing and manufacturing tea: 40% of ₹ 22,87,500		9,15,000

Illustration 44 : State whether the provisions or Sec. 41(1) of the Act can be applied to a case, where refund of excise duty has been obtained by the assessee on the basis of a decision of the CEGAT and where the matter has been taken up in further appeal to the Court by the Central Excise Department.

Solution : This question has been answered by the Apex Court in Polyflex (India) Pvt. Ltd. *v.* CIT [2003] 257 ITR 343. (SC)

The refund of excise duty pursuant to the decision of the CEGAT would be subject to tax by virtue of Sec. 41(1) and it is not necessary that the revenue should await the verdict of a higher court.

Illustration 45 : In the course of an assessment proceeding, the Assessing Officer enhanced the value of the closing stock and added the difference to the total income.

In the assessment year subsequent to this, the assessee wants the Assessing Officer to enhance, by the same amount, the value of the opening stock of the year.

Discuss the validity of the claim.

Solution : The value of the closing stock of the preceding year must be the value of the opening stock of the succeeding year. Hence, if the value of closing stock at the end of a year is enhanced, the enhanced value should be taken as the value of the opening stock of the next year for the purpose of income tax.

The claim of the assessee in this case is, therefore, valid.

Illustration 46 : What would be your advice regarding admissibility of the following items of expenditure in computing the business income:

(a) A donation of ₹ 1 lakh made to a University for starting a laboratory for scientific research (i) relating to the assessee's business, (ii) not relating to the assessee's business.

(b) Travelling expenses include a sum of ₹ 15,000 incurred by a director in travelling abroad for negotiating purchase of plant and purchase of plant and machinery.

(c) Amount payable as damages to Government on account of shortfall in export target.

(d) Overdraft from bank for payment of income tax: interest charged by the bank is ₹ 20,000.

(e) Payment of interest of ₹ 40,000 on monies borrowed from bank for payment of dividends to shareholders.

(f) ₹ 12,000 paid for shifting of business from the original site to the present place which is more advantageously located.

(g) Retrenchment compensation of ₹ 4 lakh paid to the workmen on the closure of one of the units.

(h) Fees paid to the Registrar of Companies for bringing about a change in the Memorandum and Articles of Association in regard to issue of Equity.

Answers :

(a) The donation has been made to University to be used for scientific research for starting a laboratory. If the University is approved for the purpose of Sec. 35(1)(ii), then irrespective of the consideration whether the scientific research is related to assessee's business or not, deduction could be claimed @ 125% of amount paid. If it isnot approved, donation could not be claimed as a deduction under Sec. 35 in the computation of business income. However, the assessee could claim deduction from Gross Total Income under Sec. 80G, if the same is eligible.

(b) Travelling expenses incurred by the director for negotiating the purchase of plant and machinery is a capital expenditure and hence to be disallowed.

(c) The payment is not for any infraction of law but for failure to reach a target undertaken by the company being payment made wholly in the course of business, it is deductible.

(d) Interest on overdraft taken to pay income tax is not allowable under Sec. 36(1)(iii). Interest on borrowings

(e) utilised for payment of dividend is allowable under Sec. 36(1)(iii).

(f) Shifting expenses of business premises resulting in an expenditure of enduring benefit is a capital expenditure and is not allowable.

(g) Retrenchment compensation payable to workmen on the total closure of a business cannot be allowed as deduction as the expenses are not incurred for the purpose of carrying on of its business. When, however, the tax-payer closes one of its units and continues to carry on the same business as before, the compensation will be admissible under Sec. 37(1).

(h) Fee paid to Registrar of Companies for bringing about change in memorandum and articles of association is a capital expenditure, where it relates to issue of equity shares. Where alterations are warranted by the changes made in the Companies Act, the expenses are allowable.

Illustration 47 : A company engaged in the manufacturing of fertilizer products, commenced its business on 01.04.2010. During the financial years 2007-2008 to 2009-2010 it had incurred ₹ 4.00 lakh annually as expenditure on salaries and purchase of raw material for the purpose of research connected with its business. During the previous year 2010-2011 incurred on scientific research, revenue expenditure of ₹ 3.00 lakh and a capital expenditure of ₹ 4.50 lakh on purchase of plant and machinery. Since the result of the research was unsuccessful, the company sold it its plant and machinery on 31.12.2010 for ₹ 8.00 lakh and closed its research activity. Compute the admissible deduction under Sec. 35 for the assessment year 2011-2012.

Solution :

Computation of deduction u/s 35 for Expenditure on scientific research

Particulars	₹	₹
Expenditure incurred during the earlier 3 years on salaries and purchase of raw material for the purpose of research connected with the business— fully allowed in the year of commencement of business by virtue of Explanation to Sec. 35(1)(i) : [₹ 4,00,000 × 3]		12,00,000
Revenue expenditure on scientific research incurred during the previous year 2010-2011	3,00,000	
Capital expenditure on scientific research incurred during the previous year 2010-2011	4,50,000 7,50,000	
Total Weighted deduction © 150% on ₹ 7.50 lakh u/s 35(2AB)		11,25,000
Admissible deduction u/s 35 for the AY 2011-2012		23,25,000

Illustration 48 : A company engaged in pharmaceuticals manufacturing, debited to its profit and loss account a sum of ₹ 50,000, being the interest on loan of ₹ 5,00,000 taken for financing its expansion scheme. The plant and machinery purchased for the project with the loan were not received during the year and those were still in transit at the end of the year. A sum of ₹ 4,000 was paid to a broker who arranged the loan. Discuss the admissibility of the interest.

Answer : Interest paid in respect of capital borrowed for the purposes of business or profession is admissible u/s 36(1)(iii). As per the Proviso to Sec. 36(1)(iii) inserted by the Finance Act, 2005, from assessment year 2006-2007, interest paid in respect of capital borrowed for acquiring an asset for extension of existing business or profession (whether capitalised in the books of account or not) for any period beginning from the date on which the capital is borrowed for acquisition of the asset till the date on which such asset is first put to use cannot be allowed as deduction. In this case, the asset has not been put to use till the end of the previous year. Therefore, interest of ₹ 50,000 is not be allowed as deduction. However, the cost of the asset is to be increased by the amount of interest and depreciation is admissible on enhanced cost [Proviso to Sec. 36(1)(iii)].The deduction brokerage of ₹ 4,000 paid to a broker for arranging the loan there is a bit controversial

One view is that definition of the term "interest" u/s 2(28A) includes service fee or other charges in respect of monies borrowed, "brokerage" can be considered to fall under the scope of the term "other charges" and is therefore included under the definition of interest. Hence, brokerage of ₹ 4,000 for arranging the loan should be treated in the same way as interest. As per the other view, where brokerage or commission paid to an agent for arranging a loan for the purpose of business is not allowable as deduction u/s 36(1)(iii), but is allowable under Sec. 37(1). As per this view, ₹ 4,000 paid to a broker for arranging a loan is allowable as a deduction under Sec. 37(1).

Illustration 49 : Apporva Shantilal filed his return of income for the assessment year 2010-11 on 29-1-2011 showing a loss of ₹ 11,42,000. The same represented unabsorbed depreciation of foundary business of ₹ 9,00,000 and the balance loss in foundry business. During the previous year relevant to the assessment year 2011-12, two businesses are carried on by him – a steel rolling mill at Kanpur and a fertilser manufacturing company at Cuttack. The foundry business was not carried on (discontinued). Separate books of account are being maintained for the two business carried on at different places. The following information is made available to you :

Relating to steel rolling mill at Kanpur

Particulars	₹
(a) Business Income prior to depreciation and following adjustments	5,60,000
(b) Opening WDV of factory building	6,20,000
This building, constructued 5 years back, was sold for	10,28,000
(c) Machinery (entitled to depreciation @ 15%) Opening WDV	3,20,000
All machines sold in March 2011 for	5,10,000
(d) Car Opening WDV	1,20,000

Relating to fertiliser unit at Cuttack

Particulars	₹
(a) Factory building (purchased in March, 2006) Opening WDV	2,80,000
(b) New Machinery (Rate of depreciation 15%) purchased in June, 2010	50,00,000
(c) Jeep Opening WDV	1,80,000
(d) Furniture Opening WDV	80,000
(e) Business income prior to above adjustments	7,16,000

Compute the Total Income of Mr. Apoorva Shantilal for the A.Y. 2011-12

Solution :

Previous Year : 2010-11 **Mr. Apporva Shantilal** **Assessment Year : 2011-12**

Computation of depreciation/short term capital gains in the case of Mr. Apoorva Shantilal for the A.Y. 2011-12 :

Particulars		₹
Profits and gains of business		
Profits prior to depreciation of steel rolling mill	5,60,000	
Profits prior to depreciation of fertiliser unit	7,16,000	
	12,76,000	
Depreciation for the year (Note - 1)	7,74,500	
	5,01,500	
Less : Set-off of Brought Forward Unabsorbed Depreciation u/s 31(2) – related	5,01,500	Nil
Capital Gains		
Short-term Capital Gain on Sale of Building (Note-1)	1,28,000	
Less : Set-off of Brought forward Unabsorbed Depreciation for the A.Y. 2010-11 restrocted to the amount of profits	1,28,000	Nil
Gross Total Income		**Nil**
(–) Deduction under Cl VIA		Nil
Total Income		**Nil**

Note : The assessee can carry forward ₹ 4,08,500 being unabsorbed depreciation for set off against income in the future years.

Working Note :

1. Computation of Depreciation and Short Term Capital Gains

Particulars	Block-I Factory Building	Block-II Furniture & Fixture	Block-III Plant & Machinery	Block-IV Moter Vehicles
Rate of Depreciation	10%	10%	15%	15%
Opening WDV				
— Kanpur	6,20,000	Nil	3,20,000	1,20,000
— Cuttack	2,80,000	80,000	Nil	1,80,000
Total opening WDV	9,00,000	80,000	53,20,000	3,00,000
Add : Additions during the year	Nil	Nil	50,00,000	Nil
	9,00,000	80,000	53,20,000	3,00,000
Less : Sales during the year	10,28,000	Nil	5,10,000	Nil
Short term Capital Gains	1,28,000	N/A	N/A	N/A
Net Book Value	Nil	80,000	48,10,000	3,00,000
Less : Depreciation for the year	Nil	8,000	7,21,500	45,000
Closing WDV	Nil	72,000	40,88,500	2,55,000
Total Depreciation 8,000 + 7,21,500 + 45,000 = 7,74,500				

2. Unabsorbed Depreciation – to be carried forward from Assessment Year 2010-11 ₹ 2,70,500 (after Set-off of ₹ 6,29,500 against income during the year) relating to Assessment Year 2010-12.

3. Unabsorbed Business loss of ₹ 2,42,000 (= ₹ 11,42,000 – 9,00,000) of A.Y : 2010-11 cannot be brought forward for setting off as the return of income for that Assessment Year was filed after due date of furnishing return u/s 139(1).

Illustration 50 : A firm comprising of four partners A, B, C and D carrying on business in partnership, sharing profits/losses equally shows a profit of ₹ 2,00,000 in its books after deduction of the following amounts for the year :

Particulars	₹
(a) Remuneration to partner 'A' who is not actively engaged in business	60,000
(b) Remuneration to partners 'B' & 'C' actively engaged in business	
Partner 'B'	80,000
Partner 'C'	90,000
(c) Interest to partner 'D' on loan of ₹ 1,50,000	36,000

The deed of partnership provides for the payment of above remuneration and interest to partners. You are required to work out the taxable income of the firm as well as partners for assessment year 2011-12.

Solution :

Computation of Income under the head Profits and Gains of Business or Profession

Particulars		₹
Net profit as per P/L A/c		2,00,000
Add : **Inadmissible expenses** —		
(i) Remuneration to A (not an active partner) – disallowed u/s 40(b)		60,000
(ii) Remuneration to B and C – (considered separately [₹ 80,000 + 90,000]		1,70,000
(iii) Interest paid to D on Loan advanced		36,000
Net Profit before Interest and Remuneration to Partners		**4,66,000**
Less : Maximum Permissible Interest u/s 40(b) @ 12% on Loan from D = ₹ 1,50,000 × 12% p.a.		18,000
Book Profit		**4,48,000**
Less : Maximum Permissible Remuneration to **B** and **C** u/s 40(b)		
(i) upto ₹ 3,00,000 – ₹ 1,50,000 or 90% of Book Profits, whichever is higher = 2,70,000 Balance of Book Profits – 60% of Book Profits = 60% of 1,48,000 = 88,800	3,58,000	
(ii) Actual Remuneration paid lower of (i) & (ii), allowed as deduction	1,70,000	1,70,000
Taxable Income		**2,78,000**

Taxable income of the partners

Particulars	A	B	C	D
Remuneration	Nil	80,000	90,000	Nil
Interest	Nil	Nil	Nil	18,000
Taxable income	Nil	80,000	90,000	18,000

Working Notes :

(1) In the case of a firm, remuneration to a partner who is not a working partner is not eligible for deduction. In the case of working partners the remuneration paid is disallowed if it exceeds the limit prescribed u/s 40(b) with reference to "book profit".

Book working partners remuneration is worked out as under :

	₹
First ₹ 3,00,000 of the book profit @ 90%	2,70,000
On the balance ₹ 1,98,000 of book profit @ 60%	1,18,800
Total	**3,88,800**

(2) Any interest and salary to partners disallowed in the firm's case shall not be included in the total income of the partner and shall not be chargeable to tax in the partner's hands.

(3) Share of profits of the partners is exempt u/s 10(2A) of the Income-tax Act and therefore, not included in the partner's taxable income.

Illustration 51 : X Ltd., carrying on business in manufacture and sale of textiles, showed a net profit of ₹ 10,50,000 in its Profit and Loss Account for the period ended March 31, 2011. On the basis of the following particulars noted from the company's accounts and ascertained on enquiry, compute, giving reasons, the total income of the company for the assessment year 2011-12. The company maintains books of account on the basis of mercantile system.

1. The general reserve account shows a credit of ₹ 2,75,000 under the head "Surplus on devaluation". The enquiries show that the company had exported textile to U.S.A. during the year 1995-96. The sale proceeds were placed in a separate bank account in U.S.A. which were utrlized for import of cotton from time to time After obtaining permission from the Reserve Bank of India, in January 2011 the company remitted to India a sum of ₹ 2 lakh, being the balance standing to its credit in the said bank account which included the above surplus realized on account of devaluation of the rupee in June 1996. The company claims that the said surplus is not taxable, firstly, on the ground that the said surplus did not relate to the previous year and secondly, the said surplus is not a trading receipt.
2. The company had imported automatic looms under a special permission granted by the Textile Commissioner under the Cotton Textile (Control) Order, 1948. One of the conditions laid down while granting the permission was that the company should execute a bond in favour of President of India agreeing to export an agreed quantify of cloth and in default pay a sum calculated at the rate of 10 paise per metre to cover the shortfall. The company fell short of the target during the previous year as a result of which it was required to pay a sum of ₹ 40,000 towards the shortfall. The company has debited the said amount to "General expenses account".
3. The company has set up a laboratory for conducting research in textile technology. It has incurred a capital expenditure of ₹ 1,00,000 for the said purpose. The amount is shown in the balance sheet us "Laborotory equipment account" but is claimed as deduction in the return of income for the assessment year 2011-12.
4. The interest account includes payments amounting to ₹ 50,000 on deposits made by non-resident buyers of textile manufactured by the company. The said payments were made outside India without deduction of tax.
5. The legal charge includes a sum of ₹ 60,000 paid to solicitors for framing a scheme of amalgamation of allother textile mill with the assessee-company. The scheme is approved by the Central Government in public interest.
6. Travelling expenses include a sum of ₹ 1,25,000 being expenditure incurred by the directors of the campany in connection with their tour to USA and UK for the purchase of new machinery for setting up a new plant for manufacture of caustic soda.
7. ₹ 1,00,000 (debited to profit and loss account) is paid to an approved Notional Laboratory with a specific direction that it shall be used for on approved scientific research programme.

Solution :

Previous Year : 2010-11 **X Ltd.** **Assessment Year : 2011-12**

		₹
Net profit as per Profit and Loss Account		10,50,000
Adjustments :		
Surplus arose on conversion of foreign currency into Indian currency (since foreign currency was kept for purchasing stock-in-trade, it will be revenue receipt)		(+) 2,75,000
Payment of ₹ 40,000 towards the shortfall in export (allowable as deduction since the payment is not penalty)		—
Capital expenditure on scientific research		(–) 1,00,000
Interest to non-residents [not deductible under section 40(a) since payment was made without deducting tax at source]		(+) 50,000
Legal charges for framing amalgamation scheme [deductible u/s 35DD in five years)		(+) 48,000
Travelling expenses of directors [section 37(1) does not permit a deduction of capital expenditure]		(+) 1,25,000
Weighted deduction under section 35(2AA) in respect of ₹ 1,00,000 paid to a National Laboratory [amount deductible is 125% of ₹ 1,00,000,		(–) 25,000
(–) Amount	1,25,000	
Show in P/L A/c	1,00,000	
Expenses not debited ealier	25,000	
Total Income		**14,23,400**

Illustration 52 : D Ltd., carrying on business in manufacture, sale and export of tyres, tubes and accessories, has disclosed a net profit of ₹ 21,00,000 in its P & L account for the period ended March 31, 2011. On the basis of the following particulars furnished by the company and ascertained on inquiry, compute, giving reasons, its total income for the assessment year 2011- 12. The company follows the mercantile system of accounting :

(a) A sum of ₹ 20,000 is debited to compensation account. The company had placed an order for machinery to manufacture tyres with a UK company. However, due to a sudden increase in the price of machinery by the vendor, the assessee, had to cancel the contract, in liew of compensation The company claims the said amount as deduction on revenue account or, in the alternate, as loss under the head "Capital gains" as the payment was mode towards extinguishment of right to acquire a capital asset.

(b) "Loss on export of accessories account" shows a debit of ₹ 4 lakh. In this connection it is explained that two trucks belonging to the company carrying tyres accessories were intercepted at the international border and seized by customs authorities for illegal export. The goods were confiscated by the customs authorities and a fine of ₹ 2 lakh was levied. The company claims the value of confiscated goods as a trading loss under section 28 and the payment of the fine of ₹ 2 lakh which is debited to rates and taxes account as on expenditure in the course of business under section 37(1).

(c) The company had set up a separate unit for manufacture of plastic tubes at Bangolore in 1995. The said unit suffered heavy losses. As a result the same was closed down and the plant and machinery were sold away. The company, however, claims unabsorbed depreciation amounting to ₹ 8 lakh in its return of income. It is not debited to the profit and loss account.

(d) During the previous year 1995-96, the assessee-company acquired 5,000 shores of E Ltd., on Indian company, as a result, the entire share capital of the said company is now held by the assessee-company. In May 2010, the assessee-company sold to E Ltd. plant and machinery for ₹ 6,00,000. The actual cost is ascertained at ₹ 4,00,000 and written down value at ₹ 1,50,000.

(e) In the years 2000-2001 and 2001-02, the Government of India arranged exports of tyres and tubes through the Federation of Tyre Dealers of which the company was a member. The exports which were made to For Eastern countries resulted in loss which was shared by all members including the company. The Federation thereafter took up the questions of reimbursement of losses with the Government, which after protracted discussion and correspondence agreed to grant a subsidy calculated at a certain percentage of exports. The assessee-company received its share of subsidy amounting to ₹ 3 lakh in the previous year. The amount stands credited to the "Capital reserve account" and claimed as exempt.

Solution :

Previous Year : 2010-11 **D Ltd.** **Assessment Year : 2011-12**

Computation of Total Income

	₹
Net profit as per Profit and Loss Account	21,00,000
Adjustments :	
(i) Payment of compensation [not allowable since payment is in the nature of capital expenditure, being made to avoid unnecessary investment in capital asset ; nor can it be allowed as capital loss as there is no transfer of capital asset]	(+) 20,000
(ii) Loss arising out of confiscation of stock by customs authorities [not deductible by virtue of Explanation to section 37(1)]	(+) 4,00,000
(iii) Fine [not allowable as penalty paid for breach of law is not normal incidence of business	(+) 2,00,000
(iv) Unabsorbed depreciation of a unit closed before the commencement of previous year [allowable as deduction]	(–) 8,00,000
(v) Recovery of loss [taxable under section 41 (1)]	(+) 3,00,000

(vi) Compensation paid on voluntary retirement of employees [under section 35DDA, one-fifth of such compensation is deductible in the year in which the expenditure is incured and the balance is deductible in the next four years; section 35DDA is applicable even if the voluntary retirement scheme has not been framed in accordance with the guidelines given under section 10(10C); $\left[28{,}00{,}000 - \frac{1}{5} \times 28{,}00{,}000\right]$	(+) 22,40,000
Business Profit	44,60,000
Capital gain on sale of machinery to wholly owned subsidiary company [since transferee-company is wholly owned Indian subsidiary company of the assessee, the transaction is not treated as transfer under section 47(iv) and surplus arising on transfer is not taxable as capital gain]	—
Net Income	**44,60,000**

Illustration 53 : Bharat, owner of Great India Roadways, furnishes following details for the A.Y. 2011-12.

	₹
Revenue from customers	31,00,000
Less : **Expenses**	
Rent of office premises	1,80,000
Rent of godown	2,40,000
Truck Driver salary	5,00,000
Allowance to truck driver	1,20,000
Cost of petrol, diesel, etc	7,50,000
Other expenses other than depreciation	2,00,000
Income from business without charging depreciation	11,10,000

Additional Information :

Great India Roadways have following details of its assets —

Assets	**Written down value as on 1.4.2010**
Office Premises	₹ 2,50,000
Machinery block (30%) consists of —	₹ 20,00,000
— 2 Diesel engine trucks of 13000 kgs each	
— 2 Diesel engine trucks of 10000 kgs each	
— 1 Petrol engine truck of 12000 kgs	

During the year, he purchased 2 medium-size-truck (petrol engine) for ₹ 3,50,000 each on 13.7.2010. However, 1 petrol engine truck of 12,000 kgs was sold on 9.9.2010 for ₹ 1,00,000.

Compute his income under the head Profits & gains of business or profession.

Solution :

Previous Year : 2010-11 **Shri Bharat** **Assessment Year : 2011-12**

Computation of Profits & gains of business

Particulars	Amount
Net profit as per Profit and Loss A/c	11,10,000
Less : **Expenditure allowed but not debited to P & L A/c**	
Depreciation u/s 32 (Note)	8,05,000
Profits & gains of business	**3,05,000**

Note : Computation of depreciation allowed u/s 32

Particulars	Details	Amount
Block 1 : **Office Premises @ 10%**		
W.D.V. as on 1.4.2010	2,50,000	
Add : Purchase during the year	Nil	
	2,50,000	
Less : Sale during the year	Nil	
	2,50,000	
Depreciation @ 10% on ₹ 2,50,000		25,000
Block 2 : **Trucks @ 30%**		
W.D.V. as on 1.4.2009	20,00,000	
Add : Purchase during the year	7,00,000	
	27,00,000	
Less : Sale during the year	1,00,000	
	26,00,00	
Depreciation @ 30% on ₹ 26,00,000		7,80,000
Depreciation allowed u/s 32		8,05,000

Alternative II : Computation of income u/s 44AE

No. of vehicle	Type of goods carriage	Month including part of month	Details	Income ₹
2 Diesel engine trucks of 13000 kgs each	Heavy	12	3500×12×2	84,000
2 Diesel engine trucks of 10000 kgs each	Other vehicle	12	3150×12×2	75,600
1 Petrol engine truck of 12000 kg	Other vehicle	6	3150×6×1	18,900
2 medium size truck	Other vehicle	9	3150×9×2	56,700
Profit and gains of business or profession				**2,35,200**

Income of the assessee under the head Profits & gains of business or profession shall be ₹ 2,35,200 u/s 44AE.

Illustration 54 : During the previous year 2010-11, profit and loss account of Shri Amarnath, proprietor of Free Bird Enterprises engaged in the business of dymade garments, shows profits of ₹ 4,50,000. With the following information, compute his taxable income from business -

(a) Interest on capital ₹ 5,000

(b) Purchases include goods of ₹ 42,000 from his younger brother in cash. However, market value of such goods is ₹ 35,000.

(c) Interest paid outside India ₹ 1,00,000 without deducting tax at source.

(d) Penalty paid to local government for non-filing of sales tax return ₹ 5,000

(e) Penalty paid to customer for non-fulfilling of order within time ₹ 10,000

(f) Bad debts ₹ 1,00,000. Money has been advanced for purchase of Building.

(g) Revenue expenditure on promoting family planning among employees ₹ 10,000.

(h) Premium paid on health of employees ₹ 6,000 in cash

(i) Premium paid on health of his relatives ₹ 6,000 in cheque

(j) Employer's contribution to RPF ₹ 12,000. One-half of the amount is paid after due date as per relevant Act but before 31.3.2010

(k) Employees contribution to RPF ₹ 10,000. ½ of the amount is paid after due date as per relevant Act.
(l) Interest on late payment of sales tax ₹ 1,000 (yet to be paid)
(m) Interest on loan from State Bank of India ₹10,000 (₹ 5,000 is not paid till due date of filing of return)
(n) Interest on late refund from income tax department ₹ 500
(o) Sale includes sale to Raj ₹ 10,000. (Cost of such goods ₹ 8,000; Market value of such goods ₹ 12,000)
(p) He received ₹ 80,000 from a debtor at a time in cash.
(q) Recovery of bad debt ₹10,000 (out of which ₹ 8,000 was allowed as deduction during AY. 2006-07)
(r) Depreciation (being not debited in accounts) ₹ 20,000 allowed as deduction u/s 32

Solution :

Previous Year : 2010-11 **Shri Amarnath** **Assessment Year : 2011-12**

Computation of Profits and gains of business

Particulars	Note	Details	Amount
Net profit as per Profit and Loss account			4,50,000
Add : **Expenditure disallowed but debited in P &L A/c**			
Interest on capital	1	15,000	
Payment to relative in excess of market value of goods	2	7,000	
Interest paid outside India without deducting tax at source	3	1,00,000	
Penalty paid to local government for non-filling of sales tax return	4	5,000	
Bad debt	6	10,00,000	
Premium paid on health of employees in cash	8	6,000	
Premium paid on health of his relatives in cheque	9	6,000	
Employees contribution to RPF	11	5,000	
Interest on loan from State Bank of India	13	5,000	
Cost of goods sold to himself	14	8,000	2,43,000
			3,93,000
Less : Expenditure allowed but not debited in P & L A/c			
Depreciation u/s 32		20,000	
Less : Income not taxable but credited to P & L A/c			
Sales to himself (goods withdrawn for personal purpose)	14	10,000	
Recovery of bad debts	15	2,000	
Less : Income taxable under other head but credited to P & L A/c			
Interest on late refund from income tax department	16	500	32,500
Profits and gains of business			**3,60,500**

Notes :

(1) Interest on capital to proprietor is not allowed as no one can earn from a transaction with himself. The provider of loan and receiver of loan are same hence does not involves any actual expenses.

(2) Any unreasonable payment to relative is disallowed u/s 40A(2). Hence, ₹3,000 is disallowed. Since cash payment towards allowed expenditure (i.e. ₹19,000) does not exceed ₹ 20,000, hence provision of sec. 40A(3) is not applicable.

(3) Any salary paid outside India without deducting tax at source is disallowed u/s 40(a).

(4) Any payment made for infringement of law is disallowed.

(5) Payment made for non-fulfilling of contract is not a payment for infringement of law Hence, allowed u/s 37(1).
(6) Bad debt is allowed only when such debt has been taken into account as income of previous year or any earlier previous year(s) [Sec. 36(1)(vii)]. Since, the debt is in respect of purchase of a building, which was not considered as income of any previous year, hence it is disallowed.
(7) Any expenditure for promoting family planning is allowed to company assessee [Sec. 36(1)(ix)]. However, such expenditure (revenue in nature) incurred by assessee other than company shall be allowed u/s 37(1).
(8) Payment of insurance premium on health of employees in cheque is allowed u/s 36(1)(ib).
(9) Payment of insurance premium on health of relative is not related to business, hence disallowed.
(10) Employer's contribution towards RPF is allowed if payment is made before due date of filing of return irrespective of fact that such payment was made after due date prescribed in the relevant Act.
(11) Any sum received from employees as their contribution towards RPF is allowed only when such sum has been credited to such fund within the due date prescribed in the relevant Act [Sec. 36(1)(va)].
(12) Interest on late payment of sales tax is not a penalty but compensatory in nature. Hence, it is allowed u/s 37(1) Further such interest is not governed by the provisions of sec. 43B.
(13) Any interest payable to any scheduled bank is allowed on cash basis [Sec. 43B]. Hence, unpaid amount is disallowed.
(14) Any expenditure of personal nature is not allowed. Further, no one can earn from a transaction with himself. Hence, sale made to himself is not treated as income.
(15) Bad debt recovery is treated as income in the year of recovery to the extent of bad debt allowed in the earlier year [Sec. 41(4)]
(16) Interest on late refund of income tax is taxable under the head 'Income from other sources'.
(17) Receipt from debtor ₹ 80,000 in cash is not attracted by provision of sec. 40A(3).

Illustration 55 : Discuss the admissibility or otherwise of any five of the following claims in connection with assessment to income-tax. They do not necessarily relate to the same assessee:

(i) An expenditure of ₹ 1,00,000 was incurred on the occasion of the silver jubilee of the company for presentation of silver mementos to shareholders and directors, the value of each memento being ₹ 1,000 only.

(ii) An assessee carries on business in respect of which it holds tenancy rights. It carries out improvements to the said building at a cost of ₹ 2,00,000 and claims depreciation @ 10% thereon. The assessing officer rejects the claim on the ground that the assessee is not the owner of the building.

(iii) Excise duty amounting to ₹ 2,00,000 for the period 2009-10 was paid by the company by 30-9-2010 before furnishing the return of income for the assessment year 2010-11.

(iv) A criminal case was filed against a company under the Essential Commodities Act, 1955. The company incurred litigation expenses amounting to ₹ 50,000 to defend the directors. The directors were ultimately acquitted.

(v) A company was generating electricity privately for its factory. Later, at its expense, electric lines were laid from the trunk road to the factory. It paid ₹ 5,00,000 to the State Electricity Board as its contribution for this purpose. The ownership of the power-line was to vest with the State Electricity Board.

(vi) X and Yare two shareholders of Pooja Ltd., a closely held company. X holds 55% share capital on 30-1-2010, X transfers his shares to A. Pooja Ltd. wants to set ofT brought forward loss of ₹ 4,00,000 (business loss ₹ 1,00,000; unadjusted depreciation ₹ 3,00,000) of the previous year 2008-09 against the income of the previous year 2009-10 (i.e., ₹ 9,00,000). Can it do so?

Solution :

(i) As per the decision of the Apex Court in the case of *Aluminum Corporation of fndia Ltd.* v *CIT* (1972) 86 ITR 11 (SC) and various other decisions, where an expenditure is incurred for commercial expediency, the same shall be allowed as deduction under section 37(1). If at the time the expenditure is incurred, commercial expediency justifies it, it will be taken to be for the purpose of the business even though not supported by any prevailing practice.

Presentation of silver mementos to the directors and shareholders on the occasion of silver jubilee is to motivate both the directors and the shareholders. The expenditure has been incurred on account of commercial expediency and should qualify for deduction under section 37(1).

(ii) According to Explanation to section 32(1) where the business or profession of the assessee is carried on in a building not owned by him but in respect of which the assessee holds a lease or other right of occupancy and any capital expenditure is incurred by the assessee for the purposes of the business or profession on the construction of any structure or doing of any work, in or in relation to, and by way of renovation or extension of, or improvement to, the building, then, the provisions of section 32 shall apply as if the said structure or work is a building owned by the assessee. Hence, depreciation in this case will be allowable.

(iii) As the excise duty has been paid or before the due date of furnishing return under section 139(1) in respect of the previous year in which the liability to pay such sum was incurred, the same shall be allowed as deduction on due basis as per section 43B.

(iv) Section 37(1) does not make any distinction between expenditure incurred in civil litigation and that incurred in criminal litigation. All that the court has to see is whether the legal expenses were incurred by the assessee in his character as a trader, in other words, whether the transaction in respect of which proceedings are taken arose out of and was incidental to assessee's business. Further, it is to be seen whether the expenditure was *bona fide* incurred wholly and exclusively for the purpose of the business. [*CIT* v *Birla Cotton Spg.* & *Wvg. Mills Ltd.* (1971) 82 ITR 166 (SC)]. In view of this, the litigation expenses of ₹ 50,000 incurred in detending directors is deductible under section 37(1).

(v) The new electric power lines were laid to run the factory efficiently but since the ownership of the power lines was to vest with the State Electricity Board, the contribution of ₹ 5,00,000 paid to the State Electricity Board shall be allowable as revenue expenditure under section 37(1).

(vi) According to section 79 the losses of a closely held company can be carried forward and set off in the subsequent assessment year only when at least 51% of the shares of the company carrying voting rights are held by the same persons as on the last day of the previous year in which the loss was incurred and the last day of the previous year in which the losses are set off. In this case business loss will not be allowed to be set off but unabsorbed depreciation is not a loss and shall be allowed to be set off.

Illustration 56 : Discuss the correctness or otherwise of the following propositions ith reasons therefor :

(a) Where a person draws from his own stock-in-trade for personal use, there can be no taxable profit.

(b) Even an outlay for acquiring an enduring advantage for business may be deductible as revenue expenditure.

Solution :

(a) The Supreme Court in *CIT* v. *Kikabhai Premchand* (1953) 24 ITR 506 held that when a person draws from his own stock-in-trade for personal use, there can be no taxable profit as in this case the vendor and the vendee are not different. To constitute a sale these should be one buyer and seller. The buyer and seller has to be different entity to constitute a proper sale.

(b) Normally, an amount spent for acquiring an enduring advantage for business is of capital nature but there can be certain cases when the amount spoent on acquiring an enduring advantage may be treated as revenue expenditure. The Supreme Court in *CIT* v. *Empire Jute Co. Ltd.* (1980) 124 ITR 1 held that when a jute mill as a result of an arrangement with other Jute mil had undertaken to work only for specified hours during a week but exceeded the same and paid for such excess period to other members of the pooling arrangement, such payment is known as purchasing loom hours. Though looms are capital assets, the payment was for their operations. By the purchase of loom hours no new asset was created and there was no addition to or expansion of the profit-making apparatus of the company. Hence, such payment is of revenue nature.

Illustration 57 : A Public Limited Company engaged in the generation and distribution of power had its business acquired by the Government in June 2008. Certain items of plant and machinery used by the Company in its business were taken over by the Government at a price which resulted in the Company realizing a surplus of ₹ 26,60,000 over its written down value. The compensation was received by the Company in April 2009 which was accepted by it under protest. The Company proceeded to initiate arbitration proceedings under law and was granted an additional compensation of ₹ 16 Lakhs. This was decided by the arbitrators in December 2008 and received by the Company in March 2010.

The Company claims that the assessment of the Company to tax should not be made since the business was completely taken over by the Government in June 2008 and at the time of final determination of compensation in March 2010, the Company did not exist.

Do you agree to the Company's claim? Discuss with reference to the Assessment Year(s) to which the claim to tax, if any, can be related.

Solution :

1. In case of acquisition of property under any law, the balancing charge u/s 41(2) is taxable as income of the previous year in which it becomles due and not in the year in which it was settled. [United Provinces Electric Supply Co. 110 Taxman 134 (SC)]
2. As per Explanation to Section 41(2), even when the business is not in existence, such balancing charge shall be taxable in its hands as if it is in e.xistence in the relevant previous year.
3. **Conclusion :**
   (a) Surplus of ₹ 26,60,000 — taxable in AY 2009-10 as Balancing Charge under the Business Income.
   (b) Additional Compensation of ₹16,00,000 determined in December 2009 taxable as Balancing Charge in AY 2010-2011 under Business Income.

Illustration 58 : Mr. Tony has estates in Rubber, Tea and Coffee. He derives income from them. He has also a nursery wherein he grows plants and sells. For the previous year ending 31.3.2010, he furnishes the following particulars of his sources of income from estates and sale of Plants. You are requested to compute the taxable income for the Assessment year 2010-2011.

(a)	Manufacture of Rubber	₹ 5,00,000
(b)	Manufacture of Coffee grown and cured	₹ 3,50,000
(c)	Manufacture of Tea	₹ 7,00,000
(d)	Sale of Plants from Nursery	₹ 1,00,000

Assessee : Mr. Tony **Previous Year : 2010-11** **Assessment Year : 2011-2012**

From the words 'Mr. Tony has estates', it is presumed that the had grown Tea, Coffee and Rubber, and also Plants in his Estates, and the amount given is the Profits of the Business.

Computation of Taxable Income is as under —

Particulars	Agricultural Income	Non-Agricultural Income
Growing and Manufacture of Rubber **[Rule 7A]**	5,00,000 × 65% = ₹ 3,25,000	5,00,000 × 35% = ₹ 1,75,000
Grown and Cured Coffee **[Rule 7B]**	3,50,000 × 75% = ₹ 2,62,500	3,50,000 × 25% = ₹ 87,500
Growing and Manufactured of Tea **[Rule 8]**	7,00,000 × 60% = ₹ 4,20,000	7,00,000 × 40% = ₹ 2,80,000
Growing & Sale of Plant by Nursery **[See Note]**	₹ 1,00,000	—
Total	**₹ 11,07,500**	**₹ 5,42,500**
Taxable Income	**Exempt u/s 10(1)**	**₹ 5,42,500**

9.7 CAPITAL GAINS

Charging Section: 45(1)

Any profits or gains arising from transfer of any capital asset shall be chargeable to income-tax as Capital Gains and shall be deemed to be the income of the previous year in which the transfer took place.

PROVISION FOR COMPUTATION OF CAPITAL GAINS AND RELATED EXEMPTIONS

1. Capital Asset: [Section 2(14)]

Includes :

Property of any kind, whether or not connected with business or profession

Excludes :

(a) Stock in trade
(b) Personal Effects
(c) Rural Agricultural Lands in India
(d) 6 ½ % Gold Bonds 1977; 7% Gold Bonds 1980 & National Defence Gold Bonds, 1980.
(e) Special Bearer Bonds, 1991
(f) Gold Deposit Bonds issued under Gold Deposlt Scheme 1999

N.B: Items (d) and (e) instruments do not exist now; they are only for academic significance. For the above purpose:

(a) **Stock in Trade means:** Raw material or Consumable stores used by the assessee In his business or profession.
(b) **W.e.f. A.Y. 2008-09, Personal effect means** Movable property Including wearing apparel and furniture held for personal use by the assessee or any member of his family dependent on him but excludes:

(i) Jewellery | (ii) Archaeological collections | (iii) Drawings
(iv) Paintings | (v) Sculptures or | (vi) Any work of art.

2. Short-term Capital Asset (STCA) [Section 2(42A)]

(a) **For all Capital Assets other than financial assets:** Capital assets held by an assessee for not more than 36 months Immediately preceding the date of transfer are treated as short-term capital assets.
(b) **For Financial Assets:**

Equity (or) Preference shares of a company, Unit of UTI or unit of Mutual Fund u/s 10(23D), Securities listed in a recognized stock exchange, Zero Coupon Bonds treated as STCA if they are not held for more than 12 months.

3. Long-term Capital Asset (LTCA) [Section 2(29A)] - Not a short-term capital asset.

4. Capital Gains:

(a) **Long-term Capital Gain [Section 2(29B)]** - Capital Gain arising from transfer of Long Term Capital asset.
(b) **Short-term Capital Gain [Section 2(42B)]** - Capital Gain arising from transfer of Short Term Capital Asset.

5. Zero Coupon Bond [Section 2(48)]

a. Zero Coupon Bond means a bond —

(i) **Issued By:** (I) Any Infrastructure Capital Company, or (ii) Infrastructure Capital Fund, or (iii) Public Sector Company.

(ii) **Issue Date:** On orafter 01.06.2006.

(iii) **Payment/Benefit:** No payment and benefit Is received or receivable before maturity or redemption from Infrastructure Capital Company / Infrastructure Capital. Fund/Public Sector Company, and

(iv) Notified by Central Government: The Central Government may, by notification In the Official Gazette, specify in the behalf.

b. **Treatment in the hands of Issuer u/s 36(1) (ilia) :** Discount on **Zero Coupon Bonds.**

(i) Is the difference between Maturity / Redemption Value and the issue price.

(ii) Can be written off on a pro-rata basis over the period of the bond.

c. **Treatment in the hands of Investor:**

(i) **Financial Asset:** Zero Coupon Bond is a Financial Asset for the purpose of Capital Gains.

(ii) **Taxability:** Transfer or Maturity of Zero Coupon Bond will be taxable as Capital Gains.

6. Infrastructure Capital Company and Infrastructure Capital Fund for the purpose of Zero Coupon Bonds.

a) **Infrastructure Capital Company [Sec.2 (26A)] :** It Is a Company which makes investment by way of acquiring shares or providing long-term finance to any prescribed enterprise or undertaking.

b) **Infrastructure Capital Fund [Sec.2 (26B)] :** It is a Fund operating under a Trust Deed established to raise monies by Trustee for investment by way of acquiring shares or providing long-term finance to any prescribed enterprise or undertaking.

c) **Prescribed Undertaking/Enterprise :**

(i) Enterprise/Undertaking wholly engaged in the infrastructure business referred in Sec. 80-IA/80-IAB, or

(ii) Housing Projects referred in Section 80-IB, or

(iii) Project for constructing a Hotel (atleast of 3 Star Category) or Hospital with one hundred beds for patients.

7. Transfer u/s 2 (47)

Sec 2(47)	Nature of Transaction
(i)	Sale, exchange, relinguishment
(ii)	Extinghishment of any rights in an asset
(iii)	Compulsory acquisition thereof under any law
(iv)	Conversion of capital asset into stock-in-trade
(iva)	Maturity/Redemption of a Zero Coupon Bond
(v)	Part performance of a Contract u/s 53A of the Transfer of Property Act of possesion of property
(vi)	Transactions, which have the effect of transferring/enabling the enjoyment of immovable property.

Sale: As per Sec. 54 of the Transfer of Property Act, "Sale is a transfer of ownership in exchange for a price paid or promised or part-paid and part promised".

Exchange: As per the Transfer of Property Act,1882, when two persons mutually transfer the ownership of one thing for the ownership of another, neither thing or both things being money only, the transaction, is called an exchange.

Relinquishment: Relinquishment means withdrawn from, abandoning or giving up anything. Where an assessee gives up the right to claim specific performance for purchase of immoveable property it is relinquishment of a capital-asset.

Extinguishment or any rights in an asset: It means total destruction, annihilation, termination or extinction of a capital asset. It refers to extinguishment of rights on account of transfer (Vania Silk Mills Ltd.)

8. Indexed Cost of Acquisition (ICA) and Indexed Cost of Improvement (ICI) [Section 48]

When asset is acauired bv assessee himself

(a) **Acquired prior to 1.4.1981**

Indexed Cost Acquisition

Fair Market Value on 01.04.1981 or cost of acquisition whichever is high × Cost of Inflation Index for the year of transfer/100.

(b) **Acquired after 1.4.1981,**

$$\textbf{Indexed cost of Acquisition} = \frac{\text{Cost of Acquisition} \times \text{CII for year of transfer}}{\text{CII for year of acquisition}}$$

Indexed Cost of Improvement in both the above cases

$$= \frac{\text{Cost of Im provement} \times \text{CII for year of transfer}}{\text{CII for year of Im provement}}$$

ICI can be computed **only if it is incurred after 01.04.1981.**

When assessee received the asset u/s 47

(c) **Asset acquired prior to 1.4.1981 by previous owner and received by the assessee prior to 1.4.1981.**

ICA = FMV on 1.4.81 or Cost of acquisition by previous owner whichever is high x CII for year of transfer/ 100.

(d) **Asset acquired prior to 1.4.81 by previous owner and received by the assessee after 1.4.81.**

ICA = FMV on 1.4.81 or Cost of acquisition by previous owner whichever is high x cn for Year of transfer/ CII of year in which it is **first held by the assessee.**

(e) **Asset acquired after 1.4.1981 by previous owner and received by assessee after 1.4.1981.**

$$\text{Indexed Cost of Acquisition} = \frac{\text{Cost of acquisition to the previous owner} \times \text{CII for year of transfer}}{\text{CII of year in which the asset } \textbf{is first held by the assessee}}$$

In the above cases: Indexed Cost of Improvement = Cost of improvement × CII for year of transfer/ cn for year of improvement.

9. List the circumstances in which benefit *of* indexation is not available

Nature of LTCA Transferred	**Assessee Not Eligible for**
Bonds/Debentures except Capital Indexed Bonds Issued by Govt.	All Assesses
Shares/Debentures of Indian Company acquired by using Convertible Forex under First Proviso to Section 48	Non-Residents
Depreciable Assets	All Assesses
Slump Sale	All Assesses
Units Purchased in Foreign Currency u/s 115AB	Off Shore Fund
GDRs purchased in Foreign Currency u/s 115AC Individual	Non-Residents and Resident
Securites u/s 115AD	Foreign Institutional Investors.
Foreign Exchanae Asset u/s 1150	Non-Resident Indian

10. Cost Inflation Index as notified by the Central Government is as under:

Financial Year	Cost inflation Index (CII)	Financial Year	Cost Inflation Index (CII)	Financial Year	Cost Inflation Index (CII)
1981-1982	100	1992-1993	223	2003-2004	463
1982-1983	109	1993-1994	244	2004-2005	480
1983-1984	116	1994-1995	259	2005-2006	497
1984-1985	125	1995-1996	281	2006-2007	519
1985-1986	133	1996-1997	305	2007-2008	551
1986-1987	140	1997-1998	331	2008-2009	582
1987-1988	150	1998-1999	351	2009-2010	632
1988-1989	161	1999-2000	389	2010-2011	711
1989-1990	172	2000-2001	406		
1990-1991	182	2001-2002	426		
1991-1992	199	2002-2003	447		

11. EXCEPTIONS TO TRANSFER *u/s* 46 & 47

Section	Nature of transaction not considered as a Transfer
46(1)	Distribution of a capital asset in specie on liquidation of a company by a liquidator to its shareholders Is not a transfer.
47(i)	Any distribution of capital assets on the total or partial partition of a HUF.
47(iii)	Any transfer of a capital asset under a gift or will or an irrevocable trust. Exception is also applicable In case of shares or securities received by employees from the company free of cost or at a concesslonal rate. However, a provision has been added to provide that this clause shall not apply to transfer under a gift or an irrevocable trust of a capital asset being shares, debentures or warrants allotted by a company directly or Indirectly to its employees under ESOS or ESOP of the company offered to such emoloyees in accordance with the auldelines Issued by the Central Government in this behalf.
47(iv)	Transfer of any capital asset by a holding company to Its 100% subsidiary company which is an Indian company.
47(v)	When a transfer has been made by a 100% subsidiary to its Indian holding company. Both the sections 47(iv) and (v) are subject to the restrictive conditions imposed u/s 47A(1), which is as follows: (a) If within the course of 8 years from the date of transfer, holding company looses Its 100% stake on the subsidiary company. (b) If the transferee comoanv transfers this caoital asset as their stock-In-trade within 8 Years. In both the above cases, the earlier exemption so granted shall be withdrawn and there would arise incidence of capital gains, in the original year of transfer, which would be initiated as per Sec.155 (7B) amendment proceedings.
47(vi)	Transfer of a capital asset in a scheme of amalgamation where the amalgamated company is an Indian company. The conditions of Sec.2(1B) of the Act, must be fulfilled: (a) All the property and liabilities of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of amalgamation. (b) Shareholders holding not less than 75% in the value of shares in amalgamating company or companies (other than shares held therein immediately before the amalgamation or by a nominee for the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of amalgamation.

	Amalgamation as per income-tax includes merger and absorption, provided the conditions of sec.2 (1B) are satisfied.
47(via)	Transfer of shares of an Indian company by an amalgamated foreign company to a foreign amalgamated company, provided the following conditions are satisfied : (a) The transfer of shares is under a scheme of amalgamation between two foreign companies; (b) At least 25% of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; (c) No tax is levied on such capital gain In th country where foreign amalgamating company is Incorporated.
47(viaa)	Transfer of capital asset by a banking company to a banking institution in a scheme of amalgamation sanctioned b the Central Government u/s 45(7) of the Bankin Act 1949.
47(vib)	Transfer of a capital asset by the Demerged Company to the Resulting Indian company, subject to : the fulfillment of the following conditions : (a) Transfer of capital asset should be from demerged company to a resulting company; (b) Resulting company should be an Indian company; (c) Transfer of capital asset should be made In a scheme of demerger.
47(vic)	Transfer of shares of Indian company by a demerged foreign company in a demerger to a foreign company, shall not be treated as transfer provided the following conditions are fulfilled : (a) The shareholders holding not less than 75% in value of shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and (b) No tax Is levied on capital gain in the foreign country in which the demerged company is Incorporated. The provisions of Sections 391 to 394 of the Companies Act,1956 shall not apply In case of demergers referred In this clause.
47(vica)	Any transfer in a business reorganization, of a capital asset by the predecessor co-operative bank to the successor co-operative bank.
47(vicb)	Any transfer by a shareholder, in business reorganization, of a capital asset being a share or shares held by him In the predecessor co"operative bank if the transfer is made In consideration of allotment to him of any share or shares in the successor co-operative bank.
47(vid)	Transfer/allotment of shares by the resulting company to the shareholders of the demerged company in a scheme of demerger. Only shares must be exchanged against shares.
47(vii)	Allotment of shares in amalgamated company to the shareholders of amalgamating company, will not be considered as a transfer if : (a) The transfer is made in consideration of allotment to him of any share or share in the amalgamated company; and (b) The amalgamated company is an Indian company.
47(viia)	Transfer of shares/bonds or Global Depository Receipts (GDRs) referred to in Section 115AC (1), i.e., those bonds, shares or GDRs of a public company (being an Indian company) Is' purchased in foreign currency, outside India by a non-resident to another non-resident.
47(viii)	Transfer of urban agricultural land in India effected before 1.3.1970
47(ix)	Transfer of a capital asset being a work of art, archaeological, scientific or art collection, book, manuscript, drawing, painting, photograph or print to Government or University or National Museum or National Art Gallery, National Archives or any other public museum or institution, as may be notified by the Central Government in the Official Gazette to be of national Importance or to be of renown throughout any State or States.
47(x)	Conversion of bonds or debentures, debentures-stock or deposit certificates in any form, of a company into shares or debentures of that company
47(xi)	Transfer of membership of a recognized stock exchange in India by a person (not being a company) on or before 31st December 1998, toa company in exchange of shares allotted by that company, subject to the restrictions of Sec.47A(2)

47(xii)	Transfer of capital asset being land of a sick industrial company made under a scheme prepared and sanctioned u/s 18 of the Sick Industrial Companies (Special Provisions) Act, 1985, where such sick industrial company is being managed by its worker's co-operative. Transfer should be made during the. period commencing from the previous year in which the said company has become a sick industrial company u/s 17(1) of the Act and ending with the previous year during which the entire net worth of. such company become equal to or exceeds the accumulated losses.
47(xiii)	Transfer of capital assets or intangible assets or any transfer of capital asset in the course of demutualizatlon or corporatisation of a recognized stock exchange in India, on succession of a firm concern by a company, provided the following conditions are fulfilled : (a) All the assets and liabilities of the erstwhile firm or AOP/BOI, relating to the business immediately before succession becomes the assets and liabilities of the company; (b) All the partners of the firm before the succession becomes the shareholders of the company in the same proportion in which their capital accounts stood in the books of the firm on the date of succession; (c) The partners are not in receipt of any other benefit, whether directly or Indirectly, in any form or manner, other than by way of allotment of shares In the company; (d) The aggregate of the shareholdlng in the company of the partners of the firm is not less than 50% of the total voting power in the company; (e) Their shareholding continues for a period of 5 years from the date of the succession; (f) The demutualization or corporatisation of a recognized stock exchange in India Is carried out in accordance with a scheme of corporatisation which is approved by SEBI.
47(xiiia)	Transfer of a capital asset being a membership right held by a member of a recognized stock exchange In India for acCiulsition of shares and trading or clearing rights acquired by such member in that recognized stock exchange in accordance with a scheme of demutuallzation or corporatlsatlon which is approved by SEBI.
47(xiv)	Transfer of capital asset or Intangible assets where a sole proprietary concern is succeeded by a company, provided the following conditions are fulfilled: (a) All the assets and liabilities of the erstwhile sole proprietary concern, relating to the business immediately before succession becomes the assets and liabilities of the company; (b) The sole proprietor is not in receipt of any other benefit, whether directly or indirectly, in any form or manner, other than by way of allotment of shares in the company; (d) The shareholdlng of the sole proprietor in the company Is not less than 50% of the total voting power in the company; (e) His shareholding continues for a period of 5 years from the date of the succession;
47(xv)	Any transfer under the Securities Lending Scheme,1997 for lending of any securities under an agreement or arrangement, between the assessee and borrower of securities as per the guidelines issued by SEBI or RBI.

12. COST OF ACQUISITION u/s 55(2)

- The price paid by the assessee for the acquisition of the asset.
- Expenses incurred for completing the title Is included In the cost of the asset.
- Expenses incurred In acquiring the asset or acquiring better voting rights
- Interest on capital borrowed for acquiring capital asset (however, expenditure incurred for acquiring loan amount for acquiring capital asset is not a part of cost of acquisition)
- Amount paid for discharge of mortgage, where the asset was mortgaged by the previous owner.
- Extra amount paid by coparcener for full ownership in specific property allotted to him by HUF

13. DEEMED COST OF ACQUISITION

a) **Cost to the Previous owner u/s 49 (1):** where the capital asset became property of the assesee, the cost of acquisition of the asset shall be deemed to be cost for which the previous owner of the property acquired it, in the following cases:

(i) on the distribution of assets on total or partial partition of HUF;
(ii) under a gift or will;
(iii) by succession, inheritance or devolution;
(iv) distribution of assets on the liquidation of a company;
(v) transfer to a revocable or Irrevocable trust;
(vi) transfer by a wholly owned Indian subsidiary company to Its holding company or vice versa;
(vii) transfer In the scheme of amalgamation of two Indian companies u/s 47(vl);
(viii) transfer in the scheme of amalgamation between two foreign companies;
(ix) transfer of capital asset by a banking company to a banking Instltutition In. the scheme of amalgamation;
(x) transfer in the case of business reorganization by a predecessor cooperative bank to the successor cooperative bank
(xi) on the conversion of a self acquired property of a member of an HUF to the joint property of the HUF.

b) **Cost of Shares of Amalgamated Company u/s 49(2):** the cost of acquisition of shares in the amalgamating company.

c) **Cost of acquisition in case fof shares/debentures acquired on conversion of debentures u/s 49(2A):** the cost of the shares/debentures issued on conversion shall be deemed to be that part of the cost of debenture/ debenture stock/deposit certificate, in relation to which such an asset is acquired by the assessee.

d) **Cost of acquisition of shares, debentures or warrants u/s 49(2AA):** the fair market value on the date of exercise of such option.

e) **Cost of acquisition of specified security or sweat equity shares ujs 49(2AB) read with Sec.115 WC (l)(ba):** (w.e.f. A.Y.2010-11) the fair market value of securities on the date on which the option vests with the employee.The holding period shall be reckoned from the date of allotment or transfer of such shares.

f) **Cost of acquisition of resulting company's shares on demerger. [Section 49(2C)]**

$$\frac{\text{Cost of acquisition of Demerged Co™s Shares} \times \text{Net Book Value of assets transferred to Resulting Co.}}{\text{Net Worth of the Demerged Company before demerger}}$$

Net Worth of demerged company = Paid up Share Capital and General Reserve as per books before demerger.

g) **Cost of acquisition of demerged company's shares after demerger. [Section 49(2D)]**

Original Cost of Acquisition of shares in demerged company Less Cost of acquisition of Resulting Company's shares (as calculated above)

i) **Cost.of acquisition to Transferee Company where section 47A is applicable: [section 49(3)] -** the cost of acquisition of the capital asset to the transferee company shall be the cost for which such asset was acquired by it.

h) **Business reorganization of Co-operative Bank [Sec 49(2E)]:**

Sec 49(2C) and Sec 49(2D) are applicable to business reorganization of a Co-operative Bank u/s 44DB.

j) **Cost of acquisition of Bonus Shares u/s 55(2)(iiia)**

- Where bonus shares are issued prior to 1.4.81, the cost of acquisition shall be the fair market value as on 1.4.81.
- Where such bonus shares are issued on or after 1.4.81, the cost of acquisition shall be taken as NIL.

k) **Cost of acquisition of Original Shares u/s 55(2)(b)**

- Where the original shares were acquired prior to 1.4.81, the cost of acquisition shall be the higher of the fair market value as on 1.4.81 or the original cost of acquisition.
- Where such shares were acquired on or after 1.4.81, the original cost of acquisition shall be considered.

l) **Cost of Right Shares u/s 55(2) (aa) read with sec. 55 (2) (b)**

- Cost of acquisition shall be the amount actually pald by the assessee to acquire such shares [sec.55(2)(aa)(III)]
- If such shares were acquired prior to 1.4.81, the assessee shall be entitled to opt for fair market value on 1/4/81 as the cost of acquisition.
- If the rights entitlement is renounced, the cost of acquisition of renouncing the rights entitlement to the renouncer is nil.
- Where the renounce acquires the right entitlement, the cost of acquisition of right shares to the renounce is the aggregate of (i) the amount paid to the renouncer (ii) the amount paid by him to the company/ institution for acquiring such right shares [sec.55(2)(aa)(iv)].

m) **Cost of acquisition of (i) shares allotted to a shareholder under a scheme of Demutualization or Corporatisation and (ii) Trading or Clearing Rights of a Recognized Stock Exchange [Sec. 55 (2) (ab)]**

- The cost of acquisition Is the cost of acquisition of his original membership of the stock exchange.
- Cost of Right is taken as NIL.

14. Capital gain in case of amount received from an insurer on account of damage or destruction of any capital asset u/ s 45(1A)

Damage or destruction of assets as a result of	Chargeability
1. Flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature or	1. Chargeable as income of the year in which the money or other asset was received from the insurer.
2. Riot or civil disturbance	2. In case of receipt of other Assets the Fair Market Value (FMV) of the consideration the Asset is received.
3. Accidental fire or explosion	3. Capital Gain = Money received or FMV of Asset received **Less** Cost of Acquisition or indexed cost of Acquisition.
4. Action by an enemy or action taken in combating an enemy (whether with or without a declaration of war)	

Note for Depreciable Assets :

1. The **compensation received** shall be **reduced from the WDV** of the block and any **surplus** shall be chargeable as **Short Term Capital Gains and loss** shall be treated as **Short Term Capital Loss**.
2. If some **asset still exists** in the block and **no surplus is available, then depreciation** may be **claimed on the balance**.

Illustration 59 : Ms. Ryma owns a house property which was purchased by her on 1.5.1979 for ₹3 lacs. The said property was destroyed by fire on 3.4.10 and she received a sum of ₹25 lacs from the insurance company during the year. The market value of the above property as on 1.4.81 was ₹ 4,00,000. Compute capital gains for the P.Y. 2010-11.

Solution :

Assessee Ms. Ryma

Previous Year : 2010-11 **Assessment Year : 2011-12**

Consideration for Transfer	25,00,000
Less : Indexed Cost of Acquisition	
$4,00,000 \times \frac{711}{100}$	28,44,000
Long Term Capital Loss	(3,44,000)

Illustration 60 : The w.d.v. of the block of assets as on 1.4.2010 was ₹5 lacs. Rate of Depreciation @ 15%. An asset of the same block was acquired on 11.5.10 for ₹ 3 lacs. There was a fire on 18.9.2010 and the assets were destroyed by fire and the assessee received a sum of ₹ 12 lacs from the insurance company. Compute the capital gain assuming:

(a) All the assets were destroyed by fire

(b) Part of the block was destroyed by fire

Would your answer differ if the assessee received ₹ 7,00,000 from insurance company assuming:

(a) All the assets were destroyed by fire

(b) Part of the block was destroyed by fire

Solution :

If Compensation received ₹ 12,00,000

Block of Assets u/s 2(11)

1.4.10	W.D.V. of the Block	5,00,000	5,00,000
	Add : Cost of New Asset purchased relating to the Block	3,00,000	3,00,000
		8,00,000	8,00,000
	(–) Compensation received	12,00,00	12,00,000
	Short Term Capital Gains	4,00,000	4,00,000
		u/s 50(2)	u/s 50(1)

If Compensation Received ₹ 6,00,000

Block of Assets u/s 2(11)

1.4.10	W.D.V. of the Block	5,00,000	5,00,000	
	Add : Cost of New Asset purchased relating to the Block	3,00,000	3,00,000	
		8,00,000	8,00,000	
	Less : Compensation received	7,00,00	7,00,000	
	Short Term Capital Loss	1,00,000	1,00,000	
		u/s 50(2)	WDV	(Depreciation
	Less : Depreciation @ 15%		15,000	to be cahrged
			85,000	on WDV)

15. Capital gain on conversion of capital asset into stock-in-trade u/s 45(2)

- When a capital asset is converted into stock-in-trade, it is a transfer u/s 2(47).
- Transfer shall deemed to have taken place in the year in which the asset is so converted.
- Capital gain will arise in the previous year in which such converted asset is sold or otherwise transferred.
- Indexation of cost of acquisition and cost of improvement, if required, will be applicable for the previous year in which such conversion took place.
- **Full value of consideration** = Fair Market Value of the capital asset(on the date of conversion)
- There will also arise Business Income in the previous year in which such converted asset is being sold.
- **Business income** = Sale price- Fair market value of the asset on the date of conversion.

Illustration 61 : Mr.B invested ₹ 2,00,000 on the purchase of gold ornaments on 10.1.90. He holds the gold ornaments as investments. On 16.1.2008. he started a business in dealing in jewellery and converts his holding into his stockin-trade. The market value of the gold ornaments as on the date of conversion was ₹ 10,00,000 and therefore, B credited his capital account by ₹ 10,00,000 and debited stock account by ₹ 10,00,000. The gold ornaments are now reflected in the business of Mr. B. these gold ornaments were sold in the previous year 2010-11 for a sum of ₹ 15,00,000. Compute the capital gain and business income.

Solution :

The conversion of capital asset into stock-in-trade is treated as a trsnsfer as per sec. 2(47).

Capital Asset was converted into stock-in-trade on 16.1.08 i.e. during the previous year 2007-08. Therefore, it will be treated as transfer of the previous year 2007-08. The taxability for capital gains shall arise only in the previous year in which the asset is sold i.e. previous year 2010-11.

Capital Gains for the Assessment year 2011-12

Consideration for Transfer (Market value as on the date of conversion)		10,00,000
Less :	Indexed Cost of Acquisition $2,00,000 \times \frac{551}{172}$	6,40,698
	Long term Capital Gains	**3,59,302**

Business Income for the A.Y. 2011-12

	Sale Price	15,00,000
Less :	Fair Market Value as on the date of conversion	10,00,000
		5,00,000

Illustration 62 : Romit acquired a plot of land on 1.6.75 for ₹4,00,000. He converts the plot into stock in trade of his real estate dealing business on 18.2.2007 when the fair market value of the plot was ₹ 35,00,000. The stock-in-trade is sold by him on 18.5.2010 for ₹ 40,00,000 (FMV as on 1.4.81 was ₹ 6,00,000 and FMV as on 1.4.76 ₹4,50,00).

Solution :

The conversion of capital asset into stock-in-trade is treated as a transfer as per sec. 2(47). Capital asset was converted into stock-in-trade on 18.2.2007 i.e. previous year 2006-07.

Computation of Capital Gains

		₹
Consideration for Transfer (FMV)		35,00,000
Less :	Indexed Cost of Acquisition $6,00,000 \times \frac{519}{100}$	31,14,000
	Long term Capital Gains	**3,86,000**

Computation of Business Income

	Sale Proceeds of HP	40,00,000
Less :	FMV on the date of conversion	35,00,000
		5,00,000

16. Chargeability of Capital Gain on Transfer of Beneficial interest in Securities by the Depository u/s 45(2A)

Section 45(2A) was inserted by the Depositories Act, 1996. the said Act provides that dematerialisation of securities to avoid physical movement of scrips in order to ensure faster settlement of trade. In the register of the issuing company, the depository (a company registered with SEBI) appears to be a registered owner of the dematerialised securities. In the books of the depository, the real owner of the securities appears as the beneficial owner.

A depository interacts with the investors through participants (agents of depository). For this purpose investors have to enter into an agreement and open an account (which is just like a bank account) with the participant. An investor may hold his dematerialised holdings in more than one account with one or more depositories. All the transactions of sale and purchase of dematerialised securities are through the participants and are entered in the respective accounts. The ownership is transferred through book entries in the statement of accounts.

- Capital Gain accrues to the Beneficial Owner (i.e. the Investor)-taxable as the income of the beneficial owner of the previous year in which the transfer took place.
- Cost of Acquisition and period of holding is to be determined on FIFO method

Illustration 63 : The depository account shows the following details of M's holdings:

Date of Credit	Particulars	Quantity
10.11.2001	Shares of XYZ LTD.purchased in physical form on 10.11.2001 @ ₹ 20 per share	300
30;11.2002	Purchased dematerialised shares of Y Ltd. on 25.11.2002 @ ₹ 70 per share	500
06.12.2004	Shares of XYZ LTD. held in physical form, were got dematerialised on 01.12.2004	

M sold 600 dematerialised shares on 6th June 2010 @ ₹ 200 per share. Brokerage is paid @2% of sale price. Compute capital gains.

Solution :

(a) Person Liable : The sale of shares held under Dematerialized format with a depository is chargeable to tax as the income of the beneficial owner.

(b) Cost of Acquisition and period of holdings : The cost of acquisition and the period of holding shall be determined on FIFO Method. [Circular No. 768 datd 24.6.1998]

(i) FIFO method will be applied for each account independently.

(ii) When physical stock is dematerilized, the date of credit into the depository account shall be considered for the purpose of FIFO method, but indexed cost of acquisition shall be computed on the basis of year of acquisition.

Computation of Capital Gains

	₹
Consideration for Transfer	
600 Share @ ₹ 180 per share	1,20,000
Less : Indexed Cost of Acquisition	(55,671)
(i) $500 \times 70 \times \frac{711}{447}$	
(ii) $100 \times 20 \times \frac{711}{480}$	(2,693)
Long Term Capital Gain	**61,636**

17. Capital gain on transfer of capital asset by a partner/member to a firm/AOP/BOI as capital contribution u/s 45(3)

- There shall arise capital gain from the transfer of capital asset held by a person, to a firm or AOP or BOI in which he is or becomes a partner or member. . Such transfer of capital asset may be by way of capital contribution or otherwise.
- It shall be chargeable to tax as his income of the previous year in which such transfer took place.

- **Full value of consideration** (for computing capital gains) = the amount recorded in the books of accounts ofthe firm.
- **Market value of the asset on the date of transfer is not relevant.**
- Cost of acquisition and cost of imrovement shall be allowed to be indexed accordingly.

Illustration 64 : Nisith acquired a property by way of gift from his father in the previous year 1988-89 when its FMV was ₹ 3 lacs. His father had acquired the property during 1981-82 for ₹ 4 lacs. This property was introduced as capital contribution to a partnership firm in which Nisith became a partner on 15.6.2010. The market value of the asset as on that date was ₹ 20 lacs, but it was recorded in the books of account of the firm at ₹ 17 lacs. Is there any capital gain chargeable in the hands of Mr. Nisith?

Solution :

Previous Year : 2010-11 **Mr. Nisith** **Assessment Year : 2011-12**

Computation of Capital Gains

	₹
Consideration for Transfer	17,00,000
Less : Indexed Cost of Acquisition	
$4,00,000 \times \frac{711}{161}$	17,66,460
Long Term Capital Loss	**66,460**

(a) Full value of consideration is taken as the value at which it is recorded in the books of accounts of the firm.

(b) Cost of acquisition is taken as cost to the previous owner but indexation has ben done from the date it was first held by the assessee.

(c) Market value of the aset on the date of transfer is not relevant.

Illustration 65 : Ayan has two motor cars which are used by him exclusively for his personal purposes. The cost of the cars was ₹ 6,50,000 and ₹ 8,00,000. The first car was transferred by him on 15.1.2011 to a firm in which he is a partner as his capital contribution. The market value of the car as on 15.1.2011 is ₹ 5,00,000, but it was recorded in the books of account of the firm at ₹ 6,00,000. Compute the capital gain if any, chargeable for the A.Y. 2011-12.

Solution :

Since the car is a moveable property and was used by Mr. Ayan for his perosnal purposes only, it will be trated as a personal effect.

W.e.f. A.Y. 2008-09, "Personal effect" means moveable property including wearing apparesl and furniture held for personal use by the assessee or any member of his family dependent on him but excludes :

(i) Jewellery (ii) Archeacological collections (iii) Drawings (iv) Paintings (v) Sculptures (vi) Any work or art.

18. Capital gain on transfer of a capital asset by way of distribution on the dissolution of a firm, AOP, BOI u/s 45(4)

- **Transfer:** Distribution of a Capital Asset by a Firm / AOP / BOl on its dissolution or otherwise **is a** transfer.
- **Year of Taxability: Capital gain** shall be chargeable to tax **in the hands of Firm/ AOP /BOI** in the **previous year** in which such **transfer** takes place.
- **Capital gain** = Fair Market Value on the date of transfer **Less** Cost or Indexed cost of acquisition.
- **Depreciable Assets:** Transfer of **depreciable asset** results in **short-term capital gain or loss** u/s 50.

Illustration 66 : PQR & Co. is a partnership firm, consisting 3 partners P, Q and R. the firm is dissolved on 31.12.10. The assets of the firm were distributed to the partners as under :

Particulars	Block of machinery (given to P)	Stock (given to Q)	Land (given to R)
Year of acquisition	1990-91	2002-03	1978-79
Cost of acquisition (₹)	7,20,000	4,00,000	10,000
Market value as on 31.12.10	15,00,000	6,00,000	25,00,000
WDV as on 31.12.10	10,40,000	—	—
Value at which given to partners as per agreement	10,00,000	4,50,000	18,00,000
Market value as on 1.4.81	—	—	2,70,000

Compute the income taxable in the hands of the firm for the assessment year 2011-12. What shall be the cost of acquisition of such assets to the partners of the firm?

Solution :

Computation of Short Term Capital Gains on block of machinery

	₹
Sale consideration (i.e. the market value)	15,00,000
Less : Cost of Acquisition (WDV of the block)	10,40,000
Short Term Capital Gains	**4,60,000**

Income from Business (on transfer of stock)

	₹
Market value of stock	6,00,000
Less : Cost of Acquisition	4,00,000
	2,00,000

Computation of Capital Gains on transfer of land

	₹
Consideration for transfer	25,00,000
Less : Indexed cost of Acquisition : $2,70,000 \times \frac{711}{100}$	19,19,700
	5,80,300

Cost of acquisition of assets to the partners

	₹
Partner "P"	1,00,000
Partner "Q"	4,50,000
Partner "R"	18,00,000
Less : Indexed cost of Acquisition : $2,70,000 \times \frac{711}{100}$	19,19,700
	4,80,300

Illustration 67 : A firm consists of 3 partners X, Y & Z. Z retires from the firm on 15.10.2009. His capital balance and the profits till the date of retirement stood at ₹ 16 lacs. The firm transferred Its land to Z in settlement of his account. The market value of the land as on that date was ₹ 30 lacs. The land was acquired by the firm on 1.5.93 for ₹ 4 lacs.

Compute the capital gains in the hands of the firm.

Solution :

Computation of Long Term Capital Gains for the A.Y. 2011-12

	₹
Consideration for Transfer	30,00,000
Less : Indexed Cost of Acquisition $4{,}00{,}000 \times \frac{711}{244}$	11,65,574
Long Term Capital Gain	**18,34,421**

19. Capital gain on transfer by way of compulsory acquisition of an asset u/s 45(5)

- **Chargeability:** It is a **transfer u/s 2(47)** chargeable to tax under the head **Capital Gains.**
- **Taxability of Normal/Original Compensation [Section 45(5)(a)]**
  - Normal or **original compensation** Is taxable in the previous **year in which it is first received.**
  - **Whole of the compensation is taxable** even if a portion of the amount is received.
  - Capital Gain = Whole of the normal compensation Less Cost or Indexed cost of Acquisition.
- **Indexation** shall be applied for the **year in which the asset is compulsorily acquired.**
- **Taxability of Enhanced Compensation [Section 45(5)(b)]**
  - **Enhanced compensation** shall be **taxable** in the previous **year in which it is received.**
  - The Cost of acquisition and the cost of improvement shall be taken as 'NIL'.
  - Capital Gain = Enhanced Compensation received Less Expenses on Receipt of Enhanced Compensation
- **Compensation received by Legal Heirs:** The **Compensation** received subsequent to the **death of the assessee is taxable** in the hands of **his legal heirs.**
- **Reduction of Compensation:** Where normal compensation / enhanced compensation is reduced by Court or Tribunal, then the **Capital Gain shall be recomputed** accordingly.
- **Interest on enhanced compensation** on account of compulsory acquisition is chargeable under the head "Income from other sources".

Illustration 68 : Mr. B acquired a house property for ₹ 50,000 in 1969-70. On his death in October 1985 the house was acquired by his son C. The market value of the house as on 1/4/81 was ₹ 3,00,000. This house was acquired by the Government on 15.3.2008 and a compensation of ₹ 16 lacs is paid to him on 25.3.2010. C filed a suit against the Government challenging the quantum of compensation and the court ordered for giving additional compensation of ₹ 14,00,000. He incurred an expenditure of ₹ 40,000 as an expenditure in connection with the suit. The additional compensation was received on 25.3.2011. Compute capital gains chargeable to tax.

Solution :

Capital Gain on initial compensation shall be chargeable in the A.Y. 2010-11, i.e. for the previous year 2009-10.

Computation of Long Term Capital Gains for the A.Y. 2010-11

	₹
Consideration for transfer (being the compensation)	16,00,000
Less : Indexed Cost of Acquisition $3{,}00{,}000 \times \frac{632}{133}$	14,25,564
Long Term Capital Gains	**1,74,436**

Computation of Long Term Capital Gains for the A.Y. 2011-12

		₹
Enhanced Compensation received		14,00,000
Less :	Cost of Acquisition	NIL
	Cost of Improvement	NIL
	Expenses on Transfer	(40,000)
	Long Term Capital Gains	**13,60,000**

20. Capital gain on conversion of debentures into shares

(i) Conversion of debentures into shares is exempted u/s 47(x)

(ii) In case of subsequent transfer by the transferee, the holding period in the hands of the transferee u/s 2(42A) shall not include the holding period of the earlier asset.

(iii) Const of new asset the hands of the transferee u/s 49 shall be the cost at which old asset is converted.

Illustration 69 : R acquired 400 listed debentures of ₹100 each on 15.9.2009. 50% value of the debentures was converted into 4 listed equity shares of the face value of ₹ l0 each on 20.8.2010. R therefore, received 800 shares of face value of ₹ 10 each and left with 200 debentures. The shares were sold on 25.12.10 @ ₹ 100 per share through recognized stock exchange and R paid ₹ 200 as securities transaction tax. Compute the capital gains chargeable for the assessment year 2011-12.

Solution :

Convertion of Debentures into shares is exempted from Transfer u/s 2(47)(x).

Now there shares are sold within a period of 12 months. It is a Short-term Capital asset.

Computation of Long-Term Capital Gains for the A.Y. 2011-12

		₹
Consideration for transfer of 800 shares @ ₹ 100 each		80,000
Less :	Cost of Acquisition (200 × 100)	20,000
	Short Term Capital Gains	**60,000**

21. Capital gains on distribution of assets by companies in liquidation u/s 46

No capital gain to company on distribution of assets to shareholders on liquidation u/s 46(1) provided the distribution of assets in specie (i.e. in the same form).

22. Shareholders liable to capital gain tax on receiving money and asset on the liquidation of the company:

Where a shareholder on the liquidation of a company, receives any money or other asset from the company in lieu of the shares held by him, such a shareholder shall be chargeable to income tax under the head Capital gains in respect of the excess money and the assets so received over the cost of the shares held by him.

In this case, the consideration price for capital gain purposes shall be money received and/or the market value of the other assets on the date of distribution minus deemed dividend within the meaning of Sec.2(22)(c).

Any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalized or not.

Accumulated profits for a company in liquidation includes all profits of the company upto the date of liquidation.

Accumulated profits should indude the credit balance of profit and loss account, general reserves, investment allowance, capitalized profits and profits of the year upto the date of distribution/liquidation.

However, provisions and reserves meant for specific liability, to the extent of the liability shall not be included. Provision for income tax, provision for dividend, reserve for depreciation do not form part of the accumulated profits.

- Securities premium is not accumulated profits.
- It may consist of exempted incomes, like agricultural income.
- It will indude current profits and all profits of the company till the date of liquidation, subject to the exception provided therein.

Illustration 70. A helds 15,000 shares (10% of total share holding) in B Ltd. which he had purchased on 10.2.96 for ₹ 6,00,000. The company went into liquidation on 16.7.2010 and paid a sum of ₹ 20 per share in cash and an asset whose market value as on the date of distribution i.e. 5.10.10 was ₹ 18,20,000 to A. the accumulated profits of the company were ₹ 15 lacs.

(a) Compute the income of A for the A.Y. 2011-12 assuming that he has no other income.

(b) Compute the capital gain chargeable to tax if the asset of B Ltd. is sold by A for ₹ 15 lacs on 28.3.11.

Solution :

Previous Year : 2010-11 **Mr. B** **Assessment Year : 2011-12**

Computation of Capital Gains

	₹
(a) (i) Capital Gain on transfer of shares	
Total consideration (15,000×20+18,20,000)	21,20,000
Less : Proportionate amount of deeme dividend	
(10% of ₹ 12,86,353)	1,28,635
Less : Indexed Cost of Acquisition $6,00,000 \times \frac{711}{281}$	15,18,149
Long Term Capital Gains	**4,73,216**
(ii) **Income from others Sources**	
Dividiend from Indian Company	Exempted
	4,73,216
(b) **Capital Gain on transfer of asset (B Ltd.)**	
Full Value of Consideration	15,00,000
Less : Cost of Acquisition (being the market value as on the date of distributions)	13,20,000
Short Term Capital Gains	**1,80,000**
Accumulated Profits	**15,00,000**

Dividend tax @ 16.60875% (= 15% + 7.5% + 2% Education cess + 1% SHEC)

Hence, the amount to be distributed plus tax @ 16.60875%

on such amount should be ₹ 15,00,000

$\therefore$ Amount of tax $= 15,00,000 \times \frac{16.60875}{116.60875}$ = ₹ 2,13,6470

$\therefore$ Profits available for distribution = ₹ (15,00,000 − 2,13,647) = ₹ 12,86,353.

23. Capital gain on sale of goodwill of a business, trademark or brand name, tenancy rights, route permits or loom hours, right to manufacture or right to carry on any business.

The following are chargeable to tax as capital gains:

(i) Goodwill of a business. There will not arise any capital gain on the goodwill of a profession.

(ii) Trademark or brand name associated with the business;

(iii) Right to manufacture, produce or process .any article or thing, for a consideration e.g. patent, copyright, formula, design.

(iv) Right to carry on any business;

(v) Tenancy rights;

(vi) Route permits;

(vii) Loom hours.

Cost of acquisition u/s 55(2) (a)

(a) If the assets are purchased- original cost of acquisition.

(b) In any other case- nil

Cost of improvement

(a) In case of goodwill of a business, right to manufacture ,produce or process any article or thing and right to carry on any business (whether self generated or purchased), shall always be taken as nil.

(b) For the other assets as mentioned above, it shall be taken as the actual capital expenditure incurred by the assessee on the improvement of that asset, whether such asset is self generated or purchased.

Computation of Capital Gains in case of Self Generated Goodwill of a Business (Not of a profession), Right to Manufacture/Produce/Process an article or right to carry on any business.

Particulars	**₹**	**₹**
Sale Consideration (Actual Amount)		xxx
Less: Ex enses of Transfer Actual Amount		xxx
Net Consideration		**xxx**
Less: Cost of Acquisition	NIL	
Less: Cost of Improvement	NIL	NI
Taxable Capital Gains		**xxx**

Computation of Capital Gains in case of Self Generated Tenancy Rights, Route Permits, Loom Hours, Trade Marks, Brand Name related with business —

Particulars		**₹**
Sale Consideration (Actual Amount)		xxx
Less: Expenses of Transfer (Actual Amount)		xxx
Net Consideration		**xxx**
Less: Cost of Acquisition	NIL	
Less: Cost of Improvement (Actual Amount)	XXX	xxx
Taxable Capital Gains		**xxx**

Illustration 71 : (a) P commenced a business on 10.5.92. The said business is sold by P on 25.8.10 and he received ₹ 10 lacs towards goodwill.

(b) What will be your answer in the above case, if P had acquired the goodwill for this business for a consideration of ₹ 3,00,000.

Solution :

Previous Year : 2010-11 **Mr. P** **Assessment Year : 2011-12**

Computation of Long Term Capital Gains

		₹
(a) Consideration for transfer		10,00,000
Less : Indexed Cost of Acquisition (Self-Generated)		NIL
Long term Capital Gains		**10,00,000**
(b) Consideration for transfer		10,00,000
Less : Indexed Cost of Acquisition = $3,00,000 \times \frac{711}{223}$		9,56,502
Long term Capital Gains		**43,498**

Illustration 72 : R has been living in a rented accommodation since August 1983, and he is paying a rent of ₹ 4000 per month. The landlord got the house vacated from R on 16.7.2010 and paid a sum of ₹ 5 lacs for vacating the house.

Compute Capital Gains, if any, in the hands of R.

Solution :

Previous Year : 2010-11 **Mr. R** **Assessment Year : 2011-12**

Computation of Long Term Capital Gains

	₹
Consideration for transfer	15,00,000
Less : Indexed Cost of Acquisition (Self-Generated asset)	NIL
Long term Capital Gains	**15,00,000**

Illustration 73 : Mr. Nitin is a Chartered Accountant practicing in Delhi since January 1983. He transfers the practice to another Chartered Accountant on 15.7.2010 and charges ₹ 10 lacs for goodwill.

Solution :

Since the asset transferred is Goodwill of a profession and not of a business, it is treated as self-generated asset and there is no capital gain on self-generated asset.

Illustration 74 : R purchased tenancy right on 1.4.1980 for ₹ 4,60,000. The same was sold by him on 14.8.2010 for ₹ 45 lacs. FMV of tenancy right as on 1.4.81 ₹ 6,50,000.

Solution :

Previous Year : 2010-11 **Mr. R** **Assessment Year : 2011-12**

Computation of Long term Capital Gains

	₹
Consideration for transfer	45,00,000
Less : Indexed Cost of Acquisition $4,60,000 \times \frac{711}{100}$	32,70,600
Long term Capital Gains	**12,29,400**

Illustration 75. R purchased 1200 shares on 1.4.80 for ₹ 40 each. He was allotted 1200 right shares on 1.5.80 for ₹ 50 each. He was also allotted 2,400 bonus shares on 1.3.81. Again, on 4.5.91, he was further allotted 4,800 right shares for ₹ 80 each. Further on 27.9.01, he was allotted 4,800 bonus shares. The fair market value of these shares on 1.4.81 was ₹60 each. All the above shares are sold by R on 16.10.10 for ₹ 400 per share. Compute the capital gains assuming :

(a) The above shares are not sold through recognized stock exchange.
(b) The above share is sold through recognized stock exchange and necessary securities transaction tax was paid by R.

Solution :

(a) Where Shares were not sold through recognised stock exchange

Previous Year : 2010-11 **Mr. R** **Assessment Year : 2011-12**

Computation of Capital Gains

	₹
Capital Gain on original shares purchased on 1.4.80	57,60,000
Consideration for transfer (14,400×400)	
Less : Indexed Cost of Acquisition	
(i) $1{,}200\times60\times\frac{711}{100}$	5,11,920
(ii) $1{,}200\times60\times\frac{711}{100}$	5,11,920
(iii) $2{,}400\times60\times\frac{711}{100}$	10,23,840
(Bonus shares issued prior to 1.4.81 shall opt for Fair market value as on 1.4.81 and shall be allowed to be indexed)	
(iv) $4{,}800\times80\times\frac{711}{199}$	13,71,980
(v) Cost of Acquisition for Bonus shares after 1.4.81	NIL
	23,40,340

(b) Where shares are sold through recognised stock exchange and securities transaction tax has been paid by the assessee, entire long term capital gain on there share shall be exempted u/s 10(38)

24. CAPITAL GAINS U/S 50B in case of SLUMP SALE U/S 2(42C)

Slump Sale means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales.
Cost of acquisition and cost of improvement in case of slump sale: "Net Worth" of the undertaking or the division. (NO INDEXATION OF SUCH COSTS WILL BE ALLOWED).

Note : Cost of acquisition of assets in case of slump sale of business specified under section 35AD [Section 50B] [W.e.f. A.Y. 2010-11]

Section 50B relating to slump sale amended: While computing the net worth in case of slump sale for the purpose of computing capital gain, in the case of capital assets in respect of which the whole of the expenditure has been allowed or is allowable as a deduction under section 35AD, its cost shall be taken as NIL.

NET WORTH = AGGREGATE VALUE OF TOTAL ASSETS of the undertaking or division as reduced by the VALUE OF LIABILITIES of such undertaking or division as appearing in its books of account.

Aggregate value of total assets:

(a) In case of depreciable assets- the written down value of the block of assets.
(b) In case of any other assets- the book value of such assets.

Note :

(1) Any change in the value of assets on account of revaluation of assets shall be ignored for the purposes of computing the net worth.
(2) Benefit of unabsorbed losses and unabsorbed depreciation of the undertaking transferred shall not be available to the transferee company.

(3) If the business is transferred on "severable sale" basis, the surplus will be short-term capital gains in case of depreciable assets. While in case of other assets, it may be short- term or long-term depending upon the holding period.

(4) No profit under the head profit or gains from business or profession shall arise even if the stock of the said undertaking is transferred alongwith other assets.

(5) Determination of value for stamp duty, registration fees shall not be regarded as assigning values to individual assets or liabilities.

(6) Report of a Chartered Accountant in prescribed Form 3CEA shall be enclosed.

Illustration 76 : X Ltd. has two divisions namely A and B the Balance Sheet as at 31.3.2011.

			A	B	Total
Paid up capital	6,00,000	Fixed Assets (W.D.V. as on 31.3.11)		6,00,000	6,00,000
		Land & Building		1,50,000	1,50,000
		Plant & Machinery		2,50,000	2,50,000
		Investments	—	2,00,000	2,00,000
		Debtors	2,00,000	3,00,000	5,00,000
		Stock-in-trade	1,50,000	4,00,000	5,50,000
		Other current assets			
Reserves & Surplus	8,40,000		50,000	40,000	90,000
Creditors :	3,00,000				
Paints Division	6,00,000				
Tyre Division	**23,40,000**				**23,40,000**

The company decides to sell the paint division which was established in 1983 to another company G Ltd. on 1.5.2010 for a lump sum of ₹ 14 lacs. The fixed assets of the company includes land and building whose W.D.V. as on 1.4.08 is ₹ 15 lacs, but it has been valued as ₹ 5 lacs for the purpose of stamp duty. Compute the capital gain taxable in the aforesaid case assuming that the market value of the stock transferred is ₹ 2 lacs.

Solution :

Previous Year : 2010-11 **X Ltd.** **Assessment Year : 2011-12**

Computation of Capital Gains

			₹
Consideration for transfer			14,00,000
Less :	Net worth of the division		
	Land and Building (WDV)	1,50,000	
	Plant & Machinery (WDV)	2,50,000	
	Debtors (Book Value)	2,00,000	
	Stock (Book Value)	50,000	
	Others Current Assets (Book Value)	40,000	
		7,90,000	
Less :	Liabilities	3,00,000	4,90,000
	Long term Capital Gains		**9,10,000**

25. Capital gain on re-purchase of Units of Mutual Funds under Equity Linked Savings Scheme u/s 45(6)

1. Where a shareholder receives any consideration from the company for purchase of Its own shares or other specified securities, it is a **transfer chargeable under the head Capital Gains**.

2. The capital gain is **chargeable to tax in the previous year** in which the shares or securities are purchased **by the Company**.
3. **Capital Gains** = Value of Consideration Received **Less** Cost of Acquisition or Indexed cost of acquisition.
4. In case of buy back of shares, there is no question of deemed dividend u/s 2(22) (d).

26. Capital gains on purchase by company of its own shares or other specified securities u/s 46A

Capital gain = (Value of consideration received by the shareholder) - (cost of acquisition of such specified securities)

Specified securities has been defined as per Sec.77A of the Companies Act,1956.

Specified seturities includes employees stock option or other securities as may be notified by the Central Government from time to time.

27. Capital Gains on violation of the provision of Sec. 47(iv) and 47(v) due to withdrawal of exemption u/s 47A.

Illustration 77 : R Ltd. is a wholly owned subsidiary company of S Ltd. Both R Ltd. and S Ltd. are Indian companies. R Ltd. transferred a plot of land to S Ltd. on 21.10.1982 for ₹ 3 lacs. R Ltd. had acquired this land on 1/1/76 for ₹ 80,000. The market value as on 1.4.81 was ₹ 1,50,000. What would be the capital gains if any, chargeable in the hands of R Ltd and S Ltd. in the following situations:

(a) S Ltd. sells the land on 2.9.10 for ₹ 12 lacs. S Ltd. continues to hold 100% shares of R Ltd.

(b) S Ltd. converted the land as its stock-in-trade on 5.18.88 and then sold it on 12.9.10 for ₹ 16 lacs. The market value of the asset on 5.10.88 was ₹ 8 lacs.

Solution :

Previous Year : 2010-11 | **S. Ltd.** | **Assessment Year : 2011-12**

Computation of Capital Gains

	₹
(a) (i) Consideration for Transfer	12,00,000
Less : Indexed Cost of Acquisition	9,78,440
$1,50,000 \times \frac{711}{109}$	
Long Term Capital Gains	**1,21,560**

(ii) There will be no capital gains for R Ltd. neither in the year of transfer to S Ltd. nor in the year by S Ltd, as the land has not been converted into stock and it remains a wholly owned subsidiary company.

(b) (i) **In the case of R Ltd.**

Since the land has been converted into stock-in-trade on 05.10.88 which falls within eight years of the original transfer, there will be capital gains to R Ltd. and its assessment for the A. Y. 83-84 (P. Y: 82-83) will be rectified u/s 155 as under :

Consideration for transfer (amount at which it is transferred to S Ltd.)	3,00,000
Less : Cost of Acquisition	80,000
Long term Capital Gains	**2,20,000**

The LTCG of ₹ 2,20,000 will be included int he total income for the A.Y. : 83-84 and taxed according to the provisions applicable at that time.

(ii) Although the land was converted into stock-in-trade on 5.10.08, it will be regarded as transfer, but capital gain on such transfer will be taxable in the previous year in which such converted on it is sold. The cost of acquisition in this case will be the value at which the asset was transferred to it.

Computation of Capital Gain for the A.Y. 2011-12

	₹
Consideration for transfer (being the Market value as on the date of conversion)	8,00,000
Less : Indexed Cost of Acquisition $3{,}00{,}000 \times \frac{161}{100}$	4,83,000
Long term Capital Gains	**3,17,000**

28. EXEMPTIONS OF CAPITAL GAINS

1. Capital gain on transfer of units of US 64 exempt if transfer takes place on or after 1.4.02 u/s **10(33)** w.r.e.f. A.Y. 2005-06.

2. Long-term capital gain on eligible equity shares exempt If the shares are acquired within a certain period u/s **10(36)** w.e.f. A.Y. 2006-07. these assets must have been acquired on or after 1.3.03 but before 1.3.04 and held for a period of more than 12 months.

3. Exemptlon of capital gains on compensation received on compulsory acquisition of agricultural land situated within specified urban limits u/s **10(37)** w.r.e.f. A.Y. 1.4.05.

(a) Where the compulsory acquisition has taken place before 1.4.05 but the compensation is received after 31.3.05, it shall be exempt.

(b) If the part of the original compensation in the above case has already been received before 1.4.05, then the exemption shall not be available even though the original compensation is received after 31.3.05.

(c) If enhanced compensation is received on or after 1.4.05 against agricultural land compulsorily acquired before 1.4.05 shall be exempt.

4. Exemption of long term capital gain arising from sale of shares and units u/s **10(38**) w.e.f. 1.10.05. Any income arising on or after 1.10.05 from the transfer of a long-term capital asset, being an equity share in a company or a unit of an equity oriented fund shall be exempted provided:

(a) Such equity shares are sold through recognized stock exchange, whereas units of an equity oriented fund may either be sold through the recognized stock exchange or may be sold to the mutual fund.

(b) Such transaction is chargeable to securities transaction tax.

5. Exemption of capital gain on transfer of an asset of an undertaking engaged in the business of generation, etc of power u/s 10(41), provided such transfer is effected on or before 31.3.07 to the Indian company notified u/s 80 IA(v)(a).

29. Explain the tax treatment of Capital Gain on transfer of shares, debentures of Indian Company held by non-residents. [Section 48 (Proviso) read with Rule 115A].

1. Applicability: All Non-Residents Including Foreign Companies except persons covered u/s 115AC & 115AD.
2. Assets Transferred: Shares or Debentures In an Indian Company.
3. Nature of Capital Gain: Short Term or Long Term
4. Average TT Rate = (Buying Rate + Selling Rate adopted by State Bank of India)/2

Computation of Capital Gains

Particulars	Value in ₹	Conversion Rate	Value in Foreign Curr.
Sale Consideration	xxxx	Avg. TT Rate on the date of Transfer	xxx
Less: Expenses on Transfer	(xxx)	Avg. TT Rate on the date of Transfer	(xxx)
Net Consideration	xxxx		xxx
Less: Cost of Acquisition	(xxxx)	Avg. TT Rate on the date of Acquisition	(xxx)
Capital Gain in Foreign Currency			xxx
Capital Gain in ₹		Capital Gain In Foreign Currency × Buying Rate on the date of Transfer	xxx
Less: Exemption u/s 115F, wherever applicable		$\frac{\text{Capital Gains × Amount invested}}{\text{Net consideration}}$	(xxx)
Taxable Capital Gain			xxx

Note : Indexation Benefit is not available.

30. What are the conditions and exemption from long-term capital gains on transfer of foreign exchange asset by a Non-Resident Indian [Section 115F]

1. **Condition :** Long-term capital gain on transfer of foreign exchange asset Is entitled for exemption If the whole or part of the net consideration is Invested within 6 months after the date of such transfer in prescribed assets.
2. **Prescribed Assets:**
   (a) Shares of an Indian Company or debentures of an Indian Public Limited Company.
   (b) Deposit with an Indian Public limited Company.
   (c) Central Government securities.
   (d) National Savings Certificates VI and VII issue.
3. **Exemption:** If the **whole of the net consideration** is invested, then entire capital gain is exempt.
   If a part of the net consideration is invested, then the deduction shall be computed as follows:
   Amount Exempted = Capital Gains × Amount Invested/Net consideration
4. **Holding period of the asset:** 3 years from the date of acquisition.
5. **Sale/conversion within the holding period:** Amount exempted shall be chargeable to tax as Long Term Capital Gain In the year of transfer.

31. Explain the tax treatment of income from Deep Discount Bonds (DDBs).

1. **Income based on Market Value:**
   (a) Market Value: Market Value of DDBs will be determined at the end of every financial year, 31st March, that is, as per the values declared by RBI or Primary Dealers Association of India, jointly with the Fixed Income Money Market and Derivatives Association of India.
   (b) **Income:** The difference between market values on the opening and closing dates of that financial year constitutes income of that year.
   (c) **Computation of Income:** The income chargeable will be computed as under
   - **For Original Subscribers:** Difference between market values on 31st March (Closing date) and 1st April (Opening date) of that financial year.

- **For Subsequent purchasers:** Difference between market values on 31st March (Closing date) and **cost of Purchase** of bond.

(d) **Taxable as-** this income will be treated as interest in case of investors and business income in case of traders.

2. **Transfer before maturity:** If the bondholder transfers the bond before maturity

(a) **In case of Investors:**

Capital Gains = Sale Price **Less** Cost of Acquisition of the Bond

Nature of Capital Gain: Capital Gain is always **Short-Term** since income is offered upto 31st March of the previous year and the holding period will always be less than 12 months.

Cost of Bond = Cost of Acquisition (subscription price paid by origlnal lnvestor or purchase price paid by intermediate purchaser) and the income already offered to tax by the bondholder upto the date of transfer.

(b) **In case of Traders:** Business Income = Sale Price **Less** Cost of Acquisition of the Bond

3. **Redemption on Maturity:**

(a) If the **original subscriber redeems the DDB**

- **In case of Investors:**

  Interest Income = Redemption Price **Less** Market Value as on the last valuation date immediately preceding the maturity date

- **In case of Traders:**

  Business Income = Redemption Price **Less** Market Value as on the last valuation date immediately preceding the maturit date

(b) **If an intermediate purchaser redeems the DDB**

Interest or Business Income = Redemption Price Less Cost of the Bond to such purchaser Cost = Cost of Acquisition (subscription price paid by original investor or purchase price paid by intermediate purchaser) and the income already *offered* to tax by the bondholder upto the date of redemption.

32. Write short notes on Capital Gains on Sale of Property at less than Government Value. [Sec. 50C]

1. **Nature of Asset:** Land or Building or both
2. **Consideration for transfer:** Amount is less than the value adopted or assessed by the State Government Authority (referred to as the "Stamp Valuation Authority for the purpose of payment of stamp duty.)
3. **Value to be adopted for Capital Gains:** Value **adopted by the Stamp Valuation Authority.**

Provisions for deemed valuation of immovable properly in certain cases of Transfer [Section 50C] [W.e.f. A.Y. 2010-11] — Further, new Explanation 2 has been inserted to section 50C(2) so as to clarify the meaning of the term 'assessable'.

'Explanation 2.—For the purposes of this section, the expression "assessable" means the price which the stamp valuation authority would have, notwithstanding anything to the contrary contained in any other law for the time being in force, adopted or assessed, if it were referred to such authority for the purposes of the payment of stamp duty'.

4. Reference to Valuation Officer:

(a) The assessee can claim that the value adopted or assessed by the Stamp Valuation Authority exceeds the Fair Market Value of the property as on the date of transfer.

(b) Value adopted by the Stamp Valuation Authority is **not disputed before any authority or Court.**

(c) In such case, the Assessing *Officer* may refer the case to the Valuation *Officer.*

(d) Where the value determined by the Valuation *Officer* **exceeds the value adopted by the Stamp Valuation Authority,** the Capital Gain shall be considered as follows–

Capital Gains = Value adopted by Stamp Valuation Authority Less Cost or Indexed Cost of Acquisition.

33. Advance money received on capital gains [Section 51]

1. **Reduce from Cost/WDV/FMV :** Any advance money or any other sum **received and retained by the assessee** is to be reduced either from
   (a) Cost of Acquisition; or
   (b) Written Down Value; or
   (c) Fair Market Value.

2. **Applicability:** This provision is applicable only when the **transfer as per the original agreement does not take place** and the **advance money is received and forfeited** by the assessee as per the agreement.

Illustration 78 : Rohit purchased a house in Delhi in December 2004 for ₹ 2,50,000. In March 2010, he entered into an agreement to sell the property to Z for a consideration of ₹ 5,00,000 and received an earnest money of ₹ 50,000. As per the terms of agreement, the balance payment was to be made within 30 days of the agreement. If the intending purchaser does not make the payment within 30 days, the earnest money would be forfeited. As Z could not make the payment within the stipulated time the amount of ₹ 50,000 was forfeited by Rohit. Subsequently, on 16.6.10, Rohit sold the house to Mohit for ₹ 6,00,000. He paid 3% brokerage on sale of the house. Compute capital gains chargeable to tax for the assessment year 2011-12.

Solution :

Previous Year : 2010-11 **Mr. Rohit** **Assessment Year : 2011-12**

Computation of Capital Gains

		₹
Consideration for transfer		6,00,000
Less : Expenses on transfer (Brokerage @ 3% on 6,00,000)		18,000
Net Consideration		**5,82,000**
Less : **Indexed Cost of Acquisition**		
Cost of Acquisition	2,50,000	
Less : Amount received and forfeited (u/s 51 to be adjusted against cost)	50,000	
Net Cost of Acquisition	2,00,000	
∴ Indexed Net cost of Acquisition		
$= 2,00,000 \times \frac{711}{480}$		2,96,250
Long Term Capital Gains		**2,85,750**

34. Reference to Valuation Officer [Section 55A]

Under the following circumstances the Assessing Officer may refer the valuation of the capital asset to the Valuation Officer and his valuation report shall be binding on the Assessing Officer-

1. Where the value of the asset Is estimated by the registered valuer but the Assessing Officer is of the opinion that the **value so determined is less than its fair market value.**
2. In any other case, the Assessing Officer is of the opinion that
   (a) The **fair market value** of the asset **exceeds the value of the** 'assets declared by the assessee either **by more than 15% or by ₹ 25,000** (Rule llAA); or
   (b) The nature of the asset and other relevant circumstances are such that, It is necessary to do so.

EXEMPTIONS FROM CAPITAL GAINS

35. EXEMPTIONS FROM CAPITAL, GAINS FOR TRANSFER OF RESIDENTIAL HOUSE PROPERTY u/s 54

Applicabllity	Individual / HUF
Asset Transferred	Residential House Property
Nature of the Asset	Long Term Capital Asset
New Asset to be acquired	Residential House Property
Amount to be Invested In New Asset	Long Term Capital Gain on Transfer
Amount of Exemption	**Least of:** (a) Amount invested in New Residential House, or (b) Capital Gain
Time Limit for Investment	(a) **For Purchase:** Within **one year before or two years after** the date of transfer (b) **For Construction:** Within **three years after** the date of transfer.
Unutilized Amount	(a) Amount **not utilized before the due date of filing return** shall **be kept in Capital Gain Account Scheme** of a Nationalized Bank. (b) The amount should be **utilized within the prescribed period.** (c) Amount **not utilized** within the prescribed period shall be **treated as L TCG of the previous year in which prescribed period expires.**
Holding Period of New Asset	**Three years** from the date of acquisition or construction
Sale of New Asset within holding period	Short Term Capital Gain computed as follows - Sale Consideration of New Asset Less Cost of Acquisition reduced by Capital Gains exempted u/s 54

Illustration 79 : Ravi owns a residential house which was purchased by him in 1975 for ₹ 80,000. The FMV as on 1.4.81 was ₹ 2,00,000. This house is sold by him on 16.7.2010 for a consideration of ₹ 15,00,000. The brokerage and expenses on transfer was ₹ 15,000. Compute capital gains for the assessment year 2011-12.

If he invests ₹ 5,00,000 for purchase of a new house on 15.3.2011.

If the HP so purchased in 15.3.2011 is again sold in 21.10.11 for ₹ 9 lacs, what will be the tax liability?

Solution :

Previous Year : 2010-11 **Mr. Ravi** **Assessment Year : 2011-12**

Computation of Capital Gains

	₹
Consideration for transfer	15,00,000
Less : Expenses on transfer	15,000
Net Consideration	**14,85,000**
Less : Indexed Cost of Acquisition $2{,}00{,}000 \times \frac{711}{100}$	14,22,000
Long term Capital Gains	**63,000**
Less : **Exemption u/s 54**	
Cost of New HP Purchased ₹ 5,00,000	
(exemption restricted upto the balance of LTCG)	63,000
Taxable Long term Capital Gains	NIL

If the HP purchased in 15.3.2011 is again sold on 21.10.11 for ₹ 9 lacs, there share a rise short term capital gains. The cost of acquisition shall be adjusted to the extent of long term capital gains exemption already availed.

Computation of Capital Gains for the A.Y. 2012-13

		₹
Consideration for transfer		9,00,000
Less : **Cost of Acquisition**		
Cost of purchase	5,00,000	
Less : Exemption u/s 54 availed during A.Y. 2010-11 now withdrawn	63,000	4,37,000
Short term Capital Gains		**4,63,000**

36. EXEMPTIONS AVAILABLE FOR CAPITAL GAINS ON TRANSFER OF URBAN AGRICULTURAL LAND u/s 54B

Applicability	**Individual**
Asset Transferred	Urban Agricultural Land **used for agriculture** by him or by his parents **for two years immediately prior to the date of transfer**.
Nature of the Asset	Long Term or Short Term Capital Asset
New Asset to be acauired	Agricultural Land
Amount to be invested in New Asset	Capital Gain on Transfer
Amount of Exemption	Least of: (a) Amount invested in New Agricultural Land, or (b) Capital Gain
Time Limit for Investment	Within **Two Years** from the date of transfer.
Unutilized Amount	(a) The **amount not utilized** before the due date of filing return shall be **kept in Capital Gain Account Scheme** of a Nationalized Bank. (b) The amount should be utilized within the prescribed period. (c) Amount **not utilized within the prescribed period** shall be treated as **LTCG of the previous year in which prescribed period expires**.
Holding Period of New Asset	Three Years from the date of acquisition
Sale of New Asset within holding period	Short Term Capital Gain computed as follows: Sale Consideration of New Asset Less: Cost of Acquisition reduced by Capital Gains exempted u/s 54B

Illustration 80 : On 16th January 2011, Suman sold agricultural land for ₹22 lacs. He incurred selling expenses for ₹50,000. Compute capital gains :

If the land sold, was purchased on 1st February 1995 for ₹ 4 lacs, and the land was used for agricultural purposes by his mother.

He again purchased agricultural land of ₹ 8 lacs on 25th January 2011.

Amount deposited in a scheduled bank under "Capital Gains Deposit Scheme. ₹ 4 lacs on 6th April 2011.

Solution :

Previous Year : 2010-11 **Mr. Suman** **Assessment Year : 2011-12**

Computation of Capital Gains for the A.Y. 2011-12

	₹
Consideration for transfer	22,00,000
Less : Expenses on transfer	50,000
Net Consideration	**21,50,000**
Less : Indexed Cost of Acquisition $4,00,000 \times \frac{711}{259}$	10,98,069
Long-term Capital Gains	10,51,931
Less : **Exemption u/s 54B**	
Cost of New Land purchased	8,00,000
Less : Amount deposited in "Capital Gains Account Scheme" before due date of furnishing return specified u/s 139(1) ₹ 4,00,000	
or the balanceamount of capital gains, ₹ (10,51,931–8,00,000) = ₹ 2,51,931 whichever is less	2,51,931
Taxable long term Capital Gains	**NIL**

37. EXEMPTIONS AVAILABLE FOR CAPITAL GAINS ON COMPULSORY ACQUISITION OF LAND AND BUILDING USED FOR INDUSTRIAL PURPOSES u/s 54D

Applicability	**All Assesses**
Asset Transferred	Land and Building used by an Industrial undertaking which is compulsorily acquired and such land and building were used for business purpose during the two years before the date of transfer
Nature of the Asset	Long Term or Short Term Capital Asset
New Asset to be acquired	Land and Building for Industrial Purpose
Amount to be Invested in New Asset	Capital Gain on Transfer
Amount of Exemption	Least of: (a) Amount Invested In New Land and Building, or (b) Capital Gain
Time Limit for Investment Unutilized Amount	Within **Three Years** from the date of transfer. (a) The amount not utilized before the due date of filing return shall be **kept in Capital Gain Account Scheme** of a Nationalized Bank. (b) The amount should be **utilized within the prescribed period**. (c) **Amount not utilized** within the prescribed period shall be **treated** as LTCG **of the previous year In which prescribed period expires.**
Holding Period of New Asset	Three Years from the date of acquisition
Sale of New Asset within holding period	Short Term Capital Gain computed as follows: Sale Consideration of New Asset Less Cost of Acquisition reduced by Capital Gains exempted u/s 54D

Illustration 81 : ABC Ltd. purchased a building for an industrial undertaking on 1.1.05 for ₹5 lacs. Prior to this the company had taken this building on rent for the last 3 years and was using it for its industrial activities. There is no other building in the block. This property was compulsorily acquired by the State Government on 16.7.10 and a compensation of ₹ 7 lacs was given to the company on 31.3.011. The company purchased another building for shifting its Industrial undertaking for ₹ 4 lacs on 20th November 2011. Compute the capital gain for the assessment year 2011-12. Rate of Dep. of Building 5%.

Solution :

Previous Year : 2010-11 **ABC Ltd.** **Assessment Year : 2011-12**

Computation of Capital Gains

	₹
Consideration for transfer	7,00,000
Less : **Cost of Acquisition**	
WDV as on 1.4.2010	3,77,218
Short term Capital Gains	3,22,782
Less : **Exemption u/s 54D** Cost of Building purchased ₹ 4 lacs	
or the short term Capital Gains ₹ 3,22,782 whichever is less	3,22,782
Taxable short term Capital Gains	NIL
Working :	
W.D.V as on 1.4.10 :	
Purchase price (04-05)	5,00,000
Less : Dep. for 2004-05 (less than 180 days)	
Rt. of Dep. @ 50% of 5% = 2.5% on 5,00,000	12,500
	4,87,500
Less : Dep. for 2005-06 @ 5%	24,375
	4,63,125
Less : Dep. for 2006-07 @ 5%	23,156
	4,39,969
Less : Dep. for 2007-08 @ 5%	21,998
	4,17,971
Less : Dep. for 2008-09 @ 5%	20,899
	3,97,072
Less : Depreciation for 2009-10 @ 5%	19,854
W.D.V. as on 1.4.10	3,77,218

Illustration 82 : Saptarshi acquired shares of G Ltd. on 15.12.98 for ₹5 lacs which were sold on 14.6.10 for ₹ 16 lacs. Expenses on transfer of shares ₹ 20,000. He invests ₹ 8 lacs in the bonds of Rural Electrification. Corporation Ltd. on 16.10.2010.

(a) Compute capital gain for the assessment year 2011-12.

(b) State the period for which the bonds should be held by the assessee. What will be the consequences if such bonds are sold within the specified period?

(c) What will be the consequences if Saptarshi takes a loan against the security of such bonds.

Solution :

Previous Year : 2010-11 **Mr. Saptarshi** **Assessment Year : 2011-12**

Computation of Capital Gains

	₹
Consideration for transfer	16,00,000
Less : Expenses on Transfer	20,000
Net Consideration	**15,80,000**
Less : **Indexed Cost of Acquisition** $5{,}00{,}000 \times \frac{711}{351}$	10,12,821
Long-term Capital Gains	5,67,179
Less : **Exemption u/s 54EC**	5,67,179
Rs. 6,00,000, deduction restricted upto the balance of LTCG	
Taxable long-term Capital Gain	Nil

(b) Saptarshi should not transfer or convert (otherwise than transfer) into money such bonds within 3 years from the date of their acquisition.

If these bonds are transfered or converted into money within 3 years, capital gain of ₹ 6,00,000 exempted earlier shall attract taxability towards long-term capital gain of the previous year in which such asset is transferred **or** converted into money.

(c) If any loan is taken against security of such bonds, it shall be taxable as long-term capital gains of the previous year in which such loan is taken against the security of such bonds.

EXEMPTIONS FROM CAPITAL GAINS FOR INVESTMENTS IN NOTIFIED BONDS u/s 54EC

Applicability	**All Assessees**
Asset Transferred	Any Long term Capital Asset
Nature of the Asset	Long Term Capital Asset
New Asset to be acquired	Bonds redeemable after 3 years issued on or after 01.04.2007 by National Highway Authorities of India (NHAI) or Rural Electrification Corporation Limited (RECL).However, deductions against these investments, once availed u/s54EC cannot be availed u/s 80C.
Amount to be invested in New Asset	Long term Capital Gain on Transfer.Maximum amount that can be invested by the Assessee during any Financial year is ₹50 lakhs
Amount of exemption	Least of the followings:(a) Amount invested in bonds; or,(b) Capital Gains
Time limit for investment	Within six months from the date if transfer
Holding period of new asset	Three years from the date of acquisition
Sale of new asset within holding period	Long term capital gains already exempted u/s 54EC shall be charged as LTCG of the assessee in the year of sale or creation of charge on the new asset

Illustration 83 :

Anand sold a residential building at Kolkata for ₹ 25,60,000 on 1.11.2010. The building was purchased during 1979-80 for ₹ 1,45,000. FMV as on 1.4.81 ₹ 2,75,000. Brokerage paid on sales @ 2%. deposited ₹ 8 lakhs in NHAI Capital Gains Bond in February 2011. Compute Taxable Capital Gains.

Assessee: Anand

Previous Year : 2010-11 **Assessment Year : 2011-12**

Computation of Taxable Capital Gains

Particulars		**Amount (₹)**
	Consideration for Transfer	25,60,000
Less:	Expenses on Transfer (i.e. Brokerage @ 2% on ₹25,60,000)	51,200
	Net Consideration	25,08,000
Less:	Indexed Cost of Acquisition $= \frac{\text{Cost of Acquisition} \times \text{CII of year of Acquisition}}{\text{CII of the year of Transfer}}$ $= ₹\ 2,75,000 \times \frac{711}{100}$	19,55,250
	Long term Capital Gains	5,52,750
Less:	Exemption u/s 54 EC Amount invested in NHAI Bonds ₹8 lakhs. Deduction restricted upto the balance of LTCG	5,52,750
	Taxable Capital Gains	Nil

39. EXEMPTIONS FROM CAPITAL GAINS FOR TRANSFER OF ANY LONG TERM CAPITAL ASSET OTHER THAN A RESIDENTIAL HOUSE PROPERTY u/s 54F

Applicabillty	**Individual / HUF**
Asset Transferred	Any Long Term Capital Asset other than Residential House Property
Nature of the Asset	Long Term Capital Asset
Condition	On the date of transfer of the LTCA, the assessee **should not own more than one Residential House Property**
New Asset to be acquired	Residential House Property
Amount to be invested in New Asset	Net Consideration
Amount of Exemption	$\frac{\text{Long Term Capital Gain} \times \text{Amount invested in Residential House}}{\text{Net Consideration}}$
Time Limit for Investment	(a) **For Purchase:** Within **One Year before or Two Years after** the date of transfer (b) **For Construction:** Within **Three Years after** the date of transfer.
Unutllized Amount	(a) The **amount not utilized** before the due date of filing return shall be **kept in Capital Gain Account Scheme** of a Nationalized Bank (b) The amount should be **utilized within the prescribed period** (c) Amount **not utilized** within the prescribed period shall be **treated as LTCG** of the previous **year in which the prescribed** period expires
Holding Period of New Asset	**Three Years** from the date of acquisition or construction
Sale of New Asset within holding period	(a) Short Term Capital Gain on New Asset shall be taxed separately. (b) Long Term Capital gain exempted u/s 54F shall be chargeable to tax as Long Term Capital Gain in the year of transfer.

Illustration 84: Ms. Bipasha purchased jewellery worth ₹ 2,20,000 during 1985-86. During the year 1990-91, she further purchased jewellery worth ₹ 3,50,000. All the jewellery was sold by her on 15.6.10. The jewellery purchased in 1985-86 was sold for ₹ 20 lacs and that purchased in 1990-91 was sold for

On 26.6.10 she deposited ₹50 lacs in Capital Gains Scheme account.

On 21.10.10 withdrawing from the Deposit Account, she utilised ₹ 48 lacs for purchase of a residential house property in Kolkata.

On the date of transfer she owns only one residential house.

Solution :

Previous Year : 2010-11 **Mr. Bipasha** **Assessment Year : 2011-12**

Computation of Capital Gains

	₹
(a) **On transfer of jeweller purchased during 85-86**	
Consideration for transfer	20,00,000
Less : **Indexed Cost of Acquisition**	
$2{,}20{,}000 \times \frac{711}{133}$	11,76,090
Long-term Capital Gains	8,23,910
(b) **On transfer of jewellery purchased during 1990-91**	
Consideration for transfer	32,00,000
Less : **Indexed Cost of Acquisition**	
$3{,}50{,}000 \times \frac{711}{182}$	13,67,308
	18,32,692

In order to avail the maximum benefit u/s 54F, the exemption should be computed as follows :

	Total long-term Capital Gain (8,23,910 + 18,32,692)	26,56,602
Less :	Exemption u/s 54F $\left[\frac{\text{Cost of New House} + \text{Amount Deposited} \times \text{LTCG}}{\text{Net Consideration}}\right]$	
	$= \frac{50{,}00{,}000}{52{,}00{,}000} \times 26{,}56{,}902$	25,54,425
	Taxable Long-term Capital Gains	**1,02,177**

Notes:

1. In this case, Bipasha has not fully utilised the deposit account for acquiring a residential house property. Out of ₹ 50 lacs deposited for acquiring the house, it is utilised to the extent ₹ 48 lacs.

Tax treatment of unutilised amount, will be as follows :

		₹
(a)	Unutilised amount	2,00,000
(b)	Net sale consideration	52,00,000
(c)	Original Capital Gain	26,56,602
(d)	Notional Long-term Capital Gain	1,02,177
(e)	Effective exemption u/s 54F	24,52,248
	[₹ 25,54,425 – 1,02,177]	

₹ 1,02,177 will be chargeable to tax as long-term capital gain after expiry of 3 years from the date of transfer of jewellery (i.e. 15.6.10). Consequently it will be taxable for the assessment year 2014-15.

2. The unutilised amount of ₹ 2 lacs can be utilised by Bipasha at any time after 15.6.10.
3. If Bipasha sells this new house property before 21.10.13, then ₹ 24,52,248 (exeemption u/s 54F) will be to tax as long-term capital gain of the year in which the house is sold.
4. If Bipasha purchases another house before 15.6.12 or constructs any other house (income of which is taxable u/s 22) before 15.6.13, then ₹ 24,52,248 (exemption u/s 54F) will be deemed as long-term Capital gain of the year in which another house is purchased or constructed.

40. EXEMPTIONS AVAILABLE FOR CAPITAL GAINS ON SHIFTING OF INDUSTRIAL UNDERTAKING FROM URBAN TO RURAL AREA u/s 54G

Applicability	**All Assesses**
Asset Transferred	Land and Building, Plant and Machinery used by Industrial undertaking and shifting of such undertaking from Urban area to Non-urban area
Nature of the Asset	Any Capital Asset
New asset to be acquired	Land, Building, Plant and Machinery for Industrial Undertaking in Non-urban area or to meet the exoenses of shifting
Amount to be invested in New Asset	Capital Gain on Transfer
Amount of Exemption	Least of - (a) Amount invested in New Land and Building or New Plant and Machinery, or (b) Capital Gain
Time Limit for Investment	Within One Year prior to the date of transfer or **within three years after** the date of transfer.
Unutilized Amount	**(a)Amount not utilized** before the due date of filing return shall **be kept in Capital Gain Account Scheme** of a Nationalized Bank. (b) The amount should be **utilized within the prescribed period.** (c) **Amount not utilized** within the prescribed period shall be treated as L**TCG of the previous year in which the prescribed oeriod exoires.**
Holding Period of New Asset	**Three Years** from the date of acquisition
Sale of New Asset within holding period	Short Term Capital Gain computed as follows: Sale Consideration of New Asset **Less:** Cost of Acquisition reduced by Capital Gains exempted u/s 54G

Illustration 85 : P Ltd. owns an industrial undertaking manufacturing chemicals in Bangalore owns the following assets

(a) Plant and machinery (wdv ₹5 lacs) sold for ₹15 lacs.
(b) Building (WDV ₹ 12 lacs) sold for ₹ 60 lacs.
(c) Furniture and fixtures (WDV ₹ 50,000) sold for ₹ 1,80,000
(d) Land cost of acquisition ₹ 5,00,000 during 1984-85 and sold for ₹ 30 lacs

The industrial undertaking was shifted as per policy of the Government from urban area to other area. The new assets acquired during the period 1.1.11 to 31.3.11 are as under:

Plant and machinery ₹20 lacs; Buildings ₹40 lacs.

Compute capital gain chargeable to tax for the assessment year 2011-12.

Solution :

Previous Year : 2010-11 **P Ltd.** **Assessment Year : 2011-12**

Computation Short-term Capital Gains on Depreciable assets

		₹
(i) Plant & Machinery (15,00,000 – 5,00,000)	10,00,000	
(ii) Buildings (60,00,000 – 12,00,000)	48,00,000	
(iii) Furniture & Fixtures (1,80,000 – 50,000)	1,30,000	59,30,000
Long-term Capital Gains on Industrial Land :		
Consideration for transfer	30,00,000	
Less : **Indexed Cost of Acquisition**		
$5,00,000 \times \frac{711}{125}$	28,44,000	2,56,000
Total Capital Gains		59,86,000
Less : **Exemption u/s 54G**		
Plant & Machinery	20,00,000	
Building	40,00,000	
	65,00,000	
but restricted to ₹ 58,56,000		
[= ₹ 59,86,000 —1,30,000, being STCG on furniture,		
not eligible for the purpose of claining exemption u/s 54G		58,56,000
Short term Capital Gains (on furniture)		1,30,000

41. EXEMPTION AVAILABLE TO AN UNDERTAKING WHICH SHIFTS ITS BASE TO A SPECIAL ECONOMIC ZONE AND IN THE COURSE MAKES GAIN ON TRANSFER OF ASSET u/s 54GA

Applicability	**All Assesses**
Asset Transferred	(a) Land and Building, Plant and Machinery or any right in Land or Building used by Industrial undertaking. (b) Transfer as a result of shifting of such undertaking from Urban Area to Special Economic Zone (which may be situated in Urban or Any other area).
Nature of the Asset	Any Capital Asset
New Asset to be acquired	(a) Plant, Machinery for use in the Undertaking in the SEZ. (b) Acquired Land and Acquired/Constructed Building for purpose of business in SEZ (c) Shifted the undertaking to the SEZ. (d) Expenses incurred for such purposes as specified by under the Scheme by the Central Government is also eligible for claiming exemption.
Amount to be invested in New Asset	Capital Gain on Transfer
Amount of Exemption Least of :	(a) Amount invested in any Land and Building or any Plant and Machinery and Expenses incurred in relation to transfer, or (b) Capital Gain
Time Limit for Investment	Within **One Year prior to the date** of transfer or **within three years after the date of transfer**

Unutilized Amount	**Amount not utilized** before the due date of filing return shall be **kept in Capital Gain Account Scheme** of a Nationalized Bank. • The amount should be utilized within the prescribed period. • Amount not utilized within the prescribed period shall be treated as LTCG of the previous year in which the prescribed period expires.
Holding Period of New Asset	**Three Years** from the date of acquisition
Sale of New Asset within holding period	Short Term Capital Gain computed as follows: Sale Consideration of New Asset Less: Cost of Acquisition Less: Capital Gains exempted u/s 54GA

llustration 86 : The house property of A is compulsorily acquired by the government for ₹ 10,00,000 *vide* Notification issued on 12.3.2005. A had purchased the house in 1986-87 for ₹ 2,00,000. The compensation is received on 15.4.2009. The compensation is further enhanced by an order of the court on 15.5.2010 and a sum of ₹ 2,00,000 is received as enchanced compensation on 21.10.2010. A wants to claim full exemption of the capital gains Advise A in this respect. Compute the capital gain and determine the year in which it is taxable. Also specify the period upto which the investment in the new house should be made by the assessee.

Solution :

Although the house property is compulsorily acquired on 12.3.2005, the capital gain will arise in the previous year in which full or part of the compensation is first received *i.e.* previous year 2009-10. However, indexation will be done till the year of compulsory acquisition. Therfore, capital gains will be calculated as under :

Assessment year 2010-11		₹
	Full value of consideration	10,00,000
Less :	Indexed cost of acquisition — ₹ $2,00,000 \times \frac{480}{140}$	6,85,714
	Long-term capital gain	3,14,286

The assessee should either invest at least ₹ 3,14,286 for the purchase/construction of a residential house property on or before 31.7.2010 (relevant due date) and /or deposit the amount under the capital gain scheme on or before 31.7.2010, to be utilised for purchase of house property by 14.4.2011 and /or construction of the house property by 14.4.2012.

Computation of Capital Gain for the A.Y. 2011-12

		₹
	Enhanced compensation Received	2,00,000
Less :	Cost/Indexed cost of acquisition	Nil
	Long-term Capital Gain	2,00,000

The assessee should either invest at least ₹ 2,00,000 for the additional construction of a residential house property already acquired for claiming under section 54 on or before 31.7.2011 (relevant due date) and/or deposit the amount under the capital gain scheme on or before 31.7.2011 may invest ₹ 2,00,000 in the bonds specified under section 54EC.

42. EXTENSION OF TIME LIMIT FOR ACQUIRING NEW ASSET, WHEN ENHANCED COMPENSATION IS PAID u/s 54H

(a) **Initial Compensation:** If initial compensation is **received in parts**, then the **entire initial compensation is taxable in the year in which a part is first received. Time limit for acquiring the new asset** u/s 54, 54B, 54D, 54EC and 54F shall be determined **on the basis of dates of receipt of different parts** of initial compensation.

(b) **Enhanced Compensation:** If any enhanced compensation is received, it is **taxable in the year in which such compensation is received** and for **acquiring the new asset** u/s 54, 54B, 54D, 54EC and 54F, the time limit shall be determined **from the date of receipt of additional (enhanced) compensation**.

43. PROVISIONS RELATING TO CLAIMING OF EXMPTION IN ORDER TO REDUCE TAX LIABILITY ON SHORT TERM CAPITAL GAINS

Exemption u/s	Applicable for
54B	Transfer of Agricultural Land
54D	Transfer by way of Compulsory acquisition by Government
54G	Shifting of Industrial Undertaking from Urban to Rural Area
10(37)	Compulsory acquisition of Agricultural Land by Central Government/RBI.
10(41)	Transfer by Companies engaged in Power Sector Business

44. COST IN RELATION TO CERTAIN FINANCIAL ASSETS u/s 55

	Particulars of asset	Date of Acquisition Holding	Cost of Acquisition Period
1.	Shares originally purchased :		
(a)	Primary market	Date of Allotment	Allotment price
(b) (i)	Secondary market Transactions through share brokers	Date of broker's note	Amount paid + Brokerage Charges + Adjustment for ex. & cum. dividend/ interest
(ii)	Transactions between parties directly	Date of contract of sale	As above (excluding Brokerage)
2.	Shares acquired in different lots at different Doints of time	FIFO method	FIFO method
3.	Shares held in depository system (taxable in hands of beneficial owner)	FIFO Method	FIFO Method
4.	Right shares offered to existing shareholders and subscribed by him	Date of allotment	Offer Price
5.	Right shares acquired by a person by way of renouncement	Date of allotment	Offer Price + Amount paid for renouncement
6.	Renouncement of right shares in favour of another person	Holding period is date of offer of such right to the date of renouncement **(alwavs STCG)**	NIL
7.	Financial asset acquired without any payment/consideration.	Date of allotment of such financial assets	NIL

Other Points :

1. Splitting of shares is not a transfer.
2. Debentures and Bonds are not entitled for benefit of Indexation u/s 48.

45. "DIVIDEND STRIPPING" enforced by Section 94(7) of the Income-tax Act, 1961.

1. **Purchase:** The securities or units are purchased within 3 months prior to the record date.
2. **Sale:** Sale or transfer is done within –
   (a) 3 Months for Securities, and
   (b) 9 Months for Units, after the record date.
3. **Exempt Income:** Dividend / Income on such securities/units Is exempted from tax.
4. **Dividend Stripping :** Loss arising out of such purchase and sale is ignored to the extent of dividend income.

5. **Record Date** means such date as fixed by
   (a) A Company for the purposes of entitlement of the holder of the securities to receive dividend.
   (b) A Mutual Fund or the Administrator of the Undertaking / Company specified u/s 10(35) Explanation, for the purposes of entitlement of the holder of the units to receive income or additional units, without any consideration.

46. BONUS STRIPPING: Section 94(8):

1. **Applicability:** All Assesses
2. **Transaction:** Any person who purchases Units (Original Units) within a period of 3 months prior to record date and sells such units within a period of 9 months after such record date. On the record date, he was allotted Bonus Units (additional units without any payment)
3. **Tax Implication:**
   (a) The loss on sale of such original units shall be ignored for the purpose of computing his income.
   (b) Loss so ignored will be deemed as the Cost of Acquisition of such additional units, on their subsequent sale/ transfer.

47. RATES OF CAPITAL GAIN TAX - SECTION 112

1. **Short-term capital gain** is taxed at normal rate. In respect of Listed Securities transferred on or after 1.10.2005, Section 111A will apply i.e. taxable at 10%.
2. **Long-term capital gain other than gains arising out of transfer of security including Zero Coupon Bonds are taxed as follows :**

Kind of Assessee	Tax %
(a) Individual and HUF Resident Non-Resident [not covered in (d)]	20% 20%
(b) Venture capital company on transfer of equity shares of venture capital undetaing	20%
(c) Company [not covered in (b)] Domestic Company Foreign Company (not covered in (d)]	 20% 20%
(d) Offshore funds Non-resident assesses, foreign institutional investors covered by Sections 115AB/115AC/115AD	 15%
(e) Any others (Firm, AOP, BOI etc.) • Resident • Non-Resident [not covered in (d)]	 20% 20%

Note : The rates given above are Basic Rates. Appropriate Surcharge, Education Cess and Secondary and Higher Education Cess are also applicable in addition to the tax rate mentioned above.

3. Long-term capital gain arising from transfer of security **listed in a Recognized Stock Exchange, not covered by Securities Transaction Tax:**

(a) Compute capital gain **without indexation** and charge tax @ 10%.
(b) Compute capital gain **with indexation** and charge tax @ 20% as per Section 112
(c) The assessee has the option to choose either of the above whichever is beneficial to him.
(d) Long Term Capital Gain arising on listed securities being Equity Shares and Units of Equity Oriented

Notes :

(a) **No deduction** shall be allowed **under Chapter VIA** in respect of income from long-term capital gain.
(b) **Special Benefit for Resident Individuals HUF: Applicability:** Resident Individual or Resident HUF **Condition:** Total income excluding Long-Term Capital Gains Is **less than the basic exemption. Benefit:**

Tax on Long-Term Capital Gain Is determined as follows–

Tax on LTCG = 20% [Total Income including LTCG - Basic Exemption]

Only that amount of long-term capital gains which is included in the total income would be Cir. **No. 721/13.9.95** subject to tax at a prescribed flat rate u/s 112.

4. Tax on Short Term Capital Gain on Listed Securities - Section 111A (w.e.f. 1.10.2005)

(a) **Applicability:** All Assesses

(b) **Source of Income:**

- Income from Short Term

Oriented Fund.

- The transfer has been affected on or after 1.10.2005
- Such transaction is liable for Securities Transaction Tax.

(c) **Rate of Tax:** 10% of Short-term Capital Gains

Notes :

(a) Chapter VI-A deduction shall not be allowed in respect of income from such Short Term Capital Gain.

(b) **Special Benefits for Resident Individuals or Resident HUF: Applicability:** Resident Individual or Resident HUF **Condition:** Total income excluding Short -Term Capital Gains is less than the basic exemption.

Benefit: Tax on Short-Term Capital Gain is determined as follows:

Tax on STCG = 10% [Total Income including STCG - Basic exemption]

Funds, transferred on or after 1.10.2005 is exempt from tax u/s 10(38).

48. Set off and carry forward of losses under the head Capital Gains.

1. Treatment for Current Year Loss: (Section 70 &. 71)

(a) **Current year Short Term Capital Loss** can be **set off against any capital gain** accrued during, the previous year, but It **cannot be set off against income under any other head.**

(b) Current year Long **Term Capital Loss** shall be **set off only against Long Term Capital Gains.**

2. **Treatment for Carry Forward** Loss: (Section **74)**

(a) **Unabsorbed Loss** under the head Capital Gains shall be **carried forward** for a period of 8 **Assessment Years** immediately following the Assessment Year in which such loss was incurred.

(b) The **carry forward short-term** capital loss can be set off **against any capital gains.**

(c) The **carry forward Long Term Capital Loss** can be set off **only against Long Term Capital Gains.**

9.8 INCOME FROM OTHER SOURCES - BASIS OF CHARGE [Sec. 56]

This is the residual head of charge of income. Where a source of income does not specifically fall under any one of the other heads of income viz. Salaries, Income from House Property, Profits and Gains of Business or Profession, Capital gains, such income is to be brought to charge under sec. 56 under the head 'Income from other sources'- S.G. Mercantile Corp. P. Ltd. v. CIT 83 ITR 700(SC).

This residuary head of income would be invoked only if all the following conditions are fulfilled

1. There is a taxable income- Sec. 2(24) read with Sec. 4 & 5
2. The income is not exempt from tax under - Sec. 10 to 13A
3. Income should not fall under any of the four specific heads of income viz. salaries, income from House Property, Profits and gains of Business or Profession and capital gains.

CHARGEABLE INCOME [Sec. 56(2)]

As per Sec. 56(2), the following incomes are expressly stated to be chargeable to tax under the head "Income from other sources"—

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

(ii) Any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or form, gambling or betting of any form or nature whatsoever- [Sec. 56(2)(ib)]

(iii) Any sum received by assessee from his employees as contributions to any provident fund or superannuation fund or any fund set up under the provisions of the Employees' State Insurance Act, 1948 or any other fund for the welfare of the employees, if such income is not chargeable under the head "Profits and gains of Business or Profession"- [Sec. 56(2)(ic)].

(iv) Income by way of interest on securities, if it is not chargeable as Profits and gains of business i.e. where securities are held as investments- Sec. 56(2)(id).

(v) Income from machinery, plant or furniture belonging to the assessee let on hire, if the income is not chargeable to income-tax under the head, Profits and gains of Business or Profession - Sec. 56(2)(ii).

(vi) Income from letting of machinery, plant or furniture, if such income is not chargeable under the head "Profits and gains of Business or Profession"- Sec. 56(iii)

(vii) Any sum received under "Key man insurance policy including bonus, if not charged under the head "Profits and gains of Business or Profession"- Sec. 56(iv)

(viii) Gifts aggregating to more than ₹ 50,000 in a year on or after 1st Day of April, 2006 - Sec. 56(vi)

(ix) **Taxation of property acquired without consideration or for an inadequate consideration as 'income from other sources' (Section 56(2)(vii)) [W.e.f. 1-10-2009]**

Section 56(vi) provides that any 'sum of money' (in excess of the prescribed limit of ₹ 50,000) received without consideration by an individual or HUF will be chargeable to income tax in the hands of the recipient under the head 'income from other sources'.

However, receipts of money (a) from relatives or (b) on the occasion of marriage or (c) under a will or inheritance or (d) in contemplation of death of payee or donor are outside the scope of the provisions of section 56(2)(vi) of the Income-tax Act.

Similarly, anything which is received in kind having 'money's worth' i.e. property is also outside the purview of the existing provisions.

The Act has amended section 56 of the Income-tax Act by inserting a new clause (vii) to section 56(2) w.e.f. 1-10-2009 to provide that the value of any property received without consideration or for inadequate consideration will also be included in the computation of total income of the recipient. Such properties will include: (i) immovable property being land or building or both, (ii) shares and securities, (iii) jewellery, (iv) archaeological collections, (v) drawings, (vi) paintings, (vii) sculptures (viii) any work of art.

In a case where an immovable property is received without consideration and the stamp duty value of such property exceeds ₹ 50.000, the whole of the stamp duty value of such property shall be taxed as the income of the recipient. If an immovable property is received for a consideration which is less than the stamp duty value of the property and the difference between the two exceeds ₹ 50,000 (inadequate consideration), the difference between the stamp duty value of such property and such consideration shall be taxed as the income of the recipient.

If the stamp duty value of immovable property is disputed by the assessee, the Assessing Officer may refer the valuation of such property to a Valuation Officer. In such cases, the provisions of existing section 50C and section 155(15) of the Income-tax Act shall, as far as may be, apply for determining the value of such property.

In a case, where movable property is received without consideration and the aggregate fair market value of such property exceeds ₹ 50,000, the whole of the aggregate fair market value of such property shall be taxed as the income of the recipient. If a movable property is received for a consideration which is less than the aggregate fair market value of the property and the difference between the two exceeds ₹ 50,000, the difference between the fair market value of such property and such consideration shall be taxed as the income of the recipient.

It has also been provided that :

(i) The value of moveable property shall be the fair market value as on the date of receipt in accordance with the method prescribed; and

(ii) In the case of immovable property, the value of the property shall be the 'stamp duty value' of the property.

(iii) 'Relative' shall have the meaning assigned to it in the Explanation to clause (vi of section 56(2).

Further, section 56(2)(vii) shall not apply to any sum of money or any property received—

(a) from any relative; or

(b) on the occasion of the marriage of the individual; or

(c) under a will or by way of inheritance; or

(d) in contemplation of death of the payer or donor, as the case may be; or

(e) from any local authority as defined in the Explanation to clause (20) of section 10; or

(f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in clause (23C) of section 10; or

(g) from any trust or institution registered under section 12AA.

Related amendments :

1. Section 2(24) relating to definition of income amended: The Act has inserted clause (xv) to section 2(24) to provide that any sum of money or value of property referred to in section 56(2)(vii) shall also form part of income.
2. Cost of disquisition of the property required in a manner given under section 56(2)(vii): The Act has inserted sub-section (4) to section 49 to provide that where the capital gain arises from the transfer of a property, the value of which has been subject to income-tax under section 56(2)(vii), the cost of acquisition of such property shall be deemed to be the value which has been taken into account for the purposes of the said clause (vii).

(x) **Interest received on delayed compensation or enhanced compensation shall be deemed to be income of the year in which it is received (Section 56(2)(viii), section 57(iv) and section 145A] (W.e.f. A.Y. 2010-11]**

The existing provisions of Income-tax Act provide that income chargeable under the head "Profits and gains of business or profession" or "Income from other sources", shall be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee. Further, the Hon'ble Supreme Court, in the case of Rama Bai *vs.* CIT (1990) 181 ITR 400 (SC) has held that arrears of interest computed on delayed or enhanced compensation shall be taxable on accrual basis. This has caused undue hardship to tax payers.

With a view to mitigating the hardship, the following changes have been made in this regard :

(1) Clause (b) to section 145A inserted: The Act has amended section 145A to provide that the interest received by an assessee on compensation or enhanced compensation shall be deemed to be his income for the year in which it is received, irrespective of the method of accounting followed by the assessee.

(2) Interest on compensation or on enhanced compensation to be taxed under other sources: Clause (viii) in sub-section (2) of section 56 has been inserted to provide that income by way of interest received on compensation or on enhanced compensation referred to in sub-clause (b) of section MSA shall be assessed as "income from other sources" in the year in which it is received.

(3) 50% deduction to be allowed from such interest: Clause (iv) has been inserted to section 57 to provide that in the case of income of the nature referred to in section 56(2)(viii), a deduction of a sum equal to 50% of such income shall be allowed and no deduction shall be allowed under any other clause of this section.

Some important items of income stated above are hereunder discussed :

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

Dividend means the sum paid to or received by a shareholder proportionate to his shareholding in a company out of the total sum distributed. The definition of "Dividends" under section 2(22) is an inclusive definition and it means dividend as normally understood and include in its connotation several other receipts set out in the definition- Kantilal Manilal *vs.* CIT 41 ITR 275(SC).

The term "Dividends" includes deemed dividends of the following nature :

(i) Any distribution of accumulated profits entailing the release of company's assets- Sec. 2(22)(a).

(ii) Any distribution of debenture stock, deposit certificates to shareholders and bonus to preference shareholder- Sec. 2(22)(b).

(iii) Any distribution to shareholders on liquidation of company to the extent to which the distribution is attributable to the accumulated profits of the company, other than distribution in respect of any share issued for full cash consideration where the shareholder is not entitled to participate in the surplus assets in the event of liquidation- Sec. 2(22)(c).

(iv) Any distribution on reduction of share capital to the extent to which the company possesses accumulated profit except a distribution in respect of any share issued for full cash consideration where the shareholder is not entitled to participate in the surplus asset in the event of liquidation — Sec. 2(22)(d).

(v) Any payment by way of advance or loan by a closely held company following :

(a) a shareholder, being a person who is the beneficial owner of shares (other than shares entitled to a fixed rate of dividend) holding not less than 10% of voting power; or

(b) any concern in which such shareholder is a member or partner and in which he has a substantial interest; or

(c) a person acting on behalf or for the individual benefit of any such shareholder - Sec. 2(22)(e)]

Note :

(i) An advance or loan to a shareholder of the said concern in the ordinary course of the business of the company where the lending of money is a substantial part of the company's business will not be regarded as dividend.

(ii) Any payment made by a company on purchase of its own shares from a shareholder in accordance with sec. 77A of the Companies Act, 1956, is not treated as dividend.

(iii) Distribution of shares by the resulting company to the shareholder of the demerged company is also not to be treated as dividend.

DIVIDEND EXEMPT

(i) Dividend declared/distributed/paid by domestic company including deemed dividend (i.e. other than the dividend u/s. 2(22)(e) or dividend from a foreign company) is exempt in the hands of shareholder. However, the company has to pay dividend distribution tax on it under section 115-O [Sec. 10(34)]

(ii) any dividend : (*a*) on units of a Mutual Fund specified under clause (*23D*); or (*b*) inrespect of units from the Administrator of the specified undertaking; or (*c*) in respect of units from the specified company [Sec. 10(35)]

EMPLOYEES' CONTRIBUTIONS TO PROVIDENT FUND ETC, [Sec. 56(2)(ic)]

It has to be remembered that any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set up under the provisions of the Employees' State Insurance Act, 1948 or any other fund for the welfare of such employees is income in the hands of the assessee and is chargeable as income from other sources if not chargeable as Profits and gains on Business or Profession [Sec. 2(24)(x)]

However, the tax payer is entitled to deduction of the sum of such contributions received from his employees if such sum is credited by the taxpayer to the employee's account in the relevant fund on or before the due date. Here, the due date means the date by which the assessee is required as an employer to credit an employees' contribution to the employees' account in the relevant fund under an Act, rule, etc. issued in that behalf [Sec. 36(1)(va)].

Therefore, any sum received by the assessee from his employees as contributions to any fund as aforesaid and is not deposited or deposited belatedly to the employee's account, it becomes income of the assessee.

INTEREST ON SECURITIES

Interest on securities is chargeable as income from other sources if it is not chargeable as Profits and gains of Business or Profession, i.e. when the securities are held as investment.

(**a**) **Basis of Charge –** If the books of account are maintained on cash basis the interest on securities will be chargeable on receipt basis. However, where books of account are maintained on mercantile system or where no method of accounting is regularly employed by the assessee, such interest will be chargeable on "accrual basis" i.e. as the income of the Previous Year in which such interest is due to the assessee – second proviso to sec. 145(1).

(**b**) **Interest on securities exempt –** The interest on securities of the following description is exempt from tax –

(i) interest on notified securities, bonds or certificates issued by the Central Govt.

(ii) interest to an individual or a HUF on 7% Capital investment Bond or on notified Relief Bonds.

(iii) interest to non-resident Indians on notified bonds.

(iv) interest on securities held by issue Department of the Central Bank of Ceylon.

(v) Tax planning - Taxpayer is entitled to the deduction of any reasonable sum paid as commission or remuneration to a banker or any other person for the purpose of realizing interest on securities. Similarly, he will also be entitled to the deduction of interest on capital borrowed for investing in securities.

INCOME FROM INSEPARABLE LETTING OF MACHINERY, PLANT OR FURNITURE WITH BUILDING

If an assessee lets on hire machinery, plant or furniture and also buildings and the letting of building is inseparable from the letting of machinery, plant or furniture, the income from such letting would be chargeable to tax under the residuary head where it is not chargeable under the 'Profits and gains of Business or Profession".

What is therefore, necessary to examine is whether the letting is by way of business. Whether a particular letting is of business has to be decided in the circumstances of each case. Each case has to be looked at from a businessman's point of view to find out whether the letting was the doing of business or the exploitation of his property by the owner. A commercial asset is only an asset used in a business and nothing else, and business may be carried on with practically all things. Therefore, it is not possible to say that a particular activity is business because it is concerned with an asset with which trade is carried on- Sultan Bros. (P) Ltd. vs. CIT (1964) ITR 353 (SC).

Example : Mr. A let out his building along with air conditioning plant, tube-wells, refrigerators, etc. Though separate rent is fixed in the lease deed refers to them collectively as "demised premise", it will be a case of inseparable letting and the entire rental income will be assessable as income from other sources.

GIFT

Now gift received during the previous year shall be included in the income if the aggregate of the gifts received exceeds ₹ 50,000.

However, the following gifts are not included in taxable income, viz.

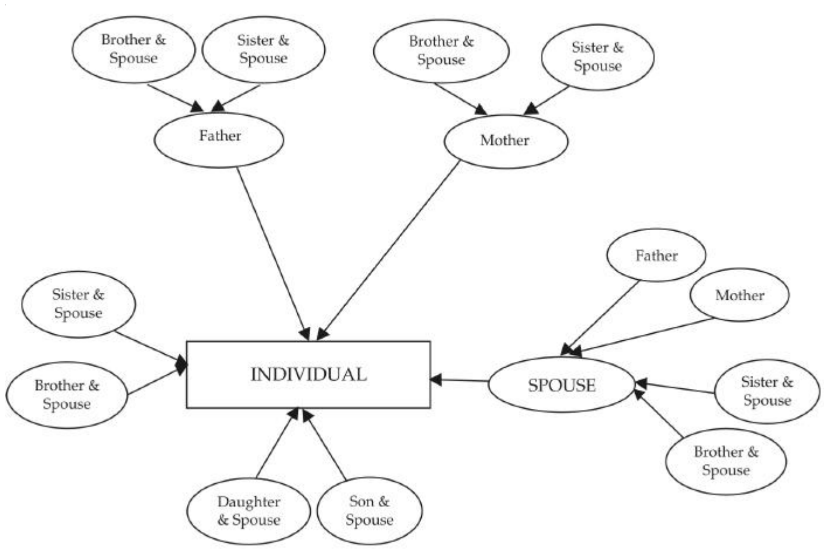
(a) from any relative; or
(b) on the occasion of the marriage of the individual; or
(c) under a will or by way of inheritance; or
(d) in contemplation of death of the payer; or
(e) from any local authority as defined in the Explanation to clause (20) of section 10; or
(f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in clause (23C) of section 10; or
(g) from any trust or institution registered under section 12AA.

For this purposes of this clause, "relative" means—

(i) spouse of the individual;
(ii) brother or sister of the individual;
(iii) brother or sister of the spouse of the individual;
(iv) brother or sister of either of the parents of the individual;
(v) any lineal ascendant or descendant of the individual;
(vi) any lineal ascendant or descendant of the spouse of the individual;
(vii) spouse of the person referred to in clauses (ii) to (vi).

In respect of gifts from relatives, although exempt from tax, in respect of income earned from such a gift, provisions relating to clubbing of income apply in certain cases e.g. gift received from spouse and father-in-law.

GIFT FROM THE FOLLOWING RELATIVES IS TAX FREE



OTHER INCOMES INCLUDIBLE UNDER THE HEAD

- Apart from the incomes specified in Sec. 56(2) of the Act, as mentioned above, courts have held that incomes of the following nature will be chargeable as income from other sources:
- Income of company in winding-up. Vijay Laxmi Sugar Mills Ltd. v. CIT
- Gratuity received by a director who is not an employee of the company. CIT v. Lady Navajbai R.J. Tata
- Interest is assessed under the head 'Income from other sources', if it not taxed as business or professional income. CIT v. Govinda Choudhury & Sons .
- Interest on tax refunds Smt. B. Seshamma v. CIT
- Interest earned prior to commencement of business - CIT v. Modi Rubber Ltd. / Goa Carbon Ltd. v. CIT
- Interest earned on short-term investment of funds borrowed for setting up of factory during construction of factory before commencement of business has to be assessed as income from other sources and it cannot be held to be non-taxable on ground that it would go to reduce interest on borrowed amount which would be capitalized - Tuticorin Alkali Chemicals & Fertilizers Ltd. v. CIT.
- Tax on salary of assessee borne by payer, for whom assessee was working under a contract, under a legal obligation - Emil Webber v. CIT
- Sale receipts prior to commencement of business CIT v. Rassi Cement Ltd.
- If the business as a whole is let out the income i.e. the rent, would not be liable to be assessed as income from business. If only the commercial assets are leased out the income would continue to be income from business- CIT Vs. Biswanath Roy, CIT Vs. Kuya & Khas Kuya Colliery Co.
- Reimbursement of taxes on salary – Z. Zizlaw Skakuz Vs. CIT
- Interest on employee's contribution to unrecognised provident fund- CIT vs. Hyatt
- Interest on bank deposits of idle business funds - Collis Line P. Ltd. Vs. ITO
- Interest deposit of share capital in bank before commencement of business Traco Cable Co. Ltd. vs. CIT
- Interest on realizations put by liquidator of company in fixed deposits- Vijay Lakshmi Sugar Mills Ltd. vs. CIT
- Interest received from Government u/s. 214/243/244/244A of the Income Tax Act, 1961- Smt. B. Seshmma vs. CIT
- Income from subletting of a House Property by a tenant.
- Insurance commission, if it is not assessable as income from business.
- Family Pension
- Director's Sitting Fees for attending board meeting
- Income from undisclosed sources
- Income received after discontinuance of business
- Examinorship fee received by a teacher.

INCOME NOT CHARGEABLE UNDER RESIDUARY HEAD

Income of the following nature will not be chargeable as income from other sources but on business income –

I. Interest on short-term deposit with State Bank received by a cooperative society carrying on banking business- Bihar State Cooperative Bank Ltd. Vs. CIT

II. Income to the principal from business carried on through an agent- CIT vs. S.K. Sahana and Sons Ltd.

III. Portion of business received by beneficiary from trust or wakf-CIT vs. P. Krishna Warier.

IV. Income from temporary letting out of business assets as a part of exploitation is to be assessable as business income and not as income from other sources- CIT vs. Vikram Cotton Mills Ltd.

INCOME FROM LETTING OF MACHINERY, PLANT OR FURNITURE

The income from machinery, plant or furniture belonging to the assessee and let out on hire is chargeable as income from other sources, if it is not chargeable as Profits and gains of Business or Profession. - Sec. 56 (2) (ii).

DEDUCTIONS [Sec. 57]

The income chargeable under the head "Income from other sources" shall be computed after the following deductions, namely –

(a) In the case of dividend income and interest on securities—
  (i) Any reasonable sum paid by way of remuneration or commission for the purpose of realizing dividend or interest, and
  (ii) interest on borrowed capital if required for investment in shares or securities.

(b) In the case of income from machinery, plant or furniture let on hire
  (i) current repairs to building - sec. 30(a)(ii)
  (ii) current repairs to machinery, plant or furniture and insurance premium -sec.(31)
  (iii) depreciation on building, machinery, plant or furniture - sec. (32) subject to sec.38 and
  (iv) unabsorbed depreciation - sec. 32(2).

(c) In the case of income in the nature of family pension- ₹ 15,000 or 33.33% of such income whichever is less.

(d) In the case of income specified in sec. 2(24)(x) i.e. deductions from employee salary for any fund, expenses of nature specified in – S. 36(1)(va) i.e. contribution to such fund on or before the due date.

(e) Any other expenditure (not being a personal or capital expenditure) expended wholly and exclusively for the purpose of earning such income. However, this deduction is not available to a foreign company in respect of dividend income.

AMOUNTS NOT DEDUCTIBLE [Sec. 58]

The following amounts are not deductible while computing income from other sources—

- Personal expenses of the assessee – Sec. 58(1)(a)(i)
- Interest payable outside India on which tax has not been paid or deducted at source Sec. 58(1)(a)(ii)
- Salary payable outside India on which no tax has been paid or deducted at source – Sec. 58(1)(a)(iii)
- Any sum paid on account of wealth tax- sec. 58(1A).
- any expenditure referred to sec. 40A i.e. excessive payment to relatives u/s. 40A(2) & 20% of cash payment where it exceeds ₹ 20,000 u/s. 40A(3).

  Enhancement of limit for disallowance of expenditure made otherwise than by an account payee cheque or account payee bank draft for plying, hiring or leasing goods carriages in the case of transporters to ₹ 35,000 from the existing limit of ₹ 20,000 (Section 40A(3) and (3A)| (applicable to transactions effected on or after 1-10-2009)

  The existing limit for other categories of payments will remain at ₹ 20,000 subject to the exceptions declared in Rule 6DD of the Income-tax Rules.

- Where an assessee has income from other sources no deduction of any expenditure or allowance in connection with such income shall be allowed under any other provisions of the Act in computing the income by way of any winnings from lotteries, crossword puzzles, races including horse races, and games – S.58(4). However, this prohibition will not apply to the owner of the horse maintained by him in horse race in computing his income from the activity of owning and maintaining such horses – Proviso to Sec. 58(4).

PROFITS CHARGEABLE TO TAX [Sec. 59]

Where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee and subsequently during any previous year he has obtained any amount or benefit in any form in respect of such loss or expenditure or trading liability the amount or value of benefit obtained by such person shall be deemed to be income from other sources. If any amount or benefit is obtained by a successor it shall be chargeable to income-tax as income of such a successor.

In short, provision of sec. 41(1) of the Act are made applicable while computing the income of an assessee under the head income from other sources, as they apply in computing the income of an assessee under the head 'Profits and gains of Business or Profession".

METHOD OF ACCOUNTING [Sec. 145]

Income chargeable under the head "Income from other sources" shall be computed in accordance with cash system of accounting or mercantile system of accounting regularly employed by the assessee.

Exception to this general rule is deemed dividend income covered by sub-clause (e) of clause (22) of section 2 which is chargeable to tax on payment basis as prescribed under section 8 of the Income-tax and not on the basis of method of accounting followed.

Points to be noted:

(i) An assessee is entitled to change his regular method of accounting by another regular method and such change can be effected in respect of apart of assesses income.- Snow White Food Products Co Ltd. v/s CIT

(ii) Where assesses is allowed to change his method of accounting from an accounting year he is entitled to claim computation of income on changed basis.- Seth Chemical Works v/s CIT

(iii) A company was regularly valuing its stock under total cost method and wanted to change the method of valuation which excluded certain expenses which were to be included under former method. The company allowed to change method. CIT v/s Carborandum Universal Ltd.

(iv) Mere circumstances that appellant should dividend income under this head in its return could not in law decide nature of dividend income. Brooke Bond & Co Ltd. v/s CIT– SC.

Illustration 87 : A Company, incorporated for the manufacture of steel, had not commenced production. The plant and machinery was in the stage of erection. During the previous year ending 31.3.2010, it paid .interest on borrowings, amounting to ₹20 Lakhs. It also received interest of ₹ 1.50 Lakhs on investment in Short-Term deposits of moneys not immediately required for business. The Assessing Officer assessed the interest income under other sources. Discuss the correctness of the assessment.

Answer :

(a) Interest on surplus funds: Interest income earned on deposits made out of surplus funds before commencement of business is taxable as "Income from other sources".

(b) In view of the above judgement, the sum received as interest on deposits shall be charged to tax under the head 'Income from Other Sources'.

(c) No part of the interest paid on the loan borrowed shall be allowed as deduction u/s 57 as the same was not borrowed wholly and exclusively for the purpose of earning such interest. Whole of such interest shall be capitalised.

(d) Therefore, the action of the Assessing Officer is correct.

Illustration 88 : AChartered Accountant handles funds belonging to his clients and maintains a separate account for these moneys. Part of these moneys, In excess of current requirements, is kept in deposit on which interest is earned. The Assessing Officer proposes to assess the interest income in the hands of the Chartered Accountant. How would you contest the action of the Assessing Officer?

Answer :

(a) Under the Chartered Accountants Act, 1949, a Chartered Accountant has to keep the monies belonging to a client in a separate bank account. He holds these funds only in a fiduciary capacity. Therefore, the Chartered Accountant cannot make use of such monies for his own benefit.

(b) The beneficial interest in the monies so deposited in a separate bank account lies with the owner of the funds, i.e. the clients. Therefore, the interest accrued on such funds also belongs to the clients.

(c) In view of the above, the interest do not accrue in the hands of the Chartered Accountant and hence not chargeable to tax in his hands.

(d) Therefore, action of the Assessing Officer is not correct.

Illustration 89 : Discuss the correctness or otherwise of the following proposition: Kumar took part in a motor-car rally and is awarded a prize money of ₹ 10,000 for winning a race. He claims that the amount of ₹ 10, 000 is exempt from tax.

Answer :

(a) Winnings from motorcar rally are a return for skill and endurance. It is taxable as income.

(b) In view of the above Supreme Court ruling, the amount of ₹10,000 won by Mr. Kumar shall be treated as income and chargeable to tax under the head Income from Other Sources.

(c) Therefore, contention of Mr. Kumar is not correct and valid in law.

Illustration 90 : Discuss the taxability of gifts received by an Assessee.

Answer :

1. Applicability: Gifts received by Individual and HUF irrespective of Residential Status.
2. Taxability: Any sum of **money, aggregate value of which exceeds ₹50,000,** is received during the previous year without consideration, by an Individual or a HUF from any person(s) on or after 1.4.2007, then the **whole of the aggregate of such sum** will be taxable.
3. **Exceptions:**

(a) Gifts received from the following persons not taxable -

- From a relative, or
- On the occasion of the marriage of the individual, or
- Under a will or by way of inheritance, or
- In contemplation of death of the payer, or
- Any Local Authority, or Fund/Foundation/University/Educational Institution or Hospital or
- other Medical Institution or
- Trust or Institution referred u/s 10(23C), or
- Trust / Institution registered u/s 12AA

(b) Gifts received in kind not taxable.

4. **Relative means:**

(a) Spouse of the individual,
(b) Brother or sister of the individual,
(c) Brother or sister of the spouse of the individual,
(d) Brother or sister of either of the parents of the individual,
(e) Any lineal ascendant or descendant of the individual,
(f) Any lineal ascendant or descendant of the spouse of the individual,
(g) Spouse of the person referred to in clauses (b) to (f) above.

Illustration 91 : B an individual, gets ₹70,000 as a birthday gift from his Grandfather. Is the receipt taxable under the Income Tax Act?

Answer : B has received the gift from his grandfather. Grandfather is a relative. Hence, the receipt is not taxable.

Illustration 92 : Discuss the taxability or otherwise of the following gifts received by H, an individual, during the Financial Year 2009-10:

(a) ₹ 25,000 each from his four friends on the occasion of his birthday.

(b) Wrist watch valued at ₹ 40,000 from his friend.

Answer:

(a) ₹1,00,000 (i.e. ₹ 25,000 × 4) from his four friends on the occasion of his birthday, is taxable as income from other sources, since friends are not relatives and the amount has exceeded ₹ 50,000.

(b) Gift in kind is not taxable. Hence, wrist watch of ₹40,000 received as a gift from friend is not taxable.

Illustration 93 : Fiona received the following gifts during the year ending 31.03.2010:

(a) ₹ 40, 000 from her elder sister.

(b) ₹60,000 from the daughter of her elder sister.

(c) ₹ 1,25,000 from various friends on the occasion of her marriage,

Discuss the taxability or otherwise of these gifts in the hands of Fiona.

Answer :

(a) ₹40,000 received from elder sister, is not taxable, as elder sister is a relative.

(b) ₹60,000 received from the daughter of her elder sister, is taxable, as the donor, in this case, is not a relative as per the definition of the Act.

(c) ₹1,25,000 is not taxable as it is received on the occasion of her marriage.

Illustration 94 : Discuss the taxability of Family Pension.

Answer :

Family pension means pension received by the family members of the deceased employee.

It is chargeable to tax under the head 'Income from Other Sources'.

Deduction u/s 57: Least of the following is allowed as a deduction -

(a) 33 1/3 % of gross pension

(b) ₹15,000

Exemptions :

(a) Family pension received by family members of Army personnel who are recipient of gallantry awards [Section 10(18)].

(b) Family pension received by the widow or children or nominated heirs of a member of the armed forces (including para-military forces) whose death has occurred in the course of operational duties [Section 10(19)].

Illustration 95 : V. G. had placed a deposit of ₹ 10 Lakhs in a bank on which he received interest of ₹80, 000. He had also borrowed ₹5 Lakhs from the same bank on the security of the deposit and was liable to pay ₹50,000 by way of interest to the bank. He therefore offered the difference between two amounts of ₹30,000 as income from other sources. Is this correct?

Answer :

(a) U/s 57, any expenditure (not being capital expenditure) expended to earn income chargeable under the head "Income from Other Sources" will be allowed as deduction against such income.

(b) Interest on bank FD was the income in the hands of the assessee and the interest on the loan taken from bank on that deposit is not an allowable expenditure.

Therefore, in the given case, the interest of ₹50,000 paid by VG is not allowable as deduction, and the entire interest of ₹80,000 is fully taxable.

Illustration 96 : Shrey purchased in 2003, 10,000 Shares of Hero Ltd. for ₹5 Lakhs by borrowing money from a bank. He holds them as 'Investments'. He received dividend during the previous year 2010-11. He has paid interest of ₹85,000 on the loan to the bank during the previous year. Please advise Shrey, how should he deal with these facts in computing his income?

Answer :

(a) In computation of total income under the Income Tax Act, the expenditure incurred in relation to income, which does not form part of Total Income, shall not be allowed as deduction. [Section 14A]

(b) Dividend Income is exempt u/s 10(34) and hence does not form part of Total Income.

Therefore, the interest payment is not an allowable expenditure.

Illustration 97 : Mr JK gets the following gifts during the previous year 2010-2011.

	Date of gift	Name of the donor	Amount of gift (₹)
1.	01.07.2008	Gift from R, a friend, by cheque	50,000
2.	01.09.2008	Cash gift from N, nephew	1,00,000
3.	01.12.2008	Gift of diamond ring on his birthday, by a friend, C	75,000
4.	15.12.2008	Cash gifts of ₹ 31,000 each made by four friends on the occasion of his marriage	1,24,000
5.	01.12.2009	Cash gift made by wife's sister on house opening ceremony	51,000
6.	15.01.2009	Cash gift from a close friend of father-in-law.	1,51,000
7.	31.01.2009	Cash gift made by great-grandfather	1,51,000
8.	01.02.2009	Cash gift received under the Will of a friend, who is seriously ill.	51,000
9.	15.02.2009	Cash gift made by a business friend on his birthday	75,000
10.	31.03.2009	Cash gifts made by three friends of ₹ 25,000 each	

Besides this, JK is engaged in the business of sale and purchase of retail goods.
He maintains no account books. Gross turnover from retail trading is ₹ 35,00,000.
Compute his total income for the assessment year 2011-2012.

Solution :

Previous Year : 2010-11 **Mr. JK** **Assessment Year : 2011-12**

Computation of taxable income for the AY 2011-2012

Particulars	Amount (₹)
1. Income from retail trading business [Sec. 44 AF] 5% ₹ 35,00,000	1,75,000
2. Income form other sources (money gifts):	
(i) Cash gift from a friend, by cheque	50,000
(ii) Cash gift from nephew, not covered by the definition of relative	1,00,000
(iii) Gift of diamond ring — non-monetary gift not taxable	—
(iv) Cash gifts on the occasion of marriage are not chargeable even if such gifts are made by unrelated persons	—
(v) Cash gift made by wife's sister, a relative, not taxable	—
(vi) Cash gift by a friend of father-in-law, unrelated person	1,51,000
(vii) Cash gift made by great-grand father, a relative	—
(viii) Cash gift received under Will in contemplation of death of a friend	—
(ix) Cash gift made by a business friend on his birthday	51,000
(x) Cash gifts, made by three friends, of ₹ 25,000 each	75,000
Total Income	**6,02,000**

Illustration 98 : Mr Ayan Goel receives the following gifts of of money:

S. No.	Date of gift	Donor	Form of gift	Amount of gifts	Remarks
1.	31.3.2010	Friend	Cheque	25,000	Cheque is encashed on 03.04.2010
2.	01.05.2010	Brother	Bank draft	50,000	
3.	30.07.2010	Non-resident friend	Cheque	30,000	
4.	01.10.2010	Brother-in-law	Cash	10,000	
5.	15.11.2010	Great-grandfather-in-law	Cash	40,000	
6.	05.12.2010	Cousin brother	Cash	21,000	On the occasion of the marriage
7.	01.01.2011	Neighbour	NSC-VIII Issue	10,000	Maturity date 31.03.2010
8.	31.03.2011	Friend	Cash	10,000	

Determine the chargeability of the aforesaid gifts. Would it make any difference if the amount of gift made on 31.03.2011 is ₹ 10,001.

Solution :

Previous Year : 2010-11 **Mr. Ayan Goel** **Assessment Year : 2011-12**

Computation of taxable gifts for the AY 2011-2012.

	Particulars	Case – I ₹	Case – II ₹
1.	Gift of cheque dated 31.03.2010 from a friend but encashed on 03.04.2010 is not taxable since it does not exceed ₹ 25,000. Chargeability is governed by the date of receipt and not by date of encashment.	—	—
2.	Gift from brother is exempt	—	—
3.	Gift from friend	30,000	30,000
4.	Gift from brother-in-law—Exempt	—	—
5.	Gift from great grandfather-in-law: Exempt	—	—
6.	Gift on the occasion of the marriage	—	—
7.	Gift from neighbour	10,000	10,000
8.	Gift from friend	10,000	10,000
		50,000	50,000
	Taxable gift	Exempt	50,001

9.9 DEDUCTIONS UNDER CHAPTER VIA

INTRODUCTION

In order to further the government policy of attracting investment and activity in the desired direction and to provide stimulus to growth or to meet social objectives, concession in the form of 'deduction' from taxable income is allowed. Chapter VI-A of the Income-tax Act, 1961 contains such deduction provisions.

with the advent of new philosophy of giving direct assistance to the desired goal and avoiding indirect route of tax concessions, the number of deductions are being omitted. this is also with a view to avoid complexity of tax law.

In computing total income of an assessee deductions under sections 80CCC to 80U are permissible from "Gross total Income". [80A(1)]

Deduction not to be allowed unless return furnished [Sec. 80AC]

Where in computing the total income of an assessee of the previous year relevant to the assessment year commencing on the 1st day of April, 2006 or any subsequent assessment year, any deduction is admissible under section 80-IA or section 80-IAB or section 80-IB or section 80-IC *or section 80-ID or section 80-IE*, no such deduction shall be allowed to him unless he furnishes a return of his income for such assessment year on or before the due date specified under sub-section (1) of section 139.

"Gross total Income" means the aggregate of income computed under each head as per provisions of the Act, after giving effect to the provisions for clubbing of incomes (Sections 60 to 64) and set off of losses and but before making any deductions under this chapter. [Section 80B(5)]

The deductions under chapter VIA are not available from the following incomes though these are included in the "Gross total Income":

(i) long term Capital gains;

(ii) winnings from lotteries, cross word puzzles etc.;

(iii) incomes referred to in sections 115A to AD, 115BBA and 115D.

The aggregate amount of deductions under chapter VIA [Sections 80CCC to 80U] shall not exceed the "Gross total Income" of the assessee. [Section 80A(2)]

Deductions under Chapter VIA available for

I	II	III
In respect of expenditure or investment made by assessee [Sec. 80C to 80GGA]	In respect of certain income [Sec. 80HH to 80RRB]	Other deduction [Section 80U]

Deduction : Sec 80C : Deduction in respect of LIP, contributions to PF, etc:

1	Eligible Assessee	Individual and HUF
2	Condition	Investment or application of funds during the previous year
3	Maximum Deduction	₹. 1,00,000 in a previous year
4	Special Provisions	Withdrawal of deductions for certain premature exit from certain investments or application of funds

It is applicable to Individual and HUF and if the assessee has invested, contributed or expended in any one or more of listed items during the previous year. The deduction is available to the maximum extent of ₹ 1,00,000.

DEDUCTIONS FROM GROSS TOTAL INCOME

(a) Deduction in respect of certain investments, contributions, subscriptions etc.

Insertion of deduction under section 80C replacing rebates u/s 88, 88B, 88C, 88D deductions u/s 80CCC and u/s 80CCD

With effect from the 1st day of April, 2006, a new deduction u/s 80C has been introduced.

Rate of deduction [Section 80C(1)]

This deduction shall be admissible only to an assessee, being an individual or a Hindu undivided family. The amount of deduction shall be actual amount paid or deposited during the previous year in prescribed saving schemes [to be calculated as qualifying amount for deduction u/s 80c or ₹ 1,00,000 which ever is less.

Qualifying Amount For Deduction u/s 80C

(i) to effect or to keep in force an insurance on the life of persons specified in sub-section (4);

(ii) to effect or to keep in force a contract for a deferred annuity, not being an annuity plan referred to in clause (*xii*), on the life of persons specified in sub-section (4):

Provided that such contract does not contain a provision for the exercise by the insured of an option to receive a cash payment in lieu of the payment of the annuity;

(iii) by way of deduction from the salary payable by or on behalf of the Government to any individual being a sum deducted in accordance with the conditions of his service, for the purpose of securing to him a deferred annuity or making provision for his spouse or children, in so far as the sum so deducted does not exceed one-fifth of the salary;

(iv) as a contribution by an individual to any provident fund to which the Provident Funds Act, 1925 (19 of 1925) applies;

(v) as a contribution to any provident fund set up by the Central Government and notified by it in this behalf in the Official Gazette, where such contribution is to an account standing in the name of any person specified in sub-section (4);

(vi) as a contribution by an employee to a recognised provident fund;

(vii) as a contribution by an employee to an approved superannuation fund;

(viii) as subscription to any such security of the Central Government or any such deposit scheme as that Government may, by notification in the Official Gazette, specify in this behalf;

(ix) as subscription to any such savings certificate as defined in clause (*c*) of section 2 of the Government Savings Certificates Act, 1959 (46 of 1959), as the Central Government may, by notification in the Official Gazette, specify in this behalf;

(x) as a contribution, in the name of any person specified in sub-section (4), for participation in the Unit-linked Insurance Plan, 1971 (hereafter in this section referred to as the Unit-linked Insurance Plan) specified in Schedule II of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 (58 of 2002);

(xi) as a contribution in the name of any person specified in sub-section (4) for participation in any such unit-linked insurance plan of the LIC Mutual Fund [*referred to in*] clause (*23D*) of section 10, as the Central Government may, by notification in the Official Gazette, specify in this behalf;

(xii) to effect or to keep in force a contract for such annuity plan of the Life Insurance Corporation or any other insurer as the Central Government may, by notification in the Official Gazette, specify;

(xiii) as subscription to any units of any Mutual Fund [*referred to in*] clause (*23D*) of section 10 or from the Administrator or the specified company under any plan formulated in accordance with such scheme as the Central Government may, by notification in the Official Gazette, specify in this behalf;

(xiv) as a contribution by an individual to any pension fund set up by any Mutual Fund [*referred to in*] clause (*23D*) of section 10 or by the Administrator or the specified company, as the Central Government may, by notification in the Official Gazette, specify in this behalf;

(xv) as subscription to any such deposit scheme of, or as a contribution to any such pension fund set up by, the National Housing Bank established under section 3 of the National Housing Bank Act, 1987 (53 of 1987) (hereafter in this section referred to as the National Housing Bank), as the Central Government may, by notification in the Official Gazette, specify in this behalf;

(xvi) as subscription to any such deposit scheme of—

(a) a public sector company which is engaged in providing long-term finance for construction or purchase of houses in India for residential purposes; or

(b) any authority constituted in India by or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both,

as the Central Government may, by notification in the Official Gazette, specify in this behalf;

(xvii) as tuition fees (excluding any payment towards any development fees or donation or payment of similar nature), whether at the time of admission or thereafter,—

(a) to any university, college, school or other educational institution situated within India;

(b) for the purpose of full-time education of any of the persons specified in sub-section (4);

(xviii) for the purposes of purchase or construction of a residential house property the income from which is chargeable to tax under the head "Income from house property" (or which would, if it had not been used for the assessee's own residence, have been chargeable to tax under that head), where such payments are made towards or by way of—

(a) any instalment or part payment of the amount due under any self-financing or other scheme of any development authority, housing board or other authority engaged in the construction and sale of house property on ownership basis; or

(b) any instalment or part payment of the amount due to any company or co-operative society of which the assessee is a shareholder or member towards the cost of the house property allotted to him; or

(c) repayment of the amount borrowed by the assessee from—

(1) the Central Government or any State Government, or

(2) any bank, including a co-operative bank, or

(3) the Life Insurance Corporation, or

(4) the National Housing Bank, or

(5) any public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes which is eligible for deduction under clause (*viii*) of sub-section (1) of section 36 or

(6) any company in which the public are substantially interested or any co-operative society, where such company or co-operative society is engaged in the business of financing the construction of houses, or

(7) the assessee's employer where such employer is an authority or a board or a corporation or any other body established or constituted under a Central or State Act, or

(8) the assessee's employer where such employer is a public company or a public sector company or a university established by law or a college affiliated to such university or a local authority or a co-operative society; or

(d) stamp duty, registration fee and other expenses for the purpose of transfer of such house property to the assessee,

but shall not include any payment towards or by way of—

(A) the admission fee, cost of share and initial deposit which a shareholder of a company or a member of a co-operative society has to pay for becoming such shareholder or member; or

(B) the cost of any addition or alteration to, or renovation or repair of, the house property which is carried out after the issue of the completion certificate in respect of the house property by the authority competent to issue such certificate or after the house property or any part thereof has either been occupied by the assessee or any other person on his behalf or been let out; or

(C) any expenditure in respect of which deduction is allowable under the provisions of section 24;

(xix) as subscription to equity shares or debentures forming part of any eligible issue of capital approved by the Board on an application made by a public company or as subscription to any eligible issue of capital by any public financial institution in the prescribed form

Explanation — For the purposes of this clause,—

(i) "eligible issue of capital" means an issue made by a public company formed and registered in India or a public financial institution and the entire proceeds of the issue are utilised wholly and exclusively for the purposes of any business referred to in sub-section (4) of section 80-IA

(ii) "public company" shall have the meaning assigned to it in section 3 of the Companies Act, 1956 (1 of 1956);

(iii) "public financial institution" shall have the meaning assigned to it in section 4A of the Companies Act, 1956 (1 of 1956);

(xx) as subscription to any units of any mutual fund referred to in clause (*23D*) of section 10 and approved by the Board on an application made by such mutual fund in the prescribed form

(xxi) *as term deposit—*

(a) *for a fixed period of not less than five years with a scheduled bank; and*

(b) *which is in accordance with a scheme*[27a] *framed and notified, by the Central Government, in the Official Gazette for the purposes of this clause.*

(xxii) as subscription to such bonds issued by the National Bank for Agriculture and Rural Development, as the Central Government may, by notification in the Official Gazette, specify in this behalf.

Taxability of Amount Received

1. In following cases the assessee shall have to pay tax on any amount received on:

(i) Termination of his contract of insurance referred to at point I above by notice to that effect or where the contract ceases to be in force by reason of failure to pay any premium , by not reviving contract of insurance :

(a) in case of any single premium policy, within two years after the date of commencement of insurance; or

(b) in any other case, before premiums have been paid for two years; or

(ii) termination of his participation in any unit-linked insurance plan referred to above in point 10 and 11 by notice to that effect or where he ceases to participate by reason of failure to pay any contribution, by not reviving his participation, before contributions in respect of such participation have been paid for five years; or

(iii) transfer of the house property before the expiry of five years from the end of financial years in which possession of such property is obtained by him, or receives back, whether by way of refund or otherwise, any sum specified in that clause, then :

(a) no deduction shall be allowed to the assessee under 80C(I) with reference to any of the sums referred to in point 1, 10, 11 and 18, paid in such previous year; and

(b) the aggregate amount of the deductions of income so allowed in respect of the previous year or years shall be deemed to be the income of the assessee of such previous year and shall be liable to tax in the assessment year relevant to such previous year.

DEDUCTION IN RESPECT OF CONTRIBUTION TO PENSION FUND OF LIC OR ANY OTHER PENSION FUND [Sec. 80CCC]

1	Eligible Assessee	Individual
2	Condition	Investment or application of funds during the previous year
3	Maximum Deduction	₹ 1,00,000 in a previous year
4	Special Provisions	Withdrawal of deductions for certain premature exit from certain investments or application of funds

Deduction of a maximum amount of ₹ 100,000 is allowed to an individual assessee for the amount paid or deposited by the assessee during previous year (out of his taxable income upto assessment year 2002-03) to effect or keep in force a contract for annuity plan of LIC or any other insurer for receiving pension from the fund referred to in s. 10(23AAB). The whole of the amount received by an assessee or his nominee shall be taxable in the year in which the amount is so received. It may be mentioned that where deduction is claimed in respect of any amount paid or deposited, under this section, no rebate u/s.88 shall be allowed with reference to the same amount. However, any payment in commutation of pension received from the fund referred to in section 10(23AAB) is exempt [u/s.10(10A)(iii)].

Deduction u/s 80CCC for investment in pension funds.

Where any amount paid or deposited by the assessee has been taken into account for the purposes of this section :

(a) a rebate with reference to such amount shall not be allowed under sec 88 for any assessment year ending before the 1st day of April , 2006;

(b) a deduction with reference to such amount shall not be allowed under section 80C for any assessment year beginning on or after the 1st day of April, 2006.

Deduction u/s 80CCD for contribution to pension scheme of Central Government

1	Eligible Assessee	Individual
2	Condition	Investment or application of funds during the previous year
3	Maximum Deduction	Up to 10% of his salary subject to maximum of ₹ 1,00,000
4	Special Provisions	Withdrawal of deductions for certain premature exit from certain investments or application of funds

Where any amount paid or deposited by the assessee has been allowed as a deduction under this section:

(a) No rebate with reference to such amount shall be allowed under section 88 for any assessment year ending before the 1st day of April ,2006;

(b) No deduction with reference to such amount shall be allowed under section 80C for any assessment year beginning on or after the 1st day of April ,2006.

Tax benefits for New Pension System - extended also to "self-employed", and tax treatment of savings under this system as "exempt-exempt-taxed" [Section 10(44), 115-0,197A and 80CCD W.r.e.f. A.Y. 2009-10]

Amendment in section 80CCD: The tax benefit under section 80CCD of the Income-tax Act, 1961 was hitherto available to "employees" only. However, the NPS now has been extended also to "self-employed". Therefore, the Act has also amended sub-section (1) of section 80CCD so as to extend the tax benefit thereunder also to "self-employed" individuals.

Further, in the case of an employee of Central Government or of any other employer, the deduction of employees' contribution shall be limited to 10% of his salary. Whereas in the case self-employed persons, it shall be limited to 10% of his Gross Total Income in the previous year.

Note : The Act has also inserted sub-section (5) to section 80CCD to provide that for the purposes of the said section the assessee shall be deemed not to have received any amount In the previous year If such amount Is used for purchasing an annuity plan In the same previous year.

Section 80CCE

The aggregate amount of deductions under Sec. 80C, Sec. 80CCC and Sec. 80CCD shall not, in any case, exceed one lakh rupees.

Sec. 80CCF : Deduction in respect of subscription to long-term infrastructure bonds :

1	Eligible Assessee	Individual and HUF
2	Condition	Subscription paid or deposited in notified long-term infrastructure bonds
3	Maximum Deduction	₹ 20,000.

DEDUCTION IN RESPECT OF MEDICAL INSURANCE PREMIA [Sec.80D]

1	Eligible Assessee	Individual and HUF
2	Condition	Investment or application of funds during the previous year by any mode of payment other than cash
3	Maximum Deduction	₹ 15,000. If they medical insurance premia is paid for senior citizen, then maximum deduction is up to ₹ 20,000

Deduction is allowed for any medical insurance premium **paid by any mode of payment other than cash** out of assessee's taxable income to GICI or any other approved insurer during the previous year, upto a maximum amount of ₹ 15,000. The deduction is allowed in respect of the following :-

(a) In case of an individual – insurance on the health of the assessee or wife or husband, dependent parents or dependent children.

(b) In case of a HUF – insurance on the health of any member of the family.

However, where the assessee or his wife or her husband or dependent parents or any member of his family of HUF is a senior citizen, the limit of deduction is raised from ₹ 15,000 to ₹ 20,000

DEDUCTION IN RESPECT OF MEDICAL TREATMENT OF HANDICAPPED DEPENDENT [Sec. 80DD]

Section 80DD of the Income Tax Act provides for a deduction to an individual or HUF, who is a resident in India, in respect of the following:

(a) Expenditure for the medical treatment (including nursing), training and rehabilitation of a dependant, being a person with disability; and

(b) Amount paid to LIC or other insurance in respect of a scheme for the maintenance of a disabled dependant.

1	Eligible Assessee	Individual and HUF
2	Condition	Expenditure for medical treatment during the previous year
3	Maximum Deduction	₹ 50,000, but where dependent is a person with servere disability, maximum deduction is ₹ 1,00,000.

Deduction is available to resident individual or HUF:

(i) For any expenditure incurred by an assessee during the previous year, for the medical treatment (including nursing) training and rehabilitation of handicapped dependent.

(ii) amount paid or deposited under any scheme framed by LICI and which is approved by CBDT and out of Income chargeable to tax for the maintenance of handicapped dependent. From the assessment year 2000-01 a straight deduction of ₹ 40,000 is allowed irrespective of actual expenditure incurred/amount deposited. If the handicapped dependent predeceases the individual or the member of HUF in whose name money has been deposited, an amount equal to the amount paid or deposited under the scheme shall be deemed to be the income of the assessee of the previous year in which sum amount is received by the assessee and chargeable to tax in that previous year.

For the purpose of this section dependent means a person who is not dependent for the suspect or main term on any person other than the assessee.

DEDUCTION IN RESPECT OF MEDICAL TREATMENT, ETC. [Sec 80DDB]

1	Eligible Assessee	Individual and HUF
2	Condition	The amount should be actually paid for the medical treatment of specified disaese.
3	Maximum Deduction	₹ 40,000 but if the amount paid is for senior citizen then the ceiling limit is ₹ 60,000
4	Special Provisions	The assessee is required to furnish with the return of income, a certificate is prescribed form No. 10-I.

Deduction is allowed to a resident individual or Hindu undivided family in respect of expenditure actually during the P.Y. incurred for the medical treatment of specified disease or ailment as specified in the Rules 11DD for himself or a dependent relative or a member of a HUF.

Conditions :

(i) The assessee has to furnish a certificate in form 10 – I from any doctor registered with Indian Medical Association with postgraduate qualifications.

(ii) "Dependent" means a person who is dependent for his support or maintenance on the assessee an on no other person.

a deduction of ₹ 40,000 is allowed irrespective of actual amount of expenditure as reduced by the amount received if any, from an insurer for the medical treatment of such person.
Specified diseases and ailments under section 80DDB and Rule 11DD –

(i) Neurological Diseases i.e.
  (a) Dementia;
  (b) Dystonia Musculorum Deformans
  (c) Motor Neuron Disease;
  (d) Atanxia;
  (e) Chorea;
  (f) Hemiballismus
  (g) Aphasia
  (h) Parkinsons Desease

(ii) Cancer

(iii) AIDS

(iv) Chronic Renal Failure

(v) Hemophilia

(vi) Thalassalmia

DEDUCTION IN RESPECT OF INTEREST ON LOAN TAKEN FOR HIGHER EDUCATION [Section 80E]

1	Eligible Assessee	Individual
2	Condition	The amount is paid by the assessee out of his income as interest on loan taken for higher education.
3	Maximum Deduction	100% of the interest paid on loan taken without any monetary ceiling limit.
4	Special Provisions	The assessee can claim the amount of interest in the initial assessment year & carry forward up to 7 assessment years.

In computing the total income of an assessee, being an individual, there shall be deducted, in accordance with and subject to the provisions of this section, any amount paid by him in the previous year, out of his income chargeable to tax, by way of interest on loan taken by him from any financial institution or any approved charitable institution for the purpose of higher education of his relative [Section 80E(1)]

The deduction specified above shall be allowed in computing the total income in respect of the initial assessment –year and seven assessment years immediately succeeding the initial assessment year or until the interest referred above is paid by the assessee in full, whichever is earlier [80E(2)]

Meaning of "relative" enlarged: The Act has enlarged the definition of "relative" given in clause (e) of sub-section (3). As per the new definition "relative", in relation to an individual, means the spouse and children of that individual or the student for whom the individual is the legal guardian.

DEDUCTION IN RESPECT OF DONATIONS TO CERTAIN FUNDS, CHARITABLE INSTITUTIONS, ETC. [Sec. 80G]

1	Eligible Assessee	Individual
2	Condition	The amount is paid by the assessee out of his income as interest on loan taken for higher education.
3	Maximum Deduction	100% of the interest paid on loan taken without any monetary ceiling limit.
4	Special Provisions	The assessee can claim the amount of interest in the initial assessment year & carry forward up to 7 assessment years.

Deduction under this section is available to all assessees.

Conditions for claiming deduction

(i) the donation should be of a sum of money and not in kind

(ii) the donation should be to specified funds/institutions.

Eligible Donation amount	*Qualifying deduction*	*Permissible*
1. PM's National Relief Fund;	From item Nos. 1 to 23	Quantum of deduction
2. PM's Armenia Earthquake Relief Fund;	there is no maximum	for item Nos. 1 to 18,
3. The Africa (Public Contributions India) Fund;	limit (i.e. 100% of the amount will qualify for deduction)	24 & 30 = 100% of the qualifying amount.
4. The national foundation for communal Harmony		For other items, quantum of deductions = 50% of
5. A university or any educational institution of national eminence as may be approved;		the qualifying amount.
6. The National Illness Assistance Fund;		
7. Any Zila Saksharta Samiti for improvement of primary education in villages and towns and for literacy activities;		
8. National Blood Transfusion Council or to any State Blood Transfusion Council;		
9. Any fund set up by the State Government for medical relief to the poor;		
10. The Army Central Welfare Fund or the Indian Naval Benevolent Fund or the Airforce Central Welfare Fund established by the armed forces of the Union for the welfare of the past and present members of the such forces or their dependants;		
11. The Chief Minister's Relief Fund or the Lieutenant Governor's Relief Fund in respect of any State or Union Territory, as the case may be;		

12. The National sports Fund to be set up by the Central Government;		
13. The National Cultural Fund set up by the Central Government;		
14. The Fund for Technology Department and Application setup by the Central Government;		
15. The National Defence Fund;		
16. Any fund setup by the State Government of Gujarat exclusively for providing relief to the victims of earthquake in Gujarat;		
17. Any sum paid during the period beginning with 26.1.2001 and ending on 30.9.2001 to any trust, institutions or fund recognised under section 80G for providing relief to the victims of earthquake in Gujarat;		
18. National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple disabilities constituted under the relevant Act of 1999;		
19. PM's Drought Relief Fund;		
20. The National Children's fund;		
21. Jawaharlal Nehru Memorial fund;		
22. Indira Gandhi Memorial Trust;		
23. Rajiv Gandhi foundation;		
24. Contribution by a company as donations to the Indian Olympic Association or to any other Association notified by the Central Government u/s. 10(23);	From Sl. Nos. 24 to 30 qualifying amount shall be restricted to 10% of adjusted total income (i.e. G.T.I. as reduced by deductions u/s. 80CCC to 80U other than 80G and other income on which no tax is payable and other incomes on which deductions under chapter VIA are not allowed)	
25. Any approved fund or institution established for charitable purposes;		
26. Government or local authority to be used for charitable purpose;		
27. Any authority set up for providing housing accommodation or town planning;		
28. Any corporation established by government for promoting interest of schedules caste/scheduled tribe/backward class;		
29. Renovation of notified temple mosque, church, or gurudwara or any other notified place of national importance;		
30. Government or local authority or approved institution/association for promotion of family planning;		

DEDUCTION IN RESPECT OF RENTS PAID [SEC. 80GG]

1	Eligible Assessee	Individual
2	Condition	The condition for deduction in respect of rents paid is given below.
3	Maximum Deduction	Amount of deduction is also given below.

The deduction in respect of rent paid is available to Individual with effect from assessment year 1998-99.

Conditions :

(i) The assessee is not being in receipt of any house rent allowance following under clause (13A) of section 10 from his employer.

(ii) The expenditure incurred (for the purpose of his own residence) by way of rent for any furnished or unfurnished accommodation is in excess of 10% of his total Income after allowing all deductions except deduction under this section.

(iii) The assessee or his spouse or minor child or an HUF of which he a is a member does not own any accommodation at the place where he ordinarily resides or performs duties of his office or employment or carries on his business/profession.

(iv) If the assessee owns any accommodation at any place other than the place of employment or business and such accommodation is not in the occupation of the assessee and shall not be assessed in his hands as self occupied property.

Deduction *:* Least of the following :–

(i) Rent paid minus 10% of adjusted total income

(ii) 25% of adjusted total income

(iii) ₹ 2,000 p.m.

Adjusted Total income : Gross Total Income as reduced by :

(a) Long term Capital gain, if any, included in the Gross Total Income

(b) all deduction under chapter VIA (Section 80CCC to 80U) other than the deduction under this section.

(c) any income referred to in sections 115A to D included in the Gross Total Income.

DEDUCTION IN RESPECT OF CERTAIN DONATIONS FOR SCIENTIFIC RESEARCH OR RURAL DEVELOPMENT [Sec. 80GGA]

In computing the total income of an assessee whose gross total income does not include income from "Profits and gains of business or profession", deduction shall be allowed of an amount paid by him to—

(a) an approved scientific research association or University or College or other institution to be used for scientific research, research in social science or statistical research.

(b) an approved association or institution to be used for carrying out any approved programme or rural development, an approved institution, association or which has the object of training of persons for implementing programmes of rural development 35CCA

(c) public sector company or local authority or an approved association or institution for carrying out any eligible project or scheme 35AC.

(d) association/institution/fund which has the object of carrying out any programme of conservation of natural resources or sec. 35CCB afforestation.

(e) National Urban Poverty Eradication Fund (NUPEF).

DEDUCTIONS BY COMPANIES TO POLITICAL PARTIES [Sec 80GGB]

Allowable to : An Indian Company

Amount of Deduction : 100% of sum contributed during a previous year to any political party, registered u/s 29A of Representation of the People Act, 1951.

DONATIONS TO POLITICAL PARTIES [Sec. 80GGC]

Allowable to : Any person except local authority and an artificial juridical person wholly or partly funded by the Government.

Amount of Deduction: 100% of sum contributed during a previous year to any political party, registered u/s 29A of Representation of the People Act, 1951.

Contributions to an Electoral Trust also eligible for deduction under section 80GGB and 80GGC

DEDUCTIONS IN RESPECT OF PROFITS & GAINS FROM INDUSTRIAL UNDERTAKINGS OR ENTERPRISES ENGAGED IN INFRASTRUCTURE DEVELOPMENT [Sec. 80IA]

The deduction under this section is applicable to all assessees whose Gross Total Income includes any profits and gains derived from any business of an industrial undertaking or an enterprise as below :

Sl.No	*Classification of Industries*	*Period of commencement*	*Deduction*
(i)	Any enterprise carrying on the business of developing or maintaining and operating or developing,maintaining and operation any infrastructure facility	On or after 1.4.1995	100% for 10 consecutive Assessment Yrs.
(ii)	Any undertaking providing telecommunication services whether basic or cellular including radio paging, domestic satellite service or network of trunking and electronic data interchange services.	1.4.95 and 31.3.2003	100% for first 5 yrs & 30% for companies& 25% for others for the next 5 yrs.
(iii)	Any undertaking which develops, develops and operates or maintains and operates an industrial park notified by the Central Government.	1.4.97 and 31.3.2002	100% for 10 consecutive assessment years.
(iv)	An Industrial undertaking set up in any part of India for the generation or generation and distribution of power.	1.4.93 and 31.3.2003	100% for 10 consecutive assessment years.
(v)	An industrial undertaking which starts transmission31.3.2003 or distribution of power by laying a network of new transmission or lays and begins to operate a cross-country natural gas distribution network.	1.4.99 and	100% for 10 consecutive assessment years.

The deduction under this section is available at the option of the assessee for any 10 consecutive assessment years out of 15 years beginning from the year in which the undertaking or enterprise develops and begins to operate any infrastructure facility or starts providing telecommunication services or develops an industrial part or generates power or commences transmission or distribution of power. However, in case of an infrastructure facility being a high way project including housing or other activities being an integral part of a high way project, the assessee can claim deduction for any 10 consecutive assessment years out of 20 years beginning from the year of operation.

Other Conditions :

(i) For the purpose of completing deduction under this section, the profits and gains of the eligible business shall be computed as if such eligible business were the only source of income during the relevant previous year.

(ii) Where housing or other activities are an integral part of the high way project and the profits and gains of which have been calculated in accordance of the provision of the section, the profits have not been liable to tax if the following conditions are not fulfilled :–

(a) The profits have been transferred to a special reserve account

(b) The same is actually utilised for the high way project excluding housing and other activities before the expiry of 3 years following the year of transfer to the reserve account.

(c) The amount remaining unutilised shall be chargeable to tax as income of the year in which such transfer to reserve account took place

(iii) Where the assessee is a person other than a company or a cooperative society, the deduction shall not be admissible unless the accounts of the industrial undertaking for the previous year relevant to the assessment year for which the deduction is claimed have been audited by an accountant and his report in form No. 10CCB (Rule 18BBB) is furnished alongwith the return of income.

(iv) Where any goods or services held for purposes of the eligible business are transferred to any other business carried on by the assessee or vice versa and if the consideration for such transfer does not correspond to the market value of such goods of services as on the date of transfer, the profits and gains of the eligible business shall be computed as if the transfer had been made at the market value of such goods or services as on that date however if the computation of profits and gains presents any difficulty in the opinion of the assessing officer, he may compute such profits and gains on such reasonable basis as he may deem feed. Similarly, Where due to close connection between the assessee and other person for any other reason it appears to the assessing officer that the profits of the eligible business is increased to more than the ordinary profit the assessing officer shall compute the profit on a reasonable basis for allowing the deduction.

(v) If the profits and gains are allowed as deduction under this section for any assessment year, no deduction under sections 80HH to 80RRA to the extent of such profits and gains shall be allowed.

(vi) Where any undertaking of an Indian company which is entitled the deduction under this section is transferred before expiry of the period of deduction to another Indian company in a scheme of amalgamation or demerger, no deduction has been admissible to the amalgamating or demerged company for the previous year in which amalgamation or demerger expressed and the amalgamated or the resulting company shall be entitled to the deduction as if the amalgamation or demerger had not taken place.

Amendments in section 80-IA

(A) Extension of sunset clause for undertakings engaged in development of industrial park [Section 8(IA(3)] [W.e.f. A.Y. 2009-10]

Under the existing provisions, in case of an undertaking which develops, develops and operates or maintains and operates an industrial park, deduction under section 80-1A is available if it commences its business before 31-3-2009. The Finance (No. 2) Act, 2009 has extended the terminal date from 31-3-2009 to 31-3-2011.

Section 80IA(4) : Extension of tax benefits for developing, operating, maintaining an infrastructure facility to authorities constituted under a Central or State Act.

The Act has amended section 80-IA(4) so as to enable an authority or a board or a corporation or any other body established or constituted under a Central or State Act which is not incorporated under the Companies Act, 1956 also to take advantage of the benefits provided under the said section.

The ordinance has extended the tax benefits under section 80-IA to an undertaking owned by an Individual company set up for re-construction or revival of a power generating plant if the following conditions are satisfied :

- Such undertaking must be owned be an Indian company.
- Such Indian company is formed before 30-11-2005 with majority equity participation by public sector companies for the purposes of enforcing the security interest of the lenders to the company owning the power generating plant.
- Such Indian company is notified before 31-12-2005 by the Central Government for the purposes of this clause.
- Such undertaking begins to generate or transmit or distribute power before 31-03-2007.

(B) Extension of sunset clause for tax holiday under section 80-IA to extend the terminal date for commencing the activity of generation, transmission or distribution of power in case of an undertaking owned by an Indian company and set up for reconstruction or revival of a power generating plant before 31-12-2005 [Section 80-IA(4)]

Under the existing provisions of section 80-IA(4)(v), an undertaking owned by an Indian company and set up for reconstruction or revival of a power generating plant is eligible for 10 year tax benefit if it fulfils the following conditions :—

(i) Such company is formed before 30-11-2005 with majority equity participation by public sector companies for enforcing the security interest of the lenders to the company owning the power generating plant;

(ii) Such Indian company is notified by the Central Government before 31-12-2005; and

(iii) The undertaking begins to generate or transmit or distribute power before 31-3-2008.

The Act has amended sub-clause (b) of clause (v) of sub-section (4) of section 80-IA to extend the terminal date for commencing the activity of generation, transmission or distribution of power in case of such undertaking from 31-3-2008 to 31-3-2011.

Deductions in respect of profits and gains by an undertaking or enterprise engaged in development of Special Economic Zone [Sec. 80IAB]

(1) Where the gross total income of an assessee, being a Developer, includes any profits and gains derived by an undertaking or an enterprise from any business of developing a Special Economic Zone, notified on or after the 1st day of April, 2005 under the Special Economic Zones Act, 2005, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction of an amount equal to one hundred per cent of the profits and gains derived from such business for ten consecutive assessment years.

(2) The deduction specified in sub-section (1) may, at the option of the assessee, be claimed by him for any ten consecutive assessment years out of fifteen years beginning from the year in which a Special Economic Zone has been notified by the Central Government :

Provided that where in computing the total income of any undertaking, being a Developer for any assessment year, its profits and gains had not been included by application of the provisions of sub-section (13) of section 80-IA, the undertaking being the Developer shall be entitled to deduction referred to in this section only for the unexpired period of ten consecutive assessment years and thereafter it shall be eligible for deduction from income as provided in sub-section (1) or sub-section (2), as the case may be :

Provided further that in a case where an undertaking, being a Developer who develops a Special Economic Zone on or after the 1st day of April, 2005 and transfers the operation and maintenance of such Special Economic Zone to another Developer (hereafter in this section referred to as the transferee Developer), the deduction under sub-section (1) shall be allowed to such transferee Developer for the remaining period in the ten consecutive assessment years as if the operation and maintenance were not so transferred to the transferee Developer.

(3) The provisions of sub-section (5) and sub-sections (7) to (12) of section 80-IA shall apply to the Special Economic Zones for the purpose of allowing deductions under sub-section (1).

DEDUCTION IN RESPECT OF PROFITS AND GAINS FOR CERTAIN INDUSTRIAL UNDERTAKING OTHER THAN INFRASTRUCTURE DEVELOPMENT UNDERTAKINGS [Sec. 80IB]

The deduction is available to the following undertaking or enterprises etc.

Sl. No.	*Undertaking*	*% of Profit deductible*	*Period of deduction*
A.	Ship- brought into use between 1.4.91 & 31.3.95	30	10 years
B.	Hotel-commenced between 1.4.97 and 31.3.2001 approved hotel in hilly are or rural area or a place of pilgrimage or in a notified area	50	10 years
C.	Any other approved hotel (Hotels in the cities of Calcutta, Chennai, Delhi and Mumbai are not eligible).	50	10 years

Sl No.	Classification of Industries	Period of Commencement between	Deduction of profits dividend
1	Industrial undertaking located in an industrially backward state specified in the Eighth schedule; (see note No. 3 below the table)	1.4.93 and 31.3.2002	100%. for initial 5 yrs. Thereafter 30% for 5 years. In case of company otherwise 25%. For cooperative society deduction is 100% of initial 5 years and thereafter 25% of 7 years.
2	Industrial undertaking located in industrially backward district notified by the Central Government -Category A -Category B	1.4.94 and 31.3.2002	100% for 5 yrs and 30% for next 5 yrs. 100% for 3 years and 30% for next 5 yrs in case of company (25% for others). For cooperative society 25% for 7 yrs. in both the category after initial 5 years.
3	Any company engaged in scientific and industrial research and development.	Approved by the prescribed authority after business for 31.3.2000 but before 1.4.2003	100% of the profits derived from such business for 10 years.
4	Undertaking which begins commercial production of mineral oil Œ a) in North Eastern Region. b) in other Regions Undertaking which begins refining of mineral oil.	Before 1.4.97 on or after 1.4.97.On or after 1.10.98	100% for the first 7 consecutive assessment years including the initial assessment years.
5	Undertaking engaged in developing and building housing projects approved by a local authorityŒ size profits derived from of the plot of land minimum 1 acre and residential unit built up of 1000 sq. ft. where such residential units other than cities of Delhi/Mumbai or within 25 kms. for the municipal limits of these cities and 1500 sq. ft. at any other place.	1.10.98 and 31.03.2003	100% of the profit derived from such business.
6	Industrial undertaking deriving profit from the business of setting up and operating a cold chain facility for agricultural produce.	1.4.99 and 31.03.2003	100% for initial 5 yrs. and thereafter 30% for 5 years in case of company (25% for others). For Co-operative Society cooperative society after initial 5 yrs 100%, 7 years @ 25%
7	Undertaking engaged in integrated business of handling, storage and transportation of food grains.	On or after 1.04.2001	100% for initial 5 yrs. Thereafter 30% for 5 years for company (25% for others).

E	Finance Act, 2002, inserted Sec. 80IB(7A) and Sec.80IB(7B) allowing deduction in case of any multiplex theatre and convention centers w.e.f. AY 2003-04 as under : - Multiplex theatre	1.4.2007 and ending 31.3.2012	50% of the profits of 5 consecutive years beginning from the initial assessment year.
	- Convention Centre	1.4.2007 and ending 31.3.2012	50% of the profits of 5 consecutive years beginning from the initial assessment year.

Section 80-IB (4) :

Extension of time limit for setting up of industries in the State of Jammu and Kashmir for the purpose of tax holiday : With a view to promote the industrial development of the State of Jammu and Kashmir the Finance Act, 2005 has extended the terminal date for setting up of industrial undertakings and commencement of eligible business in the State by two more years, from 31-03-2005 to 31-03-2007.

Section 80-IB(8A) :

Extension of the time limit for the purpose of tax holiday to any company carrying on scientific research and development : The Finance Act, 2005 has amended section 80-IB(8A) so as to allow the deduction to companies carrying on scientific research and development, which are approved by the prescribed authority before 1- 4-2007.

Amendments in section 80-IB

(A) Rationalising the provisions of deduction under section SO-IB(IO) developing and building housing projects - Not to apply to any undertaking which executes the housing project as a works contract awarded by any other person (including Central or State Government) [Section 80-IB(10)]

Sub-section (10) of section 80-IB of the Income-tax Act, 1961 provides for 100% deduction of the profits derived by an undertaking from developing and building housing projects, This benefit is available subject to the following conditions:

(a) The project is approved by a local authority before 31-3-2007. (See amendment below).

(b) The project is constructed on a plot of land having a minimum area of one acre.

(c) The built-up area of each residential unit should not exceed 1,000 sq. ft. in the cities of Delhi and Mumbai (including areas falling within 25 kms. of municipal limits of these cities) and 1,500 sq. ft. in other places.

(d) The built-up area of the shops and other commercial establishments included in the housing project should not exceed 5% of the total built-up area of the housing project or 2,000 sq. ft. whichever is less.

(e) The project has to be completed within 4 years from the end of the financial year in which the project is approved by the local authority.

The objective of this tax concession is to provide tax benefit to the person undertaking the investment risk i.e. the actual developer. However, any person undertaking pure contract risk is not entitled to the tax benefits.

With a view to clarify accordingly, the Act has inserted an Explanation after subsection (10) of section 80-IB so as to provide that nothing contained in this sub-section shall apply to any undertaking which executes the housing project as a works contract awarded by any other person (including Central or State Government).

This amendment will take effect retrospectively from 1-4-2001 and shall accordingly, apply in relation to assessment year 2001-02 and subsequent assessment years.

Further, the objective of the tax benefit for housing projects is to build housing stock for low and middle income households. This has been ensured by limiting the size of the residential unit. However, this is being circumvented by the developer by entering into agreement to sell multiple adjacent units to a single buyer. Accordingly, the Act has inserted new clauses viz. clause (e) and (/) to section 80-18(10) to provide that the undertaking which develops and builds the housing project shall not be allowed to allot more than one residential unit in the housing project to the same person, not being an individual, and where the person is an individual, no other residential unit in such housing project is allotted to any of the following person:—

(i) The individual or the spouse or minor children of such individual;

(ii) The Hindu undivided family in which such individual is the karta;

(iii) Any person representing such individual, the spouse or minor children of such individual or the Hindu undivided family in which such individual is the karta.

This amendment will take effect from 1-4-2010 and shall accordingly, apply in relation to assessment year 2010-11 and subsequent years.

Further, as per the Finance (No. 2) Act, 2009 the deduction will be available if the project is approved by the local authority before 31-3-2008 instead of 31-3-2007.

(B) Deduction available under section 80-IB relating to undertaking engaged in the business of processing, preservation and packaging of fruits or vegetables or integrated business of handling, storage and transportation of food grains also extended to certain other products [Section 80-113(11A)] [W.e.f. A.Y. 2010-11]

Under the existing provisions of section 80-18(11 A) deduction is available to an undertaking engaged in the business of processing, preservation and packaging of fruits or vegetables or integrated business of handling, storage and transportation of food grains. The Finance (No. 2) Act, 2009 has extended the benefits to an undertaking deriving profits from the business of processing, preservation and packaging of meat and meat products or poultry or marine or dairy products.

The provisions of this section shall not apply to an undertaking engaged in the business of processing, preservation and packaging of meat or meat products or poultry or marine or dairy products if it begins to operate such business before 1-4-2009.

Special provisions in respect of certain undertakings or enterprises in certain special category States [Sec. 80-IC]

(1) Where the gross total income of an assessee includes any profits and gains derived by an undertaking or an enterprise from any business referred to in sub-section (2), there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction from such profits and gains, as specified in sub-section (3).

(2) This section applies to any undertaking or enterprise,—

(a) which has begun or begins to manufacture or produce any article or thing, not being any article or thing specified in the Thirteenth Schedule, or which manufactures or produces any article or thing, not being any article or thing specified in the Thirteenth Schedule and undertakes substantial expansion during the period beginning—

(i) on the 23rd day of December, 2002 and ending before the 1st day of April, 2012, in any Export Processing Zone or Integrated Infrastructure Development Centre or Industrial Growth Centre or Industrial Estate or Industrial Park or Software Technology Park or Industrial Area or Theme Park, as notified by the Board in accordance with the scheme framed and notified by the Central Government in this regard, in the State of Sikkim; or

(ii) on the 7th day of January, 2003 and ending before the 1st day of April, 2012, in any Export Processing Zone or Integrated Infrastructure Development Centre or Industrial Growth Centre or Industrial Estate or Industrial Park or Software Technology Park or Industrial Area or Theme Park, as notified by the Board in accordance with the scheme framed and notified by the Central Government in this regard, in the State of Himachal Pradesh or the State of Uttaranchal; or

(iii) on the 24th day of December, 1997 and ending before the 1st day of April, 2012, in any Export Processing Zone or Integrated Infrastructure Development Centre or Industrial Growth Centre or Industrial Estate or Industrial Park or Software Technology Park or Industrial Area or Theme Park, as notified by the Board in accordance with the scheme framed and notified by the Central Government in this regard, in any of the North-Eastern States;

(b) which has begun or begins to manufacture or produce any article or thing, specified in the Fourteenth Schedule or commences any operation specified in that Schedule, or which manufactures or produces any article or thing, specified in the Fourteenth Schedule or commences any operation specified in that Schedule and undertakes substantial expansion during the period beginning—

(i) on the 23rd day of December, 2002 and ending before the 1st day of April, 2012, in the State of Sikkim; or

(ii) on the 7th day of January, 2003 and ending before the 1st day of April, 2012, in the State of Himachal Pradesh or the State of Uttaranchal; or

(iii) on the 24th day of December, 1997 and ending before the 1st day of April, 2012, in any of the North-Eastern States.

(3) The deduction referred to in sub-section (1) shall be—

(i) in the case of any undertaking or enterprise referred to in sub-clauses (i) and (iii) of clause (a) or sub-clauses (i) and (iii) of clause (b), of sub-section (2), one hundred per cent of such profits and gains for ten assessment years commencing with the initial assessment year;

(ii) in the case of any undertaking or enterprise referred to in sub-clause (ii) of clause (a) or sub-clause (ii) of clause (b), of sub-section (2), one hundred per cent of such profits and gains for five assessment years commencing with the initial assessment year and thereafter, twenty-five per cent (or thirty per cent where the assessee is a company) of the profits and gains.

(4) This section applies to any undertaking or enterprise which fulfils all the following conditions, namely:—

(i) *it is not formed by splitting up, or the reconstruction, of a business already in existence :*

Provided that this condition shall not apply in respect of an undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section;

(ii) it is not formed by the transfer to a new business of machinery or plant previously used for any purpose.

Explanation : The provisions of *Explanations 1* and *2* to sub-section (3) of section 80-IA shall apply for the purposes of clause (*ii*) of this sub-section as they apply for the purposes of clause (*ii*) of that sub-section.

(5) Notwithstanding anything contained in any other provision of this Act, in computing the total income of the assessee, no deduction shall be allowed under any other section contained in Chapter VIA or in section 10A or section 10B, in relation to the profits and gains of the undertaking or enterprise.

(6) Notwithstanding anything contained in this Act, no deduction shall be allowed to any undertaking or enterprise under this section, where the total period of deduction inclusive of the period of deduction under this section, or under the second proviso to sub-section (4) of section 80-IB or under section 10C, as the case may be, exceeds ten assessment years.

(7) The provisions contained in sub-section (5) and sub-sections (7) to (12) of section 80-IA shall, so far as may be, apply to the eligible undertaking or enterprise under this section.

(8) For the purposes of this section,—

(i) "Industrial Area" means such areas, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;

(ii) "Industrial Estate" means such estates, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;

(iii) "Industrial Growth Centre" means such centres, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;

(iv) "Industrial Park" means such parks, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;

(v) "Initial assessment year" means the assessment year relevant to the previous year in which the undertaking or the enterprise begins to manufacture or produce articles or things, or commences operation or completes substantial expansion;

(vi) "Integrated Infrastructure Development Centre" means such centres, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;

(vii) "North-Eastern States" means the States of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland and Tripura;

(viii) "Software Technology Park" means any park set up in accordance with the Software Technology Park Scheme notified by the Government of India in the Ministry of Commerce and Industry;

(ix) "substantial expansion" means increase in the investment in the plant and machinery by at least fifty per cent of the book value of plant and machinery (before taking depreciation in any year), as on the first day of the previous year in which the substantial expansion is undertaken;

(x) "Theme Park" means such parks, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government.

Deduction in respect of profits and gains from business of hotels and convention centres in specified area [Sec. 80ID]

(1) Where the gross total income of an assessee includes any profits and gains derived by an undertaking from any business referred to in sub-section (2) (such business being hereinafter referred to as the eligible business), there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction of an amount equal to hundred per cent of the profits and gains derived from such business for five consecutive assessment years beginning from the initial assessment year.

(2) This section applies to any undertaking,—

(i) engaged in the business of hotel located in the specified area, if such hotel is constructed and has started or starts functioning at any time during the period beginning on the 1st day of April, 2007 and ending on the 31st day of March, 2010; or

(ii) engaged in the business of building, owning and operating a convention centre, located in the specified area, if such convention centre is constructed at any time during the period beginning on the 1st day of April, 2007 and ending on the 31st day of March, 2010.

(3) The deduction under sub-section (1) shall be available only if —

(i) the eligible business is not formed by the splitting up, or the reconstruction, of a business already in existence;

(ii) the eligible business is not formed by the transfer to a new business of a building previously used as a hotel or a convention centre, as the case may be;

(iii) the eligible business is not formed by the transfer to a new business of machinery or plant previously used for any purpose.

(iv) the assessee furnishes along with the return of income, the report of an audit in such form and containing such particulars as may be prescribed, and duly signed and verified by an accountant, as defined in the Explanation below sub-section (2) of section 288, certifying that the deduction has been correctly claimed.

(4) Notwithstanding anything contained in any other provision of this Act, in computing the total income of the assessee, no deduction shall be allowed under any other section contained in Chapter VIA or section 10AA, in relation to the profits and gains of the undertaking.

(5) The provisions contained in sub-section (5) and sub-sections (8) to (11) of section 80-IA shall, so far as may be, apply to the eligible business under this section.

Special provisions in respect of certain undertakings in North- Eastern States[Sec. 80IE]

(1) Where the gross total income of an assessee includes any profits and gains derived by an undertaking, to which this section applies, from any business referred to in sub-section (2), there shall be allowed, in computing the total income of the assessee, a deduction of an amount equal to hundred per cent of the

profits and gains derived from such business for ten consecutive assessment years commencing with the initial assessment year.

(2) This section applies to any undertaking which has, during the period beginning on the 1st day of April, 2007 and ending before the 1st day of April, 2017, begun or begins, in any of the North-Eastern States,—

(i) to manufacture or produce any eligible article or thing;

(ii) to undertake substantial expansion to manufacture or produce any eligible article or thing;

(iii) to carry on any eligible business.

(3) This section applies to any undertaking which fulfils all the following conditions, namely:—

(i) it is not formed by splitting up, or the reconstruction, of a business already in existence :

Provided that this condition shall not apply in respect of an undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as referred to in section 33B, in the circumstances and within the period specified in the said section;

(ii) it is not formed by the transfer to a new business of machinery or plant previously used for any purpose.

Explanation : The provisions of *Explanations 1* and *2* to sub-section (3) of section 80-IA shall apply for the purposes of clause (*ii*) of this sub-section as they apply for the purposes of clause (*ii*) of that sub-section.

(4) Notwithstanding anything contained in any other provision of this Act, in computing the total income of the assessee, no deduction shall be allowed under any other section contained in Chapter VIA or in section 10A or section 10AA or section 10B or section 10BA, in relation to the profits and gains of the undertaking.

(5) Notwithstanding anything contained in this Act, no deduction shall be allowed to any undertaking under this section, where the total period of deduction inclusive of the period of deduction under this section, or under section 80-IC or under the second proviso to sub-section (4) of section 80-IB or under section 10C, as the case may be, exceeds ten assessment years.

(6) The provisions contained in sub-section (5) and sub-sections (7) to (12) of section 80-IA shall, so far as may be, apply to the eligible undertaking under this section.

DEDUCTION IN RESPECT OF PROFITS AND GAINS FROM BUSINESS OF COLLECTING AND PROCESSING OF BIO- DEGRADABLE WASTE. [Sec. 80JJA]

With effect from assessment year 1999-2000, where the gross total income of an assessee include profits and gains derived from the business of collecting and processing or treatment of bio-degradable waste for generating power, or producing bio-fertilizers, bio-pesticides or other biological agents or for producing bio-gas or making patents these shall be allowed in computing the total income of the assessee, a deduction of an amount equal to the whole of such profits and gains for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which such business commences.

DEDUCTION IN RESPECT OF EMPLOYMENT OF NEW WORKMEN [Sec 80JJAA]

With effect from assessment year 1999-2000, an Indian company is alongwith for deduction provided the following conditions are satisfied :

(i) The gross total income of the assessee includes profits and gains derived from any industrial undertaking

(ii) Such industrial undertaking is engaged in the manufacture or production of article or thing.

(iii) Such industrial undertaking is not forwarded by (a) splitting up of an existing undertaking, or (b) reconstruction of an existing undertaking or (c) amalgamation with another Industrial undertaking.

(iv) The assessee employs new regular workmen in the previous year

(v) The assessee furnishes the report of a chartered accountant in Form No. 10DA [Rule 19AB]

Deduction is available for 3 previous years commencing from the previous year in which such employment is provided.

Amount of deduction

(i) **New Industrial undertaking :** 30% of the wages paid to regular workmen in excess of 100 regular workmen employed during the year.

(ii) **Existing undertaking :** 30% of the wages paid to new regular workmen provided these is at least 10% increase in number of regular workmen over the existing member of workmen employed in such undertaking, as on the last day of the preceding year.

Regular workmen

It does not include :–

(a) a casual workmen or

(b) a workmen employed through contract labour; or

(c) any other workman employed for a period of less than 300 days during the previous year.

Deductions in respect of certain incomes of Offshore Banking Units and International Financial Services Centre [Sec. 80LA]

(1) Where the gross total income of an assessee,—

(i) being a scheduled bank, or, any bank incorporated by or under the laws of a country outside India; and having an Offshore Banking Unit in a Special Economic Zone; or

(ii) being a Unit of an International Financial Services Centre, includes any income referred to in sub-section (2), there shall be allowed, in accordance with and subject to the provisions of this section, a deduction from such income, of an amount equal to—

(a) one hundred per cent of such income for five consecutive assessment years beginning with the assessment year relevant to the previous year in which the permission, under clause (*a*) of sub-section (1) of section 23 of the Banking Regulation Act, 1949 (10 of 1949) or permission or registration under the Securities and Exchange Board of India Act, 1992 (15 of 1992) or any other relevant law was obtained, and thereafter;

(b) fifty per cent of such income for five consecutive assessment years.

(2) The income referred to in sub-section (1) shall be the income—

(a) from an Offshore Banking Unit in a Special Economic Zone; or

(b) from the business referred to in sub-section (1) of section 6 of the Banking Regulation Act, 1949 (10 of 1949) with an undertaking located in a Special Economic Zone or any other undertaking which develops, develops and operates or develops, operates and maintains a Special Economic Zone; or

(c) from any Unit of the International Financial Services Centre from its business for which it has been approved for setting up in such a Centre in a Special Economic Zone.

(3) No deduction under this section shall be allowed unless the assessee furnishes along with the return of income,—

(i) the report, in the form specified by the Central Board of Direct Taxes under clause (*i*) of sub-section (2) of section 80LA, as it stood immediately before its substitution by this section, of an accountant as defined in the *Explanation* below sub-section (2) of section 288, certifying that the deduction has been correctly claimed in accordance with the provisions of this section; and

(ii) a copy of the permission obtained under clause (*a*) of sub-section (1) of section 23 of the Banking Regulation Act, 1949 (10 of 1949).

Explanation : For the purposes of this section,—

(a) "International Financial Services Centre" shall have the same meaning as assigned to it in clause (*q*) of section 2 of the Special Economic Zones Act, 2005;

(b) "scheduled bank" shall have the same meaning as assigned to it in clause (*e*) of section 2 of the Reserve Bank of India Act, 1934 (2 of 1934);

(c) "Special Economic Zone" shall have the same meaning as assigned to it in clause (*za*) of section 2 of the Special Economic Zones Act, 2005;

(d) "Unit" shall have the same meaning as assigned to it in clause (*zc*) of section 2 of the Special Economic Zones Act, 2005.

DEDUCTION IN RESPECT OF CO-OPERATIVE SOCIETIES [Sec. 80P]

The following amounts are allowed as deduction under this section –

(i) 100% of the profits attributable to any or more of the following activities in the case of a cooperative society engaged in –

(a) carrying on business of banking or providing credit facilities to its members; or

(b) a cottage industry; or

(c) the marketing of the agricultural produce of its members; or

(d) the purchase of agricultural implements, seeds, live stock or other articles intended for agriculture for the purpose of supplying them to its members;

(e) processing without aid of power of the agricultural produce of its members; or

(f) the collective disposal of the labour of its members; or

(g) fishing or allied activities; or

(h) primary cooperative society engaged in supplying milk raised by its member to a Federal Milk Coop. Society or to the Government or a local authority or a Govt. Company or Corporation established under Central/State or Provincial, Act. Similar benefit is also extended to a primary Cooperative Society engaged in supplying oilseeds, fruits and vegetables raised or grown by its members.

(ii) The whole of interest and dividend income derived by a Cooperative Society from its investments in any other Cooperative Society;

(iii) The whole of interest income from securities and property income in the case of a Cooperative Society other than housing society or an urban Consumer Society or a Society carrying on transport business where gross total income does not exceed ₹ 20,000.

Urban Consumer Cooperative Society means a society for the benefit of consumers within the limits of municipal corporation, municipality, municipal committee, notified area committee, town are or cantonment.

(iv) In respect of other activities carried on either independently or in addition to above activities upto a sum of ₹ 50,000 (₹ 1,00,000 in case of consumer corporation society) – U/s. 80 P (2)(c).

DEDUCTION IN RESPECT OF ROYALTY OF AUTHORS [Sec. 80QQB]

Allowable to : Any resident individual, being an author/joint author, in respect of any income by way of Lump sum consideration or royalty or copyright fees for assignment or grant of any of his Interests in the copyright of any book.

Amount of Deduction: 100% of the royalty income etc. subject to a maximum of ₹ 3,00,000
In case of royalty or copyright fees, not in lump sum consideration, deduction shall be restricted to 15% of the value of books sold during the previous year.

Conditions:

(1) The assessee shall furnish a certificate in form 10CCD.

(2) In case of income received from a source outside India, the assessee shall furnish a certificate in form 10H

DEDUCTION IN RESPECT OF ROYALTY ON PATENTS [Sec. 80RRB]

1	Eligible Assessee	Any resident individual
2	Condition	He must be registered under the Patents Act, 1970 on or after 1.4.2003, as the true and first inventor in respect of an invention, including a co-owner of the patent. The deduction is not available to assignees or mortgagees in respect of all or any rights the patent
3	Maximum Cap	100% of such income subject to a maximum ₹ 3,00,000.
4	Special Provisions	(a) a certificate in form 10CCE duly signed by the Controller under Patents Act.(b) a certificate in form 10H , in case of income received from abroad, certifying that the deduction has been correctly claimed in accordance with this section.

Allowable to : Any resident individual, being a patentee, registered under the Patents Act, 1970 on or after 1.4.2003, as the true and first inventor in respect of an invention, including a co-owner of the patent. The deduction is not available to assignees or mortgagees in respect of all or any rights the patent.

Amount of Deduction: 100% of such income subject to a maximum ₹ 3,00,000.

Conditions: The assessee shall furnish along with his return.

(a) a certificate in form 10CCE duly signed by the Controller under Patents Act.

(b) a certificate in form 10H , in case of income received from abroad, certifying that the deduction has been correctly claimed in accordance with this section.

DEDUCTION IN RESPECT OF TOTALLY BLIND OR MENTALLY RETARDED OR PHYSICALLY HANDICAPPED PERSON [Sec. 80U]

A resident individual suffering from permanent physical disability or total blindness or partial blindness or mental retardation reducing his capacity substantially for gainful employment is allowed a deduction of ₹ 50,000 or ₹ 1,00,000 in case of severe disability. The extent of blindness or other physical disability has to be certified by a Registered Medical Practitioner of the concerned discipline.

Quantum of deduction under section 80U increased in case of a person with severe disability [Section 80U] (W.e.f. A.Y. 2010-11)

Under the existing provisions of section 80U, deduction is allowed as under :

₹ 50,000 in case of a person with disability.

₹ 1,00,000 in case of a person with severe disability.

The Act has increased the deduction of ₹ 75,000 to ₹ 1,00,000 in case of a person with severe disability. However, the deduction of ₹ 50,000 in case of a person with disability remains unchanged.

Such certificate has to be obtained from a physician, surgeon, etc. working in a Govt. Hospital. For the purpose of Sec. 80U of the Income Tax Act, 1961 any of the following disabilities shall be regarded as a permanent physical disability [Rule 11DD] e.g.–

(i) permanent physical disability of more than 50% in one limb; or

(ii) permanent physical disability of more than 60% in two or more limbs; or

(iii) permanent deafness with hearing impairment of 71 decibels and above; or

(iv) permanent and total loss of voice.

Illustration 99 : Mr. N is employed at a gross salary of ₹ 8,00,000. He gets ₹ 15,000 interest on bank deposit. He has made the following in vestment/deposit during the year 2010-2011.

		₹
1.	Life insurance premium:	
	(i) Own life, insured for ₹ 80,000	15,000
	(ii) Brother's life, dependent on him	5,000
	(iii) Major son, not dependent on him	4,000
2.	Contribution to unrecognised provident fund	60,000
3.	Contribution to public provident fund	20,000
4.	Contribution to ULIP	5,000
5.	Repayment of loan to SB1 to purchase a residential house: 50% repayment is towards interest.	1,20,000
6.	Infrastucture bonds of an Indian public company under Sec. 80C(2)(xix)	10,000
	He has paid education fees for his 3 children:	
	A	12,000
	B	9,000
	C	6,000

Besides, interest of ₹ 1,632 on NSC-VIII, (purchased during the year 2008-2009) has been credited on them during the year 2010-2011.

Compute deduction u/s 80C for the assessment year 2011-2012

Solution:

Computation of Deduction u/s 80C of Mr. N for the assessment year 2011-2012

Particulars	₹	₹
Deduction in respect of contribution to approved savings (Sec. 80C) :		
1. Life insurance premium;		
(i) Own life-	15,000	
(ii) Brother's life	—	
(iii) Major son	4,000	
2. Contribution to unrecognised provident fund	—	
3. Contribution to ULIP	5,000	
4. Contribution to public provident fund	20,000	
5. Repayment of housing loan to SBI	60,000	
6. Infrastucture bonds of Indian public company [Sec. 80C(xix)]	10,000	
7. Accrued interest on NSC- VIII issue	1,632	
8. Education fees for two children:		
A	12,000	
B	9,000	
	1,33,632	
Deduction restricted upto ₹1,00,000		**1,00,000**

Illustration 100 : Mr Jamal resident in India, has paid ₹ 60,000 for medical expenses during the previous year 2010-2011 for his wife suffering from cancer. Mrs. Jamal is also resident in India and turns 65 years of age on 31st March 2010. The full treatment cost has been reimbursed by the General Insurance Corporation of India. Please determine if Mr. Jamal is entitled to any deduction under Sec. 80DDB and if the answer is yes, determine the quantum of deduction. Also, please work but the quantum of deduction in the following circumstances :

I. Mrs. Jamal turns 65 years of age on 1 April 2009 and the amount reimbursed by the insurer is ₹ 25,000. Payment of medical treatment was made out of exempted income.

II. Jamal turns 65 years of age on 1 April 2009 but Mrs. Jamal is 64 years, 11 months and 30 days as on 31 March 2010 and the insurer has not reimbursed any expenditure.

III. Mrs. Jamal is 66 years of age, a non-residential in India and the insurer has reimbursed ₹ 35.000

IV. Mr. Jamal, though having assessable income in India, is actually resident in Sri Lanka and is getting his wife treated in India for sake of better and more advanced medical facilities Mrs. Jamal is residential in India and the insurer has reimbursed ₹ 20,000.

V. The expenditure is incurred by the assessee on cancer treatment of his 25 year old grandson who is dependent on him and is resident in India. The insurer has not reimbursed the claim.

VI. Mr. Jamal is able to produce the receipt of the medical expenditure only to the extent of ₹ 10,000 as he misplaced other receipts and the certificate in Form 10-I regarding the treatment of his wife does not mention the total amount incurred by him during the previous year. The insurer has reimbursed only ₹ 5,000.

Solution:

Amount of deduction under Sec. 80DDB: PY 2010-2011 / AY 2011-2012

Particulars	Existing	I	II	III	IV	V	VI
Gross deduction u/s 80DDB in respect of specified ailment of dependant wife.	60,000	40,000	40,000	40,000	Nil	Nil	10,000
Less : Insurance claim received	60,000	25,000	Nil	35,000	Nil	Nil	50,000
Net deduction allowable u/s 80DDB	**Nil**	**15,000**	**40,000**	**5,000**	**Nil**	**Nil**	**5,000**

Working Notes :

1. In order to be a senior citizen, a person should be a resident in India and be 65 years of age at any time during the previous year, be it one the last day of the previous year or at any time during the previous year. Therefore, except when Mrs. Jamal turns 65 after the end of the previous year or when she is a non-resident in India, the gross amount of deduction will be ₹ 40,000.

2. The assessee individual must be resident in India in order to be eligible to the deduction. A grandson is not covered by the definition of "dependant".

3. Form No. 10-I does not require the doctor to certify the amount incurred.

Illustration 101 : Mr. C, manager of L Ltd., has paid ₹ 38,000 during the previous year 2010-2011 by way of medical insurance under GIC approved medical policies. The details are given as below:

(i) For himself. ₹6,000

(ii) For Mrs C, a Canadian citizen resident in Toronto and not dependent on him ₹5,000

(iii) For B, married son living with him and dependent on him ₹3,000

(iv) For D, minor son resident in Toronto and not dependent on him ₹3,000

(v) For Mrs B, daughter-in-law, dependent on him ₹5,000

(vi) For E, a minor grandson dependent on him ₹3,000

(vii) For K, father, 67 years, resident and dependent on him ₹3,000

(viii) For M, mother, 66 years, resident in Toronto and dependent on him ₹6,000

(ix) For Grandfather, dependent on him, 95 years of age and resident in India ₹4,000.

C has earned gross salary of ₹ 2,50,000 during the year and also earns ₹ 95,000 as interest from 7% Capital Investment Bonds, purchased on 31 May 2003. Compute his eligible deduction u/s 80D for the previous year 2010-2011 assuming the following situations:

I. Premium is paid by cheque from his salary income.
II. Premium is paid in cash from his salary income. He holds a valid receipt for cash payment.
III. Premium is paid by cheque out of interest from 7% Capital Investment Bonds, acquired on 31-5-2003.
IV. Premium is paid in cash out of interest from 7% Capital Investment Bonds, acquired on 1-6-2003.

Solution:

Computation of Deduction for Medical Insurance Premium u/s 80D

Particulars of Medical Insurance premium paid	I ₹	II ₹	III ₹	IV ₹
For himself	6,000	Nil	Nil	Nil
For Mrs. C, a Canadian citizen resident in Toronto and not dependent on him	3,000	Nil	Nil	Nil
For B, married son living with him and dependent on him	2,000	Nil	Nil	Nil
For D, minor son resident in Toronto and not dependent on him	Nil	Nil	Nil	Nil
For Mrs. B, daughter-in-law, dependent on him	Nil	Nil	Nil	Nil
For E a minor grandson, dependent on him	Nil	Nil	Nil	Nil
For K, father, 67 years, resident, a senior citizen and dependent on him	2,000	Nil	Nil	Nil
For M, mother, 66 years, resident in Toronto -not a senior citizen but dependent on him	6,000	Nil	Nil	Nil
For Grandfather, 95 years of age, dependent on him, resident in India, and senior citizen (not a parent, hence not eligible)	Nil	Nil	Nil	Nil
Eligible premium for Deduction u/s 80 D	19,000	Nil	Nil	Nil

Working Notes :

1. Medical insurance premium on spouse's health is always eligible irrespective of whether the spouse is dependent on the assessee or not. The condition of dependency applies only in case of children and parents.
2. Medical premium on health of grandson, grandparents, daughter-in-law or son in-law are not eligible for deduction u/s 80D.
3. Only the premium on health of dependent father will qualify for relaxation as a senior citizen. Since dependent mother is non-resident and, therefore, outside the purview of being a "senior citizen". However, the premium for health of mother will qualify for the normal limit irrespective of the residential status.
4. Any premium paid in cash or by cheque out or exempted income does not quality for deduction u/s 80D.

Illustration 102 : Mr. Maity, a resident individual, furnishes the following particulars of his income/expenditure for the previous year 2010-2011 :

	₹
(i) Gross salary	3,00,000
(ii) Income from house property	1,70,000
(iii) Share of profit from an AOP	25,000
(iv) Long-term capital gain	50,000

He has paid medical insurance on his life, his wife and his dependent children. Total premium paid under GIC approved policies is ₹ 10,000 but a sum of ₹ 1,000 was paid in cash due to a prolonged bank clearing strike. He has spent ₹ 20,000 on the treatment of his brother, a dependant with disability. He has also deposited ₹ 25,000 with a specified company u/s 2(h) of Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2003 for maintenance of his brother.

He has paid the following donations during the year:

Particulars of donations made during the year	₹
• Donation to P.M.'s National Relief Fund	10,000
• Donation to Jamia Milia University	5,000
• Donation to National Cultural Fund, set up by Central Government	5,000
• Donation to Delhi Municipal Corporation for Family Planning	12,000
• Donation to Birla Temple (notified)	
• for repair and renovation of the temple	2,000
• for religious ceremonies, prasad, etc. for the benefit of devotees in general	5,000
• Donation to a temple managed by the Residents Welfare Association for its much needed repair and maintenance. The Association is a non-profit entity registered with the Registrar of Societies.	5,000
• Following donations to Pt. Pyare Lai Charitable Trust recognised by the Commissioner u/s 80G(5)(vi).	
(i) Donation in form of equity shares of blue chip companies: The shares were sold by the Trust at their market value of ₹ 75,000 and used wholly towards its charitable objectives. However, shares were transferred at cost,	25,000
(ii) Donation paid in cash,	5,000
(iii) Donation made by cheque,	7,000
(iv) 50 blankets costing ₹ 100 each.	5,000
• Donation made to Indian Olympic Association 80G(2)(c) paid by a/c payee cheque,	7,500
• Donation for developing low cost homes for slum-dwellers, paid	
(i) Delhi Development Authority, and	3,000
(ii) Delhi Slum-dwellers Rehabilitation Society duly registered with the Registrar,	2,500
• The Rajiv Gandhi Foundation	6,000
• National Children's Fund	3,000

Mr Maity borrowed a sum of ₹ 2,00,000 in 2003 @ 9% interest from Harsh Vardhan Charitable Trust (registered under Sec. 80G) to complete his B.Tech. degree from Nalanda University. In March 2010, he repaid a sum of ₹ 75,000 (including ₹ 20,000 interest) to the said trust.

Compute his total income for the assessment year 2011-2012.

Solution:

Computation of Total Income of Mr. Maity for the Assessment Year 2011-2012

Particulars	₹	₹
1. Income from salary		3,00,000
2. Income from house property		1,70,000
3. Share of profits from an AOP : Exempt (Sec. 86)		Nil
4. Long-term capital gains		50,000
Gross total income		**5,20,000**
5. Deduction from gross total income :		
(i) Medical insurance premium (Sec. 80D)	9,000	
(ii) Expenditure on medical treatment and deposit for maintenance of a handicapped dependent relative (Sec. 80DD) :	50,000	
(iii) Repayment of interest on loan for higher studies (Sec. 80E) (No deduction is allowed for repayment of principal amount of educational loan w.e.f. A.Y. 2008-2009)	20,000	
	79,000	
(iv) Charitable donations Sec. 80G – [See Note below]	42,500	**1,21,500**
Total Income		**3,89,500**

Working Note :

	₹	₹
Goss Total Income		5,20,000
Less : Aggregate of :		
(i) Share of profit in AOP entitled to rebate u/s 86.	Nil	
(ii) Any amount qualifying for deduction from GTI exempt for deduction for donation u/s 80G itself.	79,000	
(iii) Long-term capital gain	50,000	
(iv) Any to a NRI from dividend and interest etc. on foreign currency investment referred to u/s 115A, 115AB, 115AC, 115ACA, 115AD.	Nil	
	1,29,000	1,29,000
Adjusted Gross Total Income		**3,91,000**

Computation of Deduction for Donations u/s 80G for Assessment Year 2011-12

	₹	₹
A. Donations not subject to qualifying amount, eligible for deduction @ 100% of the amount donated :		
(i) Donation to P.M.'s National Relief Fund	10,000	
(ii) Donation to National Cultural Fund, set up by Central Government	5,000	15,000
B. Donation not subject to qualifying amount, eligible for deduction @ 50% of the amount donated :		
(i) The Rajiv Gandhi Foundation	6,000	
(ii) National Children's Fund	3,000	
Only 50% of the amount of donation available as deduction	9,000	4,500
C. Donation subject to qualifying amount :		
(i) Donation to Delhi Municipal Corporation for Family Planning	12,000	
(ii) Donation made to Indian Olympic Association 80G (2)(C) (available only to a company assessee)	Nil	
(iii) Donation to Jamia Milia University	5,000	
(iv) Donation to Birla Temple (notified) for repair and renovation of the temple.	2,000	
(v) Monetary donation to Pt. Pyare Lal Charitable Trust recognised by the Commissioner u/s 80G (5) (vi).	12,000	
(vi) Donation to Delhi Development Authority	3,000	
Aggregate of donations subject to qualifying amount	**34,000**	
Qualifying amount :		
Lower of the following :		
(a) 10% of Adjusted Gross Total Income, i.e. 39,100, or		
(b) Aggregate of donations, 34,000		
Whichever is less, is qualifying amount = 34,000		
100% of ₹ 12,000 out of the QA of 34,000	12,000	
50% of the balance of the QA i.e. 50% of (34,000-12,000)	11,000	23,000
Total deduction for donations u/s 80G		**42,500**

1. Medical Insurance Premium paid in cash is not allowable as a deduction.
2. Donation to a notified temple is allowed only if it is towards its repairs or maintenance and not otherwise.
3. Only donations paid in monetary terms that is, either in cash or by cheque are eligible for deduction. Conversion of donations in kind into cash by the donee or mere possibility of their conversion is immaterial.

Illustration 103 : Mr Jamal, a resident assessee, runs a manufacturing business in Delhi. For the previous year 2010-2011, he disclosed his taxable income as below:

	₹
Business profits	2,55,000
Long-term capital gains	25,000
Short-term capital gain	15,000

He has hired furnished accommodation for his own use and pays ₹ 4,000 p.m. He has paid donation amounting to ₹10,000 to National Defence Fund. He has deposited ₹ 50,000 under a scheme framed by the Life Insurance Corporation for maintenance of his dependant brother with a disability. The disability is certified by the medical authority. Compute his total income for the assessment year 2011-2012.

Solution:

Computation of Total Income of Mr Jamal — Assessment Year 2011-2012

Particulars	₹	₹
Income from business (computed)		2,55,000
Long-term capital gain (computed)		25,000
Short-term capital gain (computed)		15,000
Gross Total Income		**2,95,000**
Deductions from gross total income:		
(i) Deposit for maintenance of a dependent with disability [Sec. 80DD]:	50,000	
(ii) Charitable donations to National Defence Fund [Sec. 80G]: Amount of Deduction @ 100% of ₹ 10,000	10,000	
	60,000	
(iii) Expenditure incurred on rent [Sec. 80GG] [W.N.1]	17,000	77,000
Total income		**2,18,000**

Workings Note 1:

Particulars	₹	₹
Expenditure incurred on rent [Sec. 80GG]:		
• [Rent paid -10% of ATI], i.e. 48,000 -21,000 = 17,000, or		
• 25% of AGTI, i.e. 25% of 2,10,000 = 52,500, or		
• ₹ 2,000 p.m. = ₹ 24,000		
whichever is less, is to be deducted, i.e. ₹ 17,000		
Adjusted Total Income for Sec. 80GG:		
Gross total income		
Less: Aggregate of		2,95,000
(i) All permissible deduction from GTI except for deduction for u/s 80GG	60,000	
(ii) Any long-term capital gain	25,000	85,000
Adjusted Gross Total Income [AGTI] for Sec. 80GG		**2,10,000**

Illustration 104 : M, resident in India, furnishes the following particulars of his receipts and outgoings during the previous year 2010-2011.

		₹
Receipts:		
(i)	Income from salary	2,00,000
(ii)	Income from house property	3,00,000
(iii)	Gross winning from crossword puzzle	3,50,000

Outgoing :

(i)	Contribution to LIC annuity plan	15,000
(ii)	Medical insurance premium:	
(a)	For himself	4,000
(b)	His wife, not dependent	3,000
(c)	Mother, non-resident, 67 years, dependent	5,000
(d)	Nephew, wholly dependent with disability	3,000
(e)	Grandson, dependent	2,000
(iii)	Expenditure on medical treatment and maintenance of the nephew referred to	30,000
(iv)	Medical treatment for grandson, suffering from a disease specified under income-tax rules(v)	50,000
(v)	Donation to Gujarat government for family planning	50,000
(vi)	Scholarship to a poor but meritorious student	20,000
(vii)	Contribution to approved scientific research association	30,000
(viii)	Contribution to Delhi Municipal Corporation for sewage scheme for slum-dwellers, approved by National Committee	50,000
(ix)	Donation to Political party paid during November 2010 assembly elections	

Compute his total income for the assessment year 2011-2012. Make necessary assumptions and clarify them. 20,000

Solution:

Computation of Total Income for AY 2011-2012

Particulars		₹	₹
Income from salary			2,00,000
Income from house property			3,00,000
Gross winnings from crossword puzzle			3,50,000
Gross Total Income			**8,50,000**
Less: Deductions under Chapter VIA :			
Contribution to LIC annuity plan [Sec. 80CCC]		10,000	
Medical insurance premium [Sec, 80D]			
Self	4,000		
His wife	3,000		
Mother, 67 years old	5,000		
Nephew dependent with disability	x		
Grand son	x	**12,000**	
Maintenance and medical treatment of a dependent with disability [Sec. 80DD]			
Expenditure for medical treatment of grandson [Sec. 80DDB]		Nil	
Donations for scientific research or rural development [Sec. 80-GGA]			
(a) Donation to approved scientific research association		30,000	
(b) Contribution to MCD for slum-dwellers scheme, approved by National Committee		50,000	
Donations to political party [Sec. 80GGC w.e.f. 22.9.2004]		20,000	
Charitable donations [Sec. 80G]			
(a) Scholarship to a poor meritorious student		xxx	
(b) Gujarat government for family planning: 100% of qualifying amount			
1. Actual donation = 50,000, or			
2. 10% of specified GT1 = 37,800			
8,50,000 – (3,50,000 + 10,000 + 12,000 + 30,000 + 50,000 + 20,000) = ₹3,78,000			
whichever is less, is QA 37,800= 100% of 37,800		37,800	1,59,800
Total Income			**6,90,200**

Previous year	Particulars	X	Y
2005-2006	Business profits or loss before depreciation	(–) 6,00,000	14,00,000
	Depreciation	4,00,000	2,00,000
2006-2007	Business profits or loss before depreciation	5,00,000	2,00,000
	Depreciation	4,00,000	1,00,000
2008-2009	Business profits or loss before depreciation	8,00,000	10,00,000
	Depreciation	4,00,000	2,00,000
2009-2010	Business profits or loss before depreciation	28,00,000	12,00,000
	Depreciation	4,00,000	6,00,000

Compute the amount of deduction for X u/s 80-IA and total income of C Ltd. for all four previous years.

Computation of deduction u/s 80-IA for undertaking X

Particulars	2005-2006	2006-2007	2007-2008	2009-2010
Profits or loss before depreciation	(-) 6,00,000	5,00,000	8,00,000	28,00,000
Less: Depreciation		(-) 4,00,000	(-) 4,00,000	(-) 4,00,000
	6,00,000	1,00,000	4,00,000	24,00,000
Set-off of carry forward business loss		(-) 1,00,000	(-) 4,00,000	(-) 1,00,000
Set-off of carry forward depreciation		xxx	xxx	(-) 4,00,000
Profits eligible for deduction u/s 80-IA	Nil	Nil	Nil	19,00,000
Amount of deduction @ 100% of profits	**Nil**	**Nil**	**Nil**	**19,00,000**

Computation of profits of undertaking Y and total income of C Ltd.

Particulars	2005-2006	2006-2007	2007-2009	2009-2010
Profits or loss before depreciation:	14,00,000	2,00,000	10,00,000	12,00,000
Less: Depreciation of Y	(-) 2,00,000	(-) 1,00,000	(-) 2,00,000	(-) 6,00,000
	12,00,000	1,00,000	8,00,000	6,00,000
Profits of X after depreciation	Nil	1,00,000	4,00,000	24,00,000
Set-off of business loss of X	(-) 6,00,000			
Set-off of unabsorbed depreciation of X	(-) 4,00,000			
Gross Total Income	**2,00,000**	**2,00,000**	**12,00,000**	**30,00,000**
Less: Deduction u/s 80-IA	Nil	Nil	Nil	19,00,000
Total income of C Ltd.	**2,00,000**	**2,00,000**	**12,00,000**	**11,00,000**

Note: 1.

Even though the business loss and unabsorbed depreciation of X were set-off during the PY 2006-2007 itself in computation of total income of C Ltd., for the purpose of deduction u/s 80-IA, they will still be carried forward on notional basis and set-off only against the profits of business eligible u/s 80-IA.

Illustration 105 : SK Industries, a diversified group, discloses profit from the following sources for the previous year 2010-2011 :

		(₹ in lakhs)
(i)	Profits from small-scale unit, started in 2001-2002	6.00
(ii)	Profit from industrial undertaking 2002-2003, in Vidisha, a B-class industrially backward district.	10.00
(iii)	Profit from multiplex theatre, started in 2006-2007	
	(a) Delhi	4.00
	(b) Allahabad	2.00
(iv)	Profits form convention centre, started in 2007-2009	
	(a) Delhi	5.00
	(b) Allahabad	3.00
(v)	Profits from Hill View, a hotel started in 2002-2003 at Manali in Himachal Pradesh. Hotel is approved by prescribed authority	10.00
(vi)	Profits from undertakings engaged in refining of mineral oil since 1 January 2004 in Uttar Pradesh, not listed in backward state in Eighth Schedule.	10.00

Compute the total income for the assessment year 2011-2012.

Solution :

Previous Year : 2010-11 **SK Indusries Ltd.** **Assessment Year : 2011-12**

Computation of Total Income

Particulars	**(₹ lakhs)**	**(₹ lakhs)**
(i) Profits from SSI		6.00
(ii) Profits from undertaking located in industrially backward B-class district		10.00
(iii) Profits from multiplex theatre: (4 + 2) =		6.00
(iv) Profits from convention centre : (5+3) =		3.00
(v) Profits from Hill View Hotel		10.00
(vi) Profits from refining undertaking		10.00
Gross Total Income		**50.00**
Less : Deduction in respect of profits and gains from certain industrial undertaking, other than infrastructure undertakings (Sec. 80-IB) :		
1. Profits from SSI [Sec. 80-IB (3)] : 25% of ₹ 6 Lakh :	1.50	
2. Profits from undertaking in B-class industrially backward district [Sec. 80-IB (4)] 25% of ₹ 10 lakh	2.50	
3. Profits from multiplex theatre [Sec. 80-IB(7A) 50% of ₹ 2 lakh (No deduction for Delhi)	1.00	
4. Profits from convention centre [Sec. 80-IB(7B)] 50% of ₹ 8 lakh	4.00	
5. Profits from Hill View Hotel [Sec. 80-IB(7)] Allowed only for Indian company	Nil	
6. Profits from refining undertaking [Sec. 80-IB(9)]-100% of profits for 7 assessment years	10.00	**19.00**
Total Income		**31.00**

Illustration 106 : Evergreen Construction (P) Ltd. has earned profits during the PY 2010-2011 from construction and sale of f lats under three housing projects, developed at Rajarhat, Kolkata, details of which are given below:

		(₹ in lakhs)
(a)	Profits from construction and sale of flats, built up on a plot of 1.5 acres, built up area of the flat 1400 sq feet, located 30 km from Kolkata.	80.00
(b)	Profits from construction and sale of flats, built up on a plot of 1 acre, built up area 1050 sq feet, located within 25 km from Delhi.	60.00
(c)	Profits from construction and sale of flats, built on a plot of 0.90 acre, built up area 1000 sq feet, located 35 km from Kolkata.	40.00

The housing projects have been approved by the Kolkata Industrial Development Authority in the year 1 April 2006. Compute its total income for the previous year 2010-2011 relevant for the AY 2011-2012. Would your answer be different in the following cases:

(i) The housing projects were not approved.

(ii) The housing project is carried out in accordance with a scheme approved by West Bengal Government for redevelopment of buildings in slum areas.

(iii) The company was engaged only in the sale of flats and not developing and building the housing project.

Solution :

Previous Year : 2010-11 **Evergreen Construction (P) Ltd.** **Assessment Year : 2011-12**

Computation of Total Income

Particulars	(₹ in lakh)	(₹ in lakh)
Profits from Project (a)		80.00
Profits from Project (b)		60.00
Profits from Project (c)		40.00
Less :		180.00
Deductions from profits and gains from certain industrial undertaking other than infrastructure undertaking (Sec. 80-IB):		
(i) Profits from Housing Project (a) are fully deductible as the size of flat not exceeding the prescribed area 1500 sq feet.	80.00	
(ii) Profits from Housing Project (b) not deductible as the area of the flat exceeds the prescribed area of 1000 sq feet.	x	
(iii) Profits from Housing Project (c) not deductible as the size of the Housing plot is less than 1 acre.	x	(–) 80.00
Total income		**100.00**

Illustration 107 : Mekon Ltd., an Indian company, starts an industrial undertaking on 1 April 2010. During the previous year, it earns profits of ₹ 80 lakh before allowing any deduction for wages. Compute its total income for the previous year 2010-2011 taking into account the following employment schedules of workers:

Date of employment	Number of workers	Status of workers	Rate of wages
1-5-2010	90	Casual	300 p.m.
1-6-2010	20	Reuglar	4000 p.m.
1-7-2010	10	Regular	4000 p.m.

Solution :

Previous Year : 2010-11 **Mekon Ltd.** **Assessment Year : 2011-12**

Computation of Total Income

Particulars	₹	₹
Profits before allowing deduction for wages		80,00,000
Less: Wages paid to workers [Sec. 37(1)] :		
(i) 90 × ₹ 3000 × 11	29,70,000	
(ii) 20 × ₹ 4000 × 10	8,00,000	
(iii) 10 × ₹4000 × 9	3,60,000	(-) 41,30,000
Business Profits and Gross Total Income		**38,70,000**
Less: Deduction in respect of employment of new workmen		(-) 1,20,000
[Sec. 80 JJAA] 30% (₹ .4000 x 10 x 10)		
Total Income		**37,50,000**

Illustration 108 : Mr. R has developed an improved economical model of a motor cycle and got it patented on 31-3-2010 under the Patent Act, 1970. He allowed Z Ltd. to use his patent rights and licenses has been granted to it under the Patent Act, 1970. He has received royalty of ₹ 8,00,000 during the previous year 2010-2011. However, the royalty in accordance with the terms and conditions of the license settled by the Controllers under the said Act is ₹ 2,80,000.

He has incurred ₹ 1,00,000 expenses in developing his invention and getting it patented.

Compute his total income for the assessment year 2011-2012 (i) if he is resident in India, (ii) non-resident India.

Solution :

Previous Year : 2010-11 **Mr. R** **Assessment Year : 2011-12**

Computation of Total Income

Particulars	**(i)** ₹	**(ii)** ₹
Income from other sources	8,00,000	8,00,000
Less : Expenses	1,00,000	1,00,000
Gross Total Income (GTI)		
Less : Deduction for respect of royalty on patent (Sec. 80-RRB)		
Least of the followings:		
(a) Income from royalty 5,00,000; or		
(b) Royalty under the terms of license settled by the Controller 2,80,000;		
(c) Maximum limit ₹ 3,00,000		
Whichever is less, is to be deducted	2,80,000	xxx
Total Income	**2,20,000**	**7,00,000**

Illustration 109 : Mr. J is suffering with 60% locomotor disability which is certified by medical authority. He is employed as Technical Supervisor with Air Tel at a salary of ₹ 20,000 p.m.

	Particulars	₹
(i)	Income from government securities	20,000
(ii)	Long-term capital loss	(-) 40,000
(iii)	Short-term capital gain (Sec. 111A)	1,00,000
(iv)	Insurance commission (gross)	1,00,000
(v)	Interest on Saving Fund a/c from bank	10,000

He has incurred the following expenses:

(i)	Medical insurance paid by cheque for his father, resident in India and 70 years	18,000
(ii)	Deposit with LIC for maintenance of father, mainly dependant on him for support and maintenance and suffering from low-vision with a severe disability of 80%, as per certificate of the medical authority	
(iii)	Rent paid for the year 2010-2011 for accommodation hired by him.	40,000

Compute his total income for the assessment year 2011-2012.

Solution :

Previous Year : 2010-11 **Mr. J** **Assessment Year : 2011-12**

Computation of Total Income

Particulars	**₹**	**₹**
1. Income from salaries		2,40,000
2. Income from capital gains :		
(a) Short-term capital gains (Sec. 111A)		
(b) Long-term capital loss to be carried forward		1,00,000
3. Income from others sources :		Nil
(a) Interest government securities	20,000	
(b) Interest on savings fund a/c with Bank	10,000	
(c) Insurance commission	1,00,000	1,30,000
Gross Total income		**4,70,000**
Less : Deductions under Chapter VIA:		
Medical insurance (Sec. 80D)	18,000	
Deduction in respect of maintenance including medical treatment of a department, a person with severe disability (Sec. 80DD)	1,00,000	
Deduction in case of a person with disability (Sec. 80U) :	50,000	
Deduction u/s 80GG :(Least of the followings)		
(a) (i) Rent paid less 10% of Adjusted Gross Total Income 40,000-23,300 = 16,700,		
(b) (ii) 25% of 2,33,000 Adjusted Gross Total Income=58,250,		
(iii) 2,000 p.m. × 12 = 24,000	16,700	**1,84,700**
Whichever is less, is or be deducted		
Total income		**2,85,300**

Illustration 110 : Mr. Krishna is a lawyer of Allahabad High Court. He keeps his accounts on cash basis. His Receipts and Payments A/c for the year ending 31-03-2011 is given below :

	₹		₹
Balance b/d	3,820	Purchase of Infrastructure Bonds	20,000
Legal fees	3,45,000	Subscription and membership	4,500
Special commission fees	5,500	Purchase of legal books	17,500
Salary from Law College		Rent	47,500
as part time lecture	87,000	Municipal Tax paid on H. P.	3,000
Exam. Remuneration	1,480	Car expenses	44,000
Interest on Bank Deposit	3,500	Office expenses	8,500
Sale proceeds of residential		Electricity Exps.	4,000
property	3,01,000	Income tax	8,000
Dividend from Co-operative		Gift to daughter	12,000
society	1,000	Domestic expenses	85,000
Dividend received from		Donation to Institutions	
the units of UTI	2,000	approved u/s 80G	2,000
Rent from house property	15,000	Car purchased	3,27,000
		Life Insurance premium	16,000
		Balance c/d	1,26,3000
	7,65,300		7,65,300

Following information are available :

1. The Rent and electric expenses are related to a house, of which half portion in used for self residence and reamaininjg half portion in used for office.
2. Car is used only for professional purposes.
3. Outstanding legal fees ₹ 10,000.
4. Rent has been paid for 10 months only.
5. Car was purchase on 25-09-2010. Law books purchased are annual publications out of which books of ₹ 2,000 were purchasd on 6-4-2010 and balance on 31-10-2010.
6. The house was purchased in January 1987 for ₹ 50,000 and sold on 1-7-2010.
7. Rent of the property which has been sold was ₹ 5,000 p.m. The property was vacated by the tenant on 30-6-2010.

Compute his Total Income for the assessment year 2011-12.

Solution :

Previous Year : 2010-11 **Mr. Sen** **Assessment Year : 2011-12**

Computation of Total Income

			₹	₹
1.	*Income from salary*			
	Salary as a part time lecturer		87,000	
	Less: Deduction		Nil	87,000
2.	*Income from House Property*			
	Annual Rent		60,000	
	Less: Vacancy Allowance $\left(\frac{60,000}{12}\times 9\right)$		45,000	
	Gross Annual Value (GAV)		15,000	
	Less: M/ Tax paid		3,000	
	Net Annual Value (NAV)		12,000	
	Less: Standard deduction @ 30% of NAV		3,600	8,400
3.	*Income from Profession*			
	Professional Earnings:			
	(i) Legal fees		3,45,000	
	(ii) Special commission		5,500	
			3,50,000	
	Less: Allowable expenses			
	(i) Subscription etc.	4,500		
	(ii) 1/2 Rent (Office)	23,750		
	(iii) Car expenses	44,000		
	(iv) 1/2 electric charges	7,000		
	(v) Office expenses	18,500		
	(vi) Depreciation on car @ 15% on 3,27,000	49,050		
	(vii) Depreciation on books			
	[@ 100% on Annual Publication of ₹ 2,000 = 2,000			
	@ 50% on Others of 15,500 = 7,750	9,750	1,56,550	1,93,450
4.	*Capital gains :*			
	Sale consideration		3,01,000	
	Less: Indexed cost of acquisition $50,000 \times \frac{711}{140}$		2,53,929	47,071
5.	*Income from Other Sources* :			
	Interest on bank deposit		3,500	
	Examiner's fees		1,480	
	Dividend from Co-operative Society		1,000	
	Dividend from UTI		Exempt	5,980
	Gross Total Income			3,41,901
	Less : Deductions			
	(i) 80C - LIP		16,000	
	(ii) 80G - Donation @ 50% of ₹ 2,000		6,000	
	(iii) 80CCF - Purchase of Infrastructure Bonds		20,000	42,000
	Total Income			2,99,901
	Total Income (rounded off u/s 288A))			2,99,900

Notes :

1. As the assessee follows the cash system of accounting, amount actually received and payment actually made on account of expenditure, during the year, shall be considered for computing the income. Therefore, any outstanding receipts will not be included in the Total Income. Similarly rent not paid for two months will not be allowed as deduction.
2. The system of accounting does not effect the computation of income from salary, house property and capital gains. Therefore, in this case, rent for three months, though not received (as it has not been shown in the Receipt and Payment Account) shall be taken into account in computing the income under the head house property.
3. Car was purchased and put to use for more than 180 days. Therefore, full depreciation @15% has been claimed.
4. Law books worth ₹ 2,000 were purchased and put to use for more than 180 days and are. therefore, eligible for depreciation @100%. The balance books worth ₹ 15,500 were purchased on 31-10-2010; therefore, 50% of the normal depreciation will be allowed as the books were purchased and put to use for less than 180 days. The total depreciation shall, therefore, be ₹ 2,000 + 50% of ₹15,500 = ₹ 9,750.

Illustration 111 : Dr. Paul is running a Nursing Home with his wife Dr. (Mrs.) Paul as a partnership firm Paul & Co. On the basis of the following particulars, compute the total income of Dr. Paul and Dr. (Mrs.) Paul for the assessment year 2011-12.

		₹
(A)	Particulars of income of the Nursing Home	
(i)	Income as per Income and Expenditure Account	3,20,000
(ii)	Firm's tax not provided in the account	48,000
(iii)	Dontation to Public Charitable Trust exempt u/s 80G debited in the A/c	35,000

(B) Particulars of Income of Dr. Paul :

(i) 40% of profit from Nursing Home as per books ₹ 1,28,000

(ii) Dr. Paul had purchased 500 shares of Laha (P) Ltd. at ₹ 110 each in May 1990. On 14-5-2010 Dr. Paul sold 400 shares at ₹ 300 per share. He invested ₹ 40,000 out of the net sale proceeds in Bonds of RECL in June, 2010. The balance of 200 shares were sold in December, 2010 at ₹ 380 per share.

(iii) Dr. Paul is a Director in Raha (P) Ltd. from which he received director's fees amounting to ₹ 4,000.

(iv) Dr. Paul has obtained a loan of ₹ 50,000 from the said company for renovating the Nursing Home. The balance sheet of Laha (P) Ltd. for the Accounting year, *inter alia*, disclosed the following particulars.

(*a*) General Reserve	40,000
(*b*) Profit & Loss Account (Cr. Balance)	20,000
	60,000

(v) Share of income from property belonging to HUF of which Dr. Paul is the Karta amounts to ₹ 30,000.

		₹
(C)	Particulars of Income of Dr. (Mrs.) Paul :	
(i)	60% share of profit from Nursing Home as per books	1,92,000
(ii)	Income from dividend from UTI	18,000
(iii)	Income from house property (as computed under Income-tax Act)	48,000

(D) Particulars of Income of Master Pritam :

Pritam minor son of Dr. Paul and Dr. (Mrs.) Paul has been admitted to the benefits of partnership in Paul & Co. which is carrying on business as Chemists & Druggists. The said firm has two other partners Soham (brother of Dr. Paul) and Priya [brother of Dr. (Mrs.) Paul]. Pritam's share of profits is determined at ₹ 20,000.

Solution :

Computation of Total Income of the Firm

	₹
Income as per Income and Expenditure Account	3,20,000
Add : Donation to public charitable trust	35,000
Gross Total Income	3,55,000
Donation to public charitable trust being restricted to 10% of Gross Total Income (3,55,000) i.e. 50% of ₹ 35,500	17,750
Total Income	3,37,250
Total tax *plus* education cess *plus* SHEC payable by the firm ₹ 1,40,210.	

Computation of Total Income of Dr. Paul

		₹
1. His income from the Nursing Home is not taxable. (as tax is already paid by the firm)		Nil
2. **Capital Gains**	₹	
Sale proceeds : 300 shares of ₹ 400 each	1,20,000	
200 shares of ₹ 380 each	76,000	
	1,96,000	
Less : Indexed cost : $55,000 \times \frac{711}{182}$	2,14,863	
	(–) 18,863	
3. Income from other sources :		
(a) Director's fees	4,000	
(b) Deemed dividends u/s 2(22)(*e*) for having taken a loan from the company in which the assessee has substantial holding	50,000	54,000
Gross Total Income		54,000
Deduction under Chapter VI A		Nil
Total Income		54,000
Computation of Total income of Dr. (Mrs.) Paul		
1. 60% share from Nursing Home is not taxable (as tax is already paid by the firm)		Nil
2. Income from house property (net).		48,000
3. Income from other sources — dividends from UTI		Exempt
Gross Total Income		48,000
Less : Deduction under Chapter VI A		Nil
Total Income		48,000

Notes :

1. Share of profit from the fim accruing to minor is not included in the total income of parent as share of profit to a partner is exempt.
2. Long-term capital loss cannot be set off against other income and therefore has to be carried forward.

Illustration 112 : From the following details compute the total income of Mr. X, a resident of Delhi, for the AY 2011-12.

Particulars	₹
(a) Salary including Dearness Allowance	6,30,000
(b) Bonus	57,600
(c) Contribution to a Recognised Provident Fund	36,000
(d) Life Insurance Premium	57,000
(e) Rent paid by the Employer for flat provided to Mr. X	90,000
(f) Cost of Furniture provided by the employer at the aforesaid flat	80,000
(g) Rent recovered from Mr. X by employer	36,000
(h) Bills paid by the employer for gas, electricity and water provided free of cost at the above flat	18,000
(i) Mr. X was provided with Company's car (self-driven) also for personal use, not possible to determine expenditure on personal use and all expenses were borne by the employer.	

Mr. X owns a house. The particulars are :	₹
Rent received (12 months)	72,000
Municipal valuation	48,000
Municipal taxes paid	12,000
Ground rent	2,000
Insurance charges	1,000
Collection charges	3,400
Interest on borrowing used for construction of house (constructed in June 2003)	48,000
Other Information :	
Dividend received from UTI India	14,000
Deposits under National Saving Certificate	20,000

Solution :

Assessee : Mr. X **Previous Year : 2010-11** **Assessment Year : 2011-12**

Computation of Total Income

Particulars	₹	₹
Income under the head Salary		
Salary including Dearness Allowance		6,30,000
Bonus		57,600
Gross Salary before including value of perquisites		**6,87,600**
Value of Concessional Furnished Accommodation [Rule 3(1)]		
Least of Rent Paid by employer		
[₹ 90,000 or 15% of Salary ₹ 6,87,600]		62,000
10% of Furniture Value		
[₹ 80,000 × 10%]	8,000	
Less : Rent recovered from Mr. X	(36,000)	
Gas, Electricity and Water provided by the employer		18,000
Motor Car provided to the employee for use (assumed		
capacity upto 1.6 liitres)		32,400
([₹ 1,800 p.m. + ₹ 900 p.m. for chauffeur]		
× 12 Months) as per Rule 3		
Gross Income from Salary		**8,00,000**

Income from House Property :		
Gross Annual Value u/s 23(1) Higher of Municipal Value ₹ 48,000		
or Rent Received ₹ 72,000	72,000	
Less : Municipal Taxes paid	(12,000)	
Net Annual Value	**60,000**	
Less : Deduction		
Standard deduction @ 30% of Net Annual Value u/s 24(a)	(18,000)	
Interest on borrowed capital u/s 24(b)	(48,000)	**(6,000)**
Income from Other Sources :		
Income from UTI	14,000	
Exemption u/s 10(35)	(14,000)	Nil
GROSS TOTAL INCOME		**7,94,000**
Less : Deduction under Chapter VIA - Section 80C		
- Contribution to RPF	36,000	
- LIC Premium	57,000	
- Deposits in NSC	20,000	
	1,13,000	
Deduction u/s 80C restricted to ₹1,00,000 **[sec. 80CCE]**		(1,00,000)
TOTAL INCOME (Rounded Off u/s 288A)		6,94,000

Illustration 113 : Mr. X, Finance Manager of K Ltd. Mumbai, furnishes the following particulars for the Financial Year 2010-2011.

		₹
(a)	Gross Salary (per month) [Tax deducted from Salary ₹ 1,09,000]	64,000
(b)	Valuation of medical facility in a hospital maintained by the Company	7,000
(c)	Rent Free Accommodation owned by the Company	
(d)	Housing Loan of ₹ 6,00,000 at the interest rate of 5% p.a. (no repayment made during the year, to be repaid within 10 years)	
(e)	Gift made by the Company on the occassion of wedding anniversary of X	4,750
(f)	A wooden table and 4 Chairs were provided to X at his residence (Dining Table). This was purchased on 1.5.2007 for ₹ 60,000 and sold to X on 1.8.2010 for ₹ 30,000	
(g)	Personal purchases through Credit Card provided by the Company amounting to ₹ 20,000 was paid by the Company. No part of the amount was recovered from X.	
(h)	A Maruti Esteem Car which was purchased by the Company on 16.7.2006 for ₹ 5,50,000 was sold to the assessee on 14.8.2010 for ₹ 1,30,000.	
(i)	Other income received by the assessee during the previous year 2010-2011 are :	₹
	Interest on Fixed Deposits with a Company	5,000
	Income from specified mutual fund	3,000
	Interest on bank deposits of a minor married daughter	3,000
	Income from UTI received by his handicapped minor son	1,200
(j)	Contribution to LIC towards Premium u/s 80CCC	10,000
(k)	Deposit in PPF Account made during the year 2010-2011	75,000
(l)	Bonds of ICICI (Tax Savings) eligible for tax deduction	25,000

Compute the Taxable Income of Mr. X and the tax liability for the Asst. Year 2011-2012.

Solution :

Assessee : Mr. X **Previous Year : 2010-11** **Assessment Year : 2011-12**

Computation of Total Income

Particulars		₹	₹
Income from Salaries :			
Basic Salary (₹ 64,000 × 12)			7,68,000
Add : **Value of Perquisities :**			
1. Value of Medical Facility in hospital maintained by K Ltd.			
— Treatment in hospital maintained by Employer — Fully Exempt			Nil
2. Rent Free Accommodation owned by Company — Explanatio 1 to Sec. 17(2)			1,15,200
15% of salary = 15% of ₹ 7,68,000 (Population > 25 Lakhs)			
3. Housing Loans at concessional rate – Rule 3(7)(i)			
= ₹ 6,00,000 × (10% – 5%)			30,000
4. Use of Furniture & Fittings upto 1.8.2010 - Rule 3(1)(vii)			
= 10% × ₹ 60,000 × 4/12			2,000
5. Transfer of Assets - Rule 3(7)(viii)			
— Dining Table as per WN 1 (a)		12,000	
Motor Car as per WN 1 (b)		95,280	1,07,280
6. Gifts made by the Company on the occasion			
of the Wedding Anniversary			Nil
7. Credit Card Purchases taxable as perquisite u/s 17(2)			20,000
Gross Income from Salary			**10,42,480**
Less : Deduction u/s 16			Nil
Net Income from Salaries			**10,42,480**
Income from Other Sources :			
Interest on Fixed Deposits with a Company		5,000	
Income from specified mutual fund	3,000		
Less : Exempt u/s 10(35)	(3,000)		
Interest on Bank Deposits of minor married daughter	3,000		
Less : Exempt u/s 10(32)	(1,500)	1,500	
Income received by handicapped minor son - not clubbed u/s 64(lA)		Nil	6,500
GROSS TOTAL INCOME			**10,48,980**
Less : **Deduction under Chapter VI-A**			
U/s 80CCC – Contribution towards Pension Fund			10,000
U/s 80C – Contribution towards PPF			75,000
U/s 80CCF – Bonds of ICICI (Long term infrastructure bonds)			25,000
TOTAL INCOME			**9,38,980**
TAX PAYABLE			**1,35,694**
Add : Education Cess at 2%			2,714
Add : Secondary and Higher Education Cess at 1%			1,357
Gross Tax Payable			**1,39,765**
Less : Tax Deducted at source			1,09,000
Net Tax Liability			**30,765**

Working Notes :

1. **Valuation of Perquisites on transfer of Movable Assets :**

(a) Transfer of Assets	**Dining Table (₹)**
Purchase Price	60,000
Less : Depreciation till date of Sale	(18,000)
(₹ 60,000 × 3 × 10%)	
WDV as at date of transfer	42,000
Less : Deduction for	
collection from Employee	(30,000)
Value of Perquisite	**12,000**
(b) Motor Car	₹
Cost of Purchase (16.7.2006)	5,50,000
Less : Depreciation @ 20% (16.7.2006 - 15.7.2007)	1,10,000
16.7.2007 WDV	4,40,000
Less : Depreciation for 16.7.2007 - 15.7.2008	88,000
16.7.2008 WDV	3,52,000
Less : Depreciation for 16.7.2008 - 15.7.2009	70,400
16.7.2009 WDV	2,81,600
Less : Depreciation for 16.7.2009 - 15.7.2010	56,320
16.7.2010 WDV	2,25,280
Less : Amount Recovered on Transfer	1,30,000
Value of Perquisite	**95,280**

2. Gifts received from the employer on the occasion of the wedding anniversary
   (a) Taxable as perquisite u/s 17(2).
   (b) As per Rule 3(7)(vi), value of any gift or voucher or token (other than made in cash) or convertible ; in cash on ceremonial occasion or otherwise shall be taxable if the the aggregate value of Gift during the previous year is ₹ 5,000 or more. Since the value of gifts received is less than ₹ 5,000, it shall be exempt from tax.

Illustration 114 : M, an individual, retired from the services of a Company on 31.10.2010. He joined another employer on 1.11.2010 and was in service till end of March 2011, when he furnishes the following details and information —

1. Salary and Allowances for the period

From First Employer	₹ Per month
Basic Salary	30,000
Dearness Allowance	16,000
Conveyance Allowance	6,000
From Second Employer	₹ Per month
Basic Salary	35,000
Fixed Conveyance Allowance	8,000

2. While he was with the first employer, M contribllted 10% of his basic salary to a Provident Fund Account with the Regional Provident Fund Commissioner. He did not become a member of the Provident Fund maintained by the second employer.

3. M was permitted by the second employer to encash 15 days leave he had accumulated during his service and received ₹12,500 from his employer.

4. M had constructed a residential house in Chennai in February 2007 for ₹30 Lakhs. Part of the costs of construction was met by borrowals of ₹ 20 lakhs from the Housing Development Corporation, at interest of 12.5% p.a. The loan was taken on June 2005. The loan outstanding at the beginning of the current year was ₹12,00,000. The rate of interest applicable for the current year was reduced to 9% p.a. due to reduction in rates. [He had also borrowed from some relatives ₹4,00,000 on which interest at 15% p.a. was due.] The property had been let-out soon after completion.
5. In the Assessment Year 2007-08, M was allowed a deduction of ₹50,000 for irrecoverable rents. The annual value decided by the Corporation of Channai for the property is ₹ 80,000. The property was let-out in the current year to a Company on a rent of ₹20,000 p.m. The half-yearly municipal taxes on the property were fixed by the Corporation of Channai only in August 2010 at ₹15,000 for every half year from 1.4.2007. M paid the taxes due in September 2010 upto the half-year ending 31.3.2010.
6. M also received from the previous tenant ₹ 40,000 (out of the dues of ₹ 50,000).
7. After retirement from the first employer, M received ₹ 4,50,000 from the Regional Provident Fund Commissioner, money was fully invested by him in the 15% Non-Redeemable Debentures issued by the Indian Oil Corporation interest on these had not come in by the end of March 2011.
8. M received interest of ₹ 60,000 on long-term fixed deposits with Banks, ₹ 25,000 as interest on Post Office Savings Bank Accounts and ₹ 20,000 as income from units.
9. M owns a car which is used for office purposes also and it is found that the entire conveyance allowance from his employer had been fully spent on travel for official purposes.
10. One of the policies of insurance taken by M had matured for payment and ₹ 8,00,000 received by him in June 2010 from the LIC was invested by him, in the name of his 16-year old son, in fixed deposits with companies. Interest received uplo 31.3.2011 on these deposits was ₹ 90,000. On one of the continuing policies of insurance, M paid a premium of ₹ 60,000 in the year.

Compute M's total income for the Assessment Year 2011-12.

Solution :

Assessee : Mr. M **Previous Year : 2010-11** **Assessment Year : 2011-12**

Computation of Total Income

		₹	₹	₹
Income under the head Salaries				
From First Employer				
Basic Pay	(₹ 30,000 x 7)		2,10,000	
Dearness Allowance	(₹ 16,000 x 7)		1,12,000	
Conveyance Allowance	(₹ 6000 x 7)	42,000		
Less: Exempt u/s 10(14)		(42,000)	Nil	3,22,000
Amount received from Regional Provident				
Fund Commissioner		4,50,000		
Less: Exempt u/s 10(12)		(4,50,000)	Nil	
From Second Employer				
Basic Salary	(₹ 35,000 x 5)		1,75,000	
Conveyance Allowance	(₹ 8,000 x 5)	40,000		
Less: Exempt u/s 10(14) (incurred for official				
performance of duties)		(40,000)	Nil	
Leave Encashment - Fully taxable while in service			12,500	**1,87,500**
Gross Income from Salary				**5,09,500**

Income from House Property :			
Gross Annual Value u/s. 23(1) — Higher of Municipal Value of ₹80,000 or Actual Rent of ₹ 2,40,000		2,40,000	
Less: Municipal Taxes paid during the year @ ₹ 15,000 for every half year from 1.4.2007 upto 31.3.2010 (Current Year - Not Paid)		(90,000)	
Net Annual Value (NAV)		1,50,000	
Less: Deduction			
@ 30% of NAV u/s 24(a)		(45,000)	
Interest on Borrowed Capital u/s 24(b)			
Loan from Housing Development Corporation:			
Current Period Interest: ₹12,00,000 × 9%	1,08,000		
Prior Period Interest (Interest upto 31.3.2006) [(₹20,00,000 × 12.5%) + (4,00,000 × 15%)] × 10/12 × 1/5	51,667		
Loan from Relative - Current Period Interest (₹ 4,00,000 x 15%)	60,000	(2,19,667)	
Add: Unrealised Rent recovered (taxable in the year of recovery u/s 25AA]		40,000	**(74,667)**
Income from Other Sources			
Interest on Long-term Fixed Deposits with Bank		60,000	
Interest on Post Office Savings Bank A/c	25,000		
Less: Exempt u/s 10(15)	(25,000)	Nil	
Income from Units of UTI	20,000		
Less: Exempt u/s. 10(35)	(20,000)	Nil	
LIC Policy matured	8,00,000		
Less: Exempt u/s. 10(1D)	(8,00,000)	Nil	
Interest from Fixed Deposits with Companies in the name of minor son	90,000		
Less: Exemption u/s. 10(32)	(1,500)	88,500	**1,48,500**
Gross Total Income			**5,83,333**
Less: Deduction under Chapter VI–A–			
u/s 80C –LIC Premium		(60,000)	
– RPF – 10% of ₹ 1,40,000		(14,000)	74,000
Total Income			**5,09,333**
Total Income (Rounded Off u/s 288A)			**5,09,330**

Assumptions :

1. It is presumed that Mr. M accounts for his interest income on receipt basis.
2. Assumed that there has been no repayment of Housing Loan Principal during the year ending 31.3.2006 for the purpose of calculation of prior period interest.
3. Recognised Provident Fund received on retirement shall not be taxable u/s 10 (assuming conditions are satisfied).

4. **Unrealised Rent recovered :** Since the assessee has been allowed a deduction of ₹ 50,000 from his house property income in ealier years in respect of Unrealised Rent, entire ₹ 40,000 recovered during current year becomes taxable.
5. **Deduction of Interest** u/s 24 shall be allowed even if the amount is borrowed from any person other than the Banks/Financial Institutions in respect of Let Out property.

llustration 115 : Income from House Property and Set Off of Loss

Mr. A, a Senior Citizen, has furnished the following particulars relating to his House Properties —

Particulars	House I — ₹	House II — ₹
Nature of Occupation	Self Occupied	Let-out
Municipal Valuation	60,000	1,20,000
Fair Rent	90,000	1,50,000
Standard Rent	75,000	1,40,000
Actual Rent per month	—	12,000
Municipal Taxes paid	6,000	12,000
Interest on Capital borrowed	90,000	80,000

Loan for both Houses were taken on 1.4.2006. House II remained vacant for 4 months.

Besides the above two house, A has inherited during the year 1988-89 an old house from his grandfather. Due to business commitments, he sold the house immediately for a sum of ₹ 250 Lakhs. The house was purchased in 1962 by his grandfather for a sum of ₹ 2 Lakhs. However, the Fair Market Value as on 1.4.1981 was ₹ 30 Lakhs. With the sale proceeds, A purchased a new house in March 2010 for a sum of ₹ 140 Lakhs and the balance was used in his business.

The other income particulars of Mr. A besides the above are as follows (AY 2011–2012) —

- Business Loss ₹ 12 Lakhs
- Income from Other Sources (Bank Interest) ₹ 1 Lakh
- Investments made during the year PF ₹ 70,000
- ICICI Infrastructure Bond Purchased (u/s 80CCF) ₹ 30,000

Compute Total Income of Mr. A and his Tax Liability for the Assessment Year 2011–2012

Solution :

Assessee : Mr. A **Previous Year : 2010-11** **Assessment Year : 2011-12**

Computation of Total Income

Particulars	₹	₹	₹
1. Income from House Property :			
(a) **House I :** Self Occupied — Annual Value u/s 23(2)	Nil		
Less : Deduction u/s 24(b) = Interest on Housing Loan taken on 1.4.2006 (Note 1)	90,000	(90,000)	
(b) **House II :** Let-out – (Note 2)		(21,000)	(1,11,200)
2. Profits and Gains of Business or Profession – Loss			(12,00,000)
3. Capital Gains — Sale of Residential House Property — Long Term Asset			
Sale Consideration		2,50,00,000	
Less : Expenses on Transfer		Nil	
Net Consideration		2,50,00,000	
Less : Indexed Cost of Acquisition — Fair Market Value as on 1.4.81 × CII of year of Sale /CII of year of first holding (₹ 20 Lakhs × $\frac{711}{161}$)		83,32,298	
Long Term Capital Gain		1,61,67,702	
Less : Exemption u/s 54 — New House purchased		1,40,00,000	21,67,702
4. Income from Other Sources : Bank Interest			1,00,000
Gross Total Income			**9,56,502**
Less : Deduction under Chapter VI-A			
u/s 80C – Deposits in PPF		70,000	
u/s 80 CCF – Investments in Long-term Infrastructure Bonds ₹ 30,000 (restricted upto a maximum of ₹ 20,000)		20,000	90,000
Total Income			**8,66,502**

Tax on total Income of ₹ 8,66,502

(i) Other Income included in Total Income
= Income from other sources – Deduction under Chapter VIA
= 1,00,000 – 90,000 = 10,000
Tax on ₹ 10,000 — Nil

(ii) Balance of LTCG (after adjusting loss from House Property + Business loss) included in Total Income
= (21,67,702 – 1,11,200 – 12,00,000)
= 8,56,502

∴ Tax on LTCG — 1,27,100
= 20% [LTCG – Unavailed Basic Exemption limit]
= 20% [LTCG – (Basic Exemption limit – Other Income)]
= 20% [8,65,502 – (2,40,000 – 10,000)]
= 20% [8,65,502 – 2,30,000]

= 20% of 6,35,502	
(+) EC @ 2%	2,542
(+) SHEC @ 1%	1,271
Tax Payable	1,30,913
Tax Payable (Rounded off u/s 288B)	1,30,910

Notes :

1. It is assumed that the construction of the house was completed **within 3 years** from the end of the financial year in which the loan was taken.
2. **Annual Value of House Property II** is computed as under —

(i)	Municipal Value (MV)	1,20,000
(ii)	Fair Rental Value (FRV)	1,50,000
(iii)	Higher of MV + FRV	1,50,000
(iv)	Standard Rent	1,40,000
(v)	Reasonable Expected Rent (RER) [lower of (iii) + (iv)]	1,40,000
(vi)	Annual Rent @ ₹ 12,000 pm	1,44,000
(vii)	Unrealised Rent	Nil
(viii)	Actual Rent [(vi) – (vii)]	1,44,000
(ix)	Vacancy Allowance $\left[\frac{1,44,000}{12}\times 4\right]$	48,000
(x)	Gross Annual Value [(viii) – (ix)]	96,000
	Less : Municipal Tax paid	12,000
	Net Annual Value (NAV)	**84,000**
	Less : Standard deduction @ 30% of NAV u/s 24(a)	25,000
	Less : Interest on borrowed Capital u/s 24(b)	80,000
	Income for House II	**(21,200)**

3. **Loss of ₹ 3,18,000** under the head Income from House Property and Business Income has been fully set off against Long Term Capital Gain, since it is beneficial to the assessee.
4. Since Mr. A is liable to tax **only because of LTCG,** Tax on Total Income shall be computed as = 20% (Total Income – Basic Exemption Limit) = 20% (1,26,82,000 – 2,40,000).

The losses under the head "House Property" and "Business Income" are set off against the Long Term Capital Gains so that the Deductions under Chapter VI-A can be claimed against the "Income from Other Sources". (since LTCG is not eligible for deductions)

Illustration 116 : Mr Ashok a senior citizen, owns a property consisting of two blocks of identical size. The first block is used for business purposes. The other block has been let out from 14.2010 to his cousin for ₹20000 p.m. The cost of construction of each block is ₹ 5 lacs (fully met from bank loan), rate of interest on bank loan is 10% p.a. The construction was completed on 31.3.2010. During the year ended 31.3.2011, he had to pay a penal interest of ₹ 2000 in respect of each block on account of delayed payments to the bank for the borrowings. The normal interest paid by him in respect of each block was ₹ 42,000. Principal repayment for each block was ₹ 23,000 An identical block in the same neighbourhood fetches a rent of ₹25,000 per month Municipal Tax paid in respect of each block was ₹ 12,000.

The income from business prior to adjustment towards depreciation on any asset is ₹ 2,20,000. He follows Mercantile system of accounting. Depreciation on equipments used for business is ₹ 30,000.

On 23.2.2011, he sold shares of B Ltd., a listed share in BSE for ₹ 2,30,000. The share had been purchased 10 months back for ₹ 1,80,000. Security transaction tax paid may be taken as ₹ 220.

Brought forward business loss of a business discontinued on 12.1.2009 is ₹ 90,000. This loss has been determined in pursuance of a return of income filed in time and the current year is the seventh year.

The following payments were effected by him during the year :

1. LIP of ₹ 20,000 on his life and ₹ 12,000 for his son aged 22, engaged as a software engineer and drawing salary of ₹ 25,000 per month.
2. Mediclaim premium of ₹ 6,000 for himself & ₹ 5,000 for above son. The premiums were paid by cheque.

You are required to compute the total income for the assessment year 2011-12 and the tax payable. The various heads of income should be properly shown. Ignore the interest on bank loan for the period prior to 1.4.2010, as the bank had waived it.

Solution :

Previous Year : 2010-11 **Mr. Ashok** **Assessment Year : 2011-12**

Computation of Total Income

Particulars	₹	₹	₹
(1) **Income from house property (Let out)**			
Gross Annual Value (being Fair rent)		3,00,000	
Less: Municipal tax		12,000	
Net Annual Value		2,88,000	
Less: Deduction :			
u/s 24(a) Standard Deduction (30% of NAV)	86,400		
u/s 24(b) Interest on loan	42,000	1,28,400	1,59,600
(2) **Profits and gains of business or profession**			
Net profit before depreciation		2,20,000	
Less: Expenditure allowed but not debited in P & L Account			
Depreciation on equipment	30,000		
Depreciation on building i.e. 10% of ₹ 5,00,000	50,000	80,000	
Profits and gains of business or profession of current year		1,40,000	
Less: Brought forward losses set off u/s 72		(90,000)	50,000
(3) **Capital gains**			
Consideration for Transfer	2,30,000		
Less: Cost of acquisition		(1,80,000)	
Short Term Capital Gains			50,000
Gross Total Income			2,59,600
Less: Deduction u/s			
80C: LIC Premium paid	32,000		
Repayment of bank loan	23,000	55,000	
80D: Mmedical insurance premium		6,000	61,000
Total income			**1,98,600**
Tax payable			**Nil**

Notes :

1. Penal interest is not allowed u/s 24(b)
2. It has been assumed that interest, municipal tax on property used for business have already being charged while computing "business income before depreciation" i.e. ₹ 2,20,000.
3. STT is not allowed as expenditure on transfer.

Illustration 117 : Thomas took voluntary retirement from State Bank of India on 1st May, 2010 under the Voluntary Retirement Scheme (VRS) and received a sum of ₹ 25 lakh on account of VRS benefits. At the time of his retirement, Thomas was having 47 months of service left and had served the organisation for 18 years 11 months. His last drawn Basic Pay ₹ 60,000, D.A. @ 60% of B/Pay (80% of which forming part of salary). Later, he started a business of plying, hiring and leasing of goods carriages from 1st June, 2010 by acquiring 3 heavy vehicles for ₹ 12 lakh, 2 medium goods vehicle for ₹ 5 lakh and 3 light commercial vehicles for ₹ 6 lakh. Although, he did not maintain regular books of account for his business, the diary maintained by him reveled gross receipts of ₹ 3,12,000 for the financial year ended 31st March, 2011 and he incurred an expenditure of ₹ 1,68,500 on the business towards salaries of drivers, repairs, fuel, etc. Depreciation on vehicle is not included in the said expenditure.

During the financial year 2010-11, he received a sum of ₹ 3,00,000 on account of pension from bank and he contributed a sum of ₹ 65,000 to his PPF account maintained with the said bank in the same year. His PPF account was credited with interest of ₹ 35,000 during the financial year 2010-11. He also purchased long-term infrastructure bonds for ₹ 20,000; Repayment of educational loan interest for the year ₹ 50,000. He also paid medical infrastructure premium of ₹ 14,000.

Further, he had two residential properties, one is self occupied and other is let out. During the financial year 2010-11, Thomas was able to let out his property only for 11 months on a monthly rent of ₹ 17,000. The total municipal taxes on the let out property was ₹ 8,000, 50% of which was paid by the tenant and 50% by him. The interest on loan taken for renovation of the self occupied property paid by him during the year was ₹ 34,000. The insurance premium on the house and actual repairs and collection charges paid are ₹ 1,600 and ₹ 18,000 respectively and the entire expenditure is borne by him. During the financial year 2010-11, he was able to recover the unrealized rent of ₹ 33,000 from old tenant who vacated the house during the August, 2009 after spending litigation expenses of ₹ 15,000. During the financial year 2010-11. Thomas suffered short term capital loss on account of sale of shares on various dates amounting to ₹ 8,50,500.

From the aforesaid information, you are required to compute the total income of Thomas for the AY. 2011-12 giving reasons in respect of each and every item and indicate the relieflrebateldeduction which he is entitled to claim.

Solution :

Assessee : Mr. Thomas **Previous Year : 2010-2011** **Assessment Year : 2011-2012**

Computation of Total

Particulars	₹	₹	₹
(1) **Income from Salary**			
Pension Received			3,00,000
Voluntary Compensation			
Actual Amount Received		25,00,000	
Less : Exemption u/s 10(10c)			
Least of the following :			
(i) Actual Amount Received	25,00,000		
(ii) Maximum limit	5,00,000		
(iii) Higher of the following :			
(a) Last Drawn Salary × 3 × No. of Fully completed years of service = 88,800 × 3 × 18 = 47,95,200	47,.95,200	5,00,000	
(b) Last Drawn Salary × Balance of number of months of service left = 88,800 × 47 = 41,73,600			20,00,000
Last Drawn Salary = B/ Pay + D.A (forming part)			
= ₹ [60,000 + 60% of 80% of 60,000]			
= ₹ [60,000 + 28,800]			
= ₹ 88,800			

(2)	**Income from House Property**				
	(a)	**Self occupied :**			
		Annual Value	Nil		
		(–) Interest on Loan u/s 24(b) ₹ 34,000			
		– restricted upto ₹ 30,000	(30,000)	(30,000)	
	(b)	**Let-out House Property**			
		Gross Annual Value			
		(being the Rental Value) = 17,000 ×12	2,04,000		
	Less :	Municipal Tax Paid by the assessee during the year			
		= 18,000 × 50%	9,000		
		Net Annual Value (NAV)	**1,95,000**		
	Less :	Standard deduction @ 30% of NAV u/s 24(a)	58,500		
	Less :	Interest on loan u/s 24(b)	Nil	1,36,500	1,06,500
(3)	**Income from Business or Profession**				
	Presumptive Income u/s 44AE				
	in the Business of plying, leasing or hiring trucks				
	(i)	Light goods vehicles = 3 × 4,500 × 10 =	1,35,000		
	(ii)	Medium goods vehicles = 2 × 4,500 × 10 =	90,000		
	(iii)	Heavy goods vehicles = 3 × 5,000 × 10 =	1,50,000		3,75,000
(5)	**Income from Captal Gains**				
	Short Term Capital Loss				(8,50,000)
	Gross Total Income				**19,31,500**
	Less : **Deductions under Chapter VIA**				
		u/s 80 C – Deposits in PPF	65,000		
		u/s 80D – Medical Insurance Premium	14,000		
		u/s 80E – Interest paid on Education loan	50,000		
		u/s 80CCF – Investments in Long-term Infrastructure Bonds	20,000		1,49,000
	Total Income				**17,82,500**

Tax on Total Income of ₹ 17,82,500	3,88,750
(+) E/c @ 2%	7,775
(+) SHEC @ 1%	3,888
Tax Payable	**4,00,413**
Tax Payable (Rounded off u/s 288B)	4,00,410

Illustration 118 : Mr. Anurag is a Cost Accountant in practice. The Income & Expenditure Account for the year ending March 31, 2011 read as follows :

Expenses	₹	Income	₹
To Employees cost	1,50,000	By Professional earnings	16,00,000
To Travelling & Conveyance	50,000	By Dividend income	
To Administration & Office exp.	4,00,000	– from shares	2,00,000
To Interest	1,50,000	– from equity oriented mutual funds	1,00,000
To Demat charges	10,000		
To Net profit	11,40,000		
Total	**19,00,000**	**Total**	**19,00,000**

Other Information :

(a) Entire Dividend income is claimed as exempt from taxation by virtue of Section 10(34) and 10(35).

(b) Anurag claims that no expenditure has been incurred against the dividend income, which is claimed as exempt from tax.

(c) The value of investment in shares as on the first day and the last day of the previous year is ₹ 7,50,000 and ₹ 9,00,000 respectively.

(d) The value of investment in units of Mutual Funds as on the first day and the last day of the previous year is ₹ 5,00,000 and 2,00,000 respectively.

(e) All expenditure including interest expenditure of ₹ 1,50,000 incurred by Anurag are relating to taxable and non taxable Income. Demat charges are directly attributable to exempt income.

(f) The value of the total assets as appearing in the Balance sheet of the assessee as on the first day and last day of the previous year is ₹ 60,00,000 and ₹80,00,000 respectively.

You are required to compute the taxable income of Anurag for the assessment year 2011-12.

Solution :

Previous Year : 2010-11 **Mr. Anurag** **Assessment Year : 2011-12**

Computation of Taxable Income A.Y. 2011-12

Particulars	₹
Income from Profits & Gains of Business or Profession – as per Working Note 1	8,40,000
Income from other sources – as per Working Note 2	Nil
Total	**4,40,000**
Add : Disallowance u/s 14A – as per Working Note 3	31,804
Taxable Income	**4,71,804**

Working Note 1 — Profits & Gains of Business or Profession

	₹	₹
Net profit as per Income & Expenditure Account		11,40,000
Less : Income considered under other heads		
– Dividend Income from shares	2,00,000	
– Income from UTI	1,00,000	3,00,000
Taxable professional income		**8,40,000**

Working Note 2 — Income from other sources

	₹	₹
1. Dividend Income from Shares	2,00,000	
Less : Exemt under sec 10(34)	2,00,000	Nil
2. Income from units in Mutual funds	1,00,000	
Less : Exempt under sec 10(35)	1,00,000	Nil
Taxable income from other sources		**Nil**

Working Note 3 — Disallowance u/s 14A

	₹
(a) Amount of expenditure directly relating to exempt income (Other than interest) — Demat charges	10,000
(b) Amount of interest incurred by way of expenditure other than those included above (1,50,000 × 8,25,000 / 70,00,000)	17,679
(c) Amount equal to 0.5% of the average value of Investments (8,25,000 × 0.5%)	4,125
Total amount disallowed u/s 14A (a) + (b) + (c)	**31,804**

Notes:

1. Average value of Investment = (7,50,000 + 9,00,000) / 2 = ₹ 8,25,000.
2. Average value of Total Assets = (60,00,000 + 80,00,000) / 2 = ₹ 70,00,000.

Illustration 119 : Mr. Samir submits the following information for the A.Y. 2011-12.

Particulars	₹
Taxable Income from Salary	1,64,000
Income from House property :	
House 1 Income	37,000
House 2 loss	(53,000)
Textile Business (discontinued on 10.10.2010)	(20,000)
Brought forward loss of textile business - A.Y. 2008-09	(80,000)
Chemical Business (discontinued on 15.3.2010)	
– b/f loss of previous year 2008-09	(25,000)
– unabsorbed depreciation of previous yeart 2008-09	(15,000)
– Bad debts earlier deducted recovered in July '2010	40,000
Leather Business	62,000
Interest on securities held as stock in trade	10,000

Determine the gross total income for the assessment year 2011-12 and also compute the amount of loss that can be carried forward to the subsequent years.

Solution :

Previous Year : 2010-11 **Mr. Samir** **Assessment Year : 2011-12**

Computation of Gross Total Income A.Y. 2011-12

	Particulars		**₹**	**₹**
I.	Income from Salary :			1,64,000
II.	Income from House property :			
	House 1 Income		37,000	
	House 2 loss		(53,000)	(26,000)
III.	Profits and Gains of Business or Profession :			
	(i) Textile business loss		(20,000)	
	(iii) Chemical business – Bad debts			
	recovered taxable u/s 41(4)	40,000		
	Less : (i) Set off of brought forward			
	loss of P.Y. 2008-09 u/s. 72	(25,000)	15,000	
			(5,000)	
	(iii) Leather Business Income	62,000		
	(iv) Interest on securities held			
	as stock-in-trade	10,000	72,000	
			67,000	
	Less : B/f. business loss ₹ 80,000 restricted to		67,000	Nil
	Gross Total Income			**1,38,000**

Notes:

1. The unabsorbed loss of ₹ 13,000 (80,000-67,000) of Textile business can be carried forward to A.Y. 2011-12 for setoff u/s. 72, even though the business is discontinued.
2. The unabsorbed depreciation of ₹ 15,000 is eligible for set off against any income other than salary income. Since, Gross total income contains the balance of Income from Salary only, Unabsorbed depreciation cannot be adjusted. Hence, carried forward for adjustment in the susequent yeras.

9.10 SET OFF & CARRY FORWARD OF LOSSES

INTRODUCTION

If income is one side of the coin, loss is the other side. When a person earns income, he pays tax. However, when he sustains loss, law affords him to have benefit in the form of reducing the said loss from income earned during the subsequent years. Thus, tax liability is reduced at a later date, if loss is sustained. Certain provisions govern the process of carry forward and set off of loss.

This will be discussed on :

1. Set off of Loss in the Same Year
2. Carry forward and Set off of Loss in Subsequent Years
   i) Basic Conditions for carry forward of loss.
   ii) Conditions applicable to each Head of Income

As stated in section 14 of the Act computation of total income is made under certain heads viz. (i) Salaries (ii) Income from House Property (iii) Profits and gains of Business or Profession (iv) Capital gains and (v) Income from other sources.

In case computation results in to a positive figure, it is income. Likewise, if the computation results into a negative figure, it is 'Loss". Therefore, there cannot be loss from the head 'Salary'. Loss can occasion from all the remaining heads.

SET OFF OF LOSS IN THE SAME YEAR

For the purpose of computing total income and charging tax thereon, income from various sources is classified under the following heads :

A. Salaries
B. House Property
C. Profits and gains of Business or Profession
D. Capital gains
E. Other sources

These five heads of income are mutually exclusive. If any income falls under one head, it cannot be considered under any other head. Income under each head has to be computed as per provisions under that head. Then, subject to provisions of Set off of Losses (Sec. 70 to Sec. 80) between the heads of income, the income under various heads has to be added to arrive at a gross total income. From this gross total income, deductions under chapter VIA are to be allowed to arrive at the total income.

In this part, the provisions relating to set off, carry forward and set off of losses are categorised as under :-

SECTION 70

Where the net result for any Assessment Year in respect of any source falling under any head of income is a loss, the assessee shall be entitled to have the amount of such loss set off against his income from any other source under the same head.

(1) Save as otherwise provided in this Act, where the net result for any assessment year in respect of any source falling under any head of income, other than "Capital gains", is a loss, the assessee shall be entitled to have the amount of such loss set off against his income from any other source under the same head.

(2) Where the result of the computation made for any assessment year under sections 48 to 55 in respect of any short-term capital asset is a loss, the assessee shall be entitled to have the amount of such loss set off against the income, if any, as arrived at under a similar computation made for the assessment year in respect of any other capital asset.

(3) Where the result of the computation made for any assessment year under sections 48 to 55 in respect of any capital asset (other than a short-term capital asset) is a loss, the assessee shall be entitled to have the amount of such loss set off against the income, if any, as arrived at under a similar computation made for the assessment year in respect of any other capital asset not being a short-term capital asset.]

SECTION 71

Where the net result of the computation under any head of income in respect of any Assessment Year is a loss, the assessee shall be entitled to have such amount of loss set off against his income assessable for that Assessment Year under any other head of income.

Exceptions to provisions of sections 70 and 71 are as follows :

(a) **Loss from speculation business**: "Speculation transaction" means a transaction in which a contract for the purchase or sale of any commodity including stocks and shares is periodically or ultimately settled otherwise than by actual delivery or transfer of the commodity or scripts. [Sec. 43(5)] Loss from speculative transaction, if it is in the nature of business, can be set off only against income of another speculative business.

(b) **Loss under the head long term capital gains** arising from transfer of long-term capital assets will be allowed to be set off only against long term capital gains.

Note:

1. Loss can be set off against deemed income.
2. Inter head adjustment is made only when the net income computed under a head is a loss.
3. The scheme of inter source and inter head adjustment is mandatory.

(c) **Loss from owning and maintaining race horses** can be set off only against income of that activity.

(d) No expenditure or allowance is allowed from wining from lotteries, crossword puzzles, card games etc. similarly, no loss from any lottery, card games, races, etc. is allowed to be set off from the income of such sources. [Sec. 58(4)]

(e) loss incurred by an assessee from a source, income from which is exempt cannot be set off against income from a taxable source.

CARRY FORWARD AND SET OFF OF LOSS IN SUBSEQUENT YEARS BASIC CONDITIONS FOR CARRY FORWARD OF LOSS

SECTION 80: LOSS RETURNS.

In order to carry forward loss under section 72, 73, 74 and 74A. The due date is prescribed in section 139(1). No loss which has not been determined in pursuance of a return filed within the date in accordance with the provisions of section 139(3) shall be carried forward under the provisions of section.

The condition for filing of return in accordance with the provisions of sec. 139(3) shall not apply to loss from House Property carried forward u/s. 71B and unabsorbed depreciation u/s. 32(2).
Brought forward loss of earlier assessment Year in accordance with Ss. 72, 73, 74, 74A can be set off against the income of that Assessment Year and can be carried forward further, even if the return is not filed within the due date specified in section 139(1) of the Act.

CBDT has issued circular vide No. 8 of 2001 dated 16.5.2001 clarifying that the power has been delegated to Commissioner to condone delay in filing return and carry forward losses in cases where the claim for loss does not exceed ₹ 10,000 for each Assessment Year and to Chief Commissioner/Director General upto ₹ 1 lakh and beyond such limit CBDT will exercise the power.

CONDITIONS APPLICABLE TO EACH HEAD

71B.Carry forward and set off of loss from house property

Where for any assessment year the net result of computation under the head "Income from house property" is a loss to the assessee and such loss cannot be or is not wholly set off against income from any other head of income in accordance with the provisions of section 71 so much of the loss as has not been so set-off or where he has no income under any other head, the whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year and—

(i) be set off against the income from house property assessable for that assessment year; and

(ii) the loss, if any, which has not been set off wholly, the amount of loss not so set off, shall be carried forward to the following assessment year, not being more than eight assessment years immediately succeeding the assessment year for which the loss was first computed.

Sec 72AA: Carry forward and set –off accumulated loss in scheme of amalgamation of banking company

Where there has been an amalgamation of

(a) a company owning an industrial undertaking or a ship or a hotel with another company; or

(b) a banking company referred to in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949) with a specified bank; or

(c) one or more public sector company or companies engaged in the business of operation of aircraft with one or more public sector company or companies engaged in similar business.

accumulated loss and the unabsorbed depreciation of such company shall be deemed to be the loss of such banking institution for the previous year in which the scheme of amalgamation was brought into force.

Provision relating to carry forward and set- off of accumulated loss and unabsorbed depreciation allowance in a scheme of amalgamation of banking company in certain cases [Section 72 AA]

Not withstanding anything contained in section 72(2)(1B)(i)to (iii) where there has been an amalgamation of a banking company with any other banking institution under a scheme sanctioned and brought into force by the Central Government under sec 45(7)of Banking Regulation Act , 1949 the accumulated loss and the unabsorbed depreciation of such banking company shall be deemed to be the loss or , as the case may be, allowance for depreciation of such banking institution for the previous year in which the scheme of amalgamation was brought into force and other provision of this Act relating to set- off and carry forward of loss and allowance for depreciation shall apply accordingly.

For the purposes of this section :

(i) "Accumulated loss" means so much of the loss of the amalgamating banking company , under the head "Profits and gains business" (not being a loss sustained in a speculation business) which such amalgamating banking company, would have been entitled to carry forward and set-off under the provision of section 72 if the amalgamation had not taken place;

(ii) "banking company" shall have the same meaning assigned to it in sub-section (15) of section 45(15) of the Banking Regulation Act,1949.

(iii) "banking institution" shall have the same meaning assigned to it in sub-section (15) of sec 45(15) of the Banking Regulation Act, 1949.

(iv) "unabsorbed depreciation" means so much of the allowance for depreciation of the amalgamating banking company which remains to be allowed and which would have been allowed to such banking company if amalgamation had not taken place.

Provisions relating to carry forward and set off of accumulated loss and unabsorbed depreciation allowance in business reorganisation of co-operative banks [Sec. 72AB]

(1) The assessee, being a successor co-operative bank, shall, in a case where the amalgamation has taken place during the previous year, be allowed to set off the accumulated loss and the unabsorbed depreciation, if any, of the predecessor co-operative bank as if the amalgamation had not taken place, and all the other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

(2) The provisions of this section shall apply if—

(a) the predecessor co-operative bank—

(i) has been engaged in the business of banking for three or more years; and

(ii) has held at least three-fourths of the book value of fixed assets as on the date of the business reorganisation, continuously for two years prior to the date of business reorganisation;

(b) the successor co-operative bank—

(i) holds at least three-fourths of the book value of fixed assets of the predecessor co-operative bank acquired through business reorganisation, continuously for a minimum period of five years immediately succeeding the date of business reorganisation;

(ii) continues the business of the predecessor co-operative bank for a minimum period of five years from the date of business reorganisation; and

(iii) fulfils such other conditions as may be prescribed to ensure the revival of the business of the predecessor co-operative bank or to ensure that the business reorganisation is for genuine business purpose.

(3) The amount of set-off of the accumulated loss and unabsorbed depreciation, if any, allowable to the assessee being a resulting co-operative bank shall be,—

(i) the accumulated loss or unabsorbed depreciation of the demerged co-operative bank if the whole of the amount of such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting co-operative bank; or

(ii) the amount which bears the same proportion to the accumulated loss or unabsorbed depreciation of the demerged co-operative bank as the assets of the undertaking transferred to the resulting co-operative bank bears to the assets of the demerged co-operative bank if such accumulated loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting co-operative bank.

(4) The Central Government may, for the purposes of this section, by notification in the Official Gazette, specify such other conditions as it considers necessary, other than those prescribed under sub-clause (*iii*) of clause (*b*) of sub-section (2), to ensure that the business reorganisation is for genuine business purposes.

(5) The period commencing from the beginning of the previous year and ending on the date immediately preceding the date of business reorganisa-tion, and the period commencing from the date of such business reorganisa-tion and ending with the previous year shall be deemed to be two different previous years for the purposes of set off and carry forward of loss and allowance for depreciation.

(6) In a case where the conditions specified in sub-section (2) or notified under sub-section (4) are not complied with, the set off of accumulated loss or unabsorbed depreciation allowed in any previous year to the successor co-operative bank shall be deemed to be the income of the successor co-operative bank chargeable to tax for the year in which the conditions are not complied with.

Insertion of section 73A for set of off loss of the specified business : (w.e.f A.Y. 2010-11)

With reference to newly inserted Section 35AD (w.e.f A.Y. 2010-11). Any loss computed in respect of the specified business shall not he set off except against profits and gains, if any, of any other specified business. To the extent the loss is unabsorbed the same will be carried forward for set off against profits and gains from any specified business in the following assessment year and so on.

Section	Losses
72	Carried forward and set-off of business losses other than speculative business.
73	Losses in speculation business.
74	Losses under the head Capital Gains.
74A	Losses from owning and maintaining race Horses.

Sec	Nature of loss	Details of set off	Conditions / Exceptions
72	Brought forward unabsorbed business loss other than Speculation loss	Set off only against income under the head profits and gains of business or profession.	1. Carry forward and set off is permissible for 8 assessment years immediately succeeding the assessment year for which the loss was computed. 2. Loss can be carried forward only if the return is filed u/s 139(1) and it is determined and communicated u/s 157.
32(2)	Brought forward unabsorbed depreciation	Set off against any head of income	Unabsorbed depreciation loss can be carried forward for any number of years until it is fully set off.
73	Brought forward unabsorbed Speculation business loss	Set off only against income under Speculation business	1. Carry forward and set off is permissible for 4 assessment years immediately succeeding the assessment year for which the loss was computed. 2. Loss can be carried forward only if the return is filed u/s 139(1) and it is determined & communicated u/s 157.
74	Brought forward unabsorbed loss under the head Capital Gains.	Set off only against income under the head Capital Gain.	1. Carry forward and set off is permissible for 8 assessment years immediately succeeding the assessment year for which the loss was computed. 2. STCL can be set off against any Capital Gain. However, LTCL can be set off only against LTCG. 3. Loss can be carried forward only if the return is filed u/s 139(1) and it is determined & communicated u/s 157.
74A	Brought forward unabsorbed loss from activity of owning & maintaining race horses	Set off only against income from owning and maintaining race horses	1. Carry forward and set off is permissible for 4 assessment years immediately succeeding the assessment year for which the loss was computed. 2. Loss can be carried forward only if the return is filed u/s 139(1) and it is determined & communicated u/s 157.

SPECIAL PROVISIONS

Section 78(1):

Where a change has occurred in the constitution of the firm, the firm shall not be entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner remaining unabsorbed shall not be allowed to be carried forward by the firm. These restriction shall not apply to unabsorbed depreciation.

Change in constitution of the firm takes place :–

(i) If one or more of the partners cease to be partners or one or more new partners are admitted, in such circumstances that one or more of the persons who were partners of the firm before the change continue as partner or partners after the change (provided the firm is not dissolved on the death of any of its partners).

(ii) Where all the partners continue with a change in their respective shares or in the shares or in the shares of some of them.

Section 78(2) :

Where any person carrying on any Business or Profession has been succeeded in such capacity by another person otherwise than by inheritance, then the successor cannot have the loss of predecessor carried forward and set off against his income.

Section 79 :

Losses (other than unabsorbed depreciation) in case of closely held company

In case of a company in which public are not substantially interested (defined in sec. 2(18) of the Act), the unabsorbed business loss relating to any Assessment Year can be carried forward and set off against the income in a subsequent Assessment Year only (if the shares of the company carrying not less than 51% of the voting power were beneficially held by the same persons) both on the last day of the Previous Year(s) in which the loss, claimed to be set off and on the last day of the Previous Year in which loss was incurred.

Exceptions

The provisions stated supra shall not apply if the change in the voting power takes place due to the following reasons :

(a) the death of a shareholder; or

(b) transfer of shares by way of gifts to any relative of the shareholder making such gift.

(c) W.e.f. AY 2000-01, this section shall not apply to any change in the shareholding of an Indian company which is subsidiary of a foreign company arising as a result of amalgamation or demerger of a foreign company subject to the condition that 51% of the shareholders of the amalgamating or demerged foreign company continue to remain the shareholders of the amalgamated or the resulting foreign company.

Notes : Unabsorbed business losses can be carried forward and set off against profits from any business from A.Y. 2000-01. There is no need to continue the same business in which the loss was incurred.

Depreciation can be carried forward and set off against the profits from any business in the succeeding assessment year up to A.Y. 2001-02. The business in which the loss was incurred need not be continued in that year.

The effect of depreciation, business loss and investment allowance should be given in the following order:

- Current year's Depreciation
- Unabsorbed Business loss
- Unabsorbed Depreciation
- Unabsorbed Investment Allowance.

A return of loss is required to be furnished for determining the carry forward of such losses, by the due date prescribed for different assesses under section 139(1) of the Act. (Sec. 80).

Illustration 120: Following are the particulars of the income of Mr. Srikant for the previous year 2010-2011

	₹
1. Income from house property	
(a) Property R	(+) 12,000
(b) Property J	(-) 20,000
2. Profits and gains from business:	
(A) Non-speculation:	
(i) Business X	40,000
(ii) Business Y	(-) 50,000
(B) Speculation:	
(i) Silver	40,000
(ii) Bullion	(-) 10,000
3. Capital gains:	
(i) Long-term capital gains	(+) 30,000
(ii) Short-term loss	(-) 10,000
4. Income from other sources:	
(i) Card games-loss	10,000
(ii) From the activity of owing and maintaining race horses:	
(a) Loss at Mumbai	(-) 50,000
(b) Profit at Kolkata	(+) 40,000
(iii) Dividend from Indian companies	10,000
(iv) Income by letting out plant and machinery	1,11,000
The following losses have been carried forward:	
(i) Long-term capital loss from the assessment year 2006-2007:	18,000
(ii) Loss from silver speculation from the assessment year 2006-2007 and which was discontinued in the assessment year 2007-2008	25,000
Compute the gross total income for the assessment year 2011-2012	

Solution :

Previous Year : 2010-11 **Mr. Srikant** **Assessment Year : 2011-12**

Computation of Gross Total Income for the Assessment Year 2011-2012

Particulars	₹	₹
1. Income from house property (+ 12,000 - 20,000)		(-) 8,000
2. Profits from speculation:		
(i) Profit from Silver Business	40,000	
Less: Current year loss from bullion	(-) 10,000	
	30,000	
Less: Carried forward silver speculative loss	(-) 25,000	
Surplus from Speculation	5,000	
(ii) Add: Business profit from X business	40,000	
(iii) Less: Business loss from Y business	(-) 50,000	(-) 5,000

Unabsorbed business loss may be set-off against the income of any other
head except 'salaries' and 'winnings from lottery, card games, crossward puzzle, betting on race horses', etc.

3. Capital gains:		
Long-term capital gains	30,000	
Less : Short-term capital loss	(-) 10,000	
Long-term capital gain	20,000	20,000
4. Income from other sources:		
(i) Income by letting out plant and machinery		1,11,000
(ii) Card game-loss of ₹ 10,000		
Neither it can be set-off nor it can be carried forward		
(iii) Profit from race horses at Kolkata	(+) 40,000	
Less : Loss from race horses at Mumbai	(-) 50,000	
Less : to be carried forward for next four assessment year	(-) 10,000	
(iv) Dividend from Indian companies: Exempt under Sec. 10(34)		Nil
Aggregated income after setting-off current year losses from house property, profit and business against income from other sources:		1,18,000
Less : Carried forward long-term capital loss, from the assessment year 2006-2007 to be set-off against long-term capital gains		18,000
Gross total income or total income as there is no deduction available from GTI		1,00,000

Illustration 121 : Mr. Dey furnishes the following particulars of his income for the previous year 2010-2011:

Particulars	₹
Unit "A": Business loss	(-) 4,00,000
Unabsorbed depreciation	(-) 2,00,000
Unit "B": Business profit	10,00,000
Income from house property	2,00,000
Carried forward losses and allowance;	
Unit "C" business was discontinued on 31-12-2004	
Apart from the abovementioned, the following unabsorbed:	
1. Business loss	(-) 3,00,000
2. Depreciation	(-) 2,00,000
Unit "D" business was discontinued on 1-3-2007 leaving the following unabsorbed:	
1. Business loss	(-) 3,00,000
2. Depreciation	(-) 1,00,000

Compute his total income for the assessment year 2011-12.

Solution :

Previous Year : 2010-11 **Mr. Dey** **Assessment Year : 2011-12**

Computation of Total Income

Particulars	₹	₹
Income from house property		2,00,000
Business - profession		
Profit of B-business	(+) 10,00,000	
Less: Business loss of A - business	(-) 4,00,000	
Depreciation of A-business	(-) 2,00,000	
	(+) 4,00,000	4,00,000
Aggregated income		6,00,000
Less: Carried forward business loss:		
(i) Loss of C Business to be set-off against business profits	(-) 3,00,000	
(ii) Loss of D business	(-) 3,00,000	
	6,00,000	(-) 6,00,000
Total income		Nil

Note : Where business loss and depreciation both are being carried forward, business loss has got priority, over depreciation. Unabsorbed depreciation is carried forward without time-limit.

Illustration 122 : XYZ & Co., a partnership firm, submits the following particulars of its income and carry forward losses for the previous year 2010-2011:

Particulars	Betting on race horses made lawfully (₹)	Betting on race horses made illegally (₹)
1. Gross prize on race horses	15,00,000	5,00,000
2. Expenses incurred:		
(i) Horses purchased during the year	6,00,000	75,000
(ii) Medical expenses	1,00,000	20,000
(iii) Animal trainer fees	50,000	15,000
(iv) Fodder expenses	2,60,000	50,000
(v) Stable-rent/insurance	1,20,000	36,000
(vi) Depreciation in the value of horses	4,60,000	1,50,000
(vii) Staff salaries	1,00,000	40,000
3. Loses brought forward from the assessment year 2009-2010	6,00,000	2,00,000

Solution :

Previous Year : 2010-11 **XYZ & Co** **Assessment Year : 2011-12**

Computation of Total Income

Particulars	Betting on race horses made lawfully (₹)	Betting on race horses made illegally (₹)
Gross prize		
Less: Expenses incurred:	15,00,000	15,00,000
(i) Horses purchased—not allowed	—	—
(ii) Medical expenses	(-) 1,00,000	(-) 20,000
(iii) Animal trainer fees	(-) 50,000	(-) 15,000
(iv) Fodder expense	(-) 2,60,000	(-) 50,000
(v) Stable rent/insurance	(-) 1,20,000	(-) 36,000
(vi) Staff salaries	(-) 1,00,000	(-) 40,000
(vii) Depreciation in the value of horses—not allowed	—	—
	8,70,000	**3,39,000**
Less: Brought forward loss	6,00,000	Nil
	2,70,000	**3,39,000**
Total income of the firm = ₹ 6,09,000		

Note :

"Horse race" means a horse race upon which wagering or betting may be lawfully made [Explanation (b) to Sec. 74A]. Thus, where wagering or betting is not lawfully made on race horses, any loss incurred on such betting can neither be set-off nor carried forward. Hence, the carried forward loss of ₹ 2,00,000 cannot be set-off.

Illustration 123 : Mr. N discloses the following incomes for the PY 2010-2011 :

House property	Business or profession		Capital gains		Income from other sources
₹	Speculation ₹	Non-speculation ₹	STCG ₹	LTCG ₹	₹
A 50,000	P 3,00,000	X 5,00,000	C 6,00,000	F 7,00,000	Family pension 95,000
B (-) 40,000	S (-)2,00,000	Y (-) 3,00,000	D (-) 3,00,000	E (-)5,00,000	Loss from (-) 50,000 letting out from machinery/plant

Determine income under head of income for the AY 2011-2012 :

Solution : Aggregation of income under each head of income: AY 2011-2012

House property	Business or profession		Capital gains		Income from other sources
₹	Speculation ₹	Non-speculation ₹	STCG ₹	LTCG ₹	₹
A 50,000	P 3,00,000	X 5,00,000	C 6,00,000	F 7,00,000	Family pension 95,000
B (-)40,000	S (-)2,00,000	Y (-)3,00,000	D (-)3,00,000	E (-)5,00,000	Loss from (-)50,000 letting out machinery/ plant
10,000	1,00,000	2,00,000	3,00,000	2,00,000	45,000

Illustration 124 : Mr. B discloses the following incomes from business or profession for the previous year 2011-2012:

		₹
(i)	Profit from X business	6,00,000
(ii)	Loss from Y business	(-) 2,00,000
(iii)	Loss from profession Z	(-) 2,50,000
(iv)	Profit from speculation business – M	2,00,000
(v)	Loss from speculation business – N	(-) 3,00,000

Determine the income from business or profession for the assessment year 2011-2012.

Solution :

Previous Year : 2010-11 **Mr. B** **Assessment Year : 2011-12**

Computation of Income from Business

Particulars	₹
(i) X	6,00,000
(ii) Y	(-) 2,00,000
(iii) Z	(-) 2,50,000
Total Income from Non-Speculation Business and Profession	1,50,000
Income from Speculation Business	
(i) M	2,00,000
(ii) N	(-)3 ,00,000
Loss from speculation business	(-) 1,00,000

Speculation loss cannot be set-off against the income from business profit, though both of them fall under the same head of income.

Thus, taxable business profits for the assessment year 2011-2012 is ₹ 1,50,000. The speculation loss will be carried forward for future set-off for 4 assessment years, immediately succeeding the assessment year for which it was first computed [Sec. 73(4)].

The time-limit of 4 years is applicable from the assessment year 2012-2013 and subsequent year.

Illustration 125 : Mr. D has earned income of ₹ 5,60,000 from speculation business during the PY 2010-2011. However, he has suffered losses in business and profession ₹ 3,20,000 and ₹ 1,70,000, respectively during the same period. Determine his income from business profession for the assessment year 2011-2012.

Solution :

Previous Year : 2010-11 **Mr. D** **Assessment Year : 2011-12**

Computation of Income from Business and Profession

Particulars	₹
Profits from speculation business	5,60,000
Less. (i) Loss from Non-Speculation Business	(-) 3,20,000
(ii) Loss from profession	(-) 1,70,000
Income from business and profession	70,000

9.11 DEDUCTION AND COLLECTION OF TAX AT SOURCE

DEDUCTION OF TAX AT SOURCE (TDS)

LIABILITY FOR TDS

Any person responsible for making payment of certain category of incomes is liable to deduct tax at source at an appropriate occasion.

The law prescribes time when the TDS is to be made, rate at which it should be made, when TDS should be paid to the Government and associated administrative responsibilities of payer (tax deductor) and payee (tax deductee) have been prescribed.

The following chart states at a glance incomes from which TDS should be made :

Section	Nature of Income/ Payment	Threshold Limit	Person Responsible to Make TDS	Nature of payee	Rate at which to be deducted
192	Salary	Maximum amount not liable to tax for employee	Any person being an Employer	Employee having taxable salary	average rate of income-tax computed on the basis of rates inforce for the financial year in which the payment is made, on the estimated salary income of the employee for that financial year
193	Interest on securities	10,000	Any person issuing the security	Any person	Refer Note No. 1
194A	Any interest other than interest on securities exceeding	₹5,000 in a year or 10,000 in case of banking company or co-operative society or deposit with post office	Any person other than individual or HUF [Refer Note No. 4]	Any resident in India	Refer Note No. 1
194B	Winnings from lottery or crossword puzzle or card game and other game of any sort inclu-ding tele-vision game	₹ 5,000	Any person	Any person	30% [Sec. 115BBB]

Section	Nature of Income/ Payment	Threshold Limit	Person Responsible to Make TDS	Nature of payee	Rate at which to be deducted
194BB	Winnings from horse race	₹ 2,500	Winning from horse race	Any person	30% [Sec. 115BBB]
194C(1)	Any Payment in pursuance of any	If a contract exceeds contract ₹ 20,000 or total in a year contracts with the same contractor exceed ₹ 50,000.	Central or State Government, Local Authority, Central/State or Provincial Corpn., Company Cooperative Society Housing Board, Trust or University, Firm [Refer Note No. 4]	Any resident contractor for carrying out any work including supply of labour	1% for Advertisement contracts and 2% for all other contracts.
194C(2)	Any Payment in pursuance of any contract for consideration	₹ 20,000	Any contractor other than Individual and HUF [Refer Note No. 4]	Any resident sub-contractor	1%
194D	Insurance commission	₹ 5,000	Any person	Any resident person	Refer Note No. 1
194E.	Income for (i) participation in any game or sport in India; (ii) by way of remuneration for articles on sports, etc	Nil	Any person	Any non-resident sportsman who is not a citizen of India	10%
194E.	Guaranteed sum in relation to any game or sport played in India.	Nil	Any person	Any non-resident association or institution.	Refer Note No. 1
194EE	Any sum out of National Savings Scheme u/s 80CCCA	₹ 2,500	Any person	Any person	20%
194F	Amount on account of re-purchase relevant of units covered u/s. 80CCB	Nil	Any person	Any person	20%

Section	Nature of Income/ Payment	Threshold Limit	Person Responsible to Make TDS	Nature of payee	Rate at which to be deducted
194G	Commission, remuneration or prize Œ relating to lottery tickets	₹ 1,000	Any person	Any person stocking, purchasing or selling lottery tickets.	10%
194H	Commission Any person or Brokerage	₹ 2,500	Other than individual and HUF [Refer Note No. 4]	Any person	10%
194-I	Rent	₹1,20,000	Other than individual and HUF [Refer Note No. 4]	Any person	10 % plant, equipment other assets Œ15% indl. HUF payee 20% other payees
194J	Fees for Professional or technical services	₹20,000	Other than individual & HUF [Refer Note No. 4]	Any person	10%
194LA	Immovable Property Acquisition Compensation.	₹1,00,000	Any person	Any resident person	10%
195	Any interest or any sum chargeable as income (other than salary)	Nil	Any person	Any non-resident other than company Any foreign company	Refer Note No. 1 and if the NR is resident of a country with which India has Double Tax Avoidance Agreement, (DTAA) beneficial of the rate as per FA or DTAA.
196B	Income in respect of units referred to in Sec. 115A purchased in foreign currency or income of long term capital gains from such units.		Any person	Off shore fund	10%

Notes :

1. Threshold Limit: payments in a year upto this limit are not liable for TDS. In the amount of payment exceeds threshold limit, then provisions of TDS apply.
2. Rate of TDS is prescribed by the Finance Act (FA) that is applicable during the year whe TDS is to be made. For example, for the current year from 1st April, 2010 to 31st March, 2011 (2010-11) TDS rates will be available in the Finance Act, 2010.
3. TDS rates specified herein above are rates of income tax. These are required to be increased by surcharge, education cess, etc. specified in The Finance Act applicable.
4. Individual and HUF :

An individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under clause (*a*) or clause (*b*) of section 44AB during the financial year immediately preceding the financial year in which such income is credited or paid, shall be liable to deduct income-tax under this section

Payments made by way of fees which are exclusively for personal purposes will not attract provisions of sec. 194J.

Rationalisation of provisions relating to tax deduction at source (TDS) [W.e.f. 1-10 2009]

Tax deduction at source is a method of collecting taxes on behalf of the Government at the time of payment or credit. The Income-tax Act casts a legal responsibility on the deductor to deduct tax on the correct amount, at the correct rate and deposit it to the Government account. The TDS rates are specified partly in the Finance Act and partly in the provisions of the Income-tax Act. Dcductors are also required to compute surcharge and cess over and above some of the prescribed rates of TDS. If the deductor fails to deduct the tax or fails to deposit the tax after deduction, interest, penalty and prosecution provisions may get attracted. Further, under the provisions of section 40(a)(;a), if the deductor fails to deduct tax on a prescribed payment or fails to deposit the tax deducted in time, the entire expenditure is disallowed while computing his total income. To assist deductors in complying with their TDS obligations and reduce their compliance burden, it is proposed to rationalise the provisions of TDS as under:

(A) Amendment in TDS rates and other provisions of section 194C

(i) **Rate of TDS under section 194C rationalized [W.e.f. 1-10-2009]:** Under the existing provisions of section 194C of the Income-tax Act, TDS at the rate of 2% is deducted on payment for a contract. However, in the case of a sub-contract, TDS is deducted at the rate of 1%. Further, in the case of payment for an advertising contract, TDS is required to be deducted at the rate of 1%.

In order to reduce the scope for disputes regarding classification of contract as sub contract, the Act has specified the same rate of TDS for payments to both contractors as well as sub-contractors. To rationalise the TDS rates and to remove multiple classifications the Act has provided same rate of TDS in the case of payment for advertising contracts. To avoid hardship to small contractors/sub-contractors most of whom are organized as individuals/HUFs, the Act has prescribed following rates of TDS:

(a) 1% where payment for a contract are to individuals/HUF

(b) 2% where payment for a contract are to any other entity.

The nil rate will be applicable if the transporter quotes his PAN. If PAN is not quoted the rate will be 1% for an individual/HUF transporter and 2% for other transporters up to 31.3.2010.

The rate of TDS will be 20% in all the above cases, if PAN is not quoted by the deductee w.e.f. 1-4-2010.

(i) Provisions for payments and tax deducted at source to transports [W.e.f. 1-10-2009]: Under section 194C, tax is required to be deducted on payments to transport contractors engaged in the business of plying, hiring or leasing goods carriages. However if they furnish a statement that they do not own more than two goods carriages, tax is not to be deducted at source. Transport operators report problem in obtaining TDS certificates as these are not issued immediately by clients and they are not able to approach the client again as they may have to move across the country for their business. The Act has inserted sub-section (6) to section 194C and has exempted payments to transport operators (as defined in section 44AE) from the purview of TDS. However, this would only apply in cases where the operator furnishes his Permanent Account Number (PAN) to the deductor. As per section 194(7), the dcductors who make payments to transporters without deducting TDS (as they have quoted PAN) will be required to intimate these PAN details to the Income Tax Department in the prescribed format.

(iii) Clarification regarding fiworkfl under section 194C [W.e.f. 1-10-2009]: There is ongoing litigation as to wheth TDS is deductible under section 194C on outsourcing contracts and whether outsourcing constitutes work or not. To bring clarity on this issue, the Act has provided that fiworkfl shall not include manufacturing supplying a product according to the requirement or specification of a customer by using raw material purchased from a person other than such customer ns such a contract is a contract for ‚sale™. This will however not apply to a contract, which does not entail manufacture or supply of an article or thing (e.g. a construction contract). The Act has included manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer, within the definition of ‚work™. It is further provided in section 194C(3) that in such a case TDS shall be deducted on the invoice value excluding the value of material purchased from such customer if such value is mentioned separately in the invoice. Where the material component has not been separately mentioned in the invoice, TDS shall be deducted on the whole of the invoice value.

There is no change in the limit of ₹ 20,000 and ₹ 50,000 which is applicable for non deduction of tax at source under section 194C. Further, in a case where the payment is made by an individual or HUF to the contractor exclusively for personal purposes of such individual or member of HUF, there will be no need to deduct tax at source under section 194C.

(B) Rate of TDS reduced in case of section 194-I [W.e.f. 1-10-2009] : Under the existing provisions of section 194-I of the Income-tax Act, TDS on rental payments is prescribed at the rate ofŠ

(a) 10% for the use of any machinery or plant or equipment,

(b) 15% for the use of any land or building or furniture or tlttings, if the payee is an individual or HUF, and

(c) 20% if the payee is other than an individual or HUF.

The Act has rationalised and reduced the TDS rates on rental payments as under:

(a) 2% for the use of any machinery or plant or equipment,

(b) 10% for the use of any land or building or furniture or fittings for all persons.

Nature of Payment (19 4-I) - Rent		Rate upto 30-9-2009	New rate * (w.e.f. 1-10-2009)
(a)	Rent of plant, machinery of equipment	10%	2%
(b)	Rent of land, building or furniture to an individual and Hindu undivided family	15%	10%
(c)	Rent of land, building or furniture to a person other than an individual or Hindu undivided family	20%	10%

The rate of TDS will be 20% in all the above cases, if PAN is not quoted by the deductee w.e.f. 1-4-2010.

(C) Rate of TDS on unlisted debentures or security or on Interest other than securities reduced to 10%.

Rate of TDS has been reduced by the Finance (No. 2) Act, 2009 from 20% to 10% in case of the following :

(i) TDS on interest on unlisted debentures and on any income other than mentioned in Para l(o) cf Part II of Schedule I to the Finance (No. 2) Act, 2009 relating to TDS rates in case of a person other than a company who is resident in India has been reduced from 20% to 10%.

(ii) Similarly, TDS on interest other than interest on securities and on any income other than mentioned in Para 2(a) of Part II of the Schedule I to the Finance (No. 2) Act, 2009 in case of a domestic company has also been reduced from 20% to 10%.

(D) TDS to be deducted at basic rates

In order to ease the computation of TDS, the Act has removed surcharge and education cess & SHEC on tax deducted on any payment made to resident taxpayers except in case of salary. In case of salary TDS shall be deductible after including education cess and SHEC. This provision shall be effective after the Finance (No. 2) Act becomes the Act.

(E) Section 197A has been amended : relating to tax benefits for new pension system extended to fiSelf Employed u/s 10(44), 115-O and 80CCD [w.r.e.f. AY 2009-10]

Case Law :

(i) The directors of the assessee company have routed the loan taken in their individual capacity in the name of company. The company was merely acting as the agent of the directors for receiving & disbursing the loans to the directors. It was held that as per the provisions of section 194A, TDS is to be made at the time of credit of such income to the account of the payee. So the company was liable to deduct tax on the interest payment to lenders as there was no resolution passed by the Board of Directors which empowered the company to merely act as a medium for routing the borrowing & repayment. CIT v Century Building Industries P. Ltd. 293 ITR 194.

(ii) The assessee has entered into an agreement for use of the premise for storage of goods. While making payment the assessee deducted tax at 2% u/s 194C considering that it was a contractual payment. However it was concluded that the payment made by the assessee is in the nature of rent u/s 194I of the Act & TDS should have been made @20%. The Apex court held that once tax is paid by the deductee on the income received from the deductor, the deductor cannot be once again called upon to pay the tax on same income. However the assessee is liable to pay interest u/s 201(1A) for delay or non-payment of tax to the Government within prescribed time. Hindustan Coca Cola Beverages P. Ltd. v CIT 293 ITR 226 (SC).

IMPORTANT POINTS

1. Time Schedule

Nature of Activity		Time Frame	
Time of Deduction		Salary : At the time of payment Others : When income paid or credited to the account including "payable" or "suspense" account whichever is earlier.	
Time of deposit of tax (Other than on behalf of Government)		(a)	If credited on the date on which accounts are made, within two months from the end of the month in which income is credited.
		(b)	Any other case, within one week from the end of the month in which deduction is made.
Statement			For each Quarter
TDS Type	Form		For all category of Statements
Salary	No 24Q		Q1 : April – June – 15^{th} July
Non Resident	No 26Q		Q2 : July – September – 15^{th} October
All Others	No 27Q		Q3 : October – December – 15^{th} January
			Q4 : January - March - 15th June
Electronic For			every office of Government and the principal officer in the case of every company, firm, whose total sales, gross receipts or turnover from the business or profession carried on by it exceed the monetary limits specified under clause (a) or clause (b) of section 44AB during the financial year immediately preceding the financial year in which such income is credited or paid.

1. Copies of Form Nos. 15G and 15H received by the payer have to be filed with the Chief Commissioner Commissioner within 7 days of the succeeding month.
2. If the person responsible for deducting and paying tax fails to do so, he shall be considered as an assessee in default, liable to pay interest @ 12% p.a. on the amount of such tax from the date on which such tax was deductible to the date of actual payment, and penalty, not exceeding the amount of tax and rigorous imprisonment ranging from 3 months to 7 years and fine. The interest payment needs to be paid before filing of Quarterly Return.
3. Sec. 199 Œ Credit for tax deducted :
   a. Credit will be given for the assessment year in which such income is assessble.
   b. Where such income is assessable in the hands of any other person, credit shall be given to such other person.
   c. When any security, property etc. is jointly owned by two or more persons not constituting partnership, credit for TDS on income there from shall be given to such persons in the proportion in which the income is distributed.

4. A payee from whose income TDS is made must intimate his PAN to tax deductor. Tax deductor must to quote PAN of payees in TDS Certificate and TDS return [Sec. 139A].

5. TAN/TDCAN to be quoted on all quarterly statements of TDS/ TCS section 203A(ba).

6. A declaration for non-deduction of tax u/s. 197A can be furnished by the assessee only if his aggregate income is less than threshold limit. Senior Citizens can file declaration if tax on their estimated total income is likely to be NIL.

7. Disallowance due to non-deduction:

If tax deductible u/ss. 193, 194A, 194C, 194H, 194J and 195 is not deducted/paid before applicable due dates, the relevant expenditure otherwise allowable in computing Total Income of the payer would be liable for disallowance u/s 40(a)(i)/(ia). The deduction will be allowed in the year in which TDS is paid. For details see section 40(a).

8. Salary TDS:

TDS by Employer : In respect of any perquisite which is not provided for by way of monetary payment, the Employer, at his option, may pay tax on the whole or part of such income without making any deduction there from, For the purpose of paying tax as aforesaid, tax shall be determined at the average of income-tax computed on the basis of the rates in force for the financial year, on the income chargeable under the head fiSalariesf

Simultaneous employment / Successive employment : the employee may furnish to one of the many or successive employers such details of the income under the head fiSalariesfl due or received by him from t other employer or employers, the tax deducted at source there from and such other particulars and thereupon such employer shall take into account the details so furnished for the purposes of making the TDS

Relief Under Section 89(1) : Government servant or an employee in a company, co-operative society, local authority, university, institution, association or body is entitled to the relief under section 89(1), he may furnish to the employer, such particulars and thereupon the said Employer shall compute the relief and take it into account in making the TDS.

Other Income: Employee has any income chargeable under any other head of income for the same financial year, not being a loss under any such head other than the loss under the head fiIncome from house propertyf he may send to the Employer the particulars ofŠ

(*a*) such other income and of any tax deducted thereon under any other provision of this Chapter;

(*b*) the loss, if any, under the head fiIncome from house propertyfl, and thereupon the Employer shall tak

(*i*) such other income and tax, if any, deducted thereon; and

(*ii*) the loss, if any, under the head fiIncome from house propertyf

also into account for the purposes of making the TDS:

After considering such other information there should be no reduction in TDS from Salary, except reduction on account of loss from fiHouse Propertyfl hea

PF, Superannuation Trusts : The trustees the fund at the time an accumulated balance due to an employee is paid, make there from the deduction provided in rules

Salary payable in foreign currency: Value in rupees of such salary shall be calculated at the prescribed rate of exchange.

9. Income payable finet of taxfl: In a case where, the tax chargeable on any income referred subject to TDS, t amount of TDS is to be borne by the person by whom the income is payable, then, for the purposes of deduction of tax under those provisions such income shall be increased to such amount as would, after deduction of tax thereon at the rates in force for the financial year in which such income is payable, be equal to the net amount payable under such agreement or arrangement. [Sec. 195A]

Procedure for TDS

(i) To obtain Tax Dedcution and Collection Account Number (TAN) by applyinf in Form No. 49B [sec. 203A and Rule 114A]

(ii) To deduct tax at source as per provisions. TDS should be at an appropriate time and at appropriate rate.

(iii) To deposit tax in the Government treasury within the time in proper challan

(iv) To submit quarterly TDS statements.

Consequence of non compliance of TDS provisions :

Sr. No.		Section	Default	Consequence
			Section	Effect
1	197A	Delay, no submission of no TDS declarations	272A(2)(j)	₹ 100 per day / Max. Tax Amount on Decleration
2	Chapter XVII - B	Fails to deduct the whole or any part of TDS	271C(1)(a)	Penalty of a sum equal to the amount of TDS not so deducted. (ii) Fails to deduct the whole or any part of TDS: Penalty :- a sum equal to the amount of TDS not so deducted. [sec. 271C(1)(a)]
3	200	Delay in payment of TDS	201(1A)	Interest @ 1% p.m
4	200	Delay, no submission of Quarterly TDS Statement	272A(2)(k)	₹ 100 per day / Max. Tax Amount of TDS in of Quarterly TDS Statement
5	203A	Default in the matter of TAN	272BB	Penalty ₹ 10,000

Improving compliance with provisions of quoting PAN through the TDS regime [Section 206AAJ [W.e.f. 1-4 2010]

In order to strengthen the PAN mechanism, the Act has made amendments in the Income Tax Act to provide that any person whose receipts are subject to deduction of tax at source i.e. the deductee, shall mandatory furnish his PAN to the deductor failing which the deductor shall deduct tax at source at higher of the following rates :

(i) The rate prescribed in the Act;

(ii) At the rate in force i.e., the rate mentioned in the Finance Act; or

(iii) At the rate of 20%.

TDS would be deductible at the above-mentioned rates even in a case where the taxpayer files a declaration in form 15G or I5H (under section 197A) but does not provide his PAN. Further, no certificate under section 197 will be granted by the Assessing Officer unless the application contains the PAN of the applicant.

These provisions will also apply to non residents where TDS in deductable on payments or credits made to them. To ensure that the dcduclor knows about the correct PAN of the declutee it is also provided for mandatory quoting of PAN of the deductee by both the deduetor and the dcduclee in all **correspondence,** bills and vouchers exchanged between them.

Processing of statements of tax deducted at source (Section 200A inserted w.e.f. 1-4-2010)

Currently almost all statements of tax deducted at source are filed in an electronic mode. The processing of these statements should, therefore, be done only in a computerized environment.

New section 200A has been inserted provide for processing of statements of tax deducted at source on computer so that liabilities on account of interest and other defaults in TDS payment are promptly calculated and intimated to the deduetor. In order to process TDS statements on computer, the Act has provided for electronic processing on the same lines as processing of Income-tax returns.

Further, the following adjustments can be made during the computerized processing of statements of tax deducted at source :

(i) Any arithmetical error in the statement; or

(ii) An incorrect claim, if such incorrect claim is apparent from any information in the statement, for example, in respect of rate of deduction of tax at source where such rate is not in accordance with the provisions of the Act.

The Act has provided that after making adjustments, tax and interest [e.g. under section 201(1A)] would be calculated and sum payable by the deduetor or refund due to the deduetor will be determined. An intimation will be sent to the deduetor informing him of his tax liability or granting him the refund due within one year from the end of the financial year in which the statement is filed. The Act has also provided that the processing of these statements can be undertaken in a centralized processing centre.

Providing time limits for passing of orders under section 201(1) holding a person to be an assessee in default

Currently, the Income Tax Act does not provide for any limitation of time for passing an order under section 201(1) holding a person to be an assessee in default. In the absence of such a time limit, disputes arise when these proceedings arc taken up or completed after substantial time has elapsed.

In order to bring certainty on this issue, the Act has inserted sub-section (3) to section 201 to provide for express time limits in the Act within which specified order under section 201(1) will be passed.

An order under section 201(1) passed on or after 1-4-2010, for failure to deduct the whole or any part of the tax as required under this Act, if the deductee is a resident taxpayer shall be passed within two years from the end of the financial year in which the statement of tax deduction at source is filed by the deduetor.

Where no such statement is filed, such order can be passed up till four years from the end of the financial year in which the payment is made or credit is given.

Further, Explanation\to section 153 regarding exclusion of certain period (like injunction by Court) to calculate time limit shall also be applicable while determining the above time limit. Similarly like section 153(3) there will be no time limit in consequence of or to give effect to any finding or direction contained in an order under section 250, 254, 260A, 262, 263 or 264 or order of a Court. To provide sufficient time for pending cases, the Act has provided that such proceedings for a financial year beginning from 1-4-2007 and earlier years can be completed by the 31-3-2011.

However, no time-limits have been prescribed for order under section 201(1) whereŠ

(a) The deductor has deducted but not deposited the tax deducted at source, as this would be a case of defalcation of government dues,

(b) The employer has failed to pay the tax wholly or partly, under section 192(1A), as the employee would not have paid tax on such perquisites

(c) The deductee is a non-resident as it may not be administratively possible to recover the tax from the non-resident.

These amendments shall be effective from 1-4-2010. Accordingly it will apply to such orders passed on or nflcr the 1-4-2010.

TAX COLLECTION AT SOURCE [Sec. 206C]

Every seller at the time of debiting the buyer with the amount payable or receiving payments from buyers engaged in business of alcoholic liquor, forest produce, scrap, timber, tendu leaves, etc. shall collect tax at the following rates:

Sr. No	Nature of goods	TCS Rate
1	Alcoholic liquor for human consumption (other than Indian made foreign liquor)	1%
2	Tendu leaves	5%
3	Timber obtained under a forest lease	2.5%
4	Timber obtained by any mode other tha n under a forest lease	2.5%
5	Any other forest produce not being timber or tendu leaves	2.5%
6	Scrap	1%

Every person, who grants a lease or a license or enters into a contract, etc for the purpose mentioned below shall collect tax at the following rates:

Sl. No.	Nature of contract or licence or lease, etc.	TCS Rate
(i)	Parking lot	2%
(ii)	Toll plaza	2%
(iii)	Mining and quarrying	2%

The amount of tax so collected shall be paid, within one week seven from end of the month of tax collection. Delay or failure attracts interest @ 1% p.m. [sec. 206C(7) & (8)]

Responsibility & Liability of the Tax Collector

1. To obtain Tax Collection Account No. [sec. 206CA(1)]
2. To quote TCS No. in all returns, certificates and challans. [sec. 206CA(2)]
3. To furnish quarterly return in form No. 27EQ within stipulated time i.e. within fifteen days from the end of a quarter for the first three quarters and by 30 th April for the last quarter.
4. Failure to furnish TCS return: Penalty @ 100/- per day, during which the default continues, but not exceeding the amount of TCS. [sec. 272A(2)(g)]
5. Failure to deposit TCS in Government treasury, rigorous imprisonment for a term of not less than 3 months, but which may extend to 7 years, in addition to fine [secs. 276B & 276BB]

Thus, administrative provisions are similar to TDS administration.

Filing of TDS and TCS statements (W.e.f. 1-10-2009)

Section 200(3) of Income-tax Act provides that any person deducting tax in accordance with the provisions of Chapter XVII B has to furnish, within the prescribed time, quarterly statements for the period ending on the 30th June, 30th September, 31st December and 31st March in each financial year. Similarly, filing of quarterly returns for tax collection at source (TCS) have been provided in sub-section (3) of section 206C of the Act. Further section 206A provides furnishing of quarterly return in respect of payment of interest to residents without deduction of tax.

In order to provide administrative flexibility in deciding the periodicity of such TDS related statements, the Act has modified the existing provisions so as to allow the Government to prescribe periodicity of such TDS statements besides prescribing their form and manner.

Further, section 272A(2)(0 relating to non-filing of quarterly statement of TDS/TCS has been amended in order to delete the word ‚quarterly™ given for such statements.

9.12 INTEREST

Sections 234A, 234B and 234C provide for charging of mandatory interest since word 'shall' is used in the said sections. (CIT v. Anjum M.H. Ghaswala)

Interest For failure to deduct or pay any TDS [Sec. 201(A)]:

Where a person responsible for deducting tax at source does not deduct a source under Chapter XVII or after deducting tax fails to pay the same as required by Act, he is liable to pay interest @ 1% for every month or part of a month on the amount of such tax from the date on which tax deductible till the date it is actually paid.

Before furnishing the quarterly statement for each quarter in accordance with the provisions of sub-section (3) of section 200, such interest should be paid on self- assessment basis.

Interest for failure to collect any tax or pay TCS [Sec. 206C(7)] :

Where a person responsible for collecting tax at source under section 206C does not collect or after collecting tax fails to pay the same as required by Act, he is liable to pay interest @ 1% for every month or part of a month on the amount of such tax from the date on which tax should have been collected till the date it is actually paid.

Before furnishing the quarterly statement for each quarter in accordance with the provisions of sub-section (3) of section 200, such interest should be paid on self- assessment basis.

Interest on Delayed Payment of Tax other than Advance Tax [Sec. 220(2)]

Where an assessee fails to pay any tax, penalty, etc. within 30 days from the date of the Notice of Demand issued under Section.156, he shall be liable to pay interest on the outstanding demands @1% for every month or part of a month, for the period of default.

Where the Notice of Demand issued under section.156 is issued for payment of Advance Tax, interest is not chargeable on the outstanding demand, if any.

Penalty is prescribed under section 221 for any default in payment of advance tax, any other tax, penalty, etc. within 30 days from the date of the Notice of Demand issued under Section.156. Penalty can be to the extent of the amount of tax in arrears. However, where assessee has preferred, the AO can exercise his discretion so as to treat the assessee as not being in default in respect of nonpayment of tax on the amounts disputed in first appeal and then penalty under section 221 does not attract [Sec. 220(6)]

The following additional points should be considered :-

(i) Interest charged under Section.220 (2) is reduced in case of reduction of tax in appeal, rectification or revision.

(ii) Interest under Section 220(2) is to be paid on delayed payments even if extension of time making payment has been granted.

Amount on which interest is payable:

(i) Under Section 234A(1): Interest is payable on tax determined u/s 143(1) or on regular assessment u/s 143(3)/ 144/147/153A minus TDS/ Tax collected at source and advance tax paid by the assessee.

(ii) Under Section 234A(3): Tax determined u/s 147 or 153A minus tax on total income determined u/s 143(1), 144 or 147 earlier.

No Interest if Taxes are paid :

Where the assessee had paid the taxes before the date of filling the return but could not file the return for reasons beyond his control but filled it belatedly, the charge of interest u/s 234A is not valid as in such cases there is no loss to the revenue. However interest would be payable where tax has not been deposited prior to the date of filling of the return. [Prannoy Roy (Dr.) v CIT 121 Taxman 314 (Del)]

For default in paying advance tax [Sec. 234B] :

Where an assessee who has failed to pay advance tax, interest @ 1% for every month or part of month is payable on assessed tax. Such interest is payable from April 1 of the assessment year to the date of determination of income under section 143(1) or on regular assessment.

Where an assessee who had paid advance tax but the amount of advance tax paid by him less than 90% of assessed tax, interest is payable @1% for every month or part of the month on the assessed tax minus advance tax is paid. Such interest is payable from April 1 of assessment year upto the date of determination of income u/s/ 143(1) or on regular assessment.

Any tax paid after 15th March but before 31st March is considered as advance tax paid.

Where, before the date of completion of regular assessment, tax is paid on the basis of self assessment under section 140 A or otherwise, the interest will be calculated as follows-

(i) upto the date of payment of tax under section 140A or otherwise, interest will be calculated as mentioned earlier; and

(ii) from the date of payment of tax under section 140A or otherwise, interest will be calculated on the amount by which advance tax and tax payment stated in (a) above falls short assessed tax.

The CBDT is empowered to relax the provisions of Sec. 234B in appropriate cases. [Sec. 119(2)(a)]

Interest for Deferment of Advance Tax [Sec. 234C]

An advance tax is said to have been deferred, if any one or more of the installments are not paid or tax paid is less than prescribed under the law. In case of such deferment of advance tax simple interest shall be payable as follows :

(i) For Assessee other than Companies :	
(a) If the tax paid upto 15th September is less than 30%	Simple interest on the amount of shortfall @1% p.m.for 3 months
(b) If the tax paid upto 15th December is less than 60%	– do –
(c) If the tax paid upto 15th March is less than 100% of the tax due	Simple interest on the amount of shortfall @ 1%.
(ii) For Company Assessees :	
(a) If the tax paid upto 15th June is less than 15%	Simple interest on the amount of shortfall @1% p.m. for 3 months
(b) If the tax paid upto 15th September is less than 45%	– do –
(c) If the tax paid upto 15th December is less than 75%	– do –
(d) If the tax paid upto 15th March is less than 100%	Simple interest on the amount of shortfall @ 1% for 1 month

No interest under section 234C is leviable where the shortfall in payment of advance tax installments is on account of under-estimate/non-estimate of any capital gains or winning from lotteries, crossword puzzles, races, etc. This concession of not charging of interest is applicable where such incomes arise after payment of any of the installments and the whole tax on the items of income stated herein before is deposited along with the next succeeding installment falling due after the income arose.

Interest for Failure to pay Advance Tax [Sec. 234B and 234C]

Interest under sections 234B and 234C is payable even in cases where the assessee fails to pay advance tax at all.

Any tax paid after 15th March but before 31st March is considered as advance tax paid.

INTEREST IS PAYABLE TO ASSESSEE ON REFUND [Sec. 244A]

Interest on excess payment of advance tax, tax deducted or collected at source and any other tax or penalty becoming refundable shall be paid @ 1/2% for every month or part of a month. The period for which the interest is payable will be:

(i) For refund out of advance and tax deducted at source, from 1st April of relevant assessment year to the date on which the refund is granted. However, no interest is payable, if the amount of refund is less than 10% of the tax determined under section 143(1) or on regular assessment or assessment of FBT under section 115WE, and

(ii) For all other tax or penalties, from the date of payment of tax or penalty to the date on which the refund is granted.

Delay in granting refund attributable to the assessee is excluded from the period for which interest is payable. Where the amount on which interest was payable is increased or decreased due to regular assessment orders, reassessment, rectification, appeals, revision or Settlement Commission's order, interest is also will be increased of decreased.

Interest earned by assessee under section 244A is treated as taxable income of the previous year in which it is allowed.

ROUNDING OFF OF MONTH [Rule 119A]

The interest is to be calculated, any fraction of a month deemed to be full month and the interest shall be so calculated.

ROUNDING OFF OF AMOUNT [Rule 119A]

The amount of tax, penalty or other sum in respect of which interest is to be calculated is to be rounded off to the nearest multiple of ₹ 100 and for this purpose any fraction of ₹ 100 is to be ignored.

Illustration 126 : A firm made the following payments of advance tax during the Financial Year 2010-11 :

	Figures in ₹ Lakhs
15.09.2010	9.30
15.12.2010	9.0
15.03.2011	13.9
	32.20

The income returned by the firm is ₹ 100 Lakhs under the head "Business" and ₹ 10 Lakhs by way of Long-term Capital Gains on sale of a property effected on 1.3.2011. What is the interest payable by the assessee u/s 234B and 234C of the Income Tax Act for Assessment Year 2011-2012? Assume that the return of income was filed on 31.07.2011 and tax was fully made upon self-assessment.

Solution :

Assessee : Firm **Previous Year : 2010-2011** **Assessment Year : 2011-2012**

(a) **Interest u/s 234B** = **Nil** [since more than 90% of Tax Payable has been paid before the end of the previous year]

(b) **Interest u/s 234C**

Due date	**Advance Tax Payable** ₹	**Advance Tax paid** ₹	**Cumulative Advance Tax paid before due date** ₹	**Shortfall in Payment** ₹	**Surplus** ₹	**Months**	**Interest @ 1% p.m.** ₹
15.9.2010	30% of ₹ 30,90,000 = 9,27,000	9,00,000	9,30,000	—	3,000	—	—
15.12.2010	60% of ₹ 30,90,000 = 18,54,000	9,00,000	18,30,000	24,000	—	3	720
15.3.2011	100% of ₹ 32,96,000 = 32,96,000	13,90,000	32,20,000	76,000	—	1	760
							1,480

Note : Tax on LTCG has been considered only for the 3rd instalment as such gain had arisen only on 1.3.2010.

Computation of Actual Tax Payable by the Firm :

Particulars ₹		
Profits and Gains of Business or Profession		1,00,00,000
Capital Gains — Long Term Capital Gain		10,00,000
Total Income		**1,10,00,000**
Tax on Total Income including Surcharge and Cess		
On Long Term Gain of ₹ 10 lakhs @ 20%+ EC @ 2%+ SHEC @ 1%	2,06,000	
On Business Income @ of ₹ 100 lakhs @ 30%+ EC @ 2%+ SHEC @ 1%	30,90,000	
Net Tax Payable		**32,96,000**

Note : Tax on Business income alone considered for computation of 1st and 2nd instalment.

Illustration 127 : A firm made the following payments of advance tax during the financial year 2010-11 :

	₹ in lakh
September 15, 2010	7.00
December 15, 2010	7.75
March 15, 2011	13.00
	27.75

The return of income is filed on 31.7.2011 showing —

Bonus income	₹ 80 lakh
Long term capital gain taxable @ 20% (as on 1.12.2010)	₹ 20 lakh

Compute interest payable u/s 234C.

Solution :

Computation of tax liability fo A.Y. 2011-12.

₹ in lakh

Particulars	**Business income**	**Long term capital gain**
Income	80.00	20.00
Tax rate	30%	20%
Tax liability before surcharge	24.00	4.00
Add : Education Cess & SHEC	0.72	0.12
Tax liability including cess	24.72	4.12

∴ Total Tax Liability = (24.72 + 4.12) lakhs = ₹ 28.94 lakhs.

Computation of interest payable u/s 234

Due date	**Advance Tax Payment** ₹	**Advance Tax paid** ₹	**Cumulative Advance Tax paid before due date** ₹	**Shortfall in Payment** ₹	**Surplus** ₹	**Months**	**Interest @ 1% p.m.** ₹
15.9.2010	30% of ₹ 24,72,000 = 7,41,600	7,00,000	7,00,000	41,600	—	3	1,248
15.12.2010	60% of ₹ 24,72,000 = 14,83,200 (+) 60% of 4,12,000 = 2,47,200	7,75,000	14,75,000	2,55,400	—	3	7,662
15.3.2011	100% of ₹ 28,94,000 = 28,94,000	13,00,000	27,75,000	1,19,000	—	1	1,190
							10,100

Illustration 128 : In the case of Ms Laxmi, you are required to compute the interest u/s 234A, 234B & 234C from the following details—

Tax on total income ₹ 2,00,000; Due date for filing the return 30.09.2011; Actual date of filing the return 1.10.2012 and tax paid on 30.09.2011 ₹ 2,00,000.

Solution :

Computation of interest u/s 234A

Particulars	As per assessed income	
Tax		₹ 2,00,000
Less : Advance tax paid	Nil	
TDS	Nil	Nil
Amount on which interest is payable		₹ 2,00,000
Period of default (October being part of a month shall be considered)		1 month
Interest u/s 234A (1% × ₹ 2,00,000 × 1 month)		**₹ 2,000**

Computation of interest u/s 234B

Since assessee did not pay any amount by way of advance tax, hence she is liable to pay interest u/s 234B.

Particulars	Assessed income
Shortfall	₹ 2,00,000
Period of default (From April to September)	6 months
Interest (1% × 2,00,000 × 6 months)	**₹ 2,000**

Computation of interest u/s 234A

Due date	Advance Tax Payment ₹	Advance Tax paid ₹	Cumulative Advance Tax paid before due date ₹	Shortfall in Payment ₹	Surplus ₹	Months	Interest @ 1% p.m. ₹
15.9.2010	30% of ₹ 2,00,000 = 60,000	Nil	Nil	60,000	—	3	1,800
15.12.2010	60% of ₹ 2,00,000 = 1,20,000	Nil	Nil	1,20,000	—	3	3,600
15.3.2011	100% of ₹ 2,00,000 = 2,00,000	Nil	Nil	2,00,000	—	1	2,000
							7,400

Total interest payable

Particulars	Amount
U/s 234A	2,000
U/s 234B	12,000
U/s 234C	7,400
Total	**21,400**

Illustration 129 : During the financial year 2010-11, Mrs. X (aged 46 years) pays the following instalments of advance tax :

	₹
On September 15, 2010	6,000
On December 15, 2010	14,000
On March 15, 2011	16,000
On March 16, 2011	18,000

Mrs. X files return of ₹ 7,01,000. Assessment is also completed on the basis of income returned by Mrs. X after making addition of ₹ 25,000 (date of assessment order : January 20, 2012). Mrs. X is entitled to tax credit of ₹ 12,510 on account of tax deducted at source. Compute interest under sections 234B and 234C.

Solution :

Interest liability under section 234B

	₹
Income (7,01,000 + 25,000) =	7,26,000
Tax on ₹ 7,26,000	76,200
Less : Tax deducted at source	12,510
Assessed tax	63,690
90% of assessed tax	57,321

Advance tax paid during 2010-11 (i.e., ₹ 6,000 + 14,000 + 16,000 + 18,000) = ₹ 54,000.

Since advance tax during the financial year 2010-11 is less than 90% of assessed tax, Mrs. X is liable to pay interest under section 234B, i.e., on the shortfall of ₹ 9,690 (being ₹ 63,690 – 54,000) for 10 months (₹ 9,690 × 1/100 × 10) which comes to ₹ 969.

***Interest liability under section 234C* :**

Tax on ₹ 7,01,000 =

Due date	Advance Tax Payment ₹	Advance Tax paid ₹	Cumulative Advance Tax paid before due date ₹	Shortfall in Payment ₹	Surplus ₹	Months	Interest @ 1% p.m. ₹
15.9.2010	30% of ₹ 71,200 = 21,360	6,000	6,000	15,360	—	3	461
15.12.2010	60% of ₹ 71,200 = 42,720	14,000	20,000	22,720	—	3	682
15.3.2011	100% of ₹ 71,200 = 71,200	34,000	54,000	17,000	—	1	172
							1,315

9.13 ADAVNCE PAYMENT OF TAX

SECTION 4: TAX PAYABLE BY AN ASSESSES SHALL BE PAID IN ADVANCE

Who is liable to pay advance tax (Section 208)	When the advance tax-payable by any person for the assessment year Immediately following the financial year is ₹ 10,000 or more.	
Amount of Advance Tax payable	Tax on Total Income **Less:** Rebate and relief Add: Surcharge Less: Tax deducted at source and Tax collected at source.	
Due Date of Installment in a **relevant previous year**	**Amount payable by Corporate Assesses**	**Amount payable by Non-Corporate Assesses**
On or before June 15	15% of Advance tax payable	Not Applicable
On or before September 15	45% of Advance tax payable	30% of Advance tax payable
On or before December 15	75% of Advance tax payable	60% of Advance tax payable
On or before March 15	100% of Advance tax payable	100% of Advance tax payable

Notes :

1. Any amount paid by way of advance tax on or before 31st March of the relevant previous year shall also be treated as advance tax paid during the financial year ending on that day.
2. If the due date of payment of advance tax is a banking holiday, the Assessee can make the payment on the next immediately following working day. In such cases, no interest shall be leviable u/s 234B or 234C.

COLLECTION OF TAX

PROCEDURE FOR PAYMENT OF TAX UNDER A DEMAND NOTICE ISSUED u/s 156

1. **Due date for payment of tax [Section 220(1)]:** Any amount of tax other than advance tax specified as payable in a notice of demand u/s 156 shall be paid within 30 days.

2. **Reduction of time limit:** If the Assessing Officer has any reason to believe that it would be detrimental to revenue if the full period of 30 days as aforesaid is allowed, he may, with the previous approval of the Joint Commissioner, direct that the sum is to be paid within any period less than 30 days.
3. **Extension of time limit:** The Assessing Officer may extend the time on the basis of an application made by the Assessee to pay the tax demanded u/s 156(1) or allow payments by installments subject to conditions as he may think fit to impose.

CIRCUMSTANCES OF ASSESSEE BE TREATED AS DEEMED TO BE IN DEFAULT

1. **Assessee deemed** to be in **default [Section** 220 (4)]: The Assessee shall be deemed to be in default if the amount specified in the notice u/s 156 is not paid within the time allowed or within such extended time u/s 220(3).

2. **Amount of default [Section** 220(5)] Where the payment is allowed by instalments, the amount of default shall be the amount outstanding. All the other instalments shall be deemed to be in default on the same date as the instalment actually in default.

3. **Circumstances under which the Assessee is not deemed to be in default:**

   (a) If the Assessee presents an appeal to the CIT (Appeals), the Assessing Officer may, in his discretion and subject to such conditions as he may think fit to impose, treat the Assessee as not being in default as long as the appeal is not disposed of. **[Section 220(6)]**

   (b) Where the income of an Assessee arising in India is assessed in a Country where the laws prohibit or restrict the remittance of money to India, such an Assessee shall not be treated as Assessee in default in respect of tax due on the income which cannot be brought into India. **[Section 220(7)]**

   (c) Where the demand in dispute has arisen because the Assessing Officer has adopted an interpretation of law in respect of which there are conflicting High Court decisions and the Department has not accepted the interpretation of the Court, the Assessee shall not be deemed in default. **[Circular No.530/ 6-3-1989]**

   (d) Where the demand in dispute relates to issues which are decided earlier in the Assessee™s favour by an appellate authority / Court in his own case (say, for preceding assessment years), the Assessee shall not be deemed to be in default to the extent of tax liability relatable to such disputed points. **[Circular No.530/6-3-1989]**

CONSEQUENCES OF NON-PAYMENT OR DELAY IN PAYMENT AT TAX AS DEMANDED BY NOTICE u/s 156

Interest for belated **payment** of tax: **[Section 220(2)]**

1. **Interest :** If the amount demanded as per notice u/s 156 is not paid within the period specified in that notice, the Assessee shall be liable to pay a simple interest @ 1 % per month or part of a month.
2. **Period** of **Interest :** The period of interest shall be from the day immediately following the end of the period mentioned in the notice ending with the day on which the amount is paid,
3. **Penalty : [Section 221]**
   (a) Where the Assessee is in default or deemed to be in default in making payment of tax, the Assessing Officer may direct the Assessee to pay a penalty not exceeding the amount of tax in arrears,
   (b) Penalty may be levied even if the tax is paid belatedly but before the levy of such penalty.
4. **Opportunity to Assessee :** The Assessee shall be given a reasonable opportunity of being heard.
5. **No penalty :** In case the Assessee proves to the satisfaction of the Assessing Officer that the default was for good and sufficient reasons, no penalty shall be levied.
6. **Refund of penalty :** In case the amount of tax was wholly reduced in any final order, then the penalty levied shah be cancelled and amount of penalty paid shall be refunded.

RECOVERY OF TAX

CERTIFICATE OF RECOVERY u/s 222(1)

1. **Certificate of Recovery [Section 222(1)] :** When an Assessee is in default or deemed to be in default in payment of tax, the Tax Recovery Officer may draw up a statement under his signature in Form No.57 specifying the amount of arrears due from the Assessee. Such a statement is called Certificate.
2. The Assessee cannot dispute the correctness of any certificate drawn up by the TRO on any ground.**[Section 224]**
3. It is lawful on the part of the TRO to cancel the certificate for any reason he thinks necessary so to do or to correct any clerical or arithmetical mistake therein. **[Section 224]**

MODES OF **RECOVERY** OF TAX UNDER THE PROVISIONS OF **THE ACT,** BY THE TAX RECOVERY **OFFICER**

1. **Modes of Recovery of tax [Section 222]:** In accordance with the rules laid down in the Second Schedule, the amount specified in the certificate may be recovered by any one or more of the following modes -
   (a) Attachment and sale of the Assessee™s movable property,

(b) Attachment and sale of the Assessee™s immovable property,

(c) Arrest of the Assessee and his detention in prison,

(d) Appointing a receiver for the management of the Assessee™s movable and immovable properties.

2. **Movable and immovable property includes** any property which has been transferred directly or indirectly by the Assessee to his spouse or minor child or son™s wife or son™s minor child for inadequate consideration and the same is held by such persons.

3. **Property held by major:** Any movable property or immovable property transferred to the minor child or son™s minor child shall be treated as the Assessee™s property even after the minor attains majority.

4. The Tax Recovery Officer may take action u/s 222(1) for recovery of tax arrears even though any other proceedings for recovery of arrears have been taken,

OTHER MODES OF RECOVERY [Section 226]:

1. **Applicability:** Section 226 is applicable in the following situations:

   (a) No certificate u/s 222 has been drawn by the Assessing Officer

   (b) Where a certificate has been drawn u/s 226, the Tax Recovery Officer, without any Prejudice to the modes of recovery specified in Section 222, can recover by any one or more of the other modes u/s 226.

2. <u>**Modes of Recovery:**</u>

Mode	Tax arrears due from	Arrears of tax to be deducted by	payment Of sum deducted	Other Provisions
Attachment Of Salary **[Section 226(2)]**	Salaried Employee	Person paying salary to such person	To the credit of Central Government	Not applicable where the salary is exempt from attachment under the Code of Civil Procedure
Garnishee Order **(Section 226(3)]**	Any Assessee	Any Person from whom money is due or may become due to the Assessee or any person who holds any money for the Assessee jointly with any other person	To the credit of Central Government	Refer Pt.3 Below
Recovery from money belonging to Assessee lying in Courts custody **[Section 226(4)]**	Assessee whose money is in Courts custody	Court	To the AO or TRO to the extent of liability	Š
Recovery of arrears of tax of tax by distraint and sale **[Section 226(5)]**	Any Assessee	Not Applicable	Not Applicable	It should be authorized by the CIT/CCIT by general or special order. The distraint or sale shall be made in the manner as that for an attachment and sale of movable Property attachable by actual seizure

Illustration 130 : Compute the Advance Tax payable by R from the following estimated income submitted for the financial year 2010-11.

	₹
(1) Income from Salary	3,64,000
(2) Rent from house property (per annum)	1,80,000
(3) Interest on Government securities	5,000
(4) Interest on bank deposits	3,000
(5) Receipt from horse race (net)	14,000
(6) Agricultural Income	90,000
(7) Contribution towards PPF	10,000

Tax deducted at source by the employer on salary is ₹ 9,680.

Solution :

Previous Year : 2010-11 **Mr. R** **Assessment Year : 2011-12**

Computation of Estimated Total Income

	₹	₹
Income from Salary :		
Gross salary	3,64,000	
Less : Deduction	Nil	3,64,000
Income from House Property :		
Rent received	1,80,000	
Less : (Statutory deduction u/s 24(*a*) @ 30%)	54,000	1,26,000
Income from Other Sources :		
Interest on Government securities	5,000	
Interest on Bank Deposit	3,000	
Horse Races (Gross)	20,000	28,000
Estimated Gross Total Income		5,18,000
Less : Deduction under section 80C		10,000
		5,08,000
Estimated Tax :		
Step-1 : Aggregate of Agricultural income + Non-Agricultural income (90,000 + 5,08,000) = 5,98,000		
Tax on : Income from Horse Race of ₹ 20,000 @ 30%	6,000	
Balance income of ₹ 5,78,000	49,600	
		55,600
Step-2 : Aggregate of Basic exemption limit of agricultural income (1,60,000 + 90,000) = 2,50,000		
Tax on ₹ 2,50,000		9,000

Step-3 : Tax on non-agricultural income		
Tax under step-1 - Tax under step-2 (55,600 Œ 9,000) = 46,900		
Estimated tax payable		46,900
Add : Education cess @ 2%		938
Add : SHEC @ 1%		469
		48,307
Less : Estimated TDS		
on salary	9,680	
on horse races	6,000	15,680
Advance tax payable (rounded off)		32,627
First installment payable by 15.9.2010 (30%)		9,788
Second installment payable by 15.12.2010 (30%)		9,788
Third installment payable by 15.3.2011 (balance 40%)		13,051

Working Notes :

Computation of gross winnings from horse races :	₹
Net Amount	14,000
Grossing up $14{,}000 \times \frac{100}{70}$	20,000
Tax deducted at source (Gross amount ₹ 20,000 Œ Amount received₹ 14,000)	6,000

Illustration 131 : X Ltd. estimates its income for the previous year 2009-10 at ₹ 1,20,000. Besides this income, it has also earned long-term capital gain of ₹ 80,000 on transfer of gold on 1.12.2010. Compute the advance tax payable by the company in various instalments.

Solution :

	₹
Tax on ₹ 1,20,000 @ 30%	36,000
LTCG of ₹ 80,000 @ 20%	16,000
	52,000
Add : Education cess @ 2%	1,040
SHEC @ 1%	520
	53,560

Amount payable on 1st and 2nd instalment

For the first two instalments tax on LTCG will not be taken into account as this accrued on 1.12.2010 *i.e.* after the due date of the first 2 instalments.

	₹
Tax including Education Cess and SHEC payable without Long-term Capital Gain (₹ 36,000 + 720 +360)	37,080

Advance Tax Payable

Due Date	Tax Liability as on due date	Amount of Instalment Payable (₹)
15.6.2010	15% of 37,080 = 5,562	₹ 5,562
15.9.2010	45% of 37,080 = 16,680	= 16,680 Œ 5,560 = 11,118
15.12.2010	75% of 53,560 = 40,170	= 40,170 Œ 5,562 Œ 11,118 = 23,490
15.3.2011	100% of 53,560 = 53,560	= 53,560 Œ 5,562 Œ 11,118 Œ 23,490 = 13,390

Illustration 132 : Find out the amount of advance tax payable by ABC Ltd. on specified dates for the financial year 2010-11 :

Business income	₹ 1,75,000
Long term capital gain on 31-7-2010	₹ 3,50,000
Bank interest	₹ 10,000
TDS on business income	₹ 19,995

Solution :

Previous Year : 2010-11 **ABC Ltd.** **Assessment Year : 2011-12**

Computation of Total Income

Particulars	Amount ₹
Profits and gains of business or profession	1,75,000
Capital gains: Long term capital gains	3,50,000
Income from other sources: Bank Interest	10,000
Total Income	**5,35,000**

Computation of tax liability of ABC Ltd. for the previous year 2010-11

Particulars	Long term capital gain ₹	Other income ₹
Income	3,50,000	1,85,000
Tax rate	20%	30%
Tax on above	70,000	55,500
Add : Education cess & SHEC	2,100	1,665
Tax and cess payable	72,100	57,165
Less : TDS	Š	19,995
Advance tax payable	**72,100**	**37,170**

Advance tax to be paid on specified dates

Date	Advance tax on LTCG		Advance tax on income other than LTCG		
	Workings	Amount (a) ₹	Workings	Amount (b) ₹	Total (a+b) ₹
15.06.2010	As LTCG occurred on 31.7.10	Nil	15% of ₹ 37,170	5,576	5,576
15.09.2010	45% of ₹ 72,100	32,445	30% of ₹ 37,170	11,151	43,596
15.12.2010	30% of ₹ 72,100	21,630	30% of ₹ 37,170	11,151	32,781
15.03.2011	25% of ₹ 72,100	18,025	25% of ₹ 37,170	9,292	27,317
Total		**72,100**		**37,170**	**1,09,270**

Illustration 133 : Find out the amount of advance tax payable by Mr. A on specified dates under the Income tax Act, 1961 for the Previous Year 2010-11 :

	₹
Business income	2,75,000
Long term capital gain on 31-7-2010	60,000
Winning from lotteries on 12-9-2010	50,000
Bank interest	10,000
Other income	5,000
Investment in PPF	40,000
Tax deducted at source :	
Case I	48,000
Case II	25,000

Solution :

Previous Year : 2010-11 **Mr. A** **Assessment Year : 2011-12**

Computation of Total Income

Particulars	Details	Amount
Profits and gains of business or profession		2,75,000
Capital gains : Long term capital gains		1,60,000
Income from other sources		
Winning from lotteries	50,000	
Bank interest	10,000	
Other income	5,000	65,000
Gross Total Income		5,00,000
Less : Deduction u/s 80C Š Deposits in PPF		40,000
Total Income		**4,60,000**

Computation of Tax liability of Mr. A for the previous year 2010-11 :

Income	Case 1	Case 2
Long term capital gain (₹ 1,60,000 @ 20%)	32,000	32,000
Winning from lotteries (₹ 50,000 @ 30%)	15,000	15,000
Balance income (₹ 2,50,000)	9,000	9,000
Tax	56,000	56,000
Add : Education cess & SHEC	1,680	1,680
	57,680	57,680
Less : Tax Deducted at Source	48,000	25,000
Total Tax Payable	**9,680**	**32,680**

Advance tax to be paid on specified dates Š

Case I : Since amount of tax payable is less than ₹10000, assessee is not liable to pay advance tax.

Case II : Advanc e Tax Payable

Due Date	Tax Liability (₹)	Amount of Instalment (₹)
15.6.2010	30% of 32,680 = 9,804	9,804
15.9.2010	60% of 32,680 = 19,608	= 19,608 Œ 9,804 = 9,804
15.12.2010	100% of 32,680 = 32,680	= 32,680 Œ 9,804 Œ 9,804 = 13,072

9.14 RETURN OF INCOME AND ASSESSMENT PROCEDURE

9.14.1 RETURN OF INCOME

The starting point for assessment of income is furnishing of return of income. Filing of return of income is mandatory for certain category of assessees. Incidental provisions for accompaniments to the return of income, error correction, belated returns have been made. Now filing of the return electronically has been made mandatory for certain category of assessees.

Return of income is the format in which the assessee has to furnish information as to his total income and tax payable. The format for filing of returns by different assessees is notified by the CBDT.

COMPULSORY FILING OF RETURN OF INCOME [SECTION 139(1)]

(1) As per section 139(1), it is compulsory for companies and firms to file a return of income for every previous year.

(2) In case of a person other than a company or a firm, filing of return of income is mandatory, if his total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeds the basic exemption limit.

(3) Such persons should, on or before the due date, furnish a return of income in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed.

(4) Further, every person, being an individual or a HUF or an AOP or BOI or an artificial juridical person–

– whose total income or the total income of any other person in respect of which he is assessable under this Act during the previous year

– without giving effect to the provisions of section 10A or 10B or 10BA or Chapter VI-A - exceeded the basic exemption limit is required to file a return of his income or income of such other person–

(5) For company and certain other assessees like firm having tax audit, filing of return in an electronic form is mandatory. (Section 139D)

'Due date' means -

(a) 30th September of the assessment year, where the assessee is -

(i) a company; or

(ii) a person (other than a company) whose accounts are required to be audited under the Income-tax Act, 1961 or any other law in force; or

(iii) a working partner of a firm whose accounts are required to be audited under the Income-tax Act, 1961 or any other law for the time being in force.

(b) 31st July of the assessment year, in the case of any assessee other than those covered in (a) above.

INTEREST FOR DEFAULT IN FURNISHING RETURN OF INCOME [SECTION 234A]

(1) Interest under section 234A is attracted where an assessee furnishes the return of income after the due date or does not furnish the return of income.

(2) The interest is payable for the period commencing from the date immediately following the due date and ending on the following dates -

When the return is furnished after due date : the date of furnishing of the return

Where no return is furnished : the date of completion of assessment

(3) The interest has to be calculated on the amount of tax on total income as determined under section 143(1) or on regular assessment as reduced by the advance tax paid and any tax deducted or collected at source.

OPTION TO FURNISH RETURN OF INCOME TO EMPLOYER [SECTION 139(1A)]

(1) This section gives an option to a person, being an individual who is in receipt of income chargeable under the head fiSalariesfl, to furnish a return of his income for any previous year to his employer, in accordance wi such scheme as may be notified by the CBDT and subject to such conditions as may be specified therein.

(2) Such employer shall furnish all returns of income received by him on or before the due date, in such form, including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media and manner as may be specified in that scheme.

(3) In such a case, any employee who has filed a return of his income to his employer shall be deemed to have furnished a return of income under sub-section (1).

INCOME-TAX RETURN THROUGH COMPUTER READABLE MEDIA [SECTION 139(1B)]

(1) This sub-section enables the taxpayer to file his return of income in computer readable media, without interface with the department.

(2) Such person may, on or before the due date, furnish a return of income in accordance with such scheme as may be notified by the CBDT, in such form, including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media and manner as may be specified in that scheme.

RETURN OF LOSS [SECTION 139(3)]

(1) This section requires the assessee to file a return of loss in the same manner as in the case of return of income within the time allowed under section 139(1).

(2) Under section 80, an assessee cannot carry forward or set off his loss against income in the same or subsequent year unless he has filed a return of loss in accordance with the provisions of section 139(3).

(3) A return of loss has to be filed by the assessee in his own interest and the non-receipt of a notice from the Assessing Officer requiring him to file the return cannot be a valid excuse under any circumstances for the non-filing of such return.

(4) In particular, a return of loss must be filed by an assessee who has incurred a loss under the heads fiprofits an gains from business or professionfl, ficapital gainsfl, and income from the activity of owning and maintain race horses taxable under the head fiIncome from other sourcesf

(5) However, loss under the head "Income from house property" under section 71B and unabsorbed depreciation under section 32 can be carried forward for set-off even though return of loss has not been filed before the due date.

BELATED RETURN [SECTION 139(4)]

(1) Any person who has not furnished a return within the time allowed to him under section 139(1) or within the time allowed under a notice issued under section 142(1) may furnish the return for any previous year at any time -

  (i) before the expiry of one year from the end of the relevant assessment year; or

  (ii) before the completion of the assessment, whichever is earlier.

(2) Interest is required to be paid under section 234A, as stated above .

RETURN OF INCOME OF CHARITABLE TRUSTS AND INSTITUTIONS [SECTION 139(4A)]

(1) Every person in receipt of income Œ

  (i) derived from property held under a trust or any other legal obligation wholly or partly for charitable or religious purpose; or

(ii) by way of voluntary contributions on behalf of such trust or institution must furnish a return of income if the total income in respect of which he is assessable as a representative assessee, computed before allowing any exemption under sections 11 and 12 exceeds the basic exemption limit.

(2) Such persons should furnish the return in the prescribed form and verified in the prescribed manner containing all the particulars prescribed for this purpose.

(3) This return must be filed by the representative-assessee voluntarily within the time limit. Any failure on the part of the assessee would attract liability to pay interest and penalty.

RETURN OF INCOME OF POLITICAL PARTIES [SECTION 139(4B)]

(1) Under this section, a political party is required to file a return of income if, before claiming exemption under section 13A, the party has taxable income.

(2) The grant of exemption from income-tax to any political party under section 13A is subject to the condition that the political party submits a return of its total income within the time limit prescribed under section 139(1).

(3) The chief executive officer of the political party is statutorily required to furnish a return of income of the party for the relevant assessment year, if the amount of total income of the previous year exceeds the basic exemption limit before claiming exemption under section 13A.

REVISED RETURN [SECTION 139(5)]

(1) If any person having furnished a return under section 139(1) or in pursuance of a notice issued under section 142(1), discovers any omission or any wrong statement therein, he may furnish a revised return at any time before the expiry of one year from the end of the relevant assessment year or before completion of assessment, whichever is earlier.

(2) It may be noted that a belated return cannot be revised. It has been held in Kumar Jagdish Chandra Sinha v. CIT [1996] 86 Taxman 122 (SC) that only a return furnished under section 139(1) or in pursuance of a notice under section 142(1) can be revised. A belated return furnished under section 139(4), therefore, cannot be revised.

PARTICULARS REQUIRED TO BE FURNISHED WITH THE RETURN [SECTION 139(6)]

The prescribed form of the return shall, in certain specified cases, require the assessee to furnish the particulars of -

(i) income exempt from tax

(ii) assets of the prescribed nature and value and belonging to him

(iii) his bank account and credit card held by him

(iv) expenditure exceeding the prescribed limits incurred by him under prescribed heads

(v) such other outgoings as may be prescribed.

DEFECTIVE RETURN [SECTION 139(9)]

(1) Under this sub-section, the Assessing Officer has the power to call upon the assessee to rectify a defective return.

(2) Where the Assessing Officer considers that the return of income furnished by the assessee is defective, he may intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of 15 days from the date of such intimation. The Assessing Officer has the discretion to extend the time period beyond15 days, on an application made by the assessee.

(3) If the defect is not rectified within the period of 15 days or such further extended period, then the return would be treated as an invalid return. The consequential effect would be the same as if the assessee had failed to furnish the return.

(4) Where, however, the assessee rectifies the defect after the expiry of the period of 15 days or the further extended period, but before assessment is made, the Assessing Officer can condone the delay and treat the return as a valid return.

(5) A return can be treated as defective if it is nor properly filled in or the necessary enclosures are not accompanying the return.

Specific defects are only illustrative and not exhaustive - CIT v. Rai Bahadur Bissesswarlal Motilal Malwasie Trust 195 ITR 825.

SCHEME FOR SUBMISSION OF RETURNS THROUGH TAX RETURN PREPARERS [SECTION 139B]

(1) The Tax Return Preparer shall assist the persons furnishing the return in a manner that will be specified in the Scheme, and shall also affix his signature on such return. The fispecified class or classes of personsfl for th purpose means any person other than a company or a person whose accounts are required to be audited under section 44AB (tax audit) or under any other existing law, who is required to furnish a return of income under the Act.

(2) A Tax Return Preparer can be an individual, other than

(i) any officer of a scheduled bank with which the assessee maintains a current account or has other regular dealings.

(ii) any legal practitioner who is entitled to practice in any civil court in India.

(iii) a chartered accountant.

(iv) an employee of the ,specified class or classes of persons™.

(3) The Scheme notified under the said section may provide for the following Š

(i) the manner in which and the period for which the Tax Return Preparers shall be authorised,

(ii) the educational and other qualifications to be possessed, and the training and other conditions required to be fulfilled, by a person to act as a Tax Return Preparer,

(iii) the code of conduct for the Tax Return Preparers,

(iv) the duties and obligations of the Tax Return Preparers,

(v) the circumstances under which the authorisation given to a Tax Return Preparer may be withdrawn, and

(vi) any other relevant matter as may be specified by the Scheme.

PERMANENT ACCOUNT NUMBER (PAN) [SECTION 139A]

(1) Where any person in th the following category has not been allotted a permanent account number (PAN), he should apply to the Assessing Officer within the prescribed time for allotment of a PAN -

(i) Every person whose total income or the total income of any other person in respect of which he is assessable under this Act during any previous year exceeded the basic exemption limit; or

(ii) Every person carrying on any business or profession whose total sales, turnover or gross receipts exceeds or is likely to exceed ₹5 lakhs in any previous year; or

(iii) Every person who is required to furnish a return of income under section 139(4A); or

(iv) Every person, being an employer, who is required to furnish a return of fringe benefits under section 115WD [Sub-section (1)].

(2) The CBDT had introduced a new scheme of allotment of computerized 10 digit PAN. Such PAN comprises of 10 alphanumeric characters and is issued in the form of a laminated card.

(3) All persons who were allotted PAN (Old PAN) earlier and all those persons who were not so allotted but were required to apply for PAN, shall apply to the Assessing Officer for a new series PAN within specified time.

(4) Once the new series PAN is allotted to any person, the old PAN shall cease to have effect. No person who has obtained the new series PAN shall apply, obtain or process another PAN.

(5) On receipt of allotment of PAN it must be mentioned on all tax payment challans, returns, correspondence.

(6) Where TDS or TCS is made, the person from whom it is made must communicate his PAN to the person deducting or collecting tax.

(7) Every person receiving any document relating to a transaction prescribed under clause (c) of sub-section (5) shall ensure that the permanent account number or the General Index Register Number has been duly quoted in the document.

Power of Board to dispense with furnishing documents, etc. with the return[Sec. 139C]

(1) The Board may make rules providing for a class or classes of persons who may not be required to furnish documents, statements, receipts, certificates, reports of audit or any other documents, which are otherwise under any other provisions of this Act, except section 139D, required to be furnished, along with the return but on demand to be produced before the Assessing Officer.

(2) Any rule made under the proviso to sub-section (9) of section 139 as it stood immediately before its omission by the Finance Act, 2007 shall be deemed to have **been made under the provisions of this section.**

Filing of return in electronic from [Sec. 139D] : The Board may make rules providing forŠ

(*a*) the class or classes of persons who shall be required to furnish the return in electronic form;

(*b*) the form and the manner in which the return in electronic form may be furnished;

(*c*) the documents, statements, receipts, certificates or audited reports which may not be furnished along with the return in electronic form but shall be produced before the Assessing Officer on demand;

(*d*) the computer resource or the electronic record to which the return in electronic form may be transmitted.

RETURN BY WHOM TO BE SIGNED [Section 140]

The return under **section 115WD** or **section 139** shall be signed and verified as under:

Sr. No.	Assessee Category	Who can Sign
1	Individual	(*i*) by the individual himself; (*ii*) where he is absent from India, by the individual himself or by some person duly authorised by him in this behalf; (*iii*) where he is mentally incapacitated from attending to his affairs, by his guardian or any other person competent to act on his behalf; and (*iv*) where, for any other reason, it is not possible for the individual to sign the return, by any person duly authorised by him in this behalf.
2	Hindu Undivided Family (HUF)	by the Karta and where the karta is absent from India or is mentally incapacitated from attending to his affairs, by any other adult member of such family
3	Company	Managing director or where for any unavoidable reason managing director is not able to sign or where there is no managing director, by any director thereof. Exceptions : (*a*) where the company is being wound up : by the liquidator (*b*) where the management of the company has been taken over by the Government : the principal officer thereof (*c*) company is not resident in India : a person who holds a valid power of attorney
4	A Firm / Limited Liability Partnership (w.e.f. A.Y 2010-11)	Managing partner or where for any unavoidable reason managing partner is not able to sign and verify the return, or where there is no managing partner, by any partner thereof
5	A Local Authority	The Principal officer thereof

Sr. No.	Assessee Category	Who can Sign
6	A Political Party	The Chief Executive Officer of such party
7	Any other Association	any Member of the Association or the Principal Officer thereof
8	Any other Person	by that person or by some person competent to act on his behalf

Prescribed Forms :

Forms	Applicability
ITR - 1	Return of Income for Individuals having salary and interest income and no other Income
ITR-2	Return of income for Individuals and HUFs having income from any source except from business or profession
ITR-3	Return of income for Individuals and HUFs being partners in Firms and not having Proprietary business or profession
ITR -4	Return of Income for Individuals and HUFs having Proprietary business or profession
ITR-5	Combined form of Return of Income and Fringe Benefits for Firms/AOP/BOI.
ITR-6	Combined Form for Return of Income and Frlnge Benefits for Companies
ITR-7	Combined Form For Return of Income and Fringe Benefits For Charitable/Religious Trusts, Political parties and other Non-Profit Organisations
ITR-8	Stand alone form for Return of Fringe Benefits for persons who are not liable to file Return of income but are liable to file Return of Fringe-Benefits
ITR-V	Return of Income/Fringe Benefits transmitted electronically without digital signatures

SELF-ASSESSMENT TAX PAYMENT [Section 140A]

(1) Where any tax is payable on the basis of any return required to be furnished under section 115WD or section 115WH or section 139 or section 142 or section 148 or section 153A or, as the case may be, section 158BC, *after taking into account taxes paid earlier* the assessee shall be liable to pay such tax together with interest payable under any provision of this Act for any delay in furnishing the return or any default or delay in payment of advance tax, before furnishing the return and the return shall be accompanied by proof of payment of such tax and interest.

(2) If assessee fails to pay the whole or any part of such tax or interest or both on self assessment, he shall be deemed to be an assessee in default in respect of the tax or interest or both remaining unpaid. Penalty can be imposed on any assessee who is in default.

Illustration 134 : (a) What is the due date of filling of return of income in case of a non-working partner of a firm whose accounts are not liable to be audited?

Answer : Due date of furnishing return of income in case of non-working partner shall be 31st July of the assessment year whether the accounts of the firm are required to be audited or not.

A working partner for the above purpose shall mean an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner and is drawing remuneration from the firm.

(b) What do you mean by annexure less return? What is the manner of filling the return of income?

Answer : The return of income and return of fringe benefits required to be furnished in Form No.ITR-1,ITR-2,ITR-3,ITR-4,ITR-5, ITR-6 or ITR-8 shall not be accompanied by a statement showing the computation of the tax payable on the basis of the return, or proof of the tax, if any, claimed to have been deducted or collected at source or the advance tax or tax on self-assessment, if any, claimed to have been paid or any document or copy of any account or

Form or report of audit required to be attached with the return of income or the return of fringe benefits under any of the provisions of the Act.

Manner of filling the return: The return of income or return of fringe benefits referred to in sub-rule (1) may be furnished in any of the following manners, namely:-

(i) Furnishing the return in a paper form;

(ii) Furnishing the return electronically under digital signature;

(iii) Transmitting the data in the return electronically and thereafter submitting the verification of the return in Form ITR-V;

(iv) Furnishing a bar-coded return in paper form.

(c) Is e-filling of return mandatory? State the assessee™s for whom e-filling of returns is mandatory?

Answer : It shall be mandatory for the following assessee™s to file the return electronically:

(i) A firm required to furnish the return in Form ITR-5 and to whom provisions of Section.44AB are applicable, or

(ii) A company required to furnish the return in Form ITR-6

(d) Can unabsorbed depreciation be carried forward even if the return is filed after due date?

Answer : Unabsorbed depreciation can be carried forward even if the return of loss is submitted after the due date, as it is not covered under Chapter VI of set off or carry forward of losses but covered u/s 32(2).[East Asiatic Co.(India) Pvt. Ltd. vs.CIT (1986) 161 ITR 135(Mad.)]

(e) Can a belated return of income filed u/s 139(4) be revised?

Answer : There was a difference of opinion among various courts regarding filling of revised return in respect of belated returns. However, it has been held that a belated return filed u/s 139(4) cannot be revised as section 139(5) provides that only return filed u/s 139(1) or in pursuance to a notice u/s 142(1) can be revised [Kumar Jagdish Chandra Sinha vs.CIT(1996) 220 ITR 67(SC)].

(f) Can a revised return be further revised?

Answer : If the assessee discovers any omission or any wrong statement in a revised return, it is possible to revise such a revised return provided it is revised within the same prescribed time[Niranjan Lal Ram Chandra Vs.CIT (1982) 134 ITR 352 (All.)]

(g) Can an Assessing Officer himself allot permanent account number to an assessee?

Answer: The Assessing Officer having regard to the nature of the transactions as may be prescribed may also allot a permanent account number to any other person(whether any tax is payable by him or not) in the manner and in accordance with the procedure as may be prescribed.

(h) What are the consequences if a person fails to comply with the provisions of Sec.139A i.e. quoting of PAN?

Answer : As per Sec.272B(2), if a person fails to comply with the provisions of Sec.139A, the Assessing Officer may direct that such person shall have to pay, by way of penalty, a sum of ₹10,000.

(i) Who can sign the return of HUF, if HUF does not have a major member?

Answer : If the HUF has no major members as its Karta, a return may validly be signed by the eldest minor member of the family who manages the affairs of the family [Sridhar Udai Narayan Vs.CIT(1962) 45 ITR 577 (All.)]

(j) Is thumb impression valid for furnishing the Return of Income?

Answer : The General Clauses Act accepts the thumb impression, as one of the modes of signing, valid and binding. [CIT vs. Kanhaiya Lal And Sons (2005) 273 ITR 425 (All.)]

9.14.2 ASSESSMENT PROCEDURE

Inquiry before assessment. [Section 142]

Inquiry :

(1) The Assessing Officer has power to make inquiry from any person (a) who has made a return under section 139 or (b) in whose case the time allowed under section 139(1) for furnishing the return has expired. For the purpose a notice can be issued for :

(i) where such person has not made a return within the time allowed under section 139(1), to furnish a return of his income or

(ii) to produce such accounts or documents as the Assessing Officer may require, or

(iii) to furnish in writing and verified in the prescribed manner information in such form and on such points or matters including a statement of all assets and liabilities of the assessee, whether included in the accounts or not, as the Assessing Officer may require:

(2) For the purpose of obtaining full information in respect of the income or loss of any person, the Assessing Officer may make such inquiry as he considers necessary.

Audit :

If the Assessing Officer, having regard to the nature and complexity of the accounts of the assessee and the interests of the revenue, opines that it is necessary so to do, he may, direct the assessee to get the accounts audited by an accountant, as defined in the *Explanation* below section 288(2) and to furnish an audit report, within such period as may be specified, in the prescribed form. The expenses of such audit shall be paid by the assessee

These provisions of audit shall have effect notwithstanding that the accounts of the assessee have been already audited.

Opportunity to Assessee :

The assessee shall be given an opportunity of being heard in respect of any material gathered on the basis of any inquiry or any audit and proposed to be utilised for the purposes of the assessment. Such opportunity need not be given where the assessment is made under section 144.

Estimate by Valuation Officer in certain cases [Sec. 142A]

For the purposes of making an assessment under this Act, where an estimate of the value of any investment referred to in section 69 or section 69B or the value of any bullion, jewellery or other valuable article referred to in section 69A or section 69B is required to be made, the Assessing Officer may require the Valuation Officer to make an estimate of such value and report the same to him.

On receipt of the report from the Valuation Officer, the Assessing Officer may, after giving the assessee an opportunity of being heard, take into account such report in making such assessment:

Case Law :

Assessing Officer can look into documents other than books of account for issuing directions - Submission of audited accounts per se would not oust the jurisdiction of the Assessing Officer to pass a direction for special audit. While applying his mind, the Assessing Officer need not confine himself only to the books of account submitted by the assessee, but can take into consideration such other documents related thereto which would be part of the assessment proceedings - Rajesh Kumar Ors. v. Dy. CIT.287 ITR 91.

ASSESSMENT [Section 143]

Intimation [Section 143(1)]

Where a return has been made under section 139, or in response to a notice under sub-section (1) of section 142, on the basis of such a return Š

(i) if any tax or interest is found due, after reducing TDS, TCS, advance tax, any self-assessment tax or any other amount paid, then an intimation shall be sent to the assessee specifying the sum so payable,

and

(*ii*) if any refund is due to the assessee, it shall be granted to him and an intimation to this effect shall be sent to him

In all other cases i.e. where tax paid is equal to tax payable, acknowledgement of the return shall be deemed to be an intimation.

Intimation shall not be sent after the expiry of one year from the end of the financial year in which the return is made.

Power under section 143(1B) extended by one year due to delay in Centralized Processing of Returns.

The Income-tax department is in the process of setting up a Centralised Processing Centre (CPC) at Bengaluru for centralised processing of Income tax and Fringe benefits tax returns. For this purpose the Board had been empowered to relax, modify or adapt any provision of law relating to processing of returns subject to the condition that the notification for such relaxation, modification or adaptation is issued on or before 31-3-2009 and the said notification is laid on the table of the House. Since the centre has still not been operationalised, it is necessary to allow the Board a further period of one year i.e. up to 31-3-2010 to relax, modify or adapt any provision of law relating to processing of returns.

Regular Assessment [Section 143(3)]

Where a return has been furnished under section 139, or in response to a notice under sub-section (1) of section 142, the Assessing Officer shall, if he considers it necessary or expedient to ensure that the assessee has not understated the income or has not computed excessive loss or has not under-paid the tax in any manner, serve on the assessee a notice requiring him, either to attend his office or to produce, any evidence on which the assessee may rely in support of the return. However, no notice shall be served after the expiry of twelve months from the end of the month in which the return is furnished.

On the day specified in the notice issued or as soon afterwards as may be, after hearing such evidence as the assessee may produce and such other evidence as the Assessing Officer may require on specified points, and after taking into account all relevant material which he has gathered, the Assessing Officer shall, by an order in writing, make an assessment of the total income or loss of the assessee, and determine the sum payable by him or refund of any amount due to him on the basis of such assessment.

Tax has to be determined and such determination is to be made in the Asst. order or computation sheet to be annexed with the Asst. order. [Kalyan Kumar Ray vs. CIT

The assessed income may be lower than the returned income. The boards circular no 549 para 5.12 dt. 31.10.1989 has been held to be ultra-vires Gujarat Gas Co Ltd v JCIT(A)

Best Judgement Assessment [Section 144]

Best judgement assessment that is popularly known as ex-parte assessment can be made if the assessee fails to comply with the requirement of law as following :-

(1) The assessee fails to file a return U/s 139 or

(2) He fails to comply with the terms of the notice issued U/s 142(1) or fails to comply with a direction issued U/s 142(2A).

(3) After filing a return he fails to comply with all the terms of the notice issued u/s 143(2).

The non-compliances are independent and not cumulative. A single non compliance can lead to best judgement u/s 144. In such a situation the A.O. after taking into account all relevant materials which he has gathered and after giving the assessee an opportunity of being heard shall make an assessment of income or loss to the best of his judgement and determine the sum payable by him. There is no provision for granting refund u/s 144. Provision for granting refund has been withdrawn with effect from 1.4.88. However, where a notice u/s 142(1) has already been issued to the assessee it will not be necessary to give him such opportunity of being heard.

Best judgement asst. is mandatory for any one of the defaults u/s 144 - CIT vs Segn. Buchiah Sethy [1970] 77 ITR 539 (SC).

Where Assessing Officer, on finding that assessee had not maintained and kept any quantitative details/stock register for goods traded in by it; that there was no evidence on record or document to verify basis of valuation of closing stock shown by assessee; and that GP rate declared by assessee during assessment year did not match result declared by assessee itself in previous assessment years, rejected assessee™s books of account and resorted to best judgment assessment under section 144, it was held that since cogent reasons had been given by Assessing Officer for doing so, there was no reason to take a different view - Kachwala Gems v. Jt. CIT 158 Taxman 71.

The assessments made or the basis of the assessee™s accounts and those made on ‚best judgment™ basis are totally different types of assessments - *CST* v. *H.M. Esufali H.M. Abdulai* 90 ITR 271.

The mere fact that the material placed by the assessee before the assessing officer is unreliable does not empower the officer to make an arbitrary order. The power to make a best judgment assessment is not an arbitrary power - *State of Orissa* v. *Maharaja Shri B.P. Singh Deo* 76 ITR 690.

The authority making a best judgment assessment must make an honest and fair estimate of the income of the assessee and though arbitrariness cannot be avoided in such an estimate, the same must not be capricious but should have a reasonable nexus to the available material and the circumstances of the case*Brij Bhushan Lal Parduman Kumar* v. *CIT* 115 ITR 524.

Power of Joint Commissioner to issue directions in certain cases [Sec. 144A]

A Joint Commissioner may, on his own motion or on a reference being made to him by the Assessing Officer or on the application of an assessee, call for and examine the record of any proceeding in which an assessment is pending and, if he considers that, having regard to the nature of the case or the amount involved or for any other reason, it is necessary or expedient so to do, he may issue such directions as he thinks fit for the guidance of the Assessing Officer to enable him to complete the assessment and such directions shall be binding on the Assessing Officer :

Provided that no directions which are prejudicial to the assessee shall be issued before an opportunity is given to the assessee to be heard.

Provision for constitution of alternate dispute resolution mechanism for order of the Transfer Pricing Officer, and foreign company (Section 144C) (W.e.f. 1-10-2009]

The dispute resolution mechanism presently in place is time consuming and finality in high demand cases is attained only after a long drawn litigation till Supreme Court. Flow of foreign investment is extremely sensitive to prolonged uncertainty in tax related matter. Therefore, the Act has amended the Income-tax Act to provide for an alternate dispute resolution mechanism, which will facilitate expeditious resolution of disputes in a fast track basis.
The salient features of the alternate dispute resolution mechanism are as under:Š

1. The Assessing Officer shall, forward a draft of the proposed order of assessment (hereinafter in this section referred to as the draft order) to the eligible assessee if he proposes to make, on or after 1-10-2009, any variation in the income or loss returned which is prejudicial to the interest of such assessee.
2. On receipt of the draft order, the eligible assessee shall, within thirty days of the receipt by him of the draft order,
   - (a) File his acceptance of the variations to the Assessing Officer; or
   - (b) File his objections, if any, to such variation with,Š
     - (i) The Dispute Resolution Panel; and
     - (ii) The Assessing Officer.

3. The Assessing Officer shall complete the assessment on the basis of the draft order, ifŠ
   (a) The assessee intimates to the Assessing Officer the acceptance of the variation; or
   (b) No objections are received within the period specified in sub-section (2) i.e. 30 days of the receipts of draft order by the eligible assessee.
4. The Assessing Officer shall, notwithstanding anything contained in section 153, pass the assessment order under section 144C(3) within one month from the end of the month in which,Š
   (a) The acceptance is received; or
   (b) The period of filing of objections under sub-section (2) expires.
5. The Dispute Resolution Panel shall, in a case where any objections are received under sub-section (2), issue such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment.
6. The Dispute Resolution Panel shall issue the directions referred to in sub-section (5), after considering the following, namely:Š
   (a) Draft order;
   (b) Objections filed by the assessee;
   (c) Evidence furnished by the assessee;
   (d) Report, if any, of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority;
   (e) Records relating to the draft order;
   (f) Evidence collected by, or caused to be collected by, it; and (g) Result of any enquiry made by, or caused to be made by it.
7. The Dispute Resolution Panel may, before issuing any directions referred to in sub-section (5),Š
   (a) Make such further enquiry, as it thinks fit; or
   (b) Cause any further enquiry to be made by any income tax authority and report the result of the same to it.
8. The Dispute Resolution Panel may confirm, reduce or enhance the variations proposed in the draft order so, however, that it shall not set aside any proposed variation or issue any direction under sub-section (5) for further enquiry and passing of the assessment order.
9. If the members of the Dispute Resolution Panel differ in opinion on any point, the point shall be decided according to the opinion of the majority of the members.
10. Every direction issued by the Dispute Resolution Panel shall be binding on the Assessing Officer.
11. No direction under sub-section (5) shall be issued unless an opportunity of being heard is given to the assesses and the Assessing Officer on such directions which are prejudicial to the interest of the assessce or the interest of the revenue, respectively.
12. No direction under sub-section (5) shall be issued after nine months from the end of the month in which the draft order is forwarded to the eligible assessee.
13. Upon receipt of the directions issued under sub-section (5), the Assessing Officer shall, in conformity with the directions, complete, notwithstanding anything to the contrary contained in section 153, the assessment without providing any further opportunity of being heard to the assessee, within one month from the end of the month in which the direction is received.
14. The Board may make rules for the efficient functioning of the Dispute Resolution Panel and expeditious disposal of the objections filed, under subsection (2), by the eligible assessee.
15. For the purposes of this section,Š
   (a) fiDispute Resolution Panelfl means a collegium comprising of 3 Commissioners of Income tax constitute by the Board for this purpose;
   (b) fieligible assesseefl means,
      (i) Any person in whose case the variation referred to in sub-section (1) arises as a consequence of the order of the Transfer Pricing Officer passed under sub-section (3) of section 92CA; and
      (ii) any foreign company. Further, the following consequential amendments have been madeŠ

(i) Section 131(1) so as to provide that fiDispute Resolution Panelfl shall have the same powers as are vested a Court under the Code of Civil Procedure, 1908;

(ii) Section 246(1)(a) has been amended so as to exclude the order of assessment passed under sectio.i 143(3) or order of re-assessment under section 147 in pursuance of directions of fiDispute Resolution Panelfl as appealable order.

(iii) Section 253(1) has been amended to insert clause (d) so as to include an order of assessment passed under section 143(3) or order of re-assessment under section 147 in pursuance of directions of fiDispute Resolutio Panelfl as an appealable order.

An order passed under section 154 rectifying such order shall also be appealable to IT AT.

Income Escaping Assessment [Sec. 147]

If the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, following the prescribed process, assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section, or recompute the loss or the depreciation allowance or any other allowance, as the case may be, for the assessment year concerned.

Where an assessment under section 143(3) or section 147 has been made for the relevant assessment year, no action shall be taken under this section after the expiry of four years from the end of the relevant assessment year, unless any income chargeable to tax has escaped assessment for such assessment year by reason of the failure on the part of the assessee to make a return under section 139 or section 142 or section 148 or to disclose fully and truly all material facts necessary for his assessment, for that assessment year.

Assessing Officer empowered to touch upon any other issue for which no reasons have been recorded notwithstanding that the reasons for such issue have not been included in the reasons recorded [Section 147] [W.r.e.f. assessment year 1989-90]

The existing provisions of section 147 provides, inter alia, that if the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may assess or reassess such income after recording reasons for re-opening the assessment. Further, he may also assess or reassess such other income which has escaped assessment and which comes to his notice subsequently in the course of proceedings under this section.

Sonic Courts have held that the Assessing Officer has to restrict the reassessment proceedings only to issues in respect of which the reasons have been recorded for reopening the assessment. He is not empowered to touch upon any other issue for which no reasons have been recorded. The above interpretation is contrary to the legislative intent.

With a view to further clarifying the legislative intent, the Act has inserted Explanation 3 in section 147 to provide that the Assessing Officer may assess or reassess income in respect of any issue which comes to his notice subsequently in the course of proceedings under this section, notwithstanding that the reason for such issue has not been included in the reasons recorded under section 148(2).

Rationalisation of provisions of Tax Deduction and Collection at Source

Case Law :

A writ petition challenging reassessment, cannot be thrown out at the threshold on the ground that it is not maintainable - Techspan India (P.) Ltd. v. ITO 283 ITR 212 .

If the direction by the Commissioner is to reopen the assessment under section 147 by passing the statutory formalities, that would probably amount to dictating his subordinate to act in a particular way thereby taking away the discretion vested in the subordinate - CIT v. Abdul Khader Ahamed 156 Taxman 206.

Disclosure in wealth-tax proceedings will not suffice - Arun Kumar Maheshwari v. ITO 144 Taxman 651.

Sec. 148 : Issue of notice where income has escaped assessment.

(1) Before making the assessment, reassessment or recomputation under section 147, the Assessing Officer shall serve on the assessee a notice requiring him to furnish within specified period, a return of his income.

(2) The Assessing Officer shall, before issuing any notice under this section, record his reasons for doing so.

Legal Notes

- Notice under this section is to be mandatorily served by the Assessing Officer be fore initiating proceedings u/s 147. The notice is served on the assessee when it is received by him.
- Notice is to be issued within the time limits prescribed by section 149. Section 149(2) states that issue of such notice is subject to the provisions of section 151. Thus, approval for the issue of such notice is to be taken u/s 151 before its issue.
- Such notice can be issued by the Assessing Officer only after he records his reasons for doing so.
- The return to be furnished in response to such notice is treated as a return required to be furnished u/s 139 and the provisions of this Act, so far as may be, apply accordingly.
- Return in response to a notice under this section is to be furnished even if a return has been furnished earlier by the assessee under other provisions of the Act.
- Notice under this section can be issued even where an assessment u/s 143(3) has not been made but related intimations have been sent Ranchi Club Ltd. v. CIT214 ITR 643

Case Law :

If reasons are supplied along with the notice under section 148(2), it shall obviate unnecessary harassment to the assessee as well as to the revenue by avoiding unnecessary litigation which will save courts also from being involved in unproductive litigation. Above all, it shall be in consonance with the principles of natural justice - *Mitilesh Kumar Tripathi* v. *CIT* 280 ITR 16

The notice prescribed by section 148 cannot be regarded as a mere procedural requirement. It is only if the said notice is served on the assessee that the ITO would be justified in taking proceedings against the assessee. If no notice is issued or if the notice issued is shown to be invalid, then the proceedings taken by the ITO would be illegal and void - *Y. Narayana Chetty* v. *ITO* [1959] 35 ITR 388; *CIT* v. *Thayaballi Mulla Jeevaji Kapasi* 66 ITR 147 ; *CIT* v. *Kurban Hussain Ibrahimji Mithiborwala* 82 ITR 821

Where the AAC set aside the reassessment on the only ground that the assessee was not afforded opportunity to put forward his case, but did not hold that the notice issued under section 148 was invalid, there would be no need for the ITO to issue a fresh notice to the assessee - *CIT* v.*T.S.PL.P. Chidambaram Chettiar* 80 ITR 467.

Notice cannot be issued unless the return which has already been filed has been disposed of - *CIT* v. *M.K.K.R. Muthukaruppan Chettiar* 78 ITR 69 ; *Bhagwan Das Sita Ram (HUF)* v. *CIT* 146 ITR 563.

<u>Sec. 149 : Time limit for notice.</u>

(1) No notice under section 148 shall be issued for the relevant assessment year —

(a) if four years have elapsed from the end of the relevant assessment year, unless he case falls under clause (b);

(b) if four years, but not more than six years, have elapsed from the end of the relevant assessment year unless the income chargeable to tax which has escaped assessment amounts to or is likely to amount to one lakh rupees or more for that year.

- Time-limit applies for 'Issue' and not for service - R.K. Upadhyaya v. Shanabhai P Patel [1987] 166 ITR 163 (SC).
- Amended law will apply only if limitation has not already expired - Chandiram v. ITO [1996] 87 Taxman 418 (Raj.).

The word 'issued' in section 149 should be given its natural meaning and not the strained wider meaning of 'served'. Consequently, where the notice was issued within time but was served on the assessee after the expiry of the time-limit, it could not be held to be invalid - *R.K. Upadhyaya* v. *Shanabhai P. Patel* 166 ITR 163 (SC); *CIT* v. *Sheo Kumari Debi* 157 ITR 13 and *Jai Hanuman Trading Co. (P.) Ltd.* v. *CIT* 110 ITR 36.

Provision for cases where assessment is in pursuance of an order on appeal, etc. [Sec. 150]

(1) Notwithstanding anything contained in section 149, the notice under section 148 may be issued at any time for the purpose of making an assessment or reassessment or recomputation in consequence of or to give an effect to any finding or direction contained in an order passed by any authority in any proceeding under this Act by way of appeal, reference or revision or by a Court in any proceeding under any other law.

(2) The provisions of sub-section (1) shall not apply in any case where any such assessment, reassessment or recomputation as is referred to in that sub-section relates to an assessment year in respect of which an assessment, reassessment or recomputation could not have been made at the time the order which was the subject-matter of the appeal, reference or revision, as the case may be, was made by reason of any other provision limiting the time within which any action for assessment, reassessment or recomputation may be taken.

- This section prescribes the time limit for issuance of notice u/s 148 in a special case. This section overrides the provisions of section 149. Section 149 vide sub-section (2) provides that issue of notice u/s 148 is subject to the provisions of section 151. Thus, approval u/s 151 for issue of notice u/s 148(1) is not required in a case covered by section 150 {Sukhdayal Pahwa v. CIT [1983] 140 ITR 206 (MP)}.

- Notwithstanding the time limits prescribed by section 149, notice u/s 148 can be issued at any time for making assessment, etc., to give effect to any finding or direction referred to in sub-section (1). The order referred to therein may be an order u/s 250, 254, 260, 262, 263 or 264.

- The power conferred by sub-section (1) to the revenue for making assessment, etc., is withdrawn in a special case covered by sub-section (2). This covers a case where the order for an assessment year is made such order being the subject matter of an appeal, reference or revision, the finding or direction of which results in an assessment , etc., referred to in sub-section (1). However, at the time such order is made, the assessment etc, in respect of that a.y. is itself time barred by virtue of any other provision of this Act. Sub-section (2) applies to such cases.

- Also see Explanations 2 and 3 to section 153.

Sanction for issue of notice [Sec. 151]

(1) In a case where an assessment under sub-section (3) of section 143 or section 147 has been made for the relevant assessment year, no notice shall be issued under section 148 by an Assessing Officer, who is below the rank of Assistant Commissioner or Deputy Commissioner, unless the Joint Commissioner is satisfied on the reasons recorded by such Assessing Officer that it is a fit case for the issue of such notice:

Provided that, after the expiry of four years from the end of the relevant assessment year, no such notice shall be issued unless the Chief Commissioner or Commissioner is satisfied, on the reasons recorded by the Assessing Officer aforesaid, that it is a fit case for the issue of such notice.

(2) In a case other than a case falling under sub-section (1), no notice shall be issued under section 148 by an Assessing Officer, who is below the rank of Joint Commissioner, after the expiry of four years from the end of the relevant assessment year, unless the Joint Commissioner is satisfied, on the reasons recorded by such Assessing Officer, that it is a fit case for the issue of such notice.

- Reasons need not be communicated to assessee
- Commissioner must not accord sanction mechanically
- Ascent must be commissioners own hand
- Commissioner must give fair hearing to assessee
- Whether a mere yes or no endorsement will suffice.

Case Law:

There is no requirement in any of the provisions of the Act or any section laying down as a condition for the initiation of the proceedings that the reasons which induced the Commissioner to accord sanction to proceed under section 147 must also be communicated to the assessee S. Narayanappa v. CIT 63 ITR 219 .

Sec. 152 : Other provisions.

(1) In an assessment, reassessment or recomputation made under section 147, the tax shall be chargeable at the rate or rates at which it would have been charged had the income not escaped assessment.

(2) Where an assessment is reopened under section 147, the assessee may, if he has not impugned any part of the original assessment order for that year either under sections 246 to 248 or under section 264, claim that the proceedings under section 147 shall be dropped on his showing that he had been assessed on an amount or to a sum not lower that what he would be rightly liable for even if the income alleged to have escaped assessment had been taken into account, or the assessment or computation had been properly made :

Provided that in so doing he shall not be entitled to reopen matters concluded by an orderunder section 154, 155, 260, 262 or 263.

Section 153: Time limit for completion of assessment and reassessment.

Regular assessment U/s 143 or 144 must be made within twenty-one months of the relevant assessment year or one year end of the Financial Year in which the return was filed whichever is later.

Assessment in case of search or requisition [Section 153A]

Notwithstanding anything contained in section 139, section 147, section 148, section 149, section 151 and section 153, in the case of a person where a search is initiated under section 132 or books of account, other documents or any assets are requisitioned under section 132A after the 31st day of May, 2003, the Assessing Officer shallŠ

(*a*) issue notice to such person requiring him to furnish within such period, as may be specified in the notice, the return of income in respect of each assessment year falling within six assessment years referred to in clause (*b*), in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed and the provisions of this Act shall, so far as may be, apply accordingly as if such return were a return required to be furnished under section 139;

(*b*) assess or reassess the total income of six assessment years immediately preceding the assessment year relevant to the previous year in which such search is conducted or requisition is made :

The Assessing Officer shall assess or reassess the total income in respect of each assessment year falling within such six assessment years:

It is provided that assessment or reassessment, if any, relating to any assessment year falling within the period of six assessment years referred to in this section pending on the date of initiation of the search under section 132 or making of requisition under section 132A, as the case may be, shall abate.
Except as otherwise provided in this section, section 153B and section 153C, all other provisions of this Act shall apply to the assessment made under this section;
In an assessment or reassessment made in respect of an assessment year under this section, the tax shall be chargeable at the rate or rates as applicable to such assessment year.

Prior approval necessary for assessment in cases of search or requisition[Sec. 153D]

No order of assessment or reassessment shall be passed by an Assessing Officer below the rank of Joint Commissioner in respect of each assessment year referred to in clause (*b*) of section 153A or the assessment year referred to in clause (*b*) of sub-section (1) of section 153B, except with the prior approval of the Joint Commissioner.f

Illustration 135 : (a) What is a protective assessment under Income-tax law? What is the procedure followed for the recovery of tax in such cases?

Answer: A protective assessment is made in a case where there are doubts relating to the true ownership of the income. If there is an uncertainty about the taxing of an income in the hands of Mr. A or Mr. B, then at the discretion of the Assessing Officer, the same may be added in the hands of one of them on protective basis. This is to ensure that on finality, the addition may not be denied on the ground of limitation of time. Once finality regarding the identity of the tax payer to be taxed is established, the extra assessment is cancelled. But the Department cannot recover the tax from both the assessees in respect of the same income. Penalty cannot be imposed on the strength of a protective assessment.

(b) Joseph engaged in profession filed his return of income for assessment year 2011-12 on 15th November, 2011. He disclosed an income of ₹4,00,000 in the return. In February, 2012 he discovered that he did not claim certain expenses and filed a revised return on 3rd February, 2012 showing an income of ₹1,80,000 and claiming those expenses. Is the revised return filed by Joseph acceptable?

Answer: Joseph is engaged in profession. The due date for filing income tax return for assessment year 2011-12 as per section 139(1) of the Income-tax Act is 30th September, 2011 if his accounts are required to be audited under any law. The due date is 31st July, 2011 if the accounts are not required to be audited under any law.

The return was filed beyond the due date prescribed in section 139(1). The return so filed is covered by section 139(4) and the time limit is one year from the end of the relevant assessment year. The Apex court in *Kumar Jagadish Chandra Sinha v. CIT 220 ITR 67 (SC)* has held that a return filed under section 139(4) is not eligible for revision and hence a revised return cannot be filed.

Hence, the return filed by Joseph is not valid as the original return was not filed before the due date mentioned in section 139(1).

(c) An assessee filed a return of income on 31.8.2011 in respect of Assessment year 2011-12 disclosing an income of ₹5 lakhs from business. It was not accompanied by proof of payment of tax due on self-assessment. Discuss the validity of such a return.

Answer : As per Explanation to sub-section (9) of section 139 a return is regarded as defective unless it is accompanied by proof of tax deducted at source, advance tax and tax on self-assessment, if any, claimed to have been paid. Therefore, the return is prima facie defective. It is not invalid at that stage. On receipt of the return, the Assessing Officer has to intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of 15 days from the date of such intimation or within such further period which, on application by the assessee, he may, in his discretion allow. If the defect is not rectified within the said period, the return will be treated as an invalid return and the provisions of the Income-tax Act shall apply, as if the assessee has failed to furnish the return.

Also, it may noted that section 140A(3) says that if an assessee fails to pay tax or interest on self assessment he shall be deemed to be an assessee in default in respect of the tax or interest or both remaining un paid and all the provisions of the Act shall apply accordingly.

(d) If an assessment is remanded back to Assessing Officer, can he introduce new sources of income for assessment?

Answer: Where the assessment is set aside by the Tribunal and the matter remanded to the Assessing Officer, it is not open to him to introduce into the assessment new sources of income so as to enhance the assessment. Any power to enhance is confined to the old sources of income which were the subject matter of appeal [Kartar Singh vs.CIT (1978) 111 ITR 184 (P &H)].

(e) Can Department make fresh computation, once the assessment is made final?

Answer: It is now a well settled principle that an assessment once made is final and that it is not open to the department to go on making fresh computation and issuing fresh notices of demand to the end of all time. [ITO vs.Habibullah (S.K.) (1962) 44 ITR 809 (SC)]

(f) Can an Assessing Officer make an assessment for a year other than the assessment year for which the return is filed?

Answer: It is not open to the Assessing Officer to make assessment in respect of a year other than the Assessment Year for which the return is filed. Thus, in respect of a return filed for assessment year 2010-11, assessment cannot be made for the assessment year 2011-12. [CIT vs. Amaimugan Transports Pvt.Ltd.(1995) 215 ITR 553 (Mad.)]

(g) Can an Assessing Officer assess the income below the returned income or assess the loss higher than the returned loss?

Answer: The Assessing Officer cannot assess income under section 144 for an assessment below the returned income or cannot assess the loss higher than the returned loss.

(h) Can incomplete, unsigned or unverified return lead to best judgement assessment?

Answer: Incomplete, unsigned or unverified return may lead to best judgement assessment. A best judgement assessment can be made when the return is filed woefully incomplete or not signed and verified. [Behari Lal Chatterji vs.CIT (1934) 2 ITR 377 (All.)

(i) Can assessee follow different method of accounting for different businesses?

Answer: If an assessee is carrying on more than one business, he can follow cash system of accounting for one business and mercantile system (accrual system) of accounting for other business. Similarly, if he had more than one sources of income under the head income from other sources, he can follow accrual system for one source of income under the head income from other sources, he can follow accrual system for one and cash system for other sources of income.

(j) What can Assessing Officer do when the assessment is not set aside for fresh assessment but annulled?

Answer: Where an assessment is not set aside for fresh assessment but annulled, no extended limitation is available. However, if the original time limit is available, the Assessing Officer may proceed from the stage at which illegality which resulted into the annulment of the assessment supervened and make the assessment afresh. [CIT vs.Mrs.Ratanbai N.K. Dubhash (1998) 230 ITR 495(Bom.)

9.14.3 ASSESSMENT OF VARIOUS ENTITIES

9.14.3.1 ASSESSMENT OF INDIVIDUALS

Tax incidence on Individuals

While computing taxable Income of an Individual following points should be considered.

Nature of Income	Tax Treatment
Income earned by the taxpayer	Except the following all other incomes shall be included (a) income exempt under sections 10 to 13A (b) incomes to be included in income of others by virtue of section 60 to 64.
Share of Profit from Hindu undivided family	It is exempt under section 10(2)
Share of Profit from a firm assessed as firm	It is exempt under section 10(2A)
Salary and Interest from the aforesaid firm	These are taxable as business Income
Share of profit from an association of persons/body of Individuals	If the association/body is taxable at the maximum marginal rate (or at higher rate), then share of profit is not taxable in hands of recipient.
Income earned by others and included in the income of the taxpayer by virtue of section 60 to 64	Such income shall be included in the income of the taxpayer.

Special Provisions for persons governed by Portuguese Civil law (Section 5A)

This Section is applicable for the appropriation of income between spouses governed by the Portuguese Civil Code which is in force in the state of Goa and Union territories of Dadra and Nagar Haveli and Daman and Diu. By virtue of this section, income from all other sources, except from salary, should be apportioned equally between husband and wife. The income so apportioned will be included separately in the total income of the husband and of the wife and the remaining provisions of act shall apply accordingly. Salary Income is, however, taxable in the hands of the spouse who has actually earned it.

Even the income from profession will be apportioned equally between the husband and the wife-

CIT v Datta V Gaitonde [2002] 241 ITR 241/108/ taxman 533(Bom).

Taxable income- How computed

Taxable income shall be computed as follows :

Step 1- Income under the different heads of income -First find out income under the five heads of income

Step 2- Adjustment of losses of the current year and earlier years- Losses should be setoff according to the provisions of sections 70 to 78. The income after adjustment of losses is the gross total income.

Step 3- Deduction from gross total income- Deductions specified under Chapter VI A should be considered while calculating the gross total income.

Step 4- Rounding off- The balance should be rounded off to the nearest `10. it is called as net income or taxable income or total income.

Tax liability :

The net income derived shall be taxable at the rates prescribed below :

Income	**Rate (%)**
Up to 1,60,000*	NIL
1,60,001 to 3,00,000	10
3,00,001 to 5,00,000	20
Above 5,00,000	30

* Threshold limit for resident women assessees below 65 years of age and resident individuals of 65 years and above to be increased to ` 1,90,000/- and ` 2,40,000/- respectively.

Education Cess @ 2% and Secondary and Higher education cess @ 1% leviable on tax plus surcharge.

If the individual has Agricultural income then tax should be computed as per the relevant provisions.

Special Provisions relating to non-residents [Section 115C to 115I]

The benefit of Special provisions can be claimed by non-resident Indians. The following are non-resident Indians for the purpose:

a. citizen of India who is a non-resident ;

b. a person of Indian origin who is a non-resident.

A person shall be deemed to be of Indian origin if he or either of his parents or any of his grandparents, was born in an undivided India.

The Provisions of Section 115C to 115I are applicable only in respect of the following incomes derived a non resident Indian:

a. investment income derived from a "foreign exchange assets"; and

b. long term capital gains on sale or transfer of "foreign exchange assets".

Foreign Exchange Asset- It means those "specified asset" which the assessee has acquired or purchased with, or subscribed to in, convertible foreign exchange;

The following are the "specified assets":

a. shares in an Indian Company (public or private)

b. debentures issued by an Indian Company which is not a private company ;

c. deposits with an Indian Company which is not a private Company, it may be even deposit with SBI or any other banking company;

d. any security of the Central Government ; and

e. such other asset as the Central Government may specify in this behalf by notification in the Official Gazette.

Investment Income

In computing the Investment income of a non-resident Indian, no deduction in respect of any expenditure or allowance shall be allowed under any provision of the Act. Moreover, no deduction under Sections 80C to 80U shall be allowed in respect of investment income of non –resident Indians.

Long term Capital gain

Long term Capital gain on sale or transfer of foreign exchange assets shall be calculated subject to:

1. The benefit of Indexation is not available for the sale or transfer of foreign exchange assets.
2. The non-resident Indian can claim exemption under section 115F by investing sale consideration in another asset.
3. No deduction is permissible under section 80C to 80U in respect of long term capital gain.

Tax treatment on Investment and long term capital Gain:

Non resident Indians are chargeable to tax on investment and long term capital gain at the rate of 20 percent and 10 percent respectively.(plus surcharge and education cess)

Return of Income not to be filled in certain cases:

Where a non-resident Indian has income only from a foreign exchange asset or income by way of long term capital gains arising on transfer of a foreign exchange asset, or both, and tax deductible at source from such income has been deducted, he is not required to file the return of income under section 139(1).

The income from foreign exchange assets and long term capital gains arising on transfer of such assets would be treated as separate block and charged to tax at a flat rate as explained above.

If the non-resident Indian has other Income in India, such other income is treated as an altogether separate block and charged to tax in accordance with other provisions of the Act.

Benefit available even after the assessee becomes resident – These provisions are as follows:

1. A non-resident Indian in any previous year, becomes assessable as resident in India in any subsequent year.
2. He may furnish to the Assessing Officer a declaration in writing(along with his return of income under section 139 for the assessment year for which he is so assessable)to the effect that the special provisions shall continue to apply to him in relation to the investment income derived from any foreign exchange asset.
3. The foreign exchange assets for this purpose are debentures and deposit with an Indian public limited company and Central Government securities.

The special provisions shall continue to apply for that assessment year and for every subsequent assessment year till the transfer or conversion (otherwise than by transfer) into money of such assets.

Special Provisions not to apply if the assessee so chooses (section 115-I)

A non Resident Indian may opt that the special provisions should not apply to him by making a declaration to that effect in his return of income for the relevant assessment year. In such case the whole of his Income (including income from foreign exchange assets and long term capital gains arising on transfer of a foreign exchange asset) is chargeable to tax under the general provisions of the Act.

9.14.3.2 ASSESSMENT OF HINDU UNDIVIDED FAMILY

U/s. 4 of the Income Tax Act, 1961, Income-tax is payable by 'every person'. 'Person' includes a 'Hindu Undivided Family' as defined in sec. 2(31). The definition of 'Hindu Undivided Family' is not found in the Income-tax Act. Therefore the expression 'Hindu Undivided Family' must be construed in the sense in which it is understood under the 'Hindu Law' [Surjit Lal Chhabda vs. CIT 101 ITR 776(SC)].

According to Hindu Law, 'Hindu Undivided Family' is a family which consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters. A 'Hindu Undivided Family' is neither the creation of law nor of a contract but arises from status.

A Hindu coparcenary includes those persons who acquire by birth an interest in joint family property. Only a male member of a family can be a coparcener while the membership of a HUF consists of both males and females. All the coparceners of the family constitute what is called a 'Coparcenery'. All the coparceners are members of a HUF but all members of a HUF are not coparceners. A coparcener of a joint family, who acquires by birth an interest in the joint property of the family, whether inherited or otherwise acquired by the family, may have a right to enforce partition whereas the members of the family who are not coparcenars have no right to enforce partition. When a partition takes place, member (mother or widow) of the joint family may get a share equal to the sons and also it is necessary to provide for maintenance and marriage of the unmarried daughter out of family property.

There are two schools of Hindu Law- 1) Mitakshara and 2) Dayabhaga. Under the Mitakshara school, each son acquires by birth an equal interest with his father in the ancestral property. Under the Dayabhaga School which prevails in West Bengal and Assam, a son does not acquire by birth in ancestral property. He acquires interest only on the death of his father. Father enjoys an absolute right to dispose of the property of the family according to his desire. After the death of father, his son does not, by operation of law, become members of the joint family. The sons remain as co-owners with definite shares in the properties left by father unless they decide to live as a joint family.

Case Laws:

i) A single person, male or female, cannot constitute a Hindu Undivided Family. An individual, who has obtained a share on partition of a joint family, has potentialities of creating a joint family; but until he marries, he alone cannot be considered as a joint family. C. Krishna Prasad vs. CIT97 ITR 493.

ii) A joint family may consist of a single male member with his wife and daughter(s) and it is not necessary that there should be two male members to constitute a joint family [Gowli Buddanna vs. CIT 60 ITR 193.

Jain & Sikh families are not governed by Hindu Law. However, for the purpose of Income tax Act, such families are treated as 'Hindu Undivided Families'.

The income of a joint Hindu family may be assessed in the status of HUF if the following conditions are satisfied:-

(i) there should be a coparcenership

(ii) there should be a joint family property which consists of ancestral property, property acquired with the aid of ancestral property and property transferred by its members. It may be pointed out that once a joint family income is assessed as that of Hindu Undivided Family, it will continue to be assessed as such in future years till partition is claimed by its coparceners.

Under the Hindu Law, ancestral property is the property which a person inherits from any of this three immediate male ancestors, i.e. his father, grand father and great grand father. Income of ancestral property is taxable as income of HUF in the following cases:

(i) family of husband and wife without any children;

(ii) family of two widows of deceased brothers;

(iii) family of two or more brothers;

(iv) family of uncle and nephew;

(v) family of mother, son and son's wife;

(vi) family of a person and his late brother's wife;

(vii) family of widow mother and her sons.

While computing income of a Hindu Undivided Family one should give due consideration of the following :

(i) where a member of HUF converts his self acquired property into joint family, income from such property shall not be treated as income of HUF u/s. 64(2). It shall continued to be taxed in the hands of the transferor who is the member of the HUF.

(ii) Income from an impartible estate is taxable in the hands of the holder of the estate and not in the hands of HUF.

(iii) income from Stridhan of a woman is not taxable in the hands of HUF.

(iv) personal income of members cannot be treated as income of HUF.

(v) where the funds of HUF are invested in a company or a firm, fees or remuneration received by the member as a director or a partner in the company or a firm may be treated as income of HUF in case the fees and remuneration is earned essentially as a result of investment funds

(vi) where remuneration is paid by HUF to Karta or any other member for services rendered by him in conducting family's business, the remuneration is deductible provided the remuneration is paid :

(i) under a valid bonafide agreement;

(ii) in the interest of, and expedient for the business family, and

(iii) genuine and not unreasonable.

Case law:

(i) remuneration and commission received by the Karta of HUF on account of his personal qualifications and exertions and not on account of investments of the family funds in the company cannot be treated as income of HUF. Subbiah Pillai (K.S.) vs. CIT103 Taxman 400/237 ITR 11

PARTITION OF HUF

'Partition' may be a (i) total or complete partition (ii) partial partition.

Where all the properties of the family are divided amongst all the members of the family, and the family ceases to exist as an undivided family, it is known as total or complete partition.

On the other hand, where one or more coparceners of the HUF may separate from others and the remaining coparceners may continue to be joint or some of the properties are divided and the balance remain joint it is known as partial partition.

W.e.f. 31st December, 1978 partial partition are not recognised for tax purposes and as such the joint family shall continue to be liable to be assessed as if no such partial partition had taken place. Each member of such family, immediately before such partial partition and the family shall be jointly and severally liable for any sum payable under the Act. [Sec. 171(9)]

9.14.3.3 ASSESSMENT OF FIRMS

From the Assessment Year 1993-94 partnership firm has been classified for the purpose of computation of income and its assessment as under:

(a) partnership firm assessed as such (PFAS)

(b) partnership firm assessed as an association of person.

Provisions relating to assessment of firms and partners are analyzed as under :

Specific provisions to firm assessed as an AOP

Particulars	Sections
Disallowance of salary and interest to partner	40(ba)
Method of computing partner's share in the income of PFAOP	67A
Rate of tax in respect of income of AOP/BOI	167B
Taxability of partner's share of income	86, 110

Assessment of firms and conditions to be fulfilled to avail the status of PFAS [Sec. 184]

Where a firm wants to avail the status of PFAS, it has to satisfy the following conditions:-

(i) The firm shall be evidenced by an instrument and the individual shares of the partner shall be specified therein. [Sec. 184(1)]

(ii) A certified copy of the instrument of partnership shall accompany the return of income of the previous year relevant to the assessment year 1993-94 or sub sequent year in respect of which assessment of the firm is first sought. [Sec.184(2)]

(iii) Wherever during a previous year a change takes place in the constitution of the firm or in the sharing ratio of partners, a certified copy of the revised instru ment of partnership be submitted along with the return of income of the concerned year of assessment. [Sec. 184(4)]

(iv) There should not be any failure on the part of the firm as is specified in Sec. 144 [Sec. 184(5)]

It may be mentioned that once a firm is assessed as PFAS after fulfillment of the above conditions, it will be assessed as PFAS, for every subsequent year provided there is no change in either firm's constitution or partner's profit sharing ratio. However, there should not be any failure mentioned in sec. 144. [Sec. 184(3)]

A partnership deed shall be certified in writing by all the major partners. Where, however, the firm is dissolved and the return is filed after its dissolution, then the copy of deed may be certified by all the major partners in the firm immediately before is dissolution. Where a partner is dead, then it will have to be certified by his legal representative. [Sec. 184(2) Expl.]

Computation of Income

The following provisions should be given due consideration while computing income of a firm-

(i) Provision relating to deductibility of remuneration paid to partners by firm.

(ii) Provision relating to deductibility of interest paid to partners by firm.

9.14.3.4 ASSESSMENT OF ASSOCIATION OF PERSONS / BODY OF INDIVIDUALS

Association of Persons **:**

Where two or more persons voluntarily joint together in a common purpose or action with the object of producing income, Profits and gains they are said to have formed an Association of Persons.

Body of Individuals:

It is a conglomerate of individuals who happen to have come together to carry on sum activity with a view to earn income i.e. co-heirs inheriting shares or securities.

Distinction between AOP & BOI :

(i) AOP may consist of non-individuals but BOI has to consist of individuals only

(ii) An AOP is a voluntary combination of persons in a joint enterprise or com mon action to produce income whereas in case of BOI will only consist of two or more persons, may or may not have any common object.

(iii) A BOI may become an AOP, but not *vice versa.*

Share of members of AOP/BOI shall be deemed to be indeterminate or unknown, if such shares (in relation to the whole or any part of the income) are indeterminate or unknown on the date of formation of such AOP/BOI or any time thereafter.

Any payment of interest, salary, bonus, commission or remuneration by the AOP/BOI to a member is not allowable as deduction. Where interest is paid by AOP/BOI to a member who has also paid interest to the AOP/BOI, the amount of interest to be disallowed will be limited to the net amount of interest paid by the AOP/BOI. [Sec. 40(ba)]

Tax Rates :

	Where shares of members are determinate and known unknown	*Where shares of members are indeterminate or*
1. None of the members having taxable income	At the rates applicable to individual	At the maximum marginal rate.
2. Any member having income.	At the maximum marginal rate	At the maximum taxable marginal rate.

Maximum marginal rate means the rate of tax (including surcharge, if any) applicable to the highest slab of income in case of individuals. [Sec.2(29C)]

Ascertainment of member's share in AOP/BOI where shares are determinate and its taxability [Sec. 67A, 86 & 110]

		`
(i)	*Ascertainment of share in AOP/BOI [Sec. 67A]*	
	Total income of the AOP/BOI	***
Less:	Interest, salary, commission or other remuneration paid to any member	***
	Balance apportionable to the members in proportion to their shares	***
	Share of income allotted to a member	***
Add:	Salary, interest, commission or other remuneration received by the member of the AOP or BOI	***
	Total share	***
Less:	Interest paid on capital borrowed for the purpose of investment in the AOP/BOI	***
	Net assessable share income	***

(ii) Tax treatment of share income of members [Sec. 86 and Sec. 110]

In computing total income of an assessee, there shall be included share income of a member of an AOP or BOI subject to sec. 86 and 110 of the I.T. Act.

Taxation of AOP/BOI [Sec 167B]	Tax treatment of share income in the hands of members of AOP/BOI [Sec. 86 & 110]
1. AOP or BOI is taxed at maximum marginal rate orat a higher rate.	Share income of the member is not taxable.
2. AOP or BOI is taxed at normal rates applicable	Share income computed u/s. 67A is included into an Individual. the total income of the member but rebate u/s. 110 at the average of tax in respect of such share income has to be allowed.
3. AOP or BOI is not taxed at all.	Share income will be included in the total income of the member and taxed at the rates applicable to him.

"Average rate of Income-tax" is defined u/s. 2(10) to mean the rate arrived at by dividing the amount of Income-tax calculated on the total income, by such total income.

9.14.3.5 ASSESSMENT OF COMPANIES

In computing tax incidence companies are classified as follows :

(i) Domestic Company

(ii) Foreign Company

'Company' means —

(i) any Indian company; or

(ii) body corporate incorporated outside India under the laws of a foreign country; or

(iii) any institution, association or a body which is assessed or was assessable/assessed as a company for any assessment year commencing on or before 1.4.1970; or

(iv) any institution, association or body whether incorporated or not and whether Indian or non-Indian which is declared by general or special order of the Central Board of Direct Taxes to be a company. [Sec. 2(17)]

‘Domestic Company’ means —

(i) an Indian company; or

(ii) any other company which, in respect of its income liable to tax under the Act, has made the following prescribed arrangements for the declaration and pay ment of dividends within India in accordance with Sec. 194 read with Rule 27 of the Rules:

(a) The share register of the company for all shareholders should be regularly maintained at its principal place of business in India, in respect of any assessment year, from 1st April of the relevant assessment year.

(b) The general meeting for passing of accounts of the relevant previous year and for declaring dividends in respect thereof should be held only at a place within India.

(c) The dividends declared, if any, should be payable only within India to all shareholders. [Sec. 2(22A)]

‘Foreign Company’ means company which is not a domestic company. [Sec. 2(23A)]

‘Indian Company’ means a company formed and registered under the Companies Act, 1956. Besides, it includes the following:-

(a) a company formed and registered under any law relating to companies formerly in force in any part of India;

(b) a corporation established by or under a Central, State or Provincial Act;

(c) any institution, association or body which is declared by the Board to be a company u/s. 2(17).

(d) a company formed and registered under any law in force in the State of Jammu and Kashmir;

(e) a company formed and registered under any law for the time being in force in the Union territories of Dadra and Nagar Haveli, Daman and Diu, Pondicherry and State of Goa.

In the aforesaid cases, a company, corporation, institution, association or body will be treated as an Indian company only if its registered or principal office is in India. [Sec. 2(26)]

“Company’ in which the public are substantially interested” –

a company is said to be a company in which the public are substantially interested, if-

(a) a company owned by Government or Reserve Bank of India or in which not less than 40% shares are held singly or taken together by the Government or the Reserve Bank or a corporation owned by the Reserve Bank; or

(b) it is a company registered u/s. 25 of the Companies Act, 1956, i.e., companies incorporated for promotion of Commerce, Arts, Science, Religion, Charity and prohibiting the payment of any dividends to its members; or

(c) it is a company having no share capital and it is declared by the CBDT to be a company in which the public are substantially interested; or

(d) it is a company which carries on, as its principal business, the business of acceptance of deposits from its members and which is declared by the Central Government u/s. 620A of the Companies Act to be a Nidhi or Mutual Benefit Society; or

(e) it is a company which is not a private company and its equity shares are, as on the last day of previous year, listed in a recognised stock exchange in India; or

(f) it is a company which is not a private company and its shares carrying not less than 50% of the voting power (40% in the case of Indian companies whose business consists mainly in the construction of ships or in the manufacture or processing of goods or in mining or in the generation or distribution of electricity or any other form of power)have been allotted unconditionally to or acquired unconditionally to, or acquired unconditionally by, and were through out the relevant previous year beneficially held by-

(i) the Government; or

(ii) a statutory corporation; or

(iii) a company in which the public are substantially interested or any wholly owned subsidiary of such company.

(g) it is a company, wherein equity shares carrying not less than 50% of the voting power have been unconditionally allotted to or acquired by and were through out the relevant previous year beneficially held by, one or more cooperative societies. [Sec. 2(18)]

Minimum alternative tax on certain companies

A company is liable to pay tax on the total income computed in accordance with the provisions of the Income Tax Act, but the profit and loss account is prepared as per provisions of the Companies Act. There were large number of companies who had book profits as per profit and loss account but the total income as per provision of the Income-tax Act was either nil or negative or insignificant and as a result such companies were not paying any income-tax through sometimes, such companies were paying dividends to shareholder. These companies are popularly known as "Zero tax companies".

In order to being these companies under the Income-tax Act, the following sections were included time to time from assessment year 1997-98.

"Average rate of Income-tax" is defined u/s. 2(10) to mean the rate arrived at by dividing the amount of Income-tax calculated on the total income, by such total income.

AMALGAMATION [Sec. 2(1B)]

Amalgamation in relation to companies means the merger of one or more companies with another company, or merger of two or more companies to form a new company. The company so merged goes out of existence is "amalgamating company." The company into which the amalgamating company merges, or the new company that is formed to effect amalgamation, is "amalgamated company" in such a manner that :–

(a) All property of amalgamating company, immediately before amalgamation, should become the property of amalgamated company,

(b) All liabilities of amalgamating company, immediately before amalgamation, should become the liabilities of amalgamated company,

(c) Shareholders holding 75% in value of the shares in amalgamating company should become shareholders of the amalgamated company. However, if the amalgamated company or its subsidiary/nominee already holds some shares in the amalgamating company, value of such shares is excluded for calculating 75% of the value of shares of the amalgamating company.

A merger of companies will not be treated as amalgamation in case of sale or liquidation of company.

The effective date in a scheme of amalgamation is the date of transfer specified in the scheme and not the date of high court's order approving the scheme. So long as the court does not modify the date specified in the scheme, amalgamation takes effect on date of transfer specified in the scheme. The income of the amalgamating company from such date of transfer shall be assessed as income of the amalgamated company and shall be assessed accordingly. [*Marshall Sons and Co. (India) Ltd.* v. *ITO* (SC), 223 ITR 809]

Certain concessions are provided under various provisions of the Income-tax Act in respect of amalgamation which are as under:

(a) **To amalgamating company**

(i) Sec. 47 (vi): In a scheme of amalgamation capital gains tax is not attracted in case of transfer of capital asset by the amalgamating company to the amalgamated company.

(ii) Sec. 47(via): Tax concession to foreign amalgamating company.

(b) **To shareholders of an amalgamating company**

Sec.47(vii) : Transfer by a shareholder in a scheme of amalgamation of a capital asset being a share or shares held by him in amalgamating company.

(c) **To amalgamated company**

The following benefits in the hands of amalgamating company are available to the amalgamated company:

Sec. 35(5) : Expenditure on scientific research

Sec. 35A(6) : Expenditure on acquisition of patent right or copy right

Sec. 35AB(3) : Expenditure on know how

Sec. 35ABB(6) : Expenditure for obtaining license to operate telecommunication services

Sec. 35D(5) : Amortisation of preliminary expenses

Sec. 36E(7) : Deduction for expenditure on prospecting etc. for certain minerals

Sec. 36(ix) : Expenditure incurred for the purpose of promoting family planning.

Sec. 72A : Carry forward and set off of accumulated and unabsorbed depreciation

Further, the amalgamated company is entitled for :

Sec. 35DD : Amortisation of expenditure in case of amalgamation or demerger

DEMERGER SEC. 2(19AA)

"Demerger" in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956, by a demerged company of its one or more undertakings to any resulting company in such a manner that —

(i) all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;

(ii) all the liabilities relatable to the undertaking being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;

(iii) the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;

(iv) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis;

(v) the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger. Otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;

(vi) the transfer of the undertaking is on a going concern basis;

(vii) the demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

For the purpose of this definition, "undertaking" shall include any part of an undertaking, or a unit of division of an undertaking or a business activity taken as a whole, but does not include individual assets and or liabilities or a combination of these not constituting a business activity. For determining the value of the property which is subject matter of demerger, any change in the value of assets on account of revaluation shall be ignored.

Splitting up or the reconstruction of any authority or a body constituted or established under any Act, or a local authority or a public sector company, into separate authorities or bodies or local authorities or companies shall be deemed to be the demerger if such split up or reconstruction fulfils the conditions as may be notified by the Central Government.

DEMERGED COMPANY SEC. 2(19AAA)

It means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company.

DEFINITIONS

- **Undertaking** : includes any part of an undertaking or a unit or division of an undertaking or a business activity taken as a whole, but excludes individual assets or liabilities or combination of both not constituting a business activity.

Resulting Company : means one or more companies (including wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and the resulting company in consideration of such transfer of undertaking, issues shares to shareholders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger

- **Provisions applicable to Company — Amalgamation/Demerger**

  Capital Gain - Gains arising on transfer of a capital asset in a scheme of amalgamation/demerger to the amalgamated/resulting company being an Indian Company is exempt.

Carry forward of accumulated loss and/or unabsorbed depreciation

- Accumulated loss and unabsorbed depreciation of an amalgamating company owning an industrial undertaking or a ship or a hotel or a banking company can be transferred to the amalgamated company provided:
  1. it continuously holds 3/4th value of the assets acquired in a scheme of amalgamation for at least five years from the date of amalgamation.
  2. it continues to carry on business of amalgamating company for at least five years from the date of amalgamation and the amalgamating company.

- Accumulated loss and unabsorbed depreciation of a demerged company will be transferred to resulting company:
  1. Where it is directly relatable to undertaking transferred, it should be such relatable amount.
  2. Where it is not directly relatable to the undertaking transferred, it should be apportioned in the ratio of assets retained by the demerged company and trans ferred to resulting company.

Carry forward of accumulated loss and/or unabsorbed depreciation of the banking company in a Scheme of amalgamation with banking institution

Allowability of expenditure relating to amalgamation/demerger

- An Indian company will be allowed a deduction of 1/5th of the expenditure incurred for the purposes of amalgamation or demerger after 1st April, 1999 for five years from the years of amalgamation/demerger. (S. 35DD)

Depreciation in the year of amalgamation/demerger

- Depreciation to amalgamated company and amalgamating company in the year of amalgamation and depreciation to demerged company and the resulting company in the year of demerger shall be apportioned in the ratio of the number of days for which the assets were used (S. 32) (5th proviso).

Actual cost

- Actual cost of the capital asset transferred to amalgamated/resulting company shall be the actual cost in the hands of the amalgamating/demerged company provided it does not exceed WDV of such assets in the hands of the demerged company.

Written Down Value

- WDV in the hands of amalgamated company shall be the WDV of the block of assets in the hands of the amalgamating company less depreciation allowed in the year of amalgamation.

- WDV in the hands of the resulting company shall be the WDV of transferred assets as per books of the demerged company immediately before demerger.

- WDV in the hands of the demerged company shall be the WDV of the block of assets before demerger less book value of assets transferred to the resulting company.

- Deduction claimed under Section 33AC (Reserve for shipping business) would not be withdrawn on sale or transfer of a ship in any scheme of demerger.

- Transfer of patent rights or copyrights (S. 35A) or transfer of licence to operate telecommunication services (S. 35ABB) or transfer of business for prospecting etc. mineral oil (S. 42) in a scheme of amalgamation/demerger will not be treated as either sale or transfer.

- The deductions hitherto granted to amalgamating/demerged company relating to patent rights and copyrights (S. 35A) / Expenditure on know-how (S.35AB) / Licence fees to operate telecommunication services (S. 35ABB) / Preliminary expenses (S. 35D) / expenditure for prospecting etc., for certain minerals (S. 35E) / business for prospecting etc., for mineral oil (S. 42) would be available for balance period to the amalgamated/resulting company.

Provisions applicable to Shareholders

- Gains arising on transfer of shares of amalgamating company in exchange of shares of amalgamated company, being an Indian Company is exempt.
- Acquisition of shares of the resulting company by the shareholders in demerger will not be taxed either as capital gain or deemed dividend.
- Cost of acquisition of shares of :
  - — the amalgamated company will be the cost incurred for acquiring shares of amalgamating company.
  - — the resulting company will be the :
  - — Original cost of shares of demerged company X net book value of assets transferred to resulting company/ net worth of the demerged company before demerger (net worth is equal to Paid-up Share Capital + General Reserve as per books.)
  - — the demerged company will be the original cost of shares of demerged company – cost of shares of the resulting company as computed above.

9.14.3.6 ASSESSMENT OF COOPERATIVE SOCIETIES

Introduction

Cooperative society is a society registered under the Cooperative Societies Act, 1912, or under any other law for the time being in force in any State for registration of cooperative societies.

A cooperative society is entitled, to some deduction u/s. 80P of the Income-tax Act.

Steps in computing tax liability of Cooperative Societies

The steps are-

Step- I : Compute gross total income, ignoring income exempt from tax u/s. 10 to 13A

Step-II : Deduct permissible deductions u/ss. 80G, 80GGA, 80I, 80I-A 80IB, 80JJA, etc. and 80P as applicable.

Step-III : Apply the tax rates for the relevant assessment year to arrive at the tax incidence.

The tax rates applicable are as follows :–

The rates of Income-tax are —

Income Range	Rates of tax
1. Where the total income does not exceed ₹ 10,000	10% of the total income
2. Where the total income exceeds ₹ 10,000 but which the does not exceed ₹ 20,000	₹ 1,000 plus 20% of the amount by total income exceeds ₹ 10,000
3. Where the total income exceeds ₹ 20,000	₹ 3,000 plus 30%, of the amount by which the total income exceeds ₹ 20,000

However, the tax payable by every cooperative society shall be increased education cess @2% and secondary and higher education cess @ 1%.

9.14.3.7 ASSESSMENT OF TRUSTS

Introduction

Trust	A "Trust" is an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner.
Author of trust	The person who reposes or declares the confidence is called the "author of the trust".
Trustee	The person who accepts the confidence is called the "trustee".
Beneficiaries	The person for whose benefits the confidence is accepted is called the "beneficiary".

In order to ascertain the incidence of tax it is essential to know the nature and character of trusts and also the mode of computation of its income and conditions for exemptions. For the purpose of levy of income-tax, trusts may be of the following types :-

1. Charitable trust
2. Private discretionary trust
3. Oral trust

Charitable Trusts

A charitable trust is a trust established in accordance with law for charitable purpose. Charitable purpose includes relief of the poor, education, medical relief and the advancement of any other object of general public utility. [Sec. 2(15)]

Promotion of sports and games is considered to be a charitable purpose and as such an association or institution engaged in promotion of sports and games can claim exemption u/s.11, although it is not approved u/s. 10(23).

Conditions for exemption

The following essential conditions are to be fulfilled for claiming exemption u/s. 11 :–

(i) The property from which income of the trust is derived should be held for charitable or religious purposes.

(ii) The exemption is confined to such portion of the trust's income as is applied to charitable or religious purposes in India except in cases enumerated in sec.11(1)(c)

(iii) If the trust property comprises of a business undertaking, the income shown in the books of account should not be less that the income determined by the A.O. according to provisions of the Income-tax Act. From A.Y. 1992-93, trusts or institution can carry out business activities if such business activities are incidental to the attainment of its objectives and separate books of accounts are maintained.

(iv) The trust should make an application in Form No. 10A to the Commissioner of Income Tax within one year of creation of trust or the institution and such trust or institution get registered u/s. 12AA.

(v) Limit for audit of charitable institutions rationalized [Section 12A]

- Trusts and institutions covered under sections 11 and 12 to get their accounts audited only when their total income, before giving effect to the provisions of sections 11 and 12,exceeds ₹ 1,00,000.

(vi) The funds of the trust should be invested or deposited in any one or more of the modes or forms [Sec. 11(5)] such as —

- investment in Government Savings Certificate;
- deposits in any Post Office Savings Bank Account;
- deposit in any account with any scheduled or cooperative Bank;
- investment in any Central Government or State Government securities or in the units of the Unit Trust of India;
- investment in debentures of any corporate body, guaranteed by the Central Government or a State Government ;
- investments in immovable property or deposit in any public sector company ;
- deposit or investments in any Bond issued by a public company having main object of carrying on business of providing long term finance for urban infrastructure in India.
- any other form or mode of investment/deposit as may be prescribed in this behalf.

In order to claim exemption, a charitable trust or institution will have to apply at least 85% of, the income to charitable and religious purposes. Where 85% of the income is not applied to charitable or religious purposes the trust or institution may accumulate or set apart either the whole or part of its income for future application for such purposes in India.

Special rates of tax on Certain Income of Charitable Institutions.

Taxation of certain anonymous donations under section 115BBC

Income of wholly or partly charitable or religious trust etc. is exempt subject to certain conditions:

Unaccounted contribution to those institutions by way of anonymous donation a new section 115BBC has been inserted so as to provide that any income by way of anonymous donation shall be included in the total income and taxable @ 30%.

Note :

Anonymous donation means any voluntary contribution referred to sec 2(24)(iia).

Tax relief on anonymous donations for partly religious and partly charitable institutions, and wholly charitable institutions (Section 115BBC) [W.e.f. A.Y. 2010-11]

(A) Under the current provisions of section 115BBC, wholly religious entities are outside the purview of taxation of anonymous donations. Partly religious and partly charitable entitles have also been, exempted from the taxation of anonymous donations, except where the anonymous donation is made to an educational or medical institution run by such entity in which case such donations are taxed at the rate of 30%. In the case of wholly charitable entities, all anonymous donations arc taxed at the rate of 30%.

In order to mitigate the compliance burden, the Act has provided relief to such organizations by exempting a part of the anonymous donations from being taxed. The amendment will result in the following:

1. Anonymous donations received by wholly religious institutions shall remain exempt from tax.
2. In the case of partly religious and partly charitable institutions, anonymous donations directed towards a medical or educational institutions run by such entities shall be taxable @ 30% on the aggregate of anonymous donation received in excess of the higher of the following, namely:—

   (A) 5% of the total donations received by the assessee, or

   (B) ₹ 1,00,000.

3. In the case of wholly charitable institutions, anonymous donations shall be taxable @ 30% on the aggregate of anonymous donation received in excess of the higher of the following, namely

(B) 5% of the total donations received by the assessee, or

(C) ₹ 1,00,000.

(B) Meaning of charitable purpose' amended: See para 2 above.

Forfeiture of Exemption [Sec. 13]

The following incomes of charitable or religious trusts and institutions will not qualify for exemption u/s. 13 :–

(i) income from property held under a trust for private religious purpose which does not ensure for the benefit of the public. [sec. 13(1)(a)]

(ii) income of a charitable trust/institution established on or after 1.4.1962 for the benefit of any particular religious community or caste. [sec. 13(1)(b)]

(iii) income of religious/charitable trust/institutions established after 31.3.1962 for the benefit of any person specified in sec. 13(3) viz. author, founder or substantial contributor of the trust or any relative of them. Where the income is used or applied during the relevant year for the direct or indirect benefit of the above mentioned persons. [sec. 13(1)(c)(i) and (ii)]

(iv) income of a trust/institution, if its funds are invested/deposited otherwise than as specified u/s. 11(5). [sec. 13(1)(d)]

However, the provisions of section 13(1)(d) shall not apply in relation to following :-

- any asset forming part of the corpus of the trust as on 1.6.1973;
- any accretion to the corpus shares by way of bonus shares allotted to the trust;
- debentures issued by or on behalf of any company or corporation and acquired by the trust before March 1, 1983;
- any asset not covered u/s. 11(5) where such asset is held for not more than 1 year from the end of the previous year in which such asset is acquired;
- any fund representing the Profits and gains of business, being Profits and gains of any previous year relevant to the assessment year 1984-85 or any subsequent assessment year. But such relaxation of the restriction will be denied unless the trust keeps separate accounts for the business. As already noted, subject to certain exceptions, such business profits no longer enjoy exemption u/s. 11.

CHANGES RELATING TO INCOME OF CHARITABLE INSTITUTIONS.

Anonymous donations to form part of income of trust [section 13]

As per the new section 115BBC, anonymous donation shall now be taxable at the maximum marginal rate of 30%. Consequently, a new sub-section (7) has been inserted in section 13 to provide that nothing contained in section 11 or section 12 shall operate so as to exclude from the total income of the previous year of the person in receipt thereof, any anonymous donation referred to in the new section 115BBC on which tax is payable in accordance with the provisions of that section. In other words anonymous donation shall not be excluded from the total income of the assessee.

Taxation of Trust

A. Public Trust u/s. 164(2) —

(i) If income is not exempt u/s. 11 or 12, income of Trust is taxable at the rates applicable to an Association of Person.

(ii) If the exemption is forfeited due to contravention of sec. 13(1)(c) or 13(1)(d), such income of trust is taxable at minimum marginal rate.

B. Private Trust (shares of beneficiaries are determinate or known) —

i) If income does not include business Profits, the trustee is assessable at the rates applicable to each beneficiary. [Sec. 161(1)]

ii) If income includes profits from business, the whole income is taxable at maximum marginal rate. [Sec. 161(1A)]

C. Private Trust (share of beneficiaries in determinate or unknown) [S. 164(i)] —

i) If income does not include business profits, income is taxable at the rates applicable to an AOP if –

Ł none of the beneficiaries has taxable income or is a beneficiary in any other trust.

† the trust is non-testamentary trust created before 1.3.1970.

† exclusively for the relative dependents of the settle; or

† it is the only trust declared by a WILL exclusively for the benefit of any depen dent relative. In any other case, income is taxable of minimum marginal rate.

ii) If income includes business profits, the whole income is taxable at maximum marginal rate.

D. Oral Trust [Sec. 160(1)(v), Sec. 164A] : "Oral Trust" means a trust which is not declared by a duly executed instrument in writing including any wakf deed which is valid under the Mussalman wakf validating Act, 1913 and which is not deemed to be trust by virtue of explanation I to Sec. 160.

(i) Income of Oral trust is taxable at maximum marginal rate.

(ii) If Oral trust is declared to be a trust by furnishing a statement in writing containing purposes, particulars and details of trust, beneficiaries and property to the assessing officer within 3 months from the date of declaration of the trust, indicating the share of beneficiaries, the income of the trust is assess able in the hands of trustee at the rates applicable to beneficiaries.

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

Where property is held under trust partly for religious purposes and partly for other purposes and the individual share of the beneficiaries in the income applicable to purposes other than charitable purposes, is not known, the income-tax liability will be aggregated as follows :

(i) the tax which would be chargeable on the part of the relevant income which is applicable to charitable or religious purposes (as reduced by the income which is exempt u/s. 11 as if such part were the total income of an association of persons; and

(ii) the tax on that part of income attributable to purposes other than charitable or religious and in respect of which shares of beneficiaries are indeterminate or unknown, at the maximum marginal rate.

Where any part of income is not exempt u/s. 11 or 12 by virtue of sec. 13(1)(c) or (d), tax is charged on the relevant income at the maximum marginal rate.

Taxation of non-resident Indian

(i) Who is non-resident individual — Sec. 6 [refer to Study Note 1 of study material]

(ii) Who is non-resident Indian — An individual who is a citizen of India or a person of Indian origin not resident in India, is called non-resident Indian.

(iii) Taxation of non-resident assessees

- Provisions as applicable to resident assessees.
- Special provisions as provided in Sec. 115C to 115I.

The non-resident has an option to be assessed or not to be assessed under special provision for any assessment year. The option is to be exercised by a declaration in his return of Income for the Assessment Year. [Sec. 115-1]

(iv) General Provisions —

Rate of tax	Similar to resident assessees.
	Special rates of tax on Dividends, interest income from units of Mutual Fund. UTI, bonds or shares purchased in foreign currency and capital gains arising from their transfer. • 20% of the dividends [which have not been subjected to additional Income Tax u/s 115-O] [other than dividends mentioned in clause (iv) below]; • 20% of the interest received from Government or an Indian concern on monies borrowed or debt incurred in foreign currency; • 20% of the income received in respect of units purchased in foreign currency, of a Mutual Fund specified u/s 10(23D) or of the Unit Trust India; • 10% of the interest or dividends [which have not been subjected to additional income tax u./s 115-O], in respect of bonds or Global Depository Receipts in an Indian company purchased in foreign currency and issued under the Foreign Currency Convertible Bonds and Ordinary shares (Through Depository Receipt Mechanism) Scheme, 1993 (commonly known as Euro Issues/Euro Bonds) or in respect of bonds or Global Depository Receipts issued against shares of a public sector company sold by the Government to the non-resident in foreign currency; and • 10% of the long-term capital gains arising from the transfer of the aforesaid bonds or Global Depository receipts.

(v) Filing of return — Similar to resident assessees :

However, a non-resident shall not be required to file a return of income u/s. 139(1), if his total income consists only of income subject to special rates of tax as mentioned in rate of tax under clauses (iv) supra and the tax has been deducted therefrom at source.

Case Laws :

(i) For purpose of section 164(1) what is relevant is that income is receivable on behalf of beneficiaries and is not necessary that income is received by beneficiaries - *Gosar Family Trust* v. *CIT* 81 Taxman 146/215 ITR 55.

(ii) *Provision merely sets out how tax is to be charged and does not create a charge on the income. CIT* v. *Kamalini Khatau* 209 ITR 101.

ILLUSTRATIONS ON ASSESSMENT OF AOP / BOI (Sec. 86)

The assessment of the members of AOP or BOI depends on whether the AOP or BOI is chargeable to tax at the maximum marginal rate or at slab rate or is not chargeable to tax at all.

Tax-treatment in the three cases is discussed below:

(i) Where AOP or BOI is chargeable to tax at a maximum marginal rate or any higher rate, the share of profit of a member is exempt from tax. Thus, it is not to be included in the total income of the member [Sec. 86(a)]

(ii) Where AOP or BOI is not taxed at the maximum marginal rate but it is taxed at slab rates, the share of profit of a member from AOP or BOI is to be included in the total income of the member only for rate purposes. The member is entitled to a rebate of tax on the entire share of profit at the average rate of tax applicable to total income. [Sec. 86(b)].

(iii) Where AOP or BOI is not chargeable to tax at all, the share of profit of a member from AOP or BOI is included in his total income and he will pay tax on it. He is not entitled to any rebate of tax on such profits [Proviso to Sec. 86(b)].

Illustration 136 : A & B are members of AOP, sharing profit and losses in the ratio of 5 : 3 and they are allowed the following payments:

	A ₹	B ₹
(i) Salary	40,000	60,000
(ii) Interest on capital or loan	20,000	10,000

You are required to compute taxable business profits of AOP and share of each member for the previous year 2010-2011 in the following cases:

(a) AOP has earned profit of ₹ 3,00,000 after making the above payments;

(b) AOP has earned profit of ₹ 3,00,000 before making the above payments;

(c) AOP has suffered loss of ₹ 3,00,000 after making the above payments; and

(d) AOP has suffered loss of ₹ 3,00,000 before making the above payments.

Solution: Computation of income of AOP for the PY 2010-2011

Particulars ₹	**Case (a)** ₹	**Case(b)** ₹	**Case (c)** ₹	**Case (d)** ₹
Profit/ loss	(+) 3,00,000	(+) 3,00,000	(-) 3,00,000	(-) 3,00,000
Add: Inadmissible payments				
[Sec. 40 (ba)]:				
(i) Salary to members (40,000+60,000)	(+) 1,00,000	—	(+) 1,00,000	—
(ii) Interest on capital/loan	(+) 30,000	—	(+) 30,000	—
to members: (20,000 + 10,000)				
Profit/loss as per income-tax law	(+) 4,30,000	(+) 3,00,000	(-) 1,70,000	(-) 3,00,000

Computation of member's share in the income/loss of the AOP

Particulars	Case (a)		Case (b)		Case (c)		Case (d)	
	A ₹	B ₹	A ₹	B ₹	A ₹	B ₹	A ₹	B ₹
Salary	40,000	60,000	40,000	60,000	40,000	60,000	40,000	60,000
Interest	20,000	10,000	20,000	10,000	20,000	10,000	20,000	10,000
Divisible profit:								
(a) 4,30,000–1,30,000	1,87,500	1,12,500	X	X	X	X	X	X
(b) 3,00,000–1,30,000	X	X	10,6250	63750	X	X	X	X
(c) (–) 1,40,000 + (–)1,30,000= (-)2,70,000	X	X	X	X	(1,68,750)	(101250)	X	X
(d) (-) 3,00,000 + (-) 1,30,000= (-) 4,30,000	X	X	X	X	X	X	(2,68,750)	(161250)
Share of profit/loss	2,47,500	1,82,500	1,66,250	1,33,750	(108750)	(31250)	(208750)	(91250)

(i) *Where assessed business income is a profit:* Beneficial payments (i.e. salary, bonus, commission and interest) made to partners should be deducted from assessed profit to arrive at divisible profit, which is to be apportioned among members.

(ii) *Where assessed business income is a loss:* Beneficial payments made to partners should be added to assessed loss to arrive at the divisible loss which is to be apportioned among members.

Illustration 137 : Anand and Aniket are equal members in AA & Associates. The profit and loss account of the AOP for the year ended 31st March 2011 is as follows:

Particulars	₹	Particulars	₹
Selling and administrative		Gross Profit	20,00,000
Expenses	8,00,000	Income from house property	3,60,000
Interest to Anand @ 15%	60,000		
Remuneration:			
Anand	1,50,000		
Aniket	1,50,000		
Net profit:			
Anand	6,00,000		
Aniket	6,00,000		
	23,60,000		**23,60,000**

Other information :

1. Selling and administrative expenses include ₹ 60,000 paid to a consultant in cash.
2. The other income/investment details of the members are given as below:

Members	Income	Source of income	Investments
Anand	90,000	Interest on fixed deposit from bank	Purchase of NSC VIII ₹ 30,000
Aniket	1,00,000	Interest on govt. securities	Contribution to PPF ₹ 50,000

Compute the tax liability of the AOP and it members.

Computation of total income of AOP: PY 2010-2011

Particulars	₹
Net profit	12,00,000
Add: Inadmissible payments.	
1. Fees paid to consultants in cash Sec. 40A (3)	60,000
2. Interest paid to members [Sec. 40(ba)]:	60,000
3. Remuneration paid to members Sec. 40(ba)	3,00,000
	16,20,000
Less: Income from house property	3,60,000
Business profits	**12,60,000**
Add: Income from house property	3,60,000
Total income	**16,20,000**
Tax liability of AOP on total income	
Tax on slabs rates	3,90,000
Add:	
Education cess 2%	7,800
SHEC @ 1%	3,900
Tax payable	**4,01,700**

Allocation of income amongst the members:

Particulars	Anand ₹	Aniket ₹	Total ₹
Interest	60,000	—	60,000
Remuneration	1,50,000	1,50,000	3,00,000
Share of divisible profit (12,60,000-60,000-3,00,000)	4,50,000	4,50,000	9,00,000
Share of profit	6,60,000	6,00,000	12,60,000
Share of income from house property	1,80,000	1,80,000	3,60,000
	8,40,000	7,80,000	16,20,000

Computation of total income of members:

Particulars	Anand ₹	Aniket ₹
Share income from AOP	8,40,000	7,80,000
Income from other sources:		
Interest on bank deposits	90,000	—
Interest on government securities	—	1,00,000
Gross total income	9,30,000	8,80,000
Less: Deduction under Sec. 80C	30,000	50,000
Total income	9,00,000	8,30,000
Tax liability of members : Tax on slab rates	1,74,000	1,53,000
Add: Education cess @ 2% on income tax	3,480	3,060
Add : SHEC @ 1%	1,740	1,530
	1,79,220	1,57,590
Less: Rebate on share of profit at the average: (See Note below)	1,67,272	1,48,097
Tax payable	11,948	9,493
Tax payable rounded off to the nearest multiple of ₹ 10 (See. 288B)	11,950	9,490
Note: Anand $\frac{1,79,220}{9,00,000}\times 8,40,000$ Aniket : $\frac{1,57,590}{8,30,000}\times 7,80,000$	15,050	12,290

Illustration 138 : A, B and C Ltd. are three members of an AOP, sharing profit and losses in the ratio 2:2:1. The AOP discloses its income for the PY 2010-2011 as below:

Particulars	₹
(i) Long-term capital gains	4,00,000
(ii) Business profits	6,00,000

Determine tax liability of AOP in the following cases:

(i) C Ltd. is an Indian company

(ii) C Ltd. is a foreign company

Solution: Allocation of income of AOP among partners

Particulars of income	A ₹	B ₹	C Ltd ₹
Long-term capital gains	1,60,000	1,60,000	80,000
Business profits	2,40,000	2,40,000	1,20,000
Share income of the members	4,00,000	4,00,000	2,00,000

Tax liability of AOP

Particulars	Case – I C Ltd. an Indian company ₹	Case – II C. Ltd. as foreign company ₹
Tax on the share of C Ltd.		
Case I : 1,20,000 x 33.99%	40,788	—
Case II: 1,20,000 x 42.23%	—	50,676
Tax on balance income at AOP:		
(i) Long-term capital gain 4,00,000 x 22.66%	90,640	90,640
(ii) Business profits 6,00,000 x 33.99%	2,03,940	2,03,940
Total tax payable	3,35,368	3,45,256
Total Tax (Rounded off u/s 288B)	3,35,370	3,45,260

Illustration 139 : R, S and T Ltd. (a widely held domestic company) are members in an AOP for the previous year 2010-2011. They share profit and losses in the ratio 30%, 40% and 30%. Taxable business income of AOP is determined at ₹ 8,00,000. Personal income of the partners are given below:

	₹
R - House property	90,000
S – Short-term capital gain	1,00,000

R deposites ₹ 20,000 in CTDS-15-year account in Post Office in February 2010. S purchases NSC VIH-Issue for ₹ 25,000 in December 2010.

Determine the tax liability of the AOP and its partners

Solution : (a) Computation of tax liability of AOP for the previous year 2010-2011.

Allocation of AOP income among members:

Particulars	R ₹	Y ₹	T Ltd. ₹
Business profit	2,40,000	320000	240000

Tax liability of AOP: 8,00,000 × 33.99% 2,71,920

Tax liability of members:

Particulars	R ₹	Y ₹	T Ltd. ₹
Share income from AOP	2,40,000	320000	240000
AOP charged at maximum marginal rate	Exempt	Exempt	Exempt
Personal income of members	90,000	75,000	Nil
Personal income below taxable limit	Exempt	Exempt	X

Illustration 140 : GMK are partners in a firm assessed as an association of persons. They share profit and losses in the ratio of 4:3:3. The abridged profit and loss for the previous year 2010-2011 is as follows:

Particulars	₹	Particulars	₹
Business expenses	5,00,000	Gross profits	6,85,000
Salaries to partners		Short-term capital gain	2,80,000
G	60,000	Interest on drawings	
M	40,000	G	5,000
K	50,000	M	20,000
Bonus to partners:		K	10,000
G	30,000		
M	20,000		
Commission to K	40,000		
Interest to partners:			
G	20,000		
M	15,000		
K	25,000		
Net profit			
G	80,000		
M	60,000		
K	60,000		
	10,00,000		**10,00,000**

Business expenses include donation to Nalanda University ₹ 50,000.

Compute the taxable income of AOP, its tax liability and tax liability of its members in the following

Personal income of members	Case-I ₹	Case-II ₹
G: Interest on bank deposits	40,000	1,00,000
M: Interest on government securities	65,000	1,20,100
K: Income from house property	50,000	1,10,000
LIP paid by every member on a policy of ₹ 1,00,000.	20,000	20,000

Solution : (a) **Computation of taxable business profits**

Particulars	₹
Net profit as per Profit & Loss A/c	2,00,000
Add: (i) Donation to Nalanda University	50,000
(ii) Salaries to partners [Sec. 40(ba)] (60,000 + 40,000 + 50,000)	1,50,000
(iii) Bonus to partners 30,000 + 20,000	50,000
(iv) Interest on capital (Net of Interest on Drawings)	15,000
G 20,000 – 5,000 =	15,000
K 25,000 – 10,000 =	15,000
(v) Commission to K	40,000
	5,20,000
Less: Short-term capital gain	2,80,000
Taxable Profits	**2,40,000**
(a) Computation of total income	
Add: (i) Business profits	2,40,000
(ii) Short-term capital gain	2,80,000
Gross Total Income	**5,20,000**
Less: Deduction for charitabe donation (Sec. 80G)	
(a) Actual donation ₹ 50,000 or,	
(b) 10% of gross total income: $\frac{10}{100} \times 5{,}20{,}000 = 52{,}000$	
whichever is less, is qualifying amount. It is ₹ 50,000.	25,000
Amount of deduction 50% of qualifying amount	
Total Income	4,95,000

Tax liability of AOP :

Particulars	**Case I**	**Case II**
(a) Tax on total income at slab rates including Education Cess and SHEC	1,00,425	—
(b) Tax on total income at maximum marginal rates including surcharge plus education cess plus SHEC	—	1,68,251
Tax payable	1,00,425	1,68,251
Tax payable rounded off (u/s 288 B)	1,00,420	1,68,250

Tax liability of members:

Case: (a) where AOP is taxed at slab rates:

Share of income from AOP: (₹)		G (₹)	M (₹)	K (₹)	Total
(i)	Salary	60,000	40,000	50,000	1,50,000
(ii)	Bonus	30,000	20,000	—	50,000
(iii)	Commission	—	—	40,000	40,000
(iv)	Interest	15,000	—	15,000	30,000
		1,05,000	60,000	1,05,000	2,70,000
(v)	Divisible loss : (2,40,000-25,000)-270,000				
	= (-) 55,000	(-) 22,400	(-) 16,500	(-) 16,500	(-) 55,000
	Shre of business profit	83,000	43,500	88,500	2,15,000
	Share of short-term capital gain	112,000	84,000	84,000	2,80,000
	Share of income from AOP	**1,95,000**	**1,27,500**	**1,72,500**	**4,95,000**

Total income and tax liability of members :

Particulars	G	M	K
Income from house property	—	—	50,000
Income from other sources	40,000	65,000	—
Share income from AOP:	1,95,000	1,27,500	1,72,500
Gross total income	**2,35,000**	**1,92,500**	**2,22,500**
Less: Deduction under Sec. 80C: LIP restricted to 20% of policy	20,000	20,000	20,000
Total income	**2,15,000**	**1,72,500**	**2,02,500**
Gross income tax at slab rate	17,000	8,500	10,500
Add: Surcharge	Nil	Nil	Nil
Add: Education Cess @ 2%	340	170	210
Add : SHEC @ 1%	170	85	105
	17,510	8,755	10,815
Less: Rebate on share of profit from firm at the average rate	15,881	6,471	9,213
Tax payable	1,629	2,284	1,602
Tax payable rounded off (u/s 288B)	**1,630**	**2,280**	**1,600**
Note 1: 17,510 ÷2,15,000 X 195000 = 15881			
Note 2: 8,755 ÷ 172500 X 1275000 = 6471			
Note 3: 10815 ÷ 202500 X 172500 = 9213			

Case (b) where AOP is taxed at maximum marginal rate:

	G	M	K
1. Share of profit from AOP; Since the AOP was assessed at the maximum marginal rate, share of income from AOP is exempt (Sec. 86)	—	—	—
2. Personal income:			
Income from other sources	1,00,000	1,20,100	1,10,000
Less: Deduction u/s 80C	(-) 20,00	(-) 20,000	(-) 20,000
Total income	80,000	1,00,100	90,000
	Nil	Nil	Nil
Total Income	Nil	Nil	Nil

Illustration 141 : T and Q are individuals, who constitute an association of persons, sharing profit and losses in the ratio of 2:1. For the year ended 31st March 2011, the profit and loss account of the business was as under:

Particulars	Rupees in thousand	Particulars	Rupees in thousands
Cost of goods sold	6,250.00	Sales	9,900.00
Remuneration to:		Dividend from companies	25.00
T	130.00		
Q	170.00	Long-term Capital gains	1,640.00
Employees	256.00		
Interest to :			
T	48.30		
Q	35.70		
Other expenses	111.70		
Sales-tax penalty due	39.00		
Net profit	4,524.30		
	11,565.00		11,565.00

Additional information furnished:

(i) Other expenses included:

(a) entertainment expenses of ₹ 35,000;

(b) wristwatches costing ₹ 2,500 each were given to 12 dealers, who had exceeded the sales quota prescribed under a sales promotion scheme;

(c) employer's contribution of ₹ 6,000 to the Provident Fund was paid on 14th January 2011.

(d) ₹ 30,000 was paid in cash to an advertising agency for publicity.

(ii) Outstanding sales tax penalty was paid on 15th April 2011. The penalty was imposed by the sales tax officer for non-filing of returns and statements by the due dates.

(iii) T and Q had, for this year, income from other sources of ₹ 3,50,000 and ₹ 2,10,000, respectively.

Required to :

(i) Compute the total income of the AOP for the previous year 2010-2011.

(ii) Ascertain the tax liability of the Association for that year; and

(iii) Ascertain the tax liability for that year of the individual members.

Solution : (a)(i) Computation of total income of the AOP for PY 2010-2011

Particulars	₹	₹
Profit and gains of business (see Working Note below)		33,12,300
Long term capital gain		16,40,000
Income from other sources [dividend is exempt u/s 10(34), assuming it is from domestic companies]		
Total income		**49,52,300**
Computation of profits and gains of business:		
Net profit as per profit and loss account		45,24,300
Add: Inadmissible payments:		
Interest to members T & Q (₹ 48,300 + ₹ 35,700)	84,000	
Advertising [disallowance u/s 40A(3)	30,000	
Remuneration to members T & Q (₹ 1,30,000 + ₹ 1,70,000)	3,00,000	
Sales tax penalty due (See Note 3 below)	39,000	4,53,000
		49,77,300
Less : Income not taxable under this head		
Dividend from companies	25,000	
Long term capital gain	16,40,000	16,65,000
Profits and gains of business		**33,12,300**

(ii) Computation of tax liability of the AOP for PY 2010-2011

Particulars	₹	₹
Long-term capital gain (₹ 16,40,000 × 20%)		3,28,000
Other income (₹ 33,12,300 × 30%)		9,93,690
Tax on total income		13,21,690
Add : Surcharge @ 10%		1,32,169
		14,53,859
Add : Education cess @ 2%		29,077
Add : SHEC @ 1%		14,539
Total tax due		**14,97,445**
Total Tax Rounded off (u/s 288B)		**14,97,440**

Notes:

1. Since one of the members has individual income more than the basic exemption limit, the AOP will be assessed at the maximum marginal rate. The maximum marginal rate includes the surcharge applicable in relation to the highest slab of income in case of an individual and as such surcharge shall be chargeable at the rate of 10%.
2. Since the employer's contribution to PF has been paid during the previous year 2010-2011 itself, it is allowable as deduction.
3. Penalty imposed for delay in filing sales tax return is not deductible since it is on account of infraction of the law requiring filing of the return within the specified period.

(iii) Computation of tax liability of members T & Q for the PY 2010-2011

Particulars	₹	Particulars	₹
Tax on ₹ 3,50,000	54,000	Tax on ₹ 2,10,000	16,000
Add : Surcharge	Nil		Nil
	54,000		16,000
Add : Education cess @ 2%	1,080		320
Add : SHEC @ 1%	540		160
Net Tax Payable	**55,620**		**16,480**

ILLUSTRATIONS ON ASSESSMENT OF CHARITABLE TRUSTS

Illustration 142 : Shri Dubbawala Charitable Trust (Regd.) submits the particulars of its income/outgoing for the previous year 2010-2011 as below :

		₹
(i)	Income from property held under trust for charitable purposes: (₹ 5,20,000 out of ₹ 10,00,000 is received in PY 2011-2012)	10,00,000
(ii)	Voluntary contributions (out of which ₹ 50,000 will form part of the corpus)	2,00,000

The trust spends ₹ 2,77,500 during the previous year 2010-2011 for charitable purposes. In respect of ₹ 5,20,000, it has exercised its option to spend it within the permissible time-limit in the year of receipt or in the year, immediately following the year of receipt.

The trust spends ₹ 2,00,000 during the previous year 2009-2010 and ₹ 1,00,000 during the previous year 2011-2012. Compute and discuss the chargeabiliry of the income of the trust.

Solution : (a) Computation of taxable income and tax liability of the charitable trust for the PY 2010-2011/AY 2011-2012

	Particulars			₹
(i)	Income from property held under trust for charitable purposes			10,00,000
(ii)	Voluntary contributions (₹ 2,00,000 - ₹ 50,000)			1,50,000
				11,50,000
	Less: 15% set apart for future application			1,72,500
	Balance			9,77,500
	Less: Amount spent during the pervious year for charitable purposes			2,77,500
	Balance			7,00,000
	Less: Income not received during the previous year 2010-2011			5,20,000
	Taxable income			1,80,000
	Tax payable:	Rate of tax		
	1,10,000	Nil		
	40,000	10%		4,000
	30,000	20%		6,000
				10,000
	Add: Education Cess @ 2%			200
	Add: SHEC @ 1%			100
		Tax payable		10,300
(b)	Previous year 2011-2012/AY 2012-2013			
	Income received during the pervious year 2010-2011		5,20,000	
(i)	Amount spent for charitable purposes during PY 2010-2011		2,00,000	
(ii)	Amount spent for charitable purposes during 2011-2012		1,00,000	
	Taxable income		**2,20,000**	

Illustration 143 : Shri Mungeri Ram Temple Trust (Regd.) derived ₹ 6,00,000 income from the property held under charitable trust during the pervious year 2010-2011. About 40% of the income has been received by the end of the financial year. The trust could spend ₹ 60,000 for charitable purposes during the year 2010-2011 and 40% receipts, received by the year end in 2010-2011, are being planned to be applied for charitable purposes during the previous year 2011-2012. Compute its income for the said two years if the amount planned to be spent during pervious year 2011-2012 for charitable purposes is ₹ 1,00,000.

Solution : (a) Computation of taxable income of charitable trust: PY 2010-2011/AY 2011-2012.

Particulars		₹
Income from property held under trust		6,00,000
Less: 15% set apart for future application for charitable purposes		90,000
Balance		5,10,000
Less : Income applied for charitable purposes during the year 2010-2011		60,0000
Balance		4,50,000
Less: Income realised by the close of the previous year—40% of ₹ 6,00,000		2,40,000
Taxable income		**2,10,000**
(b) Previous year : 2009-2010/AY 2010-2011		
Amount set apart in 2010-2011 to be applied for charitable purposes in 2011-2012	= 2,40,000	
Less: Amount applied for charitable purposes	= 1,00,000	
Taxable income	1,40,000	

Illustration 144 : Devdas Charitable Trust submits the particulars of its receipts and outgoing during the previous year 2010-2011.

as below :

		₹
(i)	Income from property held under trust for charitable purposes	20,00,000
(ii)	Voluntary contribution (out of which ₹ 5,00,000 will form part of the corpus)	15,00,000
(iii)	Donations paid to blind charitable school	6,00,000
(iv)	Scholarship paid to poor students	4,00,000
(v)	Amount spent on holding free eye camps in urban slums	3,00,000
(vi)	Amount set apart for setting up an old age home by March 2013	10,00,000

Compute the total income of the trust for the previous years 2009-2010 and 2014-2015 if it spends ₹ 5,00,000 during the previous year 2013-2014 and ₹ 3,00,000 during the previous year 2014-2015 in setting up the old age home.

Solution : (a) Computation of the taxable income of the trust for previous year 2010-2011/AY 2011-2012.

	Particulars		₹
(i)	Income from property held under charitable trust		20,00,000
(ii)	Income from voluntary contributions (₹ 15,00,000-₹ 5,00,000)		10,00,000
	Total		**30,00,000**
	Less: 15% set apart for future application		45,00.000
	Balance		**25,50,000**
	Less: Income applied for charitable purposes:		
(i)	Donations to blind charitable school	6,00,000	
(ii)	Scholarship to poor students	4,00,000	
(iii)	Free eye camps in urban slums	3,00,000	
	Total	**13,00,000**	
	Amount set apart for old age home	**10,00,000**	23,00,000
	Taxable income		**2,50,000**
(b)	Previous year 2014-2015 /AY 2015-2016:		
	Amount set apart for old age home	10,00,000	
	Less:		
1.	Amount spent during 2013-2014	3,00,000	
2.	Amount spent during 2014-2015	5,00,000	
	Taxable income	**2,00,000**	

Illustration 145 : CD Charitable Trust furnishes the following particulars, for the year 2010-2011:

(i)	Sale price of capital assets	15,30,000
(ii)	Expenses incurred in connection with sale of the asset	30,000
(iii)	Cost of the asset sold (purchased in 2009-2010)	5,00,000
(iv)	Compute capital gain in the following cases:	
	(a) Cost of the new asset to be acquired	15,00,000
	(b) Cost of the new asset to be acquired	8,00,000
	(c) Cost of the new asset to be acquired	4,00,000

Solution: Computation of capital gain: PY 2010-2011/AY 2011-2012

Particulars	Case-l ₹	Case-II ₹	Case-III ₹
Sale price Less:	15,30,000	15,30,000	15,30,000
(i) Selling expenses	(-) 30,000	(-) 30,000	(-) 30,000
(ii) Cost of the asset Short-term capital gain	(-) 5,00,000	(-) 5,00,000	(-) 5,00,000
	10,00,000	10,00,000	10,00,000
Less: Exemption in respect of capital gain	10,00,000	3,00,000	Nil
Taxable capital gain	Nil	7,00,000	10,00,000

Notes: 1. Cost of new asset - cost of asset sold: 8,00,000 - 5,00,000 = 3,00,000

2. Cost of new asset - cost of asset sold: 4,00,000 - 5,00,000 = Nil

ILLUSTRATIONS ON ASSESSMENT OF COOPERATIVE SOCIETIES

Illustration 146 : Dinesh Pally Cooperative Society Ltd. furnishes the following particulars of its income for the previous year ended on 31st March 2011:

(i)	Interest on government securities	40,000
(ii)	Profits from banking business	3,50,000
(iii)	Income from purchase and sale of agricultural implement and seeds to its members	2,50,000
(iv)	Income from marketing of agricultural produce of its members	4,00,000
(v)	Profits and gains of business	2,20,000
(vi)	Income from cottage industry	3,50,000
(vii)	Interest and dividends (gross) from other cooperative societies	30,000

Compute total income of the society and calculate the tax payable by it for the assessment year 2011-2012.

Solution :

Dinesh Pally Cooperative Society Ltd.

Previous Year : 2010-11 **Assessment Year : 2011-12**

Computation of Total Income

Particulars	₹	₹
1. Profits and gains of business or profession:		
a) Banking business	3,50,000	
b) Income from purchase and sale of agricultural implements and seeds to its members	2,50,000	
c) Income from marketing of agricultural produce of its members	4,00,000	
d) Profits and gains of business	2,20,000	
e) Income from cottage industry	3,50,000	15,70,000
2. Income from other sources:		
a) Interest on government securities	40,000	
b) Interest and dividends from other cooperatives	30,000	70,000
Gross Total Income		**16,40,000**
Less: Deduction allowable from gross total income under Sec. 80P		
1. Banking business	3,50,000	
2. Income from purchase and sale of agricultural implement and seeds to its members	2,50,000	
3. Income from marketing of agricultural produce of its members	4,00,000	
4. Income from cottage industry	3,50,000	
5. Interest on government securities(not eligible for deduction)	Nil	
6. Interest and dividends from other cooperative societies	30,000	13,80,000
Total Income		**2,60,000**

Computation of Tax Liability :

Particulars	Rate	₹
On first ₹ 10,000	10%	1,000
On next ₹ 10,000	20%	2,000
On balance ₹ 2,40,000	30%	72,000
Income tax payable		75,000
Add: Education cess @ 2%		1,5000
Add: SHEC @ 1%		750
Tax payable		**77,250**

Illustration 147 : A co-operative society, engaged in the business of banking, seeks your opinion by the matter of eligibility of deduction under Sec. 8OP on the following items of income earned by it during the year ending 31-3-2011.

(i) Interest on investment in government securities made out of statutory reserves

(ii) Hire charges of safe deposit lockers.

Answer : From the assessment year 2008-2009 and onward, no deduction is allowed under Sec. 80P to any cooperative bank. However, a primary agricultural credit society or primary cooperative agricultural and rural development bank is outside the purview of this provision [Sec. 80P(4)].

Illustration 148 : A cooperative society was engaged in the business of banking or providing credit facilities to its members. It sold goods on credit to its members. Is the cooperative society entitled to special deduction under Sec. 80P(2)(a)(i) in respect of income derived from such an activity?

Answer : Society is not entitled to the special deduction under Sec. 80P(2)(a)(i).

ILLUSTRATIONS ON ASSESSMENT OF HUF

Computation of Tax-liability of an HUF :	₹
1. Gross income tax on its total income at the prescribed rates as aforesaid:	
(a) Gross income tax on winnings under [Sec. 115BB]	xxx
(b) Gross income tax on long-term capital gains [Sec. 112(1)]	xxx
(c) Gross income tax on short-term capital gain (Sec. 111A)	xxx
(d) Gross income tax on the balance of total income	xxx
Total gross income tax	**xxx**
2. Less: Rebate from gross income tax under Sec. 88E	xxx
Net income tax	**xxx**
3. Add: Surcharge on income tax	**xxx**
4. Add: Education surcharge @ 2% on the aggregate income tax and surcharge	**xxx**
5. Add: SHEC @ 1%	**xxx**
Total tax (3 + 4+ 5)	**xxx**
6. **Less :**	
(a) Rebate on share of profit from AOP under Sec. 86 where AOP (association of person) has been taxed at normal rate	**xxx**
(b) Relief under Sec. 89(1)	**xxx**
(c) Double taxation relief under Sec. 91	**xxx**
Tax due from an HUF	
Less: Prepaid taxes:	
(a) Tax deducted at source	**xxx**
(b) Advance payment of tax	**xxx**
(c) Tax paid on self-assessment under Sec. 140A	**xxx**
Tax payable/refund due to the assessee	
Tax payable is rounded off to the nearest multiple of ₹ 10 (Sec. 288B).	**xxx**

Illustration 149 : The following details have been supplied by the Karta, of an HUF aged 67 years. You are required to compute its total income and tax liability for the assessment year 2011-2012.

Particulars	₹
(i) Profits from business (after charging ₹ 1,00,000 salary to Karta for managing the business).	15,00,000
(ii) Salary received by the member of a family.	60,000
(iii) Director's fee received by Karta from B Ltd where HUF holds 20% shares but he became director because of his qualifications,	40,000
(iv) Rental income from house property (after deduction of municipal taxes ₹ 2,000).	78,000
(v) Dividends (gross) from Indian companies	15,000
(vi) Long-term capital gain	80,000
(vii) Short-term capital gain	30,000
(viii) Donation to a school, which is an approved institution,	1,00,000
(ix) Deposits in Public Provident Fund	20,000
(x) NSC-VIII issues purchased	40,000

Solution: Computation of Total Income for the A.Y. 2011-12

Particulars	₹	₹
(i) Income from house property:		
Gross annual value (₹ 78,000 + ₹ 12,000)	90,000	
Less: Municipal taxes paid	12,000	
Annual value	78,000	
Less: Statutory deduction: 30% ×78,000	23,400	54,600
(ii) Profits and gains from business		15,00,000
(iii) Capital gains (a) long-term + (b) short-term		1,10,000
(iv) Income from other sources—gross dividends from Indian companies: Exempt [Sec. 10(34)]		Nil
Gross Total Income		**16,64,600**
Less:		
1. Contribution to approved savings (Sec. 80C)		
(i) Deposits in Public Provident Fund	20,000	
(ii) NSC-VIII Issue	40,000	60,000
2. Donation to recognised school:		
(a) Actual donation: ₹ 1,00,000 or		
(b) 10% of adjusted total income = (Gross Total Income – Long Term Capital Gains – All deductions under Chapter VIA excluding Sec. 80G) of ₹ 15,24,600 (16,64,600 - 80,000 - 60000) whichever is less, is qualifying amount.		
Amount of deduction: : 50% of ₹ 1,00,000	50,000	1,10,000
Total Income		15,54,600

Computation of Tax Liability :

Particulars of total income	Rate of income tax		₹
	₹	₹	
(a) Long-term capital gain	80,000	20%	16,000
(b) Balance of total income: ₹ 14,74,600			
(i) First	2,40,000	Nil	—
(ii) Between 2,40,000 – 5,00,000	3,60,000	10%	26,000
(iii) Between 5,00,000 – 8,00,000	3,00,000	20%	60,000
(iv) Between 8,00,000 – 14,74,600	6,74,600	30%	2,02,380
Gross Income Tax			**3,04,380**
Add: Education cess @ 2% on income tax			6,088
SHEC @ 1% on income tax			3,044
Tax payable			**3,13,512**
Rounded off u/s 288B			**3,13,510**

ASSESSMENT OF COMPANIES

Illustration 150 : From the following information, determine the tax liability of Z Ltd., domestic company, for the assessment year 2010-2011 and 2011-2012.

S. No.	Assessment year	Book-profits (₹)	Total income (₹)
1.	2010-2011	2,80,000	1,30,000
2.	2011-2012	3,00,000	2,00,000

Solution :

Surcharge is not considered assuming, net income less than Rs. 1 crore

Assessment year	Book-profit ₹	Total Income ₹	Tax on Book-Profit ₹	Tax on Total Income @ 30.9% rounded off u/s 288B ₹	Tax Credit = Tax on Book Profits (–) Tax on Total Income ₹	Tax Payable after tax credit set off, if any ₹	Tax credit balance ₹
2010-2011	2,80,000	1,30,000	@ 15.45% on 2,80,000 = 43,260	@ 30.9% on 1,30,000 = 40,170	3,090	43,260	3,090
2011-2012	3,00,000	1,50,000	@ 18.54% on 3,00,000 = 55,620	@ 30.9% on 2,00,000 = 61,800	—	58,710 [61,800 – 3,090]	—

Note : Tax payable is rounded off to the nearest multiple of ₹ 10 (Sec. 288B)

Illustration 151 : Fashion Ltd., a well-diversified group, gives below its profit and loss account for the financial year 2010-2011:

Particulars	₹	Particulars	₹
Manufacturing expenses	9,00,000	Sale of manufactured goods	10,00,000
Salaries/wages	5,50,000	Sale of agriculture produce	15,00,000
Cultivation expenses	4,00,000	Receipt from generation/distribution of power	15,00,000
Power generation/distribution expenses	4,00,000	Receipt from water supply/ irrigation projects	
Irrigation expenses	6,00,000	Receipt from I.U. set up in backward district	
Expenses of I.U., located in backward district	5,00,000	in July 2004	10,00,000
Expenses of I.U., located in free trade		Transfer from Reserve & Provision a/c,	
zone(Sec. 10A)	1,50,000	debited to profit and loss account in 2005-06	9,50,000
Expenses of I.U. (Sec. 10B)	1,00,000	on account of free service under	
Expenses of I.U. (Sec. 10C)	50,000	warranty period	2,00,000
Provision for losses of subsidiary	4,00,000	Sale of goods of I.U. (Sec. 10B)	2,00,000
Sundry expenses	10,000	Sale of goods of I.U, located in free trade	
Provision for bad and doubtful debts	2,00,000	zone (Sec. 10A)	1,00,000
Provision for bills under discount	50,000	Sale of goods of I.U. located in Nothern	
Provision for sales tax, wealth tax against		Easthern Region (NER) (Sec. 10C)	50,000
demand notice	3,30,000	Income from UTI	5,00,000
Income tax provision against demand notice	3,00,000		
Dividend paid on preference shares	2,00,000	Long term capital gain on sale of equity	
Proposed dividend on equity shares	4,00,000	shares, transaction chargeable to	
Transfer to general reserve	1,00,000	Securities Transaction Tax	35,00,000
Dividend Equalisation reserve	2,00,000		
Penalties under direct tax laws	60,000		
Goodwill written off	50,000		
Depreciation	3,00,000		
Amortisation of patent rights	30,000		
Expenses on transfer of equity shares	20,000		
Net profit	42,00,000		
	1,05,00,000		**1,05,00,000**

The following additional information is provided as below:

1. Depreciation includes, a sum of ₹1,00,000 on account of revaluation of building and plant and machinery.
2. Past year losses, before depreciation, are given below:

	Loss (₹)	Depreciation (₹)
2006-2007	(-) 5,00,000	(-) 6,00,000
2007-2008	Nil	(-) 5,00,000
2008-2009	(-) 7,00,000	(-) 4,00,000
2009-2010	(-) 5,00,000	Nil

Compute book-profits for the previous year 2010-2011/AY 2011-2012 for MAT under Sec. 115 JB.

Solution :

Previous Year : 2010-11 **Fashion Ltd.** **Assessment Year : 2011-12**

Computation of Book Profit

Particulars	₹	₹
Net profit as per profit and loss account		42,00,000
Add:		
(i) Cultivation expenses	4,00,000	
(ii) Expenses of I.U. located in Free Trade Zone (Sec. 10A)	1,50,000	
(iii) Expenses of I.U. under Sec. 10B	1,00,000	
(iv) Provision of loss of subsidiary	4,00,000	
(v) Provision for bad and doubtful debts— an unascertained liability	2,00,000	
(vi) Provision for bills under discount— an unascertained liability	50,000	
(vii) Provision for wealth-tax, sales- tax, against demand notice— an ascertained liability	—	
(viii) Income-tax provision— an ascertained liability to be added back	3,00,000	
(ix) Dividend paid on preference shares	2,00,000	
(x) Proposed dividend on equity shares	4,00,000	
(xi) Transfer to general reserve	1,00,000	
(xii) Dividend Equalisation reserve	2,00,000	
(xiii) Depreciation [Sec. 115JB(2)(g) w.e.f. AY 2011-2012]	3,00,000	28,00,000
Adjusted profits		**70,00,000**
Less:		
(i) Sales of agriculture produce [Sec. 10(1)]	10,00,000	
(ii) Receipt from I.U. in Free Trade Zone [Sec. 10A]	2,00,000	
(iii) Receipt from I.U. Sec. 10B	2,00,000	
(iv) Depreciation, excluding depreciation on account of revaluation of assets	2,00,000	
(v) Brought forward loss or depreciation, whichever is less.	9,00,000	
(vi) Withdrawals from Reserve & Provision for free sale service, under warranty scheme	9,50,000	
(vii) Long-term capital gain on transfer of equity shares {Sec. 10(38)] — see Note below	Nil	
(viii) Receipts from UTI [Sec. 10(35)]	50,000	35,00,000
Book-profits		**35,00,000**

Note: 1. Calculation of brought forward losses or depreciation:

2006-2007	Loss	5,00,000
2007-2008	Loss/depreciation	Nil
2008-2009	Depreciation	4,00,000
2009-2010	Loss/depreciation	Nil

1. Transfer from provision for after sale service, free of cost, made during the year 2005-2006, debited to profit and loss a/c and now credited to profit and loss a/c and now credited to profit and loss a/c is an allowable deduction [Sec. 115-JB(2)].
2. Long-term capital gain from the transfer of equity shares in a company is exempt is chargeable to securities trans action tax (STT). However, for the purposes of computing book-profits, it is not to be deducted [Sec. 10(38)]. Accordingly, the expenditure incurred for the transfer of equity shares has not been added back in computing book profits.

Illustration 152 : Classic Exporters Ltd, runs a new industrial undertaking set up in 2005-2006 which satisfies the conditions of Sec. 80-IB. Given below is the profit and loss account for the previous year 2010-2011.

Particulars	₹	Particulars	₹
Stock	4,00,000	Domestic sales	24,00,000
Purchases	23,00,000	Export sales	43,00,000
Salaries and wages	9,70,000	Export incentives Sec. 28(iiia)/(iiic)	50,000
Entertainment expenses	1,30,000	Profit of foreign branch	2,50,000
Freights and insurance attributable to exports	3,00,000	Brokerage/commission/interest/ rent, etc	50,000
Travelling expenses	2,20,000	Transfer from contingency reserve	10,00,000
Depreciation	1,50,000	Stock	3,50,000
Selling expenses	1,20,000		
Income tax paid	90,000		
Income-tax penalty	20,000		
Wealth tax paid	10,000		
Custom duty payable against demand notice	30,000		
Provision for unascertained liabilities	20,000		
Provision for ascertained liabilities	50,000		
Proposed dividend	3,00,000		
Loss of subsidiary company	50,000		
Net profit	32,40,000		
	84,00,000		84,00,000

You are further informed:

(i) Excise duty for 2009-2010, amounting ₹ 1,20,000 was paid on 15 December 2010.

(ii) Depreciation under Sec. 32 is ₹ 2,20,000.

(iii) During the year 2007-2008, contingency reserve, amounting ₹ 10,00,000, debited to profit and loss a/c, was added back to the extent of ₹ 4,00,000 in the computation of book-profits. The company has transferred the said reserve to the profit and loss a/c during the year.

(iv) Brought forward business loss/depreciation:

PY	Accounting purposes		Tax purposes	
	Loss	Depreciation	Loss	Depreciation
2006-2007	(-) 10,00,000	(-) 1,00,000	(-) 5,00,000	(-) 2,50,000
2007-2008	(-) 2,00,000	(-) 3,00,000	(-) 1,00,000	(-) 2,00,000

Compute the following: (a) Total income, (b) Book-profits and (c) Tax liability.

Solution :

Previous Year : 2010-11 **Classic Exporters Ltd.** **Assessment Year : 2011-12**

Computation of Total Income

Particulars	₹	₹
Net profit as per Profit & Loss A/c		32,40,000
Add : Expenses debited to P/L A/c – disallowed		
(i) Income tax	90,000	
(ii) Wealth tax	10,000	
(iii) Custom duty payable	30,000	
(iv) Provision for unascertained liability	20,000	
(v) Proposed dividend	3,00,000	
(vi) Loss of subsidiary company	50,000	
(vii) Income-tax penalty	20,000	5,20,000
		37,60,000
Less : Allowable Expenses and wrong credits in P/L A/c		
(i) Withdrawals from contingency reserve	10,00,000	
(ii) Excise duty	1,20,000	
(iii) Depreciation	70,000	
(iv) Brokerage, commission, interest and rent, etc.	50,000	12,40,000
Business Profits		**25,20,000**
Add: Income from other sources: Brokerage/ commission, etc.		50,000
Aggregate Income		**25,70,000**
Less: (i) Brought forward losses (Sec. 72)	6,00,000	
(ii) Brought forward depreciation [Sec. 32(2)]	4,50,000	10,50,000
Gross Total Income		**15,20,000**
Less: Profit from industrial undertaking Sec. 80IB: 30% of ₹ 15,20,000 as included in GTI		4,56,000
Total Income		**10,64,000**

(b) Computation of Book Profits for the AY 2011-2012

Particulars	₹	₹
Net profits as per Profit & Loss A/c		32,40,000
Add : Expenses disallowed		
(i) Income tax	90,000	
(ii) Provision for unascertained liability	20,000	
(iii) Proposed dividend	3,00,000	
(iv) Loss of subsidiary	50,000	4,60,000
		37,00,000
Less : Allowable expenses and wrong credit in P/L A/c		
(i) Withdrawals from contingency reserve	4,00,000	
(ii) Brought forward business loss or depreciation whichever is less		
2006-2007 Depreciation	1,00,000	
2007-2008 Loss	2,00,000	7,00,000
Book-profits		**30,00,000**

(c) Computation of tax liability for the AY 2011-2012

Particulars	₹
(a) Tax on Total Income (including Education Cess and SHEC) = 30.9% of 10,64,000	3,28,776
(b) Tax on Book Profits (including Education Cess and SHEC) = 18.54% on 30,00,000	5,56,200
Tax payable	**5,56,200**

Note :

(i) No adjustment is required for depreciation debited to profit and loss a/c because it is not on account of revaluation of any asset.

(ii) MAT credit available ₹ (5,56,200 – 3,28,776) = ₹ 2,27,424

Illustration 153 : Z Ltd is a qualifying shipping company which has got two qualifying ships during the previous year 2010-2011 :

Ship	Tonnage weight	No. of operational days
Ship A	37,949 tonnes and 990 kg	300 days
Ship B	25,550 tonnes and 275 kg	365 days

Compute its tonnage income under Tonnage Tax Scheme for the assessment year 2011-2012.

Solution :

Computation of Tonnage Income under Tonnage Tax Scheme

Ship A	Ship B
(i) Tonnage consisting of kilograms is ignored.	(i) Tonnage consisting of kilograms is ignored.
(ii) If such tonnage is not a multiple of 100 tonnes and the last two digits are less than 50, the tonnage is reduced the tonnage is reduced to the previous lower tonnage which is a multiple of 100.	(ii) If such tonnage is not a multiple of 100, and last two degits are 50 or more, the tonnage is increased to next higher tonnage which is a multiple of 100
(iii) Tonnage rounded off = 37,900 tonnes	(iii) Tonnage rounded off - 25,600 tonnes

Income— computation under TTS		**Income— computation under TTS**	
Daily TI:	₹	**Daily TI:**	₹
First 1,000 tonnes = ₹ 46 × 10 =	460	First 1,000 tonnes = ₹ 46 × 10 =	460
Next 9,000 tonnes = ₹ 35 × 90 =	3150	Next 9,000 tonnes = ₹ 35 × 90 =	3150
Next 15,000 tonnes = ₹ 28 × 150 =	4200	Next 15,000 tonnes = ₹ 28 × 150 =	4200
Balance 12,900 tonnes = ₹ 19 × 129 =	2451	Balance 600 tonnes = ₹ 19 × 6 =	114
Daily TI:	10,261	Daily TI:	7,924
Total TI for the previous year ₹ 10, 261 × 300 =	30,78,300	Total TI for the previous year ₹ 7,924 × 365	28,92,260

9.15 CLUBBING OF INCOME

Certain provisions are included in the act as anti tax avoidance measures. Provisions for inclusion in assessee's income, income of some other person, who is not at arm's length, are a kind of such provisions. Such provisions arrest tax leakage likely to result from certain transactions with relatives or diversion of title without loosing control over the same, etc.

ENCOMPASS OF CLUBBING PROVISIONS

1	Clubbing of income where control over assets or income is retained while title is transferred	Sections 60, 61, 64(1)(iv),(vi),(vii),(viii)
2	Clubbing of income of relatives under certain circumstances.	Sections 64(ii)
3	Clubbing of income of minor child	Section 64(1A)

TRANSFER OF ASSETS [Sec. 60]

Where any person transfers income without transferring the ownership of the asset, such income is taxable in the hands of the transferor. Such transfer may be revocable or irrevocable. The provision applies irrespective of the time when the transfer has been made i.e. it may be before or after the commencement of the Income-tax Act.

REVOCABLE TRANSFER OF ASSETS [Sec. 61]

Any income arising to any person by virtue of revocable transfer of assets is chargeable to tax as the income of transferor. For this purpose, transfer may include any settlement or agreement.

The transfer is said to be revocable if it contains any provision for the re-transfer of the whole or any part of the income or assets to the transferor a right to reassume power over the whole or any part of the income or assets.
If any settlement contains a clause for forfeiture of rights of beneficiaries under certain circumstances, the settlement will be regarded as revocable – CIT *v.* Bhubaneshwar Kuer 53 ITR 195 (SC).

This section is, however, not applicable in the following cases-

(i) Where the income arises to any person by virtue of a transfer by any of the trust, which is not revocable, during the lifetime of the beneficiary and, in case of any transfer, which is not revocable, during lifetime of the transferee.

(ii) Where the income arises to any person by virtue of a transfer made before 1.4.1986, which is not revocable for a period of six years or more. However, income will be chargeable to tax as the income of the transferor as and when the power to revoke the transfer comes into play.

IRREVOCABLE TRANSFER OF ASSETS FOR SPECIFIED PERIOD [Sec.62]

(1) The provisions of section 61 shall not apply to any income arising to any person by virtue of a transfer—

  (i) by way of trust which is not revocable during the lifetime of the beneficiary, and, in the case of any other transfer, which is not revocable during the lifetime of the transferee ; or

  (ii) made before the 1st day of April, 1961, which is not revocable for a period exceeding six years :

  Provided that the transferor derives no direct or indirect benefit from such income in either case.

(2) Notwithstanding anything contained in sub-section (1), all income arising to any person by virtue of any such transfer shall be chargeable to income-tax as the income of the transferor as and when the power to revoke the transfer arises, and shall then be included in his total income.

TRANSFER AND REVOCABLE TRANSFER DEFINED [Sec.63]

For the purposes of sections 60, 61 and 62 and of this section,—

(a) a transfer shall be deemed to be revocable if—

  (i) it contains any provision for the re-transfer directly or indirectly of the whole or any part of the income or assets to the transferor, or

  (ii) it, in any way, gives the transferor a right to re-assume power directly or indirectly over the whole or any part of the income or assets ;

(b) "transfer" includes any settlement, trust, covenant, agreement or arrangement

REMUNERATION OF SPOUSE [Sec. 64(1)(ii)]

An individual assessee is chargeable to tax in respect of any remuneration received by the spouse from a concern in which the individual has substantial interest. However, remuneration which is solely attributable to technical or professional knowledge and experience of the spouse, will not be clubbed. Where both the spouses have a substantial interest in the concern and both are in receipt of the remuneration for such concern, such remuneration will be included in the total income of the husband or wife whose total income excluding such remuneration is greater.

The individual is deemed to have substantial interest, if the beneficiary holds equity share carrying not less than 20% voting power in the case of a company or is entitled to not less than 20% of the profits, in any other concern, not being a company at time during the Previous Year.

INCOME FROM ASSETS TO SPOUSE [Sec. 64(1)(iv)]

Where an asset (other than House Property) is transferred by an individual to his or her spouse directly or indirectly otherwise than for adequate consideration or in connection with an agreement to live apart any income from such asset will be deemed to be the income of transferor.

However, this section is not applicable in the following cases—

(a) if assets are transferred before marriage.
(b) if assets are transferred for adequate consideration.
(c) if assets are transferred in connection with an agreement to live apart.
(d) if on the date of accrual of income, the transferee is not spouse of the transferor.
(e) if property is transferred by the Karta of HUF, gifting co-parcenary property to his wife.
(f) the property is acquired by the spouse out of the pin money (i.e., an allowance given to the wife by her husband for her dress and usual household expenses).

INCOME FROM ASSETS TRANSFERRED TO SON'S WIFE OR MINOR CHILD [Sec. 64(1)(vi)]

If an individual directly or indirectly transfers the assets after 1.6.73 without adequate consideration to son's wife or son's minor child (including son's minor step child or son's minor adopted child), income arising from such assets will be included in the total income of the transferor from the Assessment Year 1976-77 onwards.

INCOME FROM ASSETS TRANSFERRED TO A PERSON FOR THE BENEFIT OF SPOUSE OR MINOR CHILD [Sec. 64(1)(vii)]

Where an asset is transferred by individual, directly or indirectly, without adequate consideration to a person or persons for the immediate or deferred benefits of his or her spouse, income arising from the transferred assets will be included in the total income of the transferor to the extent of such benefit. If no income is accrued out of the property transferred by an individual, then nothing will be included in the income of the individual.

INCOME FROM ASSET TRANSFERRED TO A PERSON FOR THE BENEFIT OF SON'S WIFE [Sec. 64 (1)(viii)]

Where an asset is transferred by an individual, directly or indirectly, or after 1.6.73 without adequate consideration to a person or an association of persons for the immediate or deferred benefits of son's wife, income arising directly or indirectly from transferred asset will be included in the total income of the transferor to the extent of such benefit with effect from the Assessment Year 1985-86.

INCOME OF MINOR CHILD [Sec. 64(1A)]

In computing the total income of any individual, there shall be included all such income as arises or accrues to his minor child. However, income of the following types will not be included in the total income of the individual where income arises or accrues to the minor child on account of any—

(a) manual work done by him; or

(b) activity involving application of his skill, talent or specialised knowledge and experience.

Person in whose hands to be clubbed :

(i) 1st year : that parent whose income is higher. Subsequent years; the same parent – unless the AO is satisfied that it should be clubbed with the other parent.

(ii) where marriage does not subsist, in the hands of the custodian parent.

However, a deduction — Upto ₹. 1,500 per minor [Sec. 10(32)] shall be allowed against such income which is clubbed in the hands of the parent.

CONVERSION OF SELF-ACQUIRED PROPERTY INTO JOINT FAMILY AND SUBSEQUENT PARTITION [Sec. 64(2)]

Where a member of a HUF has converted his self-acquired property into joint family property after 21.12.1969, income arising from the converted property will be dealt with as follows :-

(i) For the Assessment Year 1976-77 onwards, the entire income from the converted property is taxable as the income of the transferor.

(ii) If the converted property is subsequently partitioned amongst the members of the family, the income derived from such converted property, as is receivable by the spouse and minor child of the transferor will be taxable in his hands.

INCOME FROM THE ACCRETION TO ASSETS

In the above mentioned cases the income arising to the transferee from the property transferred, is taxable in the hands of the transferor. However, income arising to the transferee from such property is not includible in the total income of the transferor. Thus, if Mr. A transfers ₹. 60,000 to his wife without any adequate consideration and Mrs. A deposits the money in a bank, the interest received from the bank on such deposits is taxable in the hands of Mr. A. If however, Mrs. A purchases shares in a company from the accumulated interest, the dividend received by Mrs. A, will be taxable in her hands and will not be clubbed with the income of Mr. A.

CLUBBING OF NEGATIVE INCOME [EXPLANATION TO Sec. 64]

The income of a specified person is liable to be included in the total income of the individual in the circumstances mentioned earlier. For the purposes of including income of the specified person in the income of the individual, the word "income" includes a loss.

RECOVERY OF TAX U/S. 60 TO 64 [Sec. 65]

As per incomes belonging to ss. 60 to 64 to other persons are included in the total income of the assessee in such cases, by virtue of sec. 65, the actual recipient of income is liable, on the service of notice of demand, to pay the tax assessed in respect of income included in the income of other person (where the Income Tax Officer so desires).

ILLUSTRATIONS ON CLUBBING OF INCOME

Illustration 154 : Mrs.G holds 7% equity shares in B Ltd., where her married sister, Mrs. N also holds 14% equity shares. Mr.G is employed with C Ltd., without holding technical professional qualification. The particulars of their income for the previous year 2010-2011 are given as follows:

	Income of Mr G ₹	Income of Mrs G ₹
(i) Gross salary from B Ltd.	1,02,000	—
(ii) Dividend from B Ltd.	—	6,000
(iii) Income from house property	90,000	—

Solution : **Computation of Total income of Mr. G & Mrs. G for the A.Y. 2011-2012**

Particulars	Mr. G ₹	Mrs. G ₹
Gross salary		1,02,000
Taxable salary to be included in the total income of Mrs G [Sec. 64(1)(ii)]		
Add: Income from house property	90,000	
Add: Income from other sources : Dividends to Mrs G, but exempt under Sec. 10(34)	Nil	
Total Income	90,000	1,02,000

Notes:

1. In the instant case, Mrs G along with his sister, holds substantial interest in B Ltd., Mr. G does not hold professional qualification. Accordingly, remuneration of Mr.G has been included in the total income of Mrs. G.
2. If the requisite conditions of clubbing are satisfied, clubbing provision will apply even if their application results into lower incidence of tax.

Illustration 155 : Mrs. C, a law graduate, is legal advisor of L Ltd. She gets salary of ₹ 1,80,000. Mr. C is holding 20% shares in L Ltd. His income from business, during the previous year 2010-2011 is ₹ 4,00,000. Compute their total income.

Solution : **Computation of Total income of Mr. C & Mrs. C for the A.Y. 2011-2012**

Particulars	Mr. C ₹	Mrs. C ₹
1. Gross salary		1,80,000
2. Business profits	4,00,000	—
Total income	4,00,000	1,80,000

Note: Since Mrs. C holds professional qualification, salary income is assessable in her hands.

Illustration 156 : Mr B holds 5% shares in A Ltd., where his brother and nephew hold 11% and 6% shares, respectively. Mrs B gets commission of ₹ 1,00,000 from A Ltd. for canvassing orders. She holds no technical/professional qualification. Mr B earns income of ₹ 5,00,000 from sugar business.

Solution : **Computation of Total Income for the AY 2011-12**

Particulars of income	Mr. B ₹	Mrs. B ₹
Income from sugar business Commission for canvassing orders from Z Ltd.: Income from other sources	2,00,000	90,000
Total Income	2,00,000	90,000

Note: In the instant case, Mr B holds 7% and his brother holds only 12% shares in A Ltd. The total of their shareholding is less than 20%. They have no substantial interest.

Therefore, commission income is assessable as income of Mrs B.

Illustration 157 : The shareholding of Mr K and Mrs K in S Ltd, is given as follows:

(i)	Shareholding of K	7%
(ii)	Shareholding of Mrs K	9%
(iii)	Shareholding of M, brother of K	8%
(iv)	Shareholding of F, father of Mrs K	5%

Mr K and Mrs K are employed with S Ltd. None of them hold technical qualification. Mr K gets salary @ ₹ 10,000 p.m and Mrs K gets @ ₹ 12,000 p.m.

Income from other sources:	₹
Mr K	80,000
Mrs K	1,00,000

Compute total income for the assessment year 2011-2012

Solution : **Computation of Total Income for the AY 2011-12**

Particulars	Mr. K	Mrs. K
1. Gross Salary	1,20,000	1,44,000
Salary income of Mr.K to be included in the total income of Mrs.K as her income from other sources is greater and both of them have substantial interest alongwith their relative in s Ltd.		1,20,000
2. Income from other sources	80,000	1,00,000
Total Income	80,000	3,64,000

Illustration 158 : Mr A gifts ₹ 4,00,000 to Mrs A 1st February 2011. Mrs A starts crockery business and invests ₹ 1,00,000 from her account also. She earns profit of ₹ 60,000 during the period ending on 31 March 2011. How would you tax the business profits?

Answer: Proportionate profits, in proportion the gifted amount from the spouse on the first day of the previous year bears to the total investment in the business on the first day of the previous year, will be taxable in the income of the transferor spouse:

As Mrs A has started the new business, the first previous year will begin on the date of setting up and will end on 31 March, immediately following. Thus, the first previous year will consist a period of 2 months from 1 February 2011, to 31 March 2011. Therefore, proportionate profit of ₹ 50,000, computed as below, will be included in the income of Mr. A:

$$\frac{4{,}00{,}000}{5{,}00{,}000} \times 60{,}000 = 48{,}000$$

Illustration 159 : Mr A gifts ₹ 3,00,000 to Mrs A on 1st February 2011. Mrs A invests the same in the existing crockery business where she has already invested ₹ 5,00,000. Mrs A earns ₹ 3,00,000 from the business during the year 2010-2011 ending on 31 March 2011 How would you assess the profits?

Answer: The previous year of the existing business is April to March. On the first day of the previous year (i.e. 1 April 2010), total investment has come from Mrs A account. As the proportion of the gifted amount from spouse on 1 April 2010 to the total investment in business on the same day is **NIL**, the whole of the profits of ₹ 3,00,000 for the year 2010-2011 will be included in the total income of Mrs A.
From the previous year 2010-2011, 60% [= 3,00,000/5,00,000 × 100] of the business profits will be included in the total income of Mr A.

Illustration 160 : Mrs Z is the owner of the business units A and B. A unit has been started with capital contribution from Mr Z and B unit has been started out of capital contribution from Mrs.Z. The particulars of their income for the previous year 2010-2011 are as follows:

Particulars	Mrs Z	Mr Z
(i) Income from A unit	—	(–) 6,00,000
(ii) Income from B unit	4,00,000	—
(iii) Income from house property		2,50,000

How would you assess them for the assessment year 2011-2012?

Answer :

(a) Mrs Z is assessable on the profits from B unit. She cannot set-off the loss from A unit against the profits of B unit. Thus, she would be assessed on ₹ 4,00,000.

(b) The loss from A unit will be included in the total income of Mr Z in view of Sec. 64(1)(iv). “Income” includes “loss” also. Mr Z is entitled to set-off business loss of A’s unit against income from house property. Thus, loss of ₹ 3,50,000 would be carried forward but could be set-off only against business profits.

Illustration 161 : Mr Goutam, out of his own funds, had taken a FDR for ₹ 1,00,000 bearing interest @ 10% p.a. payable half-yearly in the name of his wife Latika. The interest earned for the year 2010-2011 of ₹ 10,000, was invested by Mrs Latika in the business of packed spices which resulted in a net profit of ₹ 55,000 for the year ended 31st March 2011. How shall the interest on FDR and income from business be taxed for the Assessment year 2011-2012?

Answer: Where an individual transfers an asset (excluding house property), directly or indirectly to his/her spouse, otherwise than for adequate consideration, or in connection with an agreement to live apart, income from such asset is included in the total income of such individual [Sec. 64(1)(iv)].
Accordingly, interest on FDR, accruing to wife, is included in the total income of her husband. However, business profits cannot be clubbed with total income of husband. Clubbing applies only to the income from assets transferred without adequate consideration. It does not apply to the income from accretion of the transferred assets. Hence, business profit is taxable as the income of wife.

Illustration 162 : Sawant is a fashion designer having lucrative business. His wife is a model. Sawant pays her a monthly salary of ₹ 20,000. The Assessing Officer while admitting that the salary is an admissible deduction, in computing the total income of Sawant had applied the provisions of Sec. 64(1) and had clubbed the income (salary) of his wife in Sawant’s hands.
Discuss the correctness of the action of the Assessing Officer.

Answer: Where an individual has got substantial interest in a concern and his spouse derives any income from such concern by way of salary, commission, fees or by any other mode, such income is clubbed with the total income of such individual [Sec. 64(1)(ii)].
However, clubbing provision does not apply if the earning spouse holds technical or professional qualification and the income is solely attributable to the application of such knowledge and experience.
Salary earned by wife as model from the concern where her husband holds substantial interest is assessable as her income.

Illustration 163 : Discuss whether the loss could be set-off in the following case:

Smt. Vatika carried on business with the gifted funds of her husband Mr.Dabuu. For the previous year ending 31.3.2010,Vatika incurred loss of ₹ 5 lakh which loss Dabbu wants to set-off from his taxable income.

Answer: Funds for business were gifted by husband to wife. Accordingly, income from business should be clubbed with the income of husband [Sec. 64(1)(iv)].
“Income” includes “loss” also. Hence, husband is entitled to set-off the business loss of wife against his taxable income.

9.16 REFUND

WHEN RIGHT TO CLAIM REFUND ARISES [Sec. 237]

Where any person satisfies the Assessing Officer that the amount of tax paid by him or on his behalf for any assessment year exceeds the amount with which he is properly chargeable under this Act for that year, he is entitled to the refund of the excess amount paid.

Case Law :

(i) The tax paid by the assessee must be accepted as it is, and in the event of the tax paid being in excess of the tax liability duly computed on the basis of return furnished and the rates applicable, the excess shall be refunded to the assessee, since its retention may offend article 265 of the Constitution - *CIT* v. *Shelly Products* 261 ITR 367.

WHO CAN CLAIM REFUND ? [Sec. 238]

Usually refund can be claimed by a person who has made excess payment of tax. If income of a person is included in the total income of another person u/s. 60 to 64, the refund can be claimed by the latter and not by the former. Where a person cannot claim any refund because of his death, incapacity, insolvency, liquidation or other cause, his legal representatives or the trustee or guardian or receiver, as the case may be, will be entitled to claim and receive such refund for the benefit of such person or his estate.

Where the value of fringe benefits provided or deemed to have been provided by one employer is included under any provisions of Chapter XII-H in the value of fringe benefits provided or deemed to have been provided by any other employer, the latter alone shall be entitled to a refund under this Chapter in respect of such fringe benefits.".

HOW TO CLAIM REFUND [Sec. 239]

Refund claim should be made in Form No. 30 and verified in the prescribed manner.

In the following cases, where an otherwise valid refund claim u/s. 237 is filed by an assessee after the expiry of the time limit, the Assessing Officer, may admit the refund claim if the following conditions are satisfied-

1. The refund arising as a result of tax deducted at source in respect of the assessment year under the provisions of section 192, 193, 194, 194A, 194B, 194C, 194D and 195 does not exceed ₹ 10,000;
2. the income returned is not a loss where the assessee claims the benefit of carry forward of the loss;
3. the refund claim is not supplementary in nature; and
4. the amount of the assessee is not assessable in the hands of any other person under any provisions of the Act.

   Moreover, the A.O. is authorised to admit belated return claims upto ₹ 10,000 where the following conditions are satisfied –

   (i) the refund arising as a result of excess advance tax payment in respect of assessment year under the provisions of sec. 208, does not exceed ₹ 10,000;

   (ii) the returned income is not a loss, where the assessee claims the benefit of carry forward of the loss;

   (iii) the refund claimed is not supplementary in nature, i.e. a claim for additional amount of refund after the completion of the original assessment for the same assessment year ; and

   (iv) the income of the assessee is not assessable in the hands of any other person under section any provisions of the Act.

Case Law :

(i) Board is competent to admit an application for refund even after expiry of period prescribed under section 239, for avoiding genuine hardship in any case or class of cases. Union of India v. Azadi Bachao Andolan 263 ITR 706.

REFUND ON APPEAL [Sec. 240]

iii) Assessee is entitled to interest if the interest is paid u/s 220(2) subsequently becomes refundable: Interest u/s 244A is payable in respect of the amount of interest earlier paid by the assessee u/s 220(2) but later determined as refundable. Modipon Ltd. V CIT 270 ITR 257.

Case Laws :

(i) Revenue is liable to pay interest on the amount of interest which it should have paid to the assessee but has unjustifiably failed to do - *CIT* v. *Narendra Doshi* 254 ITR 606/122 Taxman 717.

(ii) Interest on delayment payment of interest: The Department is liable to pay interest on interest under sections 214 and 244(1A) if payment of interest is delayed - *MC, Nally Bharat Engg. Co. Ltd.* v. *CIT* Tax L.R. 638

(iii) Calculation of interest Interest cannot be granted till date of dispatch of refund order but it has to be granted till date when order regarding payment of interest has been signed - *Rajasthan State Electricity Board* v. *CIT* 281 ITR 274

(iv) Where return is filled belatedly: Where delay in completion of assessment which led to refund was on account of delay in filing returns by assessee, assessee was not entitled to interest for period of said delay in terms of section 244A(2) - *M. Ahammadkutty Haji* v. *Chief CIT* 155 Taxman 315

SET OFF OF REFUNDS AGAINST THE REMAINING PAYABLE [Sec. 245]

Where a refund is found to be due to any person, the tax authorities may, in lieu of payment of the refunds, set off the amount of refund against the sum payable under the Income-tax Act.

Case Law :

(i) Prior intimation to assessee whether mandatory: While making set off of refunds against tax remaining payable, intimation is certainly not a jurisdictional requirement and absence thereof is merely an irregularity and, therefore, want of intimation would not vitiate the adjustment - *Brij Bhushan Lal & Sons* v. *Designated Authority* 246 ITR 353

(ii) Refund due to assessee cannot be adjusted against demand raised, against a third party *Archana Shukla* v. *Joint CIT* 244 ITR 829.

Where refund arises as a result of any order passed in appeal or other proceedings under the Act, no formal application from the assessee is required. The AO has to grant refund suo moto.

Case Laws :

(i) Clause (*a*) of proviso to section 240 added with effect from 1-4-1989 is merely clarificatory and hence, must be held to be retrospective - *CIT* v. *Chittoor Electric Supply Corpn.* 212 ITR 404 /*CIT* v. *Shelley Products* 261 ITR 367

Correctness of assessment not to be questioned [Sec. 242]

In a claim under this Chapter, it shall not be open to the assessee to question the correct ess of any assessment or other matter decided which has become final and conclusive or ask for a review of the same, and the assessee shall not be entitled to any relief on such claim except refund of tax wrongly paid or paid in excess.

INTEREST ON DELAYED REFUNDS. [Sec. 243.]

[(1) If the [Assessing] Officer does not grant the refund,—

(*a*) in any case where the total income of the assessee does not consist solely of income from interest on securities or dividends, within three months from the end of the month in which the total income is determined under this Act, and

b) in any other case, within three months from the end of the month in which the claim for refund is made under this Chapter, the Central Government shall pay the assessee simple interest at [fifteen] per cent per annum on the amount directed to be refunded from the date immediately following the expiry of the period of three months aforesaid to the date of the order granting the refund.

Explanation.—If the delay in granting the refund within the period of three months aforesaid is attributable to the assessee, whether wholly or in part, the period of the delay attributable to him shall be excluded from the period for which interest is payable.]

(2) Where any question arises as to the period to be excluded for the purposes of calculation of interest under the provisions of this section, such question shall be determined by the [Chief Commissioner or Commissioner] whose decision shall be final.

(3) [The provisions of this section shall not apply in respect of any assessment for the assessment year commencing on the 1st day of April, 1989 or any subsequent assessment years.]

Interest on refund where no claim is needed [Sec. 244]

(1) Where a refund is due to the assessee in pursuance of an order referred to in Section 240 and the [Assessing] Officer does not grant the refund within a period of [three months from the end of the month in which such order is passed], the Central Government shall pay to the assessee simple interest at [fifteen] per cent per annum on the amount of refund due from the date immediately following the expiry of the period of [three] months aforesaid to the date on which the refund is granted.

(1A) Where the whole or any part of the refund referred to in sub-section (1) is due to the assessee, as a result of any amount having been paid by him after the 31st day of March, 1975, in pursuance of any order of assessment or penalty and such amount or any part thereof having been found in appeal or other proceeding under this Act to be in excess of the amount which such assessee is liable to pay as tax or penalty, as the case may be, under this Act, the Central Government shall pay to such assessee simple interest at the rate specified in sub-section (1) on the amount so found to be in excess from the date on which such amount was paid to the date on which the refund is granted :

Provided that where the amount so found to be in excess was paid in instalments, such interest shall be payable on the amount of each such instalment or any part of such instalment, which was in excess, from the date on which such instalment was paid to the date on which the refund is granted :

Provided further that no interest under this sub-section shall be payable for a period of one month from the date of the passing of the order in appeal or other proceeding :

Provided also that where any interest is payable to an assessee under this sub-section, no interest under sub-section (1) shall be payable to him in respect of the amount so found to be in excess.]

(2) Where a refund is withheld under the provisions of Section 241, the Central Government shall pay interest at the aforesaid rate on the amount of refund ultimately determined to be due as a result of the appeal or further proceeding for the period commencing after the expiry of [three months from the end of the month in which the order referred to in Section 241 is passed] to the date the refund is granted.

(3) [The provisions of this section shall not apply in respect of any assessment for the assessment year commencing on the 1st day of April, 1989, or any subsequent assessment years.]

INTEREST ON REFUND [Sec. 244A]

Interest on Refund of Income Tax: Where refund of any amount becomes due to the assessee under the Income Tax Act, he shall be entitled to receive, in addition to the said amount, simple interest on the refund calculated in the following manner:

(a) Where the refund is out of any tax deducted at source/ tax collected at source or advance tax paid during the financial year, interest will be paid at the rate of ½%, per month or part of a month from the period starting from 1st day of April of the assessment year to the date on which refund is granted.

However, no interest shall be payable if the amount of refund is less than 10% of the tax determined u/s 143(1).

(b) In other cases, interest shall be paid @ ½% per month for every month or part of month for the period commencing from the date of payment of tax or penalty to the date on which refund is granted.

Interest on Refund of Fringe Benefit Tax: Section 244A also provides for interest @ ½% for every month or part of the month shall be payable where refund of any amount out of fringe benefit tax paid by way of advance tax becomes due.

However, no interest shall be payable if the amount of refund is less than 10% of the tax determined u/s 115WE (1).

Similarly interest @ ½% for every month or part of month shall be payable in any other case for the period or periods from the date or dates of payment of tax or penalty to the date on which the refund is granted.

Judicial Decisions

(i) Section 244(1) nowhere speaks of interest. Provisions of section 240 & 244 reveal liability to pay interest on delayed payment of refund amount but do not provide for payment of any interest on interest even though there is delay in payment of such interest to assessee. Sandvik Asia Ltd. V CIT 280 ITR 643 (SC)

(ii) As the assessee has not received the refund of the excess advance tax, he preferred a writ petition before the Delhi High Court. When the writ petition was pending, the Department granted refund of advance tax along with interest thereon. The petitioner claimed interest on delayed payment of interest. The Delhi High Court held that the petitioner is entitled to interest on delayed payment of interest & accordingly directed the revenue to pay interest on interest. R.K. Jain & Sons v CIT193 CTR 659.

(iii) Assessee is entitled to interest if the interest is paid u/s 220(2) subsequently becomes refundable: Interest u/s 244A is payable in respect of the amount of interest earlier paid by the assessee u/s 220(2) but later determined as refundable. Modipon Ltd. V CIT 270 ITR 257.

Case Laws :

(i) Revenue is liable to pay interest on the amount of interest which it should have paid to the assessee but has unjustifiably failed to do - *CIT* v. *Narendra Doshi* 254 ITR 606/122 Taxman 717.

(ii) Interest on delayment payment of interest: The Department is liable to pay interest on interest under sections 214 and 244(1A) if payment of interest is delayed - *MC, Nally Bharat Engg. Co. Ltd.* v. *CIT* Tax L.R. 638

(iii) Calculation of interest Interest cannot be granted till date of dispatch of refund order but it has to be granted till date when order regarding payment of interest has been signed - *Rajasthan State Electricity Board* v. *CIT* 281 ITR 274

(iv) Where return is filled belatedly: Where delay in completion of assessment which led to refund was on account of delay in filing returns by assessee, assessee was not entitled to interest for period of said delay in terms of section 244A(2) - *M. Ahammadkutty Haji* v. *Chief CIT* 155 Taxman 315

SET OFF OF REFUNDS AGAINST THE REMAINING PAYABLE [Sec. 245]

Where a refund is found to be due to any person, the tax authorities may, in lieu of payment of the refunds, set off the amount of refund against the sum payable under the Income-tax Act.

Case Law :

(i) Prior intimation to assessee whether mandatory: While making set off of refunds against tax remaining payable, intimation is certainly not a jurisdictional requirement and absence thereof is merely an irregularity and, therefore, want of intimation would not vitiate the adjustment - *Brij Bhushan Lal & Sons* v. *Designated Authority* 246 ITR 353.

(ii) Refund due to assessee cannot be adjusted against demand raised, against a third party *Archana Shukla* v. *Joint CIT* 244 ITR 829.

ILLUSTRATIONS ON DOUBLE TAXATION RELIEF

Illustration 164 : R a resident Indian, has derived the following income for the previous year relevant to the assessment year 2011-2012.

Particulars	₹
(1) Income from profession	3,00,000
(2) Share income from a partnership in country X (tax paid in country Y for this income in equivalent Indian rupees ₹ 25,000)	2,00,000
(3) Commission income from a concern in country Y (tax paid in country Y at 20%) converted in Indian rupee.	40,000
(4) Interest from schedule banks.	20,000

R wishes to know whether he is eligible to any double taxation relief, if so, its quantum. India does not have any Double Taxation Avoidance Agreement with countries X and Y.

Solution: (a) Computation of total income

Particulars	₹	₹
(a) Income from business:		
(i) Income from profession	3,00,000	
(ii) Share income in partnership firm in country X	2,00,000	5,00,000
(b) Income from other sources:		
(i) Interest from schedule bank	20,000	
(ii) Commission earned in country Y, assumed from other sources	40,000	60,000
Total income		**5,60,000**
(b) Computation of tax liability :		
Tax on total income of ₹ 5,60,000		46,000
Add : Education cess @ 2%		920
Add : SHEC @		460
		47,380
Less : Double taxation relief : (2,00,000 + 40,000) = 2,40,000 × 8.46%		20,304
Tax payable		**27,076**
Tax payable to be rounded off to the nearest multiple of ₹ 10 (Sec. 288B)		27,080

Notes: (i) Average rate of tax in the foreign country 20%.

(ii) Average rate of tax in India:

$$\frac{47,380}{5,60,000} \times 100 = 8.46\%$$

Whichever is less, is applicable

Illustration 165 : Mr. Prasad, ordinarily resident in India, furnished the following particulars of his income/savings during the previous year 2010-2011.

	₹
(i) Income from foreign business (Including ₹ 2,00,000 from business connection in India) accruing outside India	12,00,000
(ii) Loss from Indian business	(Œ)2,00,000
(iii) Income from house property	4,00,000
(iv) Dividends gross from Indian companies	60,000
(v) Deposit in Public Provident Fund	70,000
(vi) Tax paid in foreign country	2,50,000
There is no double taxation avoidance treaty.	
Compute the tax liability	

Solution: (a) Computation of Total Income for the A.Y. 2011-12

Particulars	₹	₹
1. Income from House Property		4,00,000
2. Income from Business :		
(a) Income from Indian business	(-) 2,00,000	
(b) (i) Income from foreign business accruing or arising outside India	(+) 10,00,000	
(ii) Income from foreign business deemed to accrue or arise in India	(+) 2,00,000	10,00,000
3. Income from other sources		
Dividends from Indian companies exempt [Sec. 10(34)]		Nil
Gross total income		**14,00,000**
Less : Deduction for approved savings (Sec. 80C): PPF Deposits		70,000
Total income		**13,30,000**
Tax liability on total income :		
Income-tax on slab rates		3,48,000
Add: Surcharge on income tax		Nil
(assuming total income less than one crore)		3,48,000
Add : Education cess : 2% on the aggregate of income tax and surcharge		6,960
Add : SHEC @ 1%		3,480
Tax liability		**3,58,440**
Less : Double taxation relief on foreign business profits, not deemed to accrue or arise in India (Sec. 91) 10,00,000 × 20.833%		2,08,330
Tax payable		**1,50,110**

Note: 1. Relief is allowed on the doubly taxed income either at average rate of Indian tax or average rate of foreign income tax, whichever is lower;

(a) Average rate of Indian income tax : 3,58,440 / 13,30,000 × 100 = 26.95%

(b) Average rate of foreign income tax: (2,50,000/12,00,000) × 100 = 20.833%

2. The amount of doubly taxed income has been worked out as under:

	₹
Income from foreign business, accruing outside India	12,00,000
Less: (i) Income from business connection deemed to accrue or arise in India which is not entitled to double taxation relief.	2,00,000
Doubly taxed income	10,00,000

3. Loss from Indian business has been set-off against profits from foreign business which is deemed to accrue or arise in India.

   The mode of set-off increases the amount of double taxation relief.

Illustration 166 : The Income-tax Act, 1961 provides for taxation of a certain income earned by X. The Double Taxation Avoidance Agreement, which applies to X, excludes the income earned by X from the purview of tax. Is X lilable to pay tax on the in come earned by him? Discuss.

Answer : Where any conflict arises between the provisions of the Double Taxation Avoidance Agreement and the Income- tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act. X is, therefore, not liable to pay tax on the income earned by him.

Illustration 167 : Explain briefly the proposition of law in case of any conflict between the provisions of the Double Taxation Avoidance Agreement (DTAA) and the Income-tax Act, 1961.

Answer : Where there is conflict between the provision as contained in the tax treaty and the provisions of Income Tax Act, a payer can take advantage of those provisions which are more beneficial to him. Thus, tax treaties override the provisions of Income Tax Act which can be enforced by the appellate authorities/courts.

Illustration 168 : Arif, a resident both in India and Malaysia in previous year 2010-2011, owns immoveable properties (including residential house) at Malaysia and India. He has earned income of ₹ 50 lakh from rubber estates in Malaysia during the previous year 2010-2011. He also sold some property in Malaysia resulting in short-term capital gain of ₹ 10 lakh during the year. Arif has no permanent establishment of business in India. However, he has derived rental income of ₹ 6 lakh from property let out in India and he has a house in Lucknow where he stays during his visit to India. The Article 4 of the Double Taxation Avoidance agreement between India and Malaysia provides that where an individual is a resident of both the contractting States, he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests).

You are required to state with reasons whether the business income of Arif arising in Malaysia and the capital gains in respect of sale of the property situated in Malaysia can be taxed in India.

Answer : Where the Central Government has entered into an aggreement with the government of any other country for granting relief to tax or for avoidance of double taxation, the provisions of the Income-tax Act, 1961 are applicable in such case to the extent they are more beneficial to the assessee.

Arif has a residential house both in Malaysia and India. Thus, he has a permanent home in both the countries. However, he has no permanent establishment of business in India. The Double Taxation Avoidance Agreement (DTAA) with Malaysia provides that where an individual is a resident of both countries, he is deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he is deemed to be resident of that country, which is the centre of his vital interests, i.e. the country with which he has closer personal and economic relations. Arif owns rubber estates in Malaysia from which he derives business income. However, Arif has no permanent establishment of his business in India. Therefore, his personal and economic relations with Malaysia are closer, since Malaysia is the place whereŠ(a) the property is located and (b) the permanent establishment (PE) has been set-up. Therefore, he is deemed to be resident of Malaysia for AY 2011-2012.

So, in this case, Arif is not liable to income tax in India for assessment year 2011-2012 in respect of business income and capital gains arising in Malaysia.

Illustration 169 : Ms. Sania, a resident Indian, furnishes the details for the assessment year 2011-2012.

	₹
(1) Income from profession	1,04,000
(2) Share income from a partnership in country X	40,000
(Tax paid in country X for this income in equivalent Indian rupees ₹ 8,000)	
(3) Commission income from concern in country Y	30,000
(Tax paid in country Y at 20% converted in Indian rupee)	
(4) Interest from scheduled banks	20,000

Ms. Sania wishes to know whether she is eligible to any double taxation relief, if so, its quantum. India does not have any Double Taxation Avoidance Agreement with countries X and Y.

Solution : (a) Computation of Total Income for the A.Y. 2011-12

Particulars	₹	₹
(a) Income from Business or Profession :		
(i) Income from Profession	1,04,000	
(ii) Share income in partnership firm in country X	40,000	1,44,000
(b) Income from other sources:		
(i) Interest from schedule bank	20,000	
(ii) Commission earned in country Y, assumed from other sources	30,000	50,000
Total Income		**1,94,000**

(b) Computation of tax liability

Particulars	₹
Tax on Total Income of ₹ 1,94,000	400
Add: Surcharge on income tax	Nil
	400
Education cess @ 2%	8
SHEC @ 1%	4
	412
Less: Dobule taxation relief : 70,000 × 0.21%	147
Tax payable	**265**
Rounded off u/s 288B	**270**
Note: (i) Average rate of tax in the foreign country : 20%	
(ii) Average rate of tax in India : $\frac{412}{194000} \times 100 = 0.21\%$	

Illustration 170 : A is a musician deriving income from foreign concerts performed outside India, ₹ 50,000. Tax of ₹ 10,000 was deducted at source in the country where the concerts were given. India does not have any agreement with that country for avoidance of double taxation. Assuming that Indian income of A is₹2,00,000, what is the relief due to him under Sec. 91 for the assessment year 2011-2012.

Solution : **Computation of Total Income for the A.Y. 2011-12**

		₹
(a) Computation of total income:		
(i)	Indian income	2,00,000
(ii)	Foreign income	50,000
	Gross Total Income or Total Income	**2,50,000**
(b)	Computation of Tax Liability :	
	Income tax on total income :	9,000
Add :		
	(i) Education cess @ 2%	180
	(ii) SHEC @ 1%	90
		9,270
Less : Double taxation relief under Sec. 91: ₹ 50,000 × 3.71%		1,855
Tax payable		**7,415**

Notes: 1. Average rate of Indian income tax $= \frac{9,270}{2,50,000} \times 100 = 3.71\%$

2. Average rate of foreign income tax:

Relief is allowed either at the average rate of Indian income tax or te average rate of foreign income tax,

$\frac{10,000}{50,000} \times 100 = 20\%$

whichever is lower. Accordingly, the relief has been allowed at the average rate of Indian income tax.

STUDY NOTE - 10

WEALTH TAX

This Study Note includes

- Introduction
- Valuation of Assets
- Other Issues relating to Wealth Tax
- Illustrations

10.1 INTRODUCTION

Wealth tax is not a very important or high revenue tax in view of various exemptions. Wealth tax is a socialistic tax. It is not on income but payable only because a person is wealthy.

Wealth tax is payable on net wealth on 'valuation date'. As per Section 2(q), valuation date is 31st March every year. It is payable by every individual, HUF and company. Tax rate is 1% on amount by which 'net wealth' exceeds ₹ 15 lakhs. No surcharge or education cess is payable.

No wealth-tax is chargeable in respect of net wealth of any company registered under section 25 of the Companies Act, 1956; any co-operative society; any social club; any political party; and a Mutual fund specified under section 10(*23D*) of the Income-tax Act [section 45]

COMPUTATION OF NET WEALTH

	Particulars	₹
	Assets specified in Section 2(ea) chargeable in the hands of assessee on the basis of location of the assets and the assessee's nationality and residential status	xxx
Less:	Aggregate value of all the debts owed by the assessee on the valuation date incurred in relation to the above said assets	(xxx)
Less:	Assets exempt u/s 5	(xxx)
Add:	Deemed asset in the assessee's hands u/s 4	xxx
	Net Wealth as per Wealth Tax Act	xxx

Rounding off Net Wealth [Section 44C] : The net wealth computed above shall be rounded off to the nearest multiple of one hundred rupees.

Debt should have been incurred in relation to the assets which are included in net wealth of assessee. Only debt owed on date of valuation is deductible.

In case of residents of India, assets outside India (less corresponding debts) are also liable to wealth tax. In case of non-residents and foreign national, only assets located in India including deemed assets less corresponding debts are liable to wealth tax [section 6].

Net wealth in excess of ₹ 30,00,000 is chargeable to wealth-tax @ 1 per cent (on surcharge and education cess).

Assessment year - Assessment year means a period of 12 months commencing from the first day of April every year falling immediately after the valuation date **[Section 2(*d*)]**.

10.1.1 Assets

Assets are defined in Section 2(*ea*) as follows.

Guest house, residential house or commercial building - The following are treated as "assets" - (a) Any building or land appurtenant thereto whether used for commercial or residential purposes or for the purpose of guest house (b) A farm house situated within 25 kilometers from the local limits of any municipality (whether known as a municipality, municipal corporation, or by any other name) or a cantonment board [Section 2(ea)(i)]

A residential house *is* not asset, if it is meant exclusively for residential purposes of employee who is in whole-time employment and the gross annual salary of such employee, officer or director is less than ₹ 5,00,000.

Any house (may be residential house or used for commercial purposes) which forms part of stock-in-trade of the assessee is not treated as "asset".

Any house which the assessee may occupy for the purposes of any business or profession carried on by him is not treated as "asset".

A residential property which is let out for a minimum period of 300 days in the previous year is not treated as an "asset".

Any property in the nature of commercial establishments or complex is not treated as an "asset".

Motor cars - Motor car is an "asset", but not the following - (a) motor cars used by the assessee in the business of running them on hire (b) motor cars treated as stock-in-trade [Section 2(ea)(ii)]. In the case of a leasing company, motor car is an asset.

Jewellery, bullion, utensils of gold, silver, etc. [Section 2(ea)(iii)] - Jewellery, bullion, furniture, utensils and any other article made wholly or partly of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals are treated as "assets" [Section 2(ea)(ii)]

For this purpose, "jewellery" includes ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, and also precious or semi-precious stones, whether or not set in any furniture, utensils or other article or worked or sewn into any wearing apparel.

Where any of the above assets (*i.e.*, jewellery, bullion, utensils of gold, etc.) is used by an assessee as stock-in-trade, then such asset is not treated as "assets" under section 2(*ea*)(*iii*).

Yachts, boats and aircrafts - Yachts, boats and aircrafts (other than those used by the assessee for commercial purposes) are treated as "assets" [Section 2(ea)(iv)]

Urban land - Urban land is an "asset" [Section 2(ea)(v)]

Urban land means land situated in the area which is comprised within the jurisdiction of a municipality and which has a population of not less than 10,000 according to the last preceding census.

Land occupied by any building which has been constructed with the approval of the appropriate authority is not 'asset'.

Any unused land held by the assessee for industrial purposes for a period of 2 years from the date of its acquisition by him is not an asset. Any land held by the assessee as stock-in-trade for a period of 10 years from the date of its acquisition by him is also not an asset.

Cash in hand - In case of individual and HUF, cash in hand on the last moment of the valuation date in excess of ₹ 50,000 is an 'asset'. In case of companies, any amount not recorded in books of account is 'asset' [Section 2(ea)(vi)]

10.1.2 Deemed assets

Often, a person transfers his assets in name of others to reduce his liability of wealth tax. To stop such tax avoidance, provision of 'deemed asset' has been made. In computing the net wealth of an assessee, the following assets will be included as deemed assets u/s 4.

Assets transferred by one spouse to another - The asset is transferred by an individual after March 31, 1956 to his or her spouse, directly or indirectly, without adequate consideration or not in connection with an agreement to live apart will be 'deemed asset' [Section 4(1)(a)(i)]

If an asset is transferred by an individual to his/her spouse, under an agreement to live apart, the provisions of section 4(1)(*a*)(*i*) are not applicable. The expression "to live apart" is of wider connotation and even the voluntary agreements to live apart will fall within the exceptions of this sub-clause.

Assets held by minor child - In computing the net wealth of an individual, there shall be included the value of assets which on the valuation date are held by a minor child (including step child/adopted child but not being a married daughter) of such individual [Section 4(1)(a)(ii)]

The net wealth of minor child will be included in the net wealth of that parent whose net wealth [excluding the assets of minor child so includible under section 4(1)] is greater.

Assets transferred to a person or an association of persons - An asset transferred by an individual after March 31, 1956 to a person or an association of person, directly or indirectly, for the benefit of the transferor, his or her spouse, otherwise than for adequate consideration, is 'deemed asset' of transferor [Section 4(1)(a)(iii)]

Assets transferred under revocable transfers - The asset is transferred by an individual to a person or an association of person after March 31, 1956, under a revocable transfer is 'deemed asset' of transferor [Section 4(1)(a)(iv)]

Assets transferred to son's wife [Section 4(1)(a)(v)] - The asset transferred by an individual after May 31, 1973, to son's wife, directly or indirectly, without adequate consideration will be 'deemed asset' of transferor [Section 4(1)(a)(iv)]

Assets transferred for the benefit of son's wife - If the asset is transferred by an individual after May 31, 1973, to a person or an association of the immediate or deferred benefit of son's wife, whether directly or indirectly, without adequate consideration, it will be treated as 'deemed asset' of the transferor [Section 4(1)(a)(vi)].

Interest of partner- Where the assessee (may or may not be an individual) is a partner in a firm or a member of an association of persons, the value of his interest in the assets of the firm or an association shall be included in the net wealth of the partner/member. For this purpose, interest of partner/member in the firm or association of persons should be determined in the manner laid down in Schedule III to the Wealth-tax Act [Section 4(1)(b)].

Admission of minor to benefits of the partnership firm - If a minor is admitted to the benefits of partnership in a firm, the value of his interest in the firm shall be included in the net wealth of parent of minor in accordance with the provisions of section 4(1)(*a*)(*ii*) [*see* para 546.2]. It will be determined in the manner specified in Schedule III.

Conversion by an individual of his self-acquired property into joint family property - If an individual is a member of a Hindu undivided family and he converts his separate property into property belonging to his Hindu undivided family, or if he transfers his separate property to his Hindu undivided family, directly or indirectly, without adequate consideration, the converted or transferred property shall be deemed to be the property of the individual and the value of such property is includible in his net wealth [Section 4(1A)]

If there was such transfer and if the converted or transferred property becomes the subject-matter of a total or a partial partition among the members of the family, the converted or transferred property or any part thereof, which is received by the spouse of the transferor, is deemed to be the asset of the transferor and is includible in his net wealth.

Gifts by book entries - Where a gift of money from one person to another is made by means of entries in the books of account maintained by the person making the gift, or by an individual, or a Hindu undivided family, or a firm or an association of persons, or a body of individuals with whom he has business connection, the value of such gift will be included in the net wealth of the person making the gifts, unless he proves to the satisfaction of the Wealth-tax Officer that the money had actually been delivered to the other person at the time the entries were made [Section 4(5A)]

Impartible estate - For the purpose of the Wealth-tax Act, the holder of an impartible estate shall be deemed to be the owner of all the properties comprised in the estate [Section 4(6)]

Property held by a member of a housing society - Where the assessee is a member of a co-operative housing society and a building or part thereof is allotted or leased to him, the assessee is deemed to be the owner of such building and the value of such building is includible in computing his net wealth. In determining the value of such building, any outstanding instalments, payable by the assessee to the society towards the costs of such house, are deductible as debt owed by the assessee. The above rules are also applicable if the assessee is a member of a company or an association of persons [Section 4(7)]

Property held by a person in part performance of a contract [Section 4(8)] - A person who is allowed to take or retain possession of any building or part thereof in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882. Similarly, a person can acquire any rights, excluding any rights by way of a lease from month to month or for a period not exceeding one year, in or with respect to any building or part thereof, by virtue of transaction as is referred to in section 269UA(f) of the Income-tax Act.

In above cases, the assets are taxable in the hands of beneficial owners, in the same manner in which they are taxed under the Income-tax Act :

10.1.3 Assets which are exempt from tax

The following assets are exempt from wealth-tax, as per section 5.

Property held under a trust - Any property held by an assessee under a trust or other legal obligation for any public purpose of charitable or religious nature in India is totally exempt from tax. [Section 5(i)].

Business assets held in trust, which are exempt - The following business assets held by as assessee under a trust for any public charitable/religious trust are exempt from tax - (a) where the business is carried on by a trust wholly for public religious purposes and the business consists of printing and publication of books or publication of books or the business is of a kind notified by the Central Government in this behalf in the Official Gazette (b) the business is carried on by an institution wholly for charitable purposes and the work in connection with the business is mainly carried on by the beneficiaries of the institution (c) the business is carried on by an institution, fund or trust specified in sections 10(23B) or 20(23C) of the Income-tax Act.

Any other business assets of a public charitable/religious trust is not exempt.

Coparcenary interest in a Hindu undivided family - If the assessee is a member of a Hindu undivided family, his interest in the family property is totally exempt from tax [Section 5(ii)].

Residential building of a former ruler - The value of any one building used for the residence by a former ruler of a princely State is totally exempt from tax [Section 5(iii)]

Former ruler's jewellery - Jewellery in possession of a former ruler of a princely State, not being his personal property which has been recognised as a heirloom is totally exempt from tax [Section 5(iv)]

The jewellery shall be permanently kept in India and shall not be removed outside India except for a purpose and period approved by the Board. Reasonable steps shall be taken for keeping that jewellery substantially in its original shape. Reasonable facilities shall be allowed to any officer of the Government, or authorised by the Board, to examine the jewellery as and when necessary.

Assets belonging to the Indian repatriates - Assets (as given below) belonging to assessee who is a person of Indian origin or a citizen of India, who was ordinarily residing in a foreign country and who has returned to India with intention to permanently reside in India, is exempt. A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grand-parents, was born in undivided India.

After his return to India, following shall not be chargeable to tax for seven successive assessment years - (a) moneys brought by him into India (b) value of asset brought by him into India (c) moneys standing to the credit of such person in a Non-resident (External) Account in any bank in India on the date of his return to India and (d) value of assets acquired by him out of money referred to in (*a*) and (*c*) above within one year prior to the date of his return and at any time thereafter [Section 5(v)]

One house or part of a house - In the case of an individual or a Hindu undivided family, a house or a part of house, or a plot of land not exceeding 500 sq. meters in area is exempt. A house is qualified for exemption, regardless of the fact whether the house is self-occupied or let out. In case a house is owned by more than one person, exemption is available to each co-owner of the house [Section 5(vi)]

10.2 VALUATION OF ASSETS

The value of an asset, other than cash, shall be its value as on the valuation date determined in the manner laid down in Schedule III.

Valuation of a building - Value of any building or land appurtenant thereto, or part thereof, is to be made in accordance with Part B of Schedule III to the Wealth-tax Act

The first step is to find out gross maintainable rent. Gross maintainable rent is (a) annual rent received/receivable by the owner or annual value of the property as assessed by local authority, whichever is higher (if the property is let out) or (b) annual rent assessed by the local authority or if the property is situated outside the jurisdiction of a local authority, the amount which the owner can reasonably be expected to receive as annual rent had such property been let (if the property is not let).

In the following cases "actual rent" shall be increased in the manner specified below : (a) Taxes borne by tenant (b) If property is rented, one-ninth of actual rent will be added, if expenditure on repairs in respect of the property is borne by the tenant (c) Interest @ 15% on deposit given by tenant or difference (d) Premium received as consideration for leasing of the property or any modification of the terms of the lease will be divided over the number of years of the period of the lease and will be added to 'actual rent' (d) If the derives any benefit or perquisite as consideration for leasing of the property or any modification of the terms of the lease), the value of such benefit or perquisite shall be added to actual rent.

Net maintainable rent is determined by deducting from the gross maintainable rent (a) the amount of taxes levied by any local authority in respect of property (deduction is available even if these are to be borne by the tenant) ; and (b) *A* sum equal to 15% of gross maintainable rent.

The net maintainable rent is finally capitalized to arrive as value of net asset.. This can be done by multiplying the net maintainable rent by 12.5. If the property is constructed on leasehold land, net maintainable rent is to be multiplied by 10 when the unexpired period of lease of such land is 50 years or more and multiplied by 8 where the unexpired period of lease of such land is less than 50 years).

If a property is acquired/constructed after March 31, 1974, then the value of the house property is determined as above. Original cost of construction/acquisition *plus* cost of improvement of the house property is calculated. The higher of the above is taken as capitalised value of net maintainable rent. This exception is applicable in respect one house property. The cost of acquisition/construction (*plus* cost of improvement) does not exceed ₹ 50 lakh, if the house is situated at Bombay, Calcutta, Delhi and Madras (₹ 25 lakh at any other place).

If unbuilt area of the plot of land on which the property is built exceeds the specified area, premium is to be added to the capitalised value determined above.

Valuation of self-occupied property - If assessee owns a house (or a part of the house), being an independent residential unit and is used by the assessee exclusively for his residential purposes throughout 12 months ending on the valuation date, valuation will be as per provisions of section 7(2).

Assessee can either take value of the house as determined above on the valuation date relevant for the current assessment year or he take value of the house, as determined above, on the first valuation date next following the date on which he became the owner or the valuation relevant for the assessment year 1971-72, whichever is later. The choice is of the assessee.

Where the house has been constructed by the assessee, he shall be deemed to have become the owner thereof on the date on which the construction of such house was completed.

Valuation of assets of business - If the assessee is carrying on a business for which accounts are maintained by him regularly, the net value of the assets of the business as a whole, having regard to the balance sheet of such business on the valuation date, is taken as value of such assets [Part D, Schedule III].

(A) The assets are valued as follows - ***Depreciable assets*** - Written down value, plus 20%, ***Non-depreciable assets (other than stock-in- trade)*** - Book value, plus 20%, ***Closing stock*** - Value adopted for the purpose of income-tax, plus 20%.

(B) Then value of house property, life interest, jewellery and other assets is calculated as per other provisions of Wealth Tax Act.

Higher of A or B is taken as value of assets.

Value of interest in firm or association of persons - The net wealth of the firm on the valuation date is ascertained.. For determining the net wealth of the firm (or association), no account shall be taken of the exemptions given by section 5. The portion of the net wealth as is equal to the amount of the capital of the firm or association is allocated amongst the partners or the members in the proportion in which capital has been contributed by them.

The residue of the net wealth is allocated amongst the partners or the members in accordance with the agreement of the partnership or association of persons for the distribution of assets in the event of dissolution of the firm or association or in the absence of such agreement, in the proportion in which the partners (or members) are entitled to share profits [Part E, Schedule III]

Value of life interest **-** The value of life interest of an assessee shall be determined as per Part F, Schedule III. Average net annual income of the assessee derived from the life interest during 3 years ending on the valuation date is calculated. While computing net annual income, expenses incurred on the collection of such income (maximum of 5% of the average of annual gross income) shall be deducted. This is multiplied as per formula prescribed to arrive at value of asset.

Valuation of jewellery **-** The value of jewellery shall be estimated to be the price which it would fetch if sold in the open market on the valuation date (*i.e.,* fair market value). Where the value of jewellery does not exceed ₹ 5,00,000, a statement in Form No. O-8A is to be submitted. Where the value of the jewellery exceeds ₹ 5,00,000, a report of a registered valuer in Form No. O-8 should be submitted. The report is not binding on assessing officer (Valuation Officer) and he can determine fair market value of jewellery.

The value of jewellery determined by the Valuation Officer for any assessment year shall be taken to be the value of such jewellery for the subsequent four assessment years subject to the prescribed adjustments.

Valuation of any other asset **-** The value of any asset, other than cash (being an asset which is not covered in above paras) shall be estimated either by the Assessing Officer himself or by the Valuation Officer if reference is made to him under section 16A. In both these cases, the value shall be estimated to be the price which it would fetch if sold in the open market, on the valuation date. If the asset is not saleable in the open market, the value shall be determined in accordance with guidelines or principles specified by the Board from time to time by general or special order.

10.3 OTHER ISSUES RELATING TO WEALTH TAX

Charitable or religious trusts **-** A trust can forfeit exemption for any of the following reasons - (a*)* any part of the trust's property or any income of the trust, including income by way of voluntary contributions, is used for the benefit of the settlor, the trustee, their relatives etc.; or (b) any part of the income of the trust, created on or after April 1, 1962, including income by way of voluntary contributions, enures directly or indirectly, for the benefit of any of the persons referred to in section 13(3) of the Income-tax Act ; or (c) any funds of the trust are invested or deposited or any shares in a company are held by the trust in contravention of the investment pattern for trust funds laid down in section 11(5) of the Income-tax Act.

In such case, tax shall be leviable upon and recoverable from the trustee or manager in respect of the property held by him under trust at the rate of tax applicable to a resident in India.

These provisions are not applicable in the case of a scientific research association [Section 10(*21*) of the Income-tax Act] and in the case of any institution, fund or trust referred to in section 10(*22*), (*22A*), (*22B*) or (*23C*) of the Income-tax Act in specified situations [Section 21A]

Association of persons where shares of members are indeterminate/unknown **-** If assets chargeable to wealth-tax are held by an association of persons and the individual shares of the members in the income or assets of the association are indeterminate or unknown, wealth-tax is levied to the same extent as it would be leviable upon and recoverable from an individual who is citizen of India and resident in India [Section 21AA]

10.3.1 Return of wealth and assessment

Every person is required to file with the Wealth-tax Officer a return of net wealth in Form BA, if his net wealth or net wealth of any other person in respect of which he is assessable under the Act on the valuation date is of such an amount as to render him liable to wealth-tax. Return can be filed on or before the "due date" specified under section 139 of the Income-tax Act.

Return in response to a notice **-** In the case of any person who, in the opinion of Wealth-tax Officer, is assessable to tax, the Wealth-tax Officer may, before the end of the relevant assessment year, issue a notice requiring him to furnish, within 30 days from the date of service of such notice, a return of net wealth in the prescribed form.

Assessment **-** The assessee is required to pay the tax before filing of the return and such return is to be accompanied by the proof of such payment. Provisions of regular assessment, as applicable under Income Tax, will apply to wealth tax also.

Interest or penalty and prosecution **-** Interest @ 1% per month is payable for failure to pay wealth tax on due date. Penalty and prosecution provisions also apply.

10.4 ILLUSTRATIONS

Illustration 1 :

ALtd is engaged in the construction of residential flats. For the valuation date 31.3.2011, it furnishes the following data and requests you to compute the taxable wealth -

(a) Land in urban area (Construction is not permitted as per Municipal Laws in force) ₹ 55,00,000
(b) Motor-cars (used on hire by the company) ₹ 10,00,000
(c) Jewellery (Investment) ₹ 25,00,000. Loan taken for purchasing the same ₹ 20,00,000
(d) Cash Balance (as per books) ₹ 2,75,000
(e) Bank Balances ₹ 5,50,000
(f) Guest House (situated in a place which is 30 Kms away from the local limits of the municipality) ₹ 10,00,000
(g) Residential flats occupied by the Managing Director ₹ 15,00,000. The Managing Director is on whole time appointment and is drawing remuneration of ₹ 2,00,000 per month.
(h) Residential house were let out on hire for 200 days ₹ 10,00,000

Solution :

The computation should be supported with proper reasoning for inclusion or exclusion.

Valuation Date: 31.03.2011 Computation of Taxable Wealth

Nature of asset	₹	Reason
Land in Urban Area	NIL	Land in which construction is not permitted as per municipal law is not an asset u/s 2(ea)
Motor Cars	NIL	Motor cars used in business of hire is not an asset u/s 2(ea)
Jewellery	25,00,000	Not held as stock in trade
Cash Balance	NIL	Cash as per books - Not an asset U/s 2(ea)
Bank Balance	NIL	Not an asset u/s 2(ea)
Guest House	10,00,000	Asset u/s 2(ea)
Residential Flat occupied by MD	15,00,000	Asset u/s 2(ea) since Annual Gross Salary is greater than ₹5,00,000.
Residential House Let-out	10,00,000	Asset U/s 2(ea) as it is not let-out for a period - 300 days.
Total Assets		
Less: Debt incurred in relation to	**60,00,000**	
an asset: Loan for Jewellery	(20,00,000)	
Taxable Net Wealth	**40,00,000**	
Less : Basic Exemption	30,00,000	
Taxable Net Wealth	10,00,00	
Tax Payable @1%	10,000	

Illustration 2 : Samir furnishes the following particulars for the compilation of his Wealth Tax return for Assessment Year 2011-12.

(a) Gifts of jewellery made to wife from time to time aggregating ₹80,000.Market value on valuation date ₹3,00,000

(b) Flat purchased under installment payment scheme in 1979 for ₹9,50,000. Used for purposes of his residence and market value as on 31.3.2010. (Installment remaining unpaid ₹ 80,000) ₹10,00,000

(c) Urban land transferred to minor handicapped child valued on 31.3.2010 ₹5,00,000.

Solution : Explain how you will deal with these items. Make suitable assumptions if required.

Particulars	Taxable	Reasons
Gift of Jewellery made to wife	₹ 3,00,000	Deemed asset u/s 4. Fair Market Value of the Jewellery is taxable.
Flat used for residence	NIL	Taxable as an asset u/s 2(ea) but the assessee can claim exemption u/s 5(vi). So full value of the asset is exempt from tax.
Urban Plot in the hands of the minor	NIL	Asset held by the minor who is handicapped u/s 80U, clubbing provisions does not apply.

Illustration 3 : Compute the net wealth of Nivedita, a resident individual as on 31.3.2011 from the following particulars furnished —

(a) She has a house property at Delhi, valued at ₹ 20,00,000 which is occupied by a firm in which she is a partner for its business purposes. Another house at Mumbai, valued at ₹ 8,00,000 is being used for his own business.

(b) Vehicles for personal use - (i) Motor Car ₹ 10,00,000 (ii) Motor Van — ₹ 3,00,000 (iii) Jeep — ₹ 5,00,000.

(c) Cash on hand - ₹ 3,10,000

(d) Jewellery - ₹ 10,00,000

(e) Nivedita has gifted to a Trust a residential property situated at Kolkata purchased 5 years back for ₹20,00,000 for the benefit of the smaller HUF consisting of herself and her spouse and let-out for 8 months. Schedule-Ill, Rule 3 value as on 31.3.2010 is ₹ 14 Lakhs.

(f) She had transferred an urban house plot in February 1999 in favour of her niece which was not revocable during her life time. This niece died on 14.3.2009. Nivedita could get the title to the plot retransferred to her name only on 15.4.2009 despite sincere and honest efforts. The market value of the house as on 31.3.2011 is ₹ 10,00,000.

(g) Nivedita is the holder of an impartible estate in which urban agricultural lands of the value of ₹ 4,30,000 as on 31.3.2010 are comprised.

Solution :

Assessee: Ms. Nivedita Valuation Date: 31.3.2011 Assessment Year: 2011-12

Computation of Net Wealth

Nature of Asset	Amount Taxable	Reasons
House Property at Delhi used for business by a firm in which he is a partner	NIL	Property used for business purpose is not an asset u/s 2(ea) (Refer Note)
House Property at Mumbai used for his own business	NIL	Property used for business purpose is not an asset u/s 2(ea)
Vehicles for Personal Use		
1. Motor-car	10,00,000	Vehicles used for personal purposes are assets
2. Motor-van	3,00,000	u/s 2(ea)
3. Jeep	5,00,000	
Cash on Hand	2,60,000	For an Individual, cash in excess of ₹ 50,000 shall be chargeable to Wealth Tax u/s 2(ea) (₹3,10,000 -₹50,000)
Jewellery	10,00,000	Jewellery other than those held as stock-in-trade are asset u/s 2(ea)

Contd...

Property at Kolkata transferred to a Trust 20,00,000 Less: Exemption u/s 5(vi) 20,00,000	NIL	Taxable u/s 4(1A). Value = Higher of Value as on Valuation Date ₹14 Lakhs or Cost of Acquisition ₹ 20 Lakhs
Urban House Plot transferred to Niece	10,00,000	Taxable u/s 4(5) as the title to the property stands vested in Nivedita's hands immediately on niece's demise
Urban Agricultural Land	4,30,000	Holder of an impartible estate is deemed to be the owner of all properties comprised therein u/s 4(6)
NET WEALTH	**44,90,000**	
Less : Basic Exemption	30,00,000	
Taxable Net Wealth	14,90,000	
Tax Payable @ 1%	14,900	

Illustration 4 : SIPRA Constructions Ltd. is engaged in the construction of residential flats. For the valuation date 31.3.2011, furnishes the following data and requests you to compute the taxable wealth:

(a) Land in urban area (construction is not permitted as per Municipal laws in force) ₹ 50 lakhs

(b) Motor-cars (in the use of company) ₹10lakhs

(c) Jewellery (Investment) ₹10 lakhs

(d) Cash balance (As per books) ₹ 3 lakhs

(e) Bank Balance (As per books) ₹ 6 lakhs

(f) Guest House (Situated in rural area) ₹ 8 lakhs

(g) Residential flat occupied by Managing Director (Annual remuneration of whom is ₹8 Lakhs excluding perquisites) ₹ 10 lakhs

(h) Residential house let-out for 100 days in the financial year ₹ 5 lakhs

(i) Loan obtained for :

- Purchase of Motor Car ₹ 3 lakhs
- Purchase of Jewellery ₹ 2 lakhs

Solution :

Assessee: SIPRA Constructions Ltd. Valuation Date: 31.3.2011 Assessment Year: 2011-12

Nature of Asset	Amount taxable (₹ Lakhs)	Reasons
Land in Urban Area	NIL	Land in which construction is not permitted as per municipal laws is not an asset u/s 2(ea)
Motor-cars	10	Motor-car other than those used in the business of hire or held as stock-in-trade is an asset u/s 2(ea)
Jewellery	10	Not held as stock-in-trade - asset u/s 2(ea)
Cash Balance	NIL	Cash as per books - not an asset u/s 2(ea)
Bank Balance	NIL	Not an asset u/s 2(ea)
Guest House	8	Asset u/s 2(ea)
Residential Flat Occupied by MD	10	Asset u/s 2(ea)-since Gross Annual Salary of Managing Director is greater than ₹ 5 Lakhs
Let-out Residential House Property	5	Asset u/s 2(ea) - since not let-out for a period exceeding 300 days
TOTAL ASSETS	**43**	
Less: Debt incurred in relation to Assets		
1. Purchase of Motor-car	(3)	
2. Purchase of Jewellery	(2)	
NET WEALTH	**38**	
Less : Basic Exemption	30	
Taxable Net Wealth	8	
Tax Payable @ 1%	8,000	

Illustration 5 : Sunrise Promoters & Developers Ltd. a widely held company owns the following assets as on 31.3.2011 : -

(a) Land at Rajarhat (West Bengal) purchased in 2002 on which a residential complex consisting of 24 flats, to be sold on ownership basis, is under construction for last 18 months

(b) Two office flats at Noida purchased for resale in the year 2003

(c) Shares of Group Companies, break-up value of which is ₹ 19,00,000

(d) Cash at construction site ₹ 8,00,000

(e) Residential flat in occupation of company's whole-time director drawing a salary of ₹4,50,000 per annum.

Which of the above assets will be liable for wealth? Give reasons in brief.

Solution : **Assessee: Sunrise Promoters & Developers Ltd. Valuation Date: 31.3.2011**
Assessment Year: 2011-12

Nature of Asset	Amount Taxable	Reasons
Land at Rajarhat purchased in 2005	NIL	Urban Land held as stock-in-trade for a period less than 10 Years -not an asset u/s 2(ea)
Residential Flats at Noida purchased in 2004 for resale	NIL	House Property held as stock-in-trade - not an asset u/s 2(ea)
Shares of Group Companies	NIL	Not an asset u/s 2(ea)
Cash at construction site	NIL	Any amount recorded in the books of account is not an asset u/s 2(ea)
Residential House Property for Whole-Time Director	NIL	Since Gross Annual Salary of Whole Time Director is less than ₹ 5 Lakhs - not an asset u/s 2(ea)

Illustration 6 : Hassan, a person of Indian origin was working in Australia since 1986. He returned to India for permanent settlement in June 2004 when he remitted the moneys into India. He furnished the following particulars of his wealth as on 31.3.2011. You are required to arrive at his wealth in respect of Assessment Year 2011-12 :

(a) Market Value of Residential house in Jharkhand (let-out for residence) ₹ 10,00,000 with Net Maintainable Rent p.a. of ₹ 1,20,000.

(b) Share in building owned by a firm in which Hassan is a Partner - used for business ₹ 5,00,000

(c) Motor-car purchased in April 2009, out of moneys remitted to India from Australia ₹ 4,00,000

(d) Value of interest in Firm excluding item (b) above ₹ 5,00,000

(e) Shares in companies (quoted) ₹ 2,00,000

(f) Assets purchased out of amount remitted from Australia :
- Jewellery purchased in March 2002 ₹ 5,50,000
- Vacant land purchased in October 2000 ₹ 10,00,000

(g) Amount standing to the credit of NRE Account ₹ 15,00,000

(h) Cash on hand (out of sale proceeds of agricultural income) ₹ 65,000

Solution : **Assessee: Hassan Valuation Date: 31.3.2011 Computation of Net Wealth**

Nature of Asset	Amount Taxable	Reasons
Residential House in Jharkhand	NIL	Not an Asset u/s 2(ea) - Let-out for whole year -Hence, not taxable
Share in the building owned by the firm	NIL	Not an asset u/s 2(ea), used for its own business - not chargeable to tax
Motor-car 4,00,000		
Less: Exempt u/s 5(v)-acquired out of money brouqht into India (4,00,000)	NIL	Asset u/s 2(ea). But, exemption available u/s 5(v), since acquisition out of money brought into India.
Value of Interest in a Firm	5,00,000	Assumed as deemed asset u/s 4(1)(b)
Shares in Companies	NIL	Not an asset u/s 2(ea)
Value of Jewellery	5,50,000	Asset u/s 2(ea) - Not entitled for exemption
Vacant Land	10,00,000	Asset u/s 2(ea) - Purchased in October 2000
Money in NRE A/c	NIL	Not an asset u/s 2(ea)
Cash in Hand in excess of ₹ 50,000	15,000	Asset u/s 2(ea), being an Individual
NET WEALTH	**20,65,000**	
Tax Liability	**Nil**	

Since less than the Basic Exemption limit.

Illustration 7 : Romit Roy, a Not Ordinarily Resident in India seeks your advice with regard to the furnishing of his Wealth Tax Return. The value of assets held on 31.3.2011 is indicated below. You are requested to compute the Taxable Wealth.

- Motor cars of foreign make held as Fixed Assets ₹26 lakhs
- Gold bonds under Gold Deposit Scheme, 2000 ₹25 lakhs
- Residential House Property at Kolkata let out w.e.f.10.2.2010 ₹30 lakhs
- Jewellery held ₹20 lakhs
- Lands purchased for industrial purpose: (a) on 1.1.2004 ₹ 7 lakhs (b)on 24.2.2010 ₹10 lakhs
- Loans against the purchase of land : (a) on 1.1.2005 ₹ 4 lakhs (b) on 24.2.2010 ₹5 lakhs
- Fixed Assets located in Abu Dhabi ₹ 80 lakhs
- Cash at Bank ₹4 lakhs
- Cash in Hand ₹ 80,000
- Mrs. Roy acquired out of gifts received from her husband:

(a) Shares and securities ₹3,00,000

(b) Residential House property at Bangalore ₹20,00,000

Solution : **Assessee: Romit Roy** **Valuation Date: 31.3.2011** **Assessment Year: 2011-12**

Computation of Net Wealth

Nature of Asset	₹	Reasons
Motor-cars	26,00,000	Motor-car other than those used in the business of hire or held as stock-in-trade is an asset u/s 2(ea)
Gold Bonds, 1999	Nil	Not an asset under WT Act.
Residential House Property	Nil	Any residential house property let-out for 300 days or more is not an asset
Jewellery	20,00,000	Jewellery other than those held as stock-in-trade is an asset
Land purchased on 1.1.02 for Industrial Purpose	7,00,000	Land held beyond two years from the date of acquisition for industrial purposes is an asset
Land purchased 24.2.2009	Nil	Land held for first two years from the date of acquisition for industrial purposes is not an asset
Cash-on-Hand	30,000	Cash held beyond ₹ 50,000 is an asset
Cash-at-Bank	Nil	Not an asset under WT Act.
Fixed Asset located in Abu Dhabi	Nil	Not chargeable to tax for Not Ordinary Resident
Deemed Assets acquired and held by Mrs.Roy		
(a) Shares and Securities	Nil	Not an asset u/s 2(ea)
(b) Res.House Property at Bangalore 20,00,000		Asset u/s 2(ea).
Less: Exemption u/s 5(vi) (20,00,000)	Nil	One house or part of the house exempt u/s 5(vi)
Total Assets	**53,30,000**	
Less: Debts incurred on Taxable Assets		Wealth Tax Liability and Debts incurred in relation to exempted assets are not deductible
On Land acquired on 1.1.2004	(4,00,000)	
Net Wealth	**49,30,000**	
Less: Basic Exemption	**30,00,000**	
Taxable Net Wealth	**19,30,000**	
Tax Payable @ 1%	**19,300**	

VALUATION OF IMMOVABLE PROPERTY

Illustration 8 : Abhishek, a person of Indian origin was working in Austria since 1991. He returned to India for permanent settlement in May 2010 when he remitted money into India. For the valuation date 31.3.2011, the following particulars were furnished. You are required to compute the taxable wealth. The reason for inclusion or exclusion should be stated –

- Building owned and let-out for 270 days for residence. Net maintainable rent (₹1,00,000) and the Market Value (Excess of Unbuilt Area over Specified Area is 20% of the Aggregate Area) ₹ 30 lakhs
- Jewellery **:** (a) Purchased in April 2010 out of money remitted to India from Austria ₹12,00,000

  (b) Purchased in May 2010 out of sale proceeds of motor-car brought from abroad and sold for ₹ 40 lakhs.
- Value of interest in urban land held by a firm in which he is a partner ₹10 lakhs
- Bonds held in companies ₹10 lakhs
- Motor car used for own business ₹ 25 lakhs
- Vacant house plot of 480 sq. mts. (purchased in December 2003) market value of ₹ 20,00,000
- Cash in hand ₹ 45,000
- Urban land purchased in the year 2007 out of withdrawals of NRE Account ₹ 15,00,000

Assessee : Abhishek Valuation Date : 31.3.2011 Assessment Year : 2011-12

Computation of Net Wealth

Nature of the Asset	₹	₹	Reasons
Value of the House		**18,50,000**	Asset u/s 2(ea). Working Note 1
Jewellery: Purchased in April 2010	12,00,000		Asset u/s 2(ea).
Less: Exempt u/s 5(v) Jewellery	(12,00,000)	**Nil**	Purchased out of money brought into India
Jewellery: Purchased in May 2010	40,00,000		Asset u/s 2(ea).
Less: Exempt u/s 5(v)	(40,00,000)	**Nil**	Purchased out of sale proceeds of assets brought into India
Interest in Urban Land held by firm		**10,00,000**	Deemed Asset u/s 4(1)(b)
Bonds held in companies	—	**Nil**	Not an asset u/s 2(ea)
Motor car		**25,00,000**	Asset u/s 2(ea). Not held as stock-in-trade
Vacant House Plot (480 sq. mts.)	20,00,000		Asset u/s 2 (ea)
Less: Exempt u/s 5(vi)	(20,00,000)	**Nil**	House/part of house/plot less than 500 sq.mts.
Cash in hand		**Nil**	Since not exceeding ₹50,000
Urban Land Purchased	15,00,000		Purchased out of money
Less: Exempt u/s 5(v)	(15,00,000)	**Nil**	brought into India
NET WEALTH		**53,50,000**	
Less **:** Basic Exemption		**30,00,000**	
Net Taxable Wealth		**23,50,000**	
Tax Payable @ 1%		**23,500**	

(1) Working Notes: Valuation of Building :

Net Maintainable Rent(NMR)	= ₹1,00,000
Capitalized Value of NMR=NMR×12.5 (Owner of the land) = ₹ 1,00,000 × 12.5	= ₹12,50,000
Add : Premium for excess of unbuilt area (20%) over specified area = 40% of CNMR	= ₹ 5,00,000
VALUE OF THE HOUSE	**₹18,50,000**

Illustration 9 : Mr. Kushal Sengupta owns a house at Jharkhand, which is let-out at ₹1,35,000 per annum. The annual value of the property as per municipal records also is ₹1,00,000. Municipal taxes are partly borne by the owner (₹5,000) and partly by the tenant (₹6,000). Repair expenses are borne by tenant (₹10,000) the difference between the un-built area and specified area does not exceed 5%. The property was acquired on 10.5.1998 for ₹ 15,00,000.

Determine for purposes of Wealth Tax Act, the value of the property as on 31.3.2011 on the following situations —

(a) The house is built on a freehold land.

(b) It is built on a leasehold land, the unexpired period of lease of the land is more than 50 years.

(c) If the area of the plot on which the house is built is 800 sq. meters. FSI, permissible is 1.4 and FSI utilised is 1088 Sq. metres. (136 Sq. metres × 8 Storeys)

(d) The tenant had made interest free deposit of ₹ 1,00,000 with the landlord.

Solution :

Assessee : Mr. Kushal Sengupta Valuation Date : 31.3.2011 Assessment Year : 2011-12

Computation of Value of House Property

For Situations (a) & (b):

Computation of Gross Maintainable Rent (Amount in ₹)

Particulars	No Rental Deposit	Rental Deposit excess of 3 Mths
Actual Annual Rent	1,35,000	1,35,000
Add: Municipal Taxes borne by the tenant	6,000	6,000
l/9th of Actual Rent Receivable since repair expenses are borne by the tenant (₹1,35,000/ 9)	15,000	15,000
Rental Deposits - 15% Interest on ₹ 1,00,000	Nil	15,000
GROSS MAINTAINABLE RENT	**1,56,000**	**1,71,000**
Less: Municipal Taxes Paid	11,000	11,000
Less: 15% of Gross Maintainable Rent	23,400	25,650
Net Maintainable Rent	**1,90,400**	**2,07,650**
Case (a) Capitalization of Net Maintainable Rent		
-Freehold Land NMR x 12.5	**23,80,000**	**25,56,625**
Case (b) Capitalization of Net Maintainable Rent		
-Leasehold Land - Unexpired Lease 50 Years = NMR×10	**19,04,000**	**20,07,650**
Property Acquired after 31.3.1974 i.e. 10.5.1997	**15,00,000**	**15,00,000**
Therefore, Value of the Property (whether on Lease-hold Land or on Freehold Land)	**15,00,000**	**15,00,000**

For Situation (c) : In case of excess unbuilt area :

Unbuilt Area = (Actual Area of the Land **less** Built up Area) = (800 sq. mt **less** 136 sq. mt). = 664 sq. mt.

Excess Unbuilt Area = (Unbuilt Area **less** Specified Area) = 664 sq. mt. **less** 70% of 800 sq. mt. = 664 Less 560 = 104 sq. mt

% of Excess Unbuilt Area = **Excess Unbuilt Area** × **100/Aggregate Area** = 104 × 100/800 = 13%

Therefore, Value of the Property = Substituted Net Maintainable Rent i.e. ₹15,00,000 + 30% of SNMR = ₹ 19,50,000

Illustration 10 : From the following dated furnished by Mr.Soumitra, determine the value of house property built on leasehold land as at the valuation date 31.3.2011 :

Particulars	₹
Annual Value as per Municipal valuation	1,40,000
Rent received from tenant (Property vacant for 3 months during the year)	1,08,000
Municipal tax paid by tenant	10,000
Repairs on property borne by tenant	8,000
Refundable deposit collected from tenant as security deposit which does not carry any interest	50,000
The difference between unbuilt area and specified area over aggregate area is 10.5%.	

Solution :

Assessee: Mr. Soumitra Valuation Date: 31.3.2011 Assessment Year: 2011-12

Computation of Value of House Property

Step I: Computation of Gross Maintainable Rent(GMR)

Particulars	₹	₹
Actual Annual Rent- ₹ 1,08,000 x 12 Months/9 Months		1,44,000
Add: Municipal tax paid by the Tenant10,000		
l/9th of Actual Rent Receivable as repair expenses are borne by the tenant - ₹ 1,44,000/9	16,000	
Interest on Refundable Security Deposit- ₹ 50,000 x 15% x 9/12	6,000	32,000
GROSS MAINTAINABLE RENT (GMR)		**1,76,000**

Step II: Computation of Net Maintainable Rent (NMR)

Particulars	₹	₹
Gross Maintainable Rent (GMR)		1,76,000
Less: Municipal Taxes levied by the local authority	10,000	
15% of Gross Maintainable Rent - ₹1,76,000 x 15%	26,400	(36,400)
NET MAINTAINABLE RENT (NMR)		**1,39,600**

Step III: Capitalisation of the Net Maintainable Rent (CNMR) (Assumed that unexpired lease period is more than 50 Years)

NMR × Multiple Factor for an Unexpired Lease Period - ₹ 1,39,600 × 10 = ₹ 13,96,000

Step IV: Addition of Premium to SNMR in case of excess inbuilt area:

Particulars		₹
Add: Capitalisation of the Net Maintainable Asset		13,96,000
Premium for excess of 10.5% unbuilt area over specified area-30% of CNMR		4,18,800
Value of House Property as per Wealth Tax Act		**18,14,800**

Illustration 11 : Property Company Ltd. has let-out a premise with effect from 1.10.2010 on monthly rent of ₹1.5 lakh. The lease is valid for 10 years and the tenant has made a deposit equivalent to 3 months rent. The tenant has undertaken to pay the municipal taxes of the premises amounting to ₹ 2 lakh. What will be the value of the property under Schedule III of the Wealth Tax Act for assessment to wealth tax?

Solution :

Assessee: Property Company Ltd. Valuation Date: 31.3.2011 Assessment Year : 2011-12

Computation of Value of Let-out Property

Actual Annual Rent Receivable - ₹ 1,50,000 × 12 Months	18,00,000
Add: Municipal Taxes borne by the Tenant	2,00,000
	20,00,000
GROSS MAINTAINABLE RENT	
Less: Municipal Taxes levied by the Municipal Authority	2,00,000
Less: 15% of Gross Maintainable Rent (₹ 20,00,000 × 15%)	3,00,000
NET MAINTAINABLE RENT	15,00,000

Value of the Property = Capitalized Value of NMR

NMR × 8 (unexpired period of lease is less than 50 years) = ₹ 15,00,000×8 = ₹ **1,20,00,000**

VALUATION OF PARTNER'S INTEREST IN FIRM

Illustration 12 : Net wealth of firm consisting of three partners Bidyut, Kingshuk and Deepak in 2:2:1 and a capital contribution of ₹17 Lakhs, ₹13 Lakhs, and ₹12 Lakhs respectively is as under -

(a) Value of assets located outside India	₹ 30,00,000
(b) Value of assets located in India	₹ 80,00,000
(c) Debts incurred in relation to assets in India	₹ 40,00,000

Determine the value of interest of the partners in the firm under the Wealth Tax Act, 1957.

Solution :

Assesses: Bidyut, Kingshuk & Deepak Valuation Date: 31.3.2011
Assessment Year: 2011-12

Computation of net wealth of the Firm

Particulars	₹	₹
Value of Assets located in India	80,00,000	
Less: Liability in relation to assets in India	40,00,000	40,00,000
Value of Assets located outside India		30,00,000
Net Wealth of the Firm		**70,00,000**

Solution :

Computation of Interest of the Partner in the net wealth of the Firm (Amount in ₹)

Particulars	Bidyut	Kingshuk	Deepak
To the extent of Capital Contribution	17,00,000	13,00,000	12,00,000
Balance (Net Wealth-Capital Contribution) in Profit sharing ratio since dissolution ratio is not given	11,20,000	11,20,000	5,60,000
Interest of the Partner in the Net Wealth of the Firm	**28,20,000**	**24,20,000**	**17,60,000**

Computation of the Interest of the Partner in the net wealth of the Firm on the basis of location of assets: (Interest of the Partner in the Firm **apportioned** in the ratio of **4:3)**

Particulars	Balu	Kausik	Deepu
Assets Located Inside India	16,11,429	13,82,857	10,05,714
Assets Located Outside India	12,08,571	10,37,143	7,54,286
Interest of the Partner in the Net Wealth of the Firm	28,20,000	24,20,000	17,60,000

VALUATION OF LIFE INTEREST

Illustration 13 : Satender is aged 35 years. His father settled a property in trust giving whole life interest therein to Satender. The income from the property for the years 2006-07 to 2009-10 was ₹ 70,000, ₹ 84,000, ₹ 90,000, ₹ 108,000, respectively. The expenses incurred each year were ₹ 2,000, ₹ 4,000, ₹ 5,000 and ₹6,000 respectively. Calculate the value of life interest of Mr. Jogi in the property so settled on the valuation date 31.3.2011, with the help of the factor of 9.267.

Step	Procedure
1	Average Income for last three years = (₹ 84,000 + ₹ 90,000 + ₹ 1,08,000)/ 3 = ₹ 94,000.
2	Average Expenses for the last three years = (₹ 4,000 + ₹ 5,000 + ₹ 6,000) / 3 = ₹ 5,000.
3	Maximum Permissible Expenses = Average Expenses **or** 5% of Average Income, whichever is less = 5% of ₹ 70,000 = ₹ 3,500
4	Average Annual Income = ₹ 94,000 Less ₹ 3,500 = ₹ 90,500.
5	Life Interest=Average Annual Income×Life Interest Factor = ₹ 90,500 × 9.267 = ₹ 8,38,664.

Illustration 14 : 'X' received a vacant site under his father's will. The value of the site on 31.3.2011 is ₹15 Lakhs. As per terms of the 'Will' in the event 'X' wants to sell the site he should offer it to his brother for sale at ₹10 Lakhs. 'X', therefore, claims that the value of the site should be taken at ₹10 Lakhs as at 31.3.2011. Is the claim correct?

Solution :

1. As per Rule 21 of Schedule III to the Act, the **price or other consideration for which** any property may be **acquired by or transferred to any person under the terms of a deed of trust** or through or under any restrictive agreement in any instrument of transfer **shall be ignored** for the purpose of determining the value under the provisions of the Schedule.
2. In view of the above, the value of the site should be taken as ₹ 15 Lakhs and not as ₹ 10 Lakhs.
3. Therefore, **claim of X is incorrect.**

STUDY NOTE - 11

DIFFERENT ASPECTS OF DIRECT TAX PLANNING

This Study Note includes

- **Different Aspects of Direct Tax Planning**

11.1 INTRODUCTION

The provisions of the Income-Tax are contained in the Income-Tax Act, 1961 (the Act), which extends to whole of India and is operative from the 1st day of April, 1962(the Rules). The Act provides for determination of taxable income, tax liability, procedures for assessment, appeals, penalties, interest levies, the tax payment schedules and its determination, refunds and prosecutions.

Depending upon Government polices certain income is exempted from tax, for example SEZ (Special Economic Zone) units income, Agriculture income, etc. and deduction are also provided on fulfillment of prescribed criteria. Provisions relating to such exemptions and deduction are also contained in the Act.

Corporate form of business is much in vogue. Therefore, certain taxes specific to companies like Tax on Book profit (115JB), tax on Dividend Distributed (115O), are levied.

At times in Cross border transactions income earned get exposed to tax in India as well as in some other countries. Provisions for upholding relief from double taxation are also made in the Income Tax Act.

The Act also lays down the powers duties of various income-tax authorities. Being revenue legislation, the act is amended once a year through union budgets and the finance bill is normally presented to the Parliament for approval around February. The Act has empowered the Central Board of Direct Taxes (CBDT) to frame the rules and these rules are implemented after necessary Gazette notifications. The CBDT also issues circulars and clarifications from time to time for implementation by the income-tax authorities by virtue of section 119, which gives such rule making powers to the CBDT. It is impracticable for the Act to provide exhaustively for everything relating to limits, conditions, procedures, forms and various other aspects. Therefore this power has been delegated to CBDT and thus periodical changes and modification by an executive authority is facilitated. The power to frame rules is vested with the Board u/s 295 of the Act and the word 'prescribed' used in section 2(33) means what is prescribed by rules made under the Act.

The Income-Tax Act gives definitions of the various terms expressions used in the Act. Unless the context otherwise requires, these definition should be applied. The words 'means' 'includes' and 'means and includes' are used in these definitions and the significance of these terms needs to be understood. When a definition uses the word 'means' the definition is self-explanatory, restrictive and in a sense exhaustive. It implies that the term or expression so defined means only as to what is defines as and nothing else. For example, the terms 'agricultural income' 'assessment year' 'capital asset', are exhaustively defined. When the legislature wants to widen the scope of a term or expression and where an exhaustive definition cannot be provided, it uses the word 'includes' in the definition. Generally an inclusive definition provides an illustrative meaning and the definition could include what is not specifically mentioned in the definition so long as the stipulated criteria are satisfied. To illustrate refer to the definitions of 'income', 'person', 'transfer' in the Act. When the legislature intends to define a term or expression to mean something and also intends to specify certain items to be included, other the words ' means' as well as ' includes' are used. Such definition is not only exhaustive but also illustrative in specifying what is intended to be included. Sometimes specific items are included in an exhaustive definition in order to avoid ambiguity and to provide clarity. Please refer to definitions of 'assessee', 'Indian company','recognised provident fund', under the Act.

Further any decision given by the Supreme Court also becomes a law on the subject and will be binding on all the courts, tribunals, income-tax authorities as well as the taxpayers. In case of apparent contradictions in the Supreme Court rulings, the following rules may have to be followed:-

1. The decision of the larger bench would prevail.
2. The principle of the later decision shall prevail, where the decisions are by equal number if judges.

Decisions given by High Courts are binding on all taxpayers and It authorities, which fall under its jurisdiction till it is overruled by higher authority.

TAX PLANNING VS. TAX EVASION

The word 'tax planning' connotes the exercise carried out by the taxpayer to meet his tax obligations in proper, systematic and orderly manner availing all permissible exemptions, deductions and reliefs available under the statute as may be applicable to his case. To illustrate, assessee software company setting up assessee software technology park in assessee notified area to avail benefits of section 10A of the Act is assessee legally allowable course. Planning does not necessarily mean reduction in tax liability but is also aimed at avoiding controversies and consequential litigations.

Every taxpayer is expected to voluntarily make disclosures of his incomes and tax liabilities through legal compliance. When a tax payer deliberately or consciously do not furnish material particulars or furnishes inaccurate or false particulars or defrauds the State by violating any of the legal provisions, it shall be termed as 'tax evasion'. It is also illegal, but also unethical and immoral. Inflation of expenditure, suppuration of income, recording of fictitious transactions, claiming deductions wrongly are few examples.

Benjamin Franklin is credited with this classical statement: There are two certainties in this world – death and taxes. This makes all tax payers in general, and the companies in particular, realize the bitterness or hardship of taxes. Three methods of saving taxes have been developed in most countries of the world in the past few decades: tax evasion, tax avoidance and tax planning. A great deal of confusion prevails in corporate sector about correct connotations of these terms. Hence, we shall attempt to explain these terms to show tax planning is absolutely legal. The expression 'Tax Evasion' means illegally hiding income or concealing the particulars of income or concealing the particular source or sources of income or in manipulating the accounts so as to inflate the expenditure and other outgoings with a view to illegally reduce the burden of taxation. Hence, tax evasion is illegal and unethical. It is uneconomical as well. It deserves to be deprecated not only by the Government but by the companies as well. The next expression is 'Tax avoidance' which is assessee art of dodging taxes without breaking the law. In my opinion, tax avoidance means traveling within framework of the law or acting as per language of the law only in form, but murdering the very spirit of the law and defeating the purpose of the particular legal enactment. If, by adopting an artifice or device against the intension of the legislature but apparently on the face of it acting within the framework of the law, a company is able to dodge income tax, it would be a clear case of tax avoidance. In contrast, 'Tax Planning' takes maximum advantages of the exemptions, deductions, rebates, reliefs, and other tax concessions allowed by taxation statutes, leading to the reduction of the tax liability of the tax payer. Tax planning has been contrasted with the expression tax avoidance and has the legal sanction of the Supreme Court as well. In recent years the sentiments in favor of tax avoidance have changed and the courts view tax avoidance with displeasure. For example, Lord Summer in IRC Vs Fisher's Executors ac 395, 412 had earlier as per the ratio of Westminister's case said:

"My Lords, the highest authorities have always recognized that the subject is entitled so to arrange his affairs as not to attract taxes imposed by the Crown, so far as he can do so with the law, and that he may legitimately claim the advantage of any express terms or any omissions that he could find in this favor in taxing Acts. In so doing, he neither comes under liability nor incurs blame."

The significance of Ramsay as assessee turning point in the interpretation of tax laws in England and the departure from the principle of Westminister's case were explained in TRC Vs. Burmah Oil Co. Ltd., STC 30 where Lord Diplok said:

"It would be disingenuous to suggest and dangerous on the part of those who advise on elaborate tax-avoidance scheme to assume, that Ramsay 's case did not mark assessee significant change in the approach adopted by this House its judicial role to assessee pre-ordained series of transactions into which they were inserted steps that have no commercial purpose apart from the avoidance of tax liability, which in the absence of those particular steps would have been payable. The difference is in approach."

Commenting on this judgment the Supreme Court of India in the McDowell Co. Ltd., Vs. CTO 154 ITR 148(SC) said:

"It is neither fair nor desirable to except the legislature to intervene and take care of every device and scheme to avoid taxation, it is up to the court to determine the nature of new and sophisticated legal devices to avoid tax and consider whether the situation created by the devices for what they really are and to refuse to give judicial benediction."

In the same judgment, Supreme Court Judges made a clear distinction between tax avoidance and tax planning. This is what the judges of the Supreme Court have said in the same case:

"Tax Planning may be legitimate provided it is within the framework of law. Colorable devises cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honorable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay the taxes honestly without resorting to subterfuges."

Form the above it is very clear that tax planning by Assessee Company cannot be called a crime or an illegal activity or an immoral action as is wrongly considered by confused thinkers on the subject. What constitutes a crime is tax evasion and what is undesirable is tax avoidance but it is certainly desirable to engage in the exercise of tax planning.

In UK, wherefrom the principal coined in McDowell's case was coined, the House of Lords expressly reaffirmed the basic principle, 'A subject is entitled to arrange his affairs so as to reduce his liability to tax. The fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides'.

The House of Lords expressly reaffirmed the cardinal principle of *Duke of Westminister,* 'Given that a document or transaction is genuine, the Court cannot go behind it to some supposed underlying substance'. They only ruled against the principle being overstated or overextended.

Mukharji J, who in his prompt and lethal report in CWT v Arvind Narottam said: '…no amount of moral sermons would change people's attitude towards tax avoidance', and soon thereafter in UoI v Playworld Electronics stated: 'one should avoid subverting the rule of law'. As a matter of law, the Supreme Court in these two latter cases reiterated that where the true effect of a transaction is clear, the appeal to discourage tax avoidance is not a relevant consideration.

In any event, when the language of a deed of settlement is clear, an attempt to invoke McDowell would be futile even if the deed results in tax avoidance. as the Madras High Court held in Valliapan Vs. ITO, McDowell does not hit tax planning.

The manner in which McDowell is to be dealt with was well summed up by the Gujarat High Court in Banyan and Berry Vs. CIT thus:

The court (in McDowell) nowhere said that every action or inaction on the part of the taxpayer which results in reduction of the tax liability to which he may be subjected in future, is to be viewed with suspicion and be treated as a device for avoidance of tax irrespective of legitimacy or genuineness of the act…. The principle enunciated in the above case has not affected the freedom of the citizen to the act in a manner according to his requirements, his wishes in the manner to do any trade, activity or planning his affairs with circumspection, within the framework of law, unless the same falls in the category of colourable device.

The House concluded that steps which had no commercial purpose and had been artificially inserted for tax purposes into a composite transaction, should be disregarded; but that a transaction which came into statutory language could not be disregarded merely because it was entered into solely for tax purposes.

Therefore, while tax planning these principles emanating from court made law need to be kept in sight. Otherwise, planning looking good on paper may fail in practice.

Tax Management

Planning which leads to filing of various returns on time, compliance of the applicable provisions of law and avoiding of levy of interest and penalties can be termed as efficient tax management. In short, it is an exercise by which defaults are avoided and legal compliance is secured. Through proper tax planning and management, the penalty of upto ₹100000 for delay in furnishing of tax audit reports u/s 44AB can be avoided.

Similarly by applying for Permanent Account Number (PAN), the penalty under the Act can be avoided. The borrowal of loan otherwise than by way of an account payee cheque or bank draft attracts 100% penalty and this can be avoided by conscious planning of the execution of loan transactions. Planning is a perception conceived on legitimate grounds and achieved through genuine transactions within the framework of law e.g. contribution to Public Provident Fund and claiming rebate u/s 88 of the Act. The filing of the returns with all proper documentary evidence for the various claims, rebates, reliefs, deductions, income computations and tax liability calculations would also be termed as tax management.

Tax management is also an important aspect of tax planning.

Assessee is exposed to certain unpleasant consequences if obligations cast under the tax laws are not duly discharged. Such consequences take shape of levy of interest, penalty, prosecution, forfeiture of certain rights, etc.

Therefore, any effort in tax planning is incomplete unless proper discharge of responsibilities is not made.

Tax management includes:

1. Compiling and preserving data and supporting documents evidencing transactions, claims, etc.
2. Making timely payment of taxes e.g. advance tax, self assessment tax, etc.
3. TDS and TCS compliance
4. Following procedural requirements e.g. payment of expenses or acceptance of loans or repayment thereof, over ₹ 20,000 by account payee bank cheque or bank draft, etc.
5. Compliance with the prescribed requirements like tax audit, certification of international transactions, etc.
6. Timely filing of returns, statements, etc.
7. Responding to notices received from the authorities.
8. Preserving record for the prescribed number of years.
9. Mentioning PAN, TAN, etc. at appropriate places.
10. Responding to requests for balance confirmation from the other assessees.

Tax Implications in Planning

The main objectives in any exercise on tax planning are to :—

1. Avail all concessions and relief's and rebates permissible under the Act.
2. Arrange the affairs in a commercial way to minimize the incidence of tax.
3. Claim maximum relief where taxes are paid in more than one country.
4. Become tax compliant and avoid penalties, prosecutions and interest payments.
5. Fruitful investment of savings.
6. Timely compliance of procedural requirements like tax audit, TDS, TCS, etc.
7. Appropriate record keeping
8. Avoidance of litigation.
9. Growth of economy and its stability.
10. Pay taxes – not a penny more, not a penny less.

Tax Implications on International Joint Ventures

Under the existing provisions of the Income Tax Act in India, a resident is taxed on his global income subject to specific exemptions and deductions sanctioned under the law. Under section 9 of the Income Tax Act, any income that is deemed to accrue or arise in India is taxable. The crucial factor in determining the deeming accrual in India is the existence of 'business connection'. Equally important is the Double Taxation Avoidance Agreement (DTAA) if it exists between India and the respective country.

The concept of 'Permanent Establishment' (PE) dealt with in each DTAA is for taxability of certain income with reference to the country in which the income is earned. Normally the two important criteria for taxability under any tax law are the 'residence' and the 'source'. On account of this, when a resident of the country derives income from a source in other country, he is likely to get taxed both in the residence country (Home state) and the source country (Host state). This gives rise to double taxation of the same income in the case of same person by two different countries. If DTAA exists double taxation is avoided either by exemption or by tax credit method. Under our tax laws a resident gets relief u/s 90 and91 of the Act. The specific provisions of the DTAA should override the general provisions of the Income Tax Act.

As per the source of the Income Tax Rule, the income may be subject to tax in the country where the source of such income exists (where the PE is situate or where the asset or property is located) whether the income earner is a resident in that country or not. On the other hand the income earner may be taxed on residential basis in the country. For example, if a person is a resident of a country, he may have to pay tax on the income earned outside the country as well. Further some countries may follow a mixture of the above two rules. Thus a problem of double taxation arises if the person in respect of any income on the basis of source of income rules in one country on the basis of residence in another country or on the basis of mixture of the above two rules. Relief against such hardships normally takes either of the two routes-

(a) Bilateral relief and

(b) Unilateral relief.

The Governments of two countries can enter into treaty agreements under bilateral relief and where no such treaty agreements exist, the home state can provide relief unilaterally in respect of such double taxation issues (Section 90 and 91).

Under section 90 of the Act, the Central Government may enter into an agreement with the Government of any country outside India to provide for the following:

(a) A relief in respect of income on which income-tax has been paid in both the countries

(b) The type of income, which shall be chargeable to tax in either country with a view to provide relief under double taxation.

(c) Exchange of information on evasion or avoidance of Income-tax or investigation in latter cases.

(d) For recovery of Income-tax under either of the country laws.

Although treaties entered into by various countries are unique, a certain amount of uniformity is desirable in its framework. With this end in view, the tax treaties either the Organisation of Economic Co-operation and Development (OECD) model or United Nations (UN) model of Double Taxation Convention between developed and developing countries 1980. Most of the Indian treaties are based on the former. The agreements in turn can also be categorised into-

(a) limited agreements and

(b) comprehensive agreements

Limited agreements are generally entered into to avoid double taxation relating to income derived from operation of aircrafts, ships, carriage of cargo and freight. On the other hand, comprehensive agreements are very elaborate documents, which lay down in detail how income under various heads may have to be dealt with. Limits under various heads like income from immovable property, capital gains, dividends, interests, royalties, fees for technical services, etc and the manner of taxing the same are generally laid down in the comprehensive agreements. Some the agreements provide for taxation of annuities and pensions.

Section 91 of the Income Tax Act deals with the double taxation reliefs in respect of countries with which no agreement exists. The relief will be available subject to the following conditions satisfied:

1. The assessee in question must have been resident in the taxable territories.
2. That some income must have accrued or arisen to him outside the taxable territory during the previous year and it should India.
3. In respect of that income, the assessee must have paid by deduction or otherwise tax under the law in force in the foreign country in question in which the income outside India has arisen.

If the above conditions are satisfied, the person would be entitled to relief from the Indian Income-tax payable by him on such doubly taxed income at the average Indian rate of tax or the average rate of tax of the said country, whichever is lower or at the Indian rate of tax, if both rules are equal. The average rate of tax means the tax payable on total income divided by the total income.

In a landmark judgement, the Income-tax Appellate Tribunal has held that the Central Government cannot withdraw from the tax payer exemptions granted under DTAA with another country.

FOREIGN COLLABORATION AGREEMENTS

The following may have to be borne in mind in entering into foreign collaboration agreements:

Choose the right country:

It is essential to choose the right country from where the investments must be made into the Indian country. Such choice would depend upon the effective rate of taxation in the hands of the foreign company on dividend income and income tax on capital gains. Similarly technology transfer should take place from a country where the effective rate of taxation on royalty income / fees for technical services earned by the foreign company is the least. The right choice of the country can mitigate the tax burden to a large extent.

Tax credit:

DTAA provide for the tax credit in respect of taxes paid in the other country. Tax credit is normally a benefit, which accrues to the foreign collaborator and should be taken into account in fixing the consideration payable to the foreign collaborator. Generally treaties contain a provision that any tax credit received by the foreign collaborator would be passed on by him to his Indian counterpart.

Dependent services:

Generally, the salaries, wages and other remunerations received by the foreign personnel deputed to India are not taxable if the period of stay does not exceed 181 days in a fiscal year. In case the period of stay is likely to exceed 181 days in a fiscal year, it may be worthwhile to spread the stay of the foreign technicians to 2 fiscal year so that it does not exceed 181 days in aggregate in a single fiscal year.

Royalty and technical service fees:

Royalty and technical service fees can be negotiated nett of Indian taxes. The Indian tax will than be separately paid by Indian party. The payment will however be towards meeting the foreign parties Indian tax liability. The tax so paid by the Indian party is not treated as Indian income in the hands of the foreign party. This has the effect of some tax saving.

The hypothetical tax situation may be illustrated with the help of DTAA with Denmark on royalty fees:

Tax paid on gross basis	5%
Tax on 20% of 5%	1%
Net remittance	4%
Taxes on net basis	4.165%
Tax at 20% of 4.165%	0.833%
Net remittance	4.165%

Thus there is an advantage of 0.165% to the foreign company while the Indian company pays only 5% tax. This situation has arisen because there no tax on tax paid in respect of royalties and technical service fees under section 10(6A).In both the situations, the Foreign company would be eligible for a credit of Indian tax against its foreign tax liability. The aforesaid exercise may not be worthwhile, if the foreign company is able to take full advantage of tax credit abroad for the tax paid in India.

Split up of total consideration payable to foreign party:

In respect of many treaties, different rates are provided for royalty and technical service fees. For example under the DTAA with some country, royalty is taxed at 10% of the gross sum and the technical service fees are taxed at 20% of the gross sum. In such a situation it would be advantageous to split up the consideration into royalty and technical service fees and maximum consideration should be attributed to either royalty or technical service fees, whichever is taxed at a lower rate.

Take advantages of the examples given in the treaty:

The examples given in the treaty entered into with United States offer an excellent medium for tax planning. These examples draw distinction between situations where may be taxed as fees for included services and those situations where it may not be so taxed. The agreements may be drafted in such a manner so as not to include the services within the purview of fees for included services.

Tax sparing:

Tax spearing provisions in the treaties should be carefully considered. For instance, in the treaty with Japan, the credit with respect of interest income will be provided not only for tax paid in Indian but also for tax spared u/s 10(15)(iv) of the Income- tax Act as per agreement between the two Governments vide Article 23 of the convention. Similarly, as per paragraph 3(b) of Article 23 of the Convention with Japan, Japanese taxpayer deriving dividend income from an Indian company in which the Japanese taxpayer owns not less than 25% of the voting share capital, will be eligible for credit against Japanese tax not only in respect of 15% tax paid on dividend income, but also for Indian tax payable by the company paying dividend in respect of its income.

Render services outside India to save tax:

In some treaties like that with Austria technical services fees would be taxed in India if the activities were performed in India. In such cases, the parties to the agreement may consider rendering of technical services outside India.

Royalty vis-a-vis business profits:

In many countries, the definition of royalties is narrower than the definition in the Indian Income-tax Act and this may have a bearing on the tax liability of the foreign enterprise providing technical know-how. The tax liability in India may be avoided, for instance, in respect of payments received by say a UK enterprise if the payment is not in the nature of royalty as per the definition of the DTAA although it may be so under the Indian Income-tax Act. For instance lumpsum payment for transfer of technical know-how package abroad may not constitute royalty as per the DTAA. The same may be taxed as business profit I the UK enterprise has a PE in India. In case it does not so have, it would not be taxed in India. The Calcutta High Court in CIT Vs Davy Ashmore India Ltd. (1991) 190 ITR 62 has held that where there is an outright purchase or sale as per the DTAA between India and UK, the consideration is for the transfer of such designs, secret formula, etc and cannot be treated as royalty.

Presumptive tax:

There are provisions in the Indian Income-tax Act pertaining to presumptive taxation like section 44B, 44BB, 44BBA and 44BBB. The same may be advantageous vis-à-vis getting the business income taxed on the basis of income less expenses. The foreign parties should take advantage of such provisions. It may be mentioned that as per section 90 of Income-tax Act, the provisions of the Treaty or the normal provisions of the lncome-tax Act, whichever is more beneficial would be applicable to the foreign party:

Improvements provided free of cost:

In case the foreign technical cum financial collaboration agreement with a foreign party provides for making available updates free of cost, it is advisable to show in the agreement that in consideration of providing free updates, equity shares are being issued to the foreign party. This would enable the foreign party to claim the cost of updates as part of the cost acquisition of equity shares and may enable the foreign party to mitigate tax on capital gains in the event of sale of shares. It is advisable that the agreement should provide for such free updates only for a limited period.

Accommodation/ living expenses for technicians:

It is advisable to provide in the agreement that the accommodation and living expenses the foreign technicians deputed should be met by the Indian company.The same would be taxable in India because of:

(a) There is no employer - employee relationship and there is no question of taxing perquisite u/s 9(I)(ii) of the Act [ITAT Hyderabad Bench in Flores Gonther Others Vs ITO 29 TTJ 392.]

(b) If it is assumed that such benefits accrue to the foreign technicians by virtue of contract of service entered into by them with the foreign collaborators, the same would be exempt u/s 10(14) if the Income-tax Act [CIT Vs D S Blackwood (1989) 178 ITR 470 (Cal); ITO Vs R T Lowerance 15 lTD 490 (All) and E Bettelli Vs ITO (1986) 26 TTJ 96 (Ahd)).

E-Commerce and Taxation:

In the era of e-commerce, the determination of the place of source with reference to an item of income may quite often pose difficulty. The source-based taxation of business income depends on physical presence in the form of fixed place of business or a dependent agent in the source country. With e-commerce the need for physical presence virtually ceases. The change in mode of delivery from physical to online raises characterization issues and the lack of physical presence also creates problems in enforcement of tax laws. Therefore the long-term solution of the problems created by characterization lies in making direct taxation identical for all streams of income in a manner aimed at ensuring equitable sharing of revenues between residence country and source country. The following rulings by the Authority for Advanced Ruling may be worth remembering in this context:

1. A company incorporated in Mauritius for sale and distribution of television channels enters into an agreement with an Indian company where under the latter would solicit orders from purchasers of airtime and pass on those orders to the former. The business profits earned by the Mauritian company through Indian company are profits deemed to accrue or arise in India u/s 9 of the Act. However by virtue of Article 7 of the DTAA between India and Mauritius, they are not liable to be taxed in India, if: a) The liability of the Mauritian company to pay tax in Mauritius was established and b) The Mauritian company and not the Indian company is shown to exercise generally the power to conclude the advertisement contract for sale of airtime - P No. 296 of 1996 T V M Vs CIT 237 ITR 230 (AAR).
2. An American company is engaged in providing international credit cards, travelers cheques and travel related services. It has Central Processing Unit (CPU) in USA and Consolidated Data Network (CDN) in Hong Kong. Indian company is given access to the CPU through CDN for the reporting and processing of information on travel by customers in India. Charges for the use of CPU and CDN of American company paid by Indian company is royalty for the case of 'design or model ,plan secret formula and process' and therefore taxable in India under Article 12(3)(a) of DTAA between India and USA – p. no. 30 of 1999 238 ITR 296 (AAR).
3. Where there is a PE for a non resident income attributable to such PE is chargeable to tax in the country in which such PE exist – p. no.28 of 1999 242 ITR 208 (AAR). A foreign company having a fixed office will be constructed to have a PE-p. no.13 of 1995 228 ITR 487 (AAR).

TAX ASPECTS OF MERGERS AND AMALGAMATIONS

The business and economic environment has thrown up the need for rationalization of laws relating to business reorganization for restructuring of production system and better utilization of resources, which have become necessary with a view to enabling the Indian industry to rearrange itself to become globally competitive. It was in this background that tax concessions to conversation of proprietary/partnership concerns into company were provided for in the Finance Act, 1998.the Act now provides for tax concessions in the following cases of business reorganization.

1. Amalgamation/ merger of companies.
2. Conversation of proprietary concern/ firm in to a company.

3. De-merger of a company.
4. Slump sale.

Merger is a combination of two or more companies into one company and may involve either absorption or consolidation. Where the assets and liabilities of one company are taken over by another and former losses its identity, it is referred to as absorption, for e.g.TOMCO with HLL, RPL with RIL, etc. In case a new company comes into existence and the participating companies go out of existence, the re-arrangement is known as amalgamation, e.g. Renusager with Hindalco.

Examples for the amalgamation/consolidation variety include the merger of Tetrapack and Alfalaval to form Tetralaval. In merger transactions, the consideration is paid for and received in shares and both the merging partners receive money in future in the form of dividends/yields. No money transaction is usually implied at the time of entering into a merger agreement. Whether the share capital is pooled or assets are pooled, so long as a share for share exchange takes place between the contracting parties, the transaction is merger. In an acquisition, the consideration is in the form of cash. The person or the corporation intending the control another corporation pays cash for number of shares that give the controlling interest. Thus the seller of the shares receives money in the current period of the transaction and the buyer of the shares also pays in today's values.

The de-merger signifies spinning-off or hiving-off the existing divisions of the company into a separate company. Therefore the de-merger means a split or division of the company. The division hived off could be transferred to a new company or it could be sold to an existing company. A de-merger takes place in the cases of internal restructuring or family settlements or in cases of tax planning. For example, in settlement of disputes between Ambani brothers de-merger of Reliance Industries Ltd. (RIL) took place and companies like Reliance Communications Ltd; Reliance Natural Resources Limited; etc. were demerged and shareholders of the RIL received free of cost, shares in the demerged companies.

The slump sale refers to the sale of the undertaking as a going concern. In this case, the consideration is not fixed for each and every asset separately and a lump sum consideration is arrived at for the undertaking as a whole.

The term amalgamation has not been defined u/s 394 of the Companies Act and various judicial decisions points to the meaning of term. The amalgamation under the company law may be pursuant to a court order or under an order of the central Government, if it is in the public interest.

The term 'amalgamation' has been defined u/s 2(1B) of the income-tax Act and if the amalgamated company wishes to the set off the losses and unabsorbed depreciation of the amalgamating company with its profits, the condition laid down u/s 72A of the Act shall have to be complied with. For amalgamation of banking companies, provisions are made u/s. 72AA.

In order that an amalgamation may fall under section 2(1B) of the Income-tax Act, the following conditions must necessarily be fulfilled:

1. All the property of the amalgamating company should be vested in the amalgamated company.
2. All the liabilities of the amalgamating company should become the liabilities of the amalgamated company.
3. Shareholders holding not less than $3/4^{th}$ in the value of the share in the amalgamating company should become the shareholders of the amalgamated company. However the shares already held by or its subsidiary immediately before the amalgamation shall be excluded.

In the following cases the merger will not be called an amalgamation:

a. Where the property of the company say 'A', which merges is sold to the other company say 'B' and the amalgamation comes about by virtue of a transaction of sale. This is to exclude from amalgamation, the cases where the amalgamation scheme is not approved by the High Court;
b. Where the company 'A' which is wound up in liquidation and the Liquidator distributes the property of company 'A' to the company 'B' and the amalgamated company 'B' receives the property of the company 'A' (the amalgamating company) from the liquidator as on liquidation.

The amalgamated company is entitled to carry forward the unabsorbed depreciation and brought forward loss of the amalgamating company provided the following conditions are fulfilled (S. 72A):

1. The amalgamation should be of —
   (a) a company owning an industrial undertaking or a ship or a hotel with another company; or
   (b) a banking company referred to in clause (c) *of section 5 of the Banking Regulation Act, 1949 with a specified bank; or*
   (c) one or more public sector company or companies engaged in the business of operation of aircraft with one or more public sector company or companies engaged in similar business,
2. *If the above conditions are satisfied then, (i) the accumulated loss and (ii) the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected. The amalgamated company shall set off and carry forward of loss and unabsorbed depreciation. For the purpose of carry forward, year of amalgamation shall be considered to be the year of origination.*
3. The benefit of *set off and carry forward of loss and unabsorbed depreciation is not allowed if the following further conditions are not complied with [s. 72A(2)]:*
   (a) the amalgamating company—
   (*i*) has been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years;
   (*ii*) has held continuously as on the date of the amalgamation at least three-fourths of the book value of fixed assets held by it two years prior to the date of amalgamation;
   (b) the amalgamated company—
   (*i*) holds continuously for a at least of five years from the date of amalgamation at least three-fourths of the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation;
   (*ii*) continues the business of the amalgamating company for a minimum period of five years from the date of amalgamation;
   (*iii*) fulfils such other conditions as may be prescribed.
4. In a case where any of the conditions laid down in section 72A (2) are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the amalgamated company shall be deemed to be the income of the amalgamated company chargeable to tax for the year in which such conditions are not complied with.

Tax concessions/Incentives in the case of amalgamation

If any amalgamation takes place within the meaning of the section 2(1B) of the Income-tax Act, the following tax concessions are available:

I. Tax concessions to amalgamating company.

II. Tax Concessions to the shareholders of the amalgamating company.

III. Tax concessions to the amalgamated company.

I. Tax concessions to the amalgamating company.

a. Capital gains tax is not attracted as section 47(iv) exempts from capital gains tax liability in case of any transfer of capital assets in a scheme of amalgamation of the amalgamating company to the amalgamated company provided the amalgamated company is an Indian company.

b. Even if there is a transfer of any asset by an amalgamating company for inadequate consideration in the scheme of amalgamation, no tax implications exist.

c. Tax concessions to a foreign amalgamating company – Where a foreign company holds any shares in an Indian company and transfers the same in the scheme of amalgamation to another foreign company, such transactions will not be regarded as transfer for the purpose of capital gain u/s 45 of the Income-Tax Act if the following conditions are satisfied:

1. Atleast 25% of the shareholders of the amalgamating foreign company should continue as shareholders of the amalgamated foreign company and,
2. Such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated.

II. Tax concessions to the shareholders of an amalgamating company.

Where a shareholder of an amalgamating company transfers his shares in a scheme of amalgamation, such transactions will not be regarded as a transfer for capital gain purpose if the following conditions are satisfied:

a. The transfer of shares is made in consideration of the allotment to him of any share or shares in the amalgamated company, and
b. The amalgamated company is an Indian company.

The cost of acquisition of such assets of shares in the amalgamated company shall be the cost of acquisition of shares in the amalgamating company and for computing the period of holding of such shares, the period for which such shares were held in the amalgamating company shall also be included.

III. Tax concessions to the amalgamated company.

The amalgamated company shall be eligible for tax concessions provided the amalgamation satisfies all the three laid down in section 2(1B) and the amalgamated company is an Indian company. Subject to the above, the amalgamated company shall be eligible for following tax concessions:

(1) Expenditure on scientific research [Sec 35(5)] –

Any unabsorbed capital expenditure will be allowed to be carried forward and set off in the hands of the amalgamated company. Further if such asset ceases to be used in a previous year for scientific research related to the business of the amalgamated company and the amalgamated company sells such assets, the sale price to the extent of the cost of the asset shall be treated as business income of the amalgamated company. The excess of the sale price over the cost of the asset shall be subject to the provisions of the capital gains.

(2) Expenditure for obtaining licence to operate telecommunication services [Sec 35 ABB (6)]

Where in a scheme of amalgamation, the amalgamating company sells or otherwise transfers its licence to the amalgamated company (being an Indian company) the provisions of section 35ABB become applicable in the same manner to the amalgamated company and consequently the expenditure on acquisition of licence not yet written off shall be allowed to the amalgamated company in the same number of balance instalments and where such licence is sold by the amalgamated company, the treatment of the deficiency/ surplus will be same as would have been in the case of amalgamating company.

(3) Treatment of preliminary expenses [Sec 35D (5)] –

The amount of preliminary expenses of the amalgamating company to the extent not written off shall be allowed as a deduction to the amalgamated company.

(4) Amortization of expenses in case of amalgamation [Sec 35DD] - One- fifth of the expenditure on amalgamation shall be allowed for each of the 5 successive previous years beginning with the pre vious year in which the amalgamation or de-merger takes place. No deduction shall be allowed for this expenditure under any other provisions of the Act. This is subject to the rider that the expenditure is incurred in the process of running the business or remaining in business.

(5) Treatment of expenditure on prospecting, etc of certain minerals [Sec 35E (7A)] –

The amount of expenditure on prospecting, etc of certain minerals of the amalgamating company, which is not yet written off, shall be allowed as deduction to the amalgamated company as it would have been to the amalgamating company.

(6) Treatment of capital expenditure on family planning [Sec 36(1) (ix)] –

Where in a scheme of amalgamation a capital expenditure is transferred to an amalgamated company, such transfer shall not be regarded as transfer and the capital expenditure on family planning not yet written off shall be allowed to the amalgamated company in the same number of balance instalments and where such assets are sold by the amalgamated company, the treatment of the deficiency / surplus will be the same as would have been in the case of the amalgamated company.

(7) Treatment of bad debts [Sec 36(1) (vii)] –

The debt of the company taken over by the amalgamated company in a scheme of amalgamation shall be allowed to be written off as bad debts of the amalgamated company if it turns bad [CIT Vs T Veerabhadra Rao, K. Koteswara Rao & Co. 155 ITR 152 (SC)].

(8) Carry forward and set off of business losses unabsorbed depreciation –

The amalgamated company shall be allowed to carry forward and set off the business losses and unabsorbed depreciation of the amalgamating company if all the conditions laid u/s 72A are satisfied.

(9) In case of no depreciable assets transferred by an amalgamating company to an Indian amalgamated company, the cost of acquisition of the asset shall be taken at the same value as it was to the original owner duly adjusted for any cost of improvement [Sec 45]. In the case of depreciable assets, it would be transferred at WDV of the assets in the case of amalgamating company for the immediately preceding previous year as reduced by the amount of depreciation actually allowed in relation to the said preceding previous year. The provisions of section 50 regarding computation of capital gains would apply.

(10) The benefit of tax concession is allowed to the amalgamating company and the amalgamated company only when the conditions laid down in section 2 (1B) of the Act. Amalgamation, in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that —

(i) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;

(ii) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;

(iii) shareholders holding not less than three-fourths in value of the shares in the amalgamating company or companies, other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary become shareholders of the amalgamated company by virtue of the amalgamation,

otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first-mentioned company.

(11) As per section 72A, the amalgamated company can carry forward the business loss and unabsorbed depreciation of the amalgamating company subject to certain conditions. Where it is not possible to satisfy such conditions, the companies may opt for a reverse merger i.e. instead of the loss making company merging with the profit making company, the profit making company may merge with loss making company. In this case the amalgamated company which was the loss making company will be able to carry forward its own business loss and unabsorbed depreciation and set it off against the profits of the business which has merged in the scheme of amalgamation.

(12) The benefit u/s 47(vii) shall be allowed only when the shareholders of the amalgamating company are allowed shares of the Indian amalgamated company in lieu of shares held by them in the amalgamating company. If the shareholders are allotted something more than the shares in the amalgamated company i.e. bonds, debenture, etc no benefit will be available u/s 47 (vii).

Slump Sale

According to Section 2(42C) defines Slump Sale as slump sale means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales. The determination of the value of an asset or liability for the sole purpose of payment of stamp duty, registration fees, etc, shall not be regarded as assignment of values of individual assets and liabilities.

Any profits or gains arising from the slump sale affected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

Provided that any profits or gains arising from the transfer under the slump sale of any capital asset being one or more undertakings owned and held by an assessee for not more than thirty-six months immediately preceding the date of its transfer shall be deemed to be the capital gains arising from the transfer of short-term capital assets. The "net worth" of the undertaking or division so transferred shall be deemed to be the cost of acquisition and the cost of improvement in computing the capital gain. However, indexation benefit shall not be allowed.

"Net worth" shall be the aggregate value of total assets of the undertaking or division as reduced by the value of liabilities of such undertaking or division as appearing in its books of accounts. Any change in the value of assets on account of revaluation of assets shall be ignored for the purposes of computing the net worth.

For computing the net worth, the aggregate value of total assets shall be –

(a) in the case of depreciable assets, the written down value of the block of assets determined in accordance with the provisions contained in section 43 (6); and

(b) in the case of other assets, the book value of such assets.

A report of a Chartered Accountant indicating the computation of the net worth and certifying the correctness of net worth is required to be enclosed along with the return of income.

The following are the advantages u/s 50B-

(i) If the undertaking is in existence for more than 36 months, the gain arising on slump sale is treated as long term even though some of the assets comprised in the undertaking may be held only for few months.

(ii) If the gain is long term it will suffer only 20% tax rate u/s 112.

(iii) No distinction is made between depreciable and non- depreciable assets.

(iv) It is possible to plan for exemption under the various applicable sections such as 54EC, 54ED or 54F if the undertaking is long term capital asset.

The only disadvantage u/s 50B appears to be the denial of indexation benefit respect of non-depreciable long term capital assets comprised in the business.

An assessee may have to weigh the options of selling a business as a going concern by way of slump sale or alternatively, selling the assets independently and decide about the advantageous mode of transferring the business keeping in view the above aspects discussed.

FOREIGN COLLABORATION AGREEMENT AND TAX IMPLICATIONS

Foreign collaboration in India is encouraged by the Government of India on a selective basis. Instead of encouraging mere financial collaborations, collaboration involving import of know-how, which would contribute to the growth of industry and technology in India is generally preferred. Stipulations are made with regard to the following:

1. Initial lumpsum payment to be paid to the foreign collaborator for importing know how or transfer of rights in any technology; Payments for supply of drawings and designs.
2. Royalty and fees for technical services.
3. Payment for supply of machinery and equipment.
4. Payment of interest on monies due.
5. Dividend in respect of shares allotted.

Tax implications in respect of the above are analysed hereunder. Tax planning can be done keeping in view the provisions of Income-tax Act; aspects relating to Double Taxation Avoidance Agreement and the case laws discussed in order to avail exemption or concessional rate or to avoid taxability.

Recently law on transfer pricing has been overhauled and certain stipulations have been made. Compliance with the transfer pricing law is obligatory.

Strategic Management Decisions – Tax Implications

In business, the decisions are taken with a view of optimize returns to the stakeholders. A dominant aspect to be considered taking in view the tax consequences of the same on the bottom-line so as to share minimum profits with Government without violating any tax or any other laws in force.

It is significant that tax consequences alone need not bind the management to take a decision and it is only a factor which influences the management decisions.

Moreover, in case of taxes, there are both direct as well as indirect taxes and in efforts for planning implications of both category of taxes are required to be considered.

Management decisions, which have a bearing on the bottom-line are analyzed below from the point of view of income-tax implications.

1. Make or Buy

Following are the relevant factors for deciding raw materials or components:

(a) Desire for specialization.

(b) Inadequacy of funds to establish new unit for manufacture.

(c) To guard against the risk of technological obsolescence.

(d) To conserve monetary and managerial resources.

(e) Containing risk in case of any new technology.

In making the final decision, the comparison of total cost of manufacture as compared to the buying cost of the product is important.

In computing the costs, care should to be taken so as to include all fixed and variable cost applicable to both the alternatives. In considering the option, possibility of utilizing idle capacity needs to be examined and principles of marginal costing should be applied.

While manufacturing the product or component, it will result in levy of taxes like excise duty, while buying the same will result in payment of taxes in form of VAT, Sales Tax, Octroi. Thus statutory levies such as duty payable, Octroi, VAT, Sale tax, cess etc should be taken into consideration wherever they are applicable in both the alternatives. Aspects of set off of duty or any tax should be considered.

Tax concessions available under the provisions on the Income Tax Act for setting a new unit for making the product will have to be taken in to account. Provisions of different benefits available under various Central, state and local Acts for setting up of a unit will have to be considered.

The costs which are to be compared, in both the cases, should be 'post-tax' calculations.

If purchase price is less than the cost of manufacture, the management should decide to buy the product or component and if it is the other way round, the decision should be in favour to manufacture the product or component.

In case of organizations following transfer pricing for transfer of products from one division to another, this comparison is made to evaluate the efficiency of each division. In case of multinationals, which outsource the manufacture, the design and quality control are kept at the head office while products are manufactured at small scale units. In such cases concessions available to the manufacturing unit should be kept in mind. Other industries for example mineral based industries like steel and cement manufacture, the conservation of mineral wealth have to be kept in mind while taking the decision to make or buy.

2. Own or Lease

The factors which influence the decisions of management relating to owing or leasing of fixed asset are as follows :

(a) **Capital outlay –** In case of ownership o assets, huge resources are committed on long term basis while case of lease of assets the same is not required. Leasing helps to pay as when we earn. Liquidity and opportunity costs for the amount required which is blocked in acquiring assets weigh a lot in decision making in this regard.

(b) **Depreciation -** While depreciation can be claimed in the case of assets owned or acquired on hire purchase basis, depreciation is not allowed in case of leased assets. However the entire lease rentals paid are chargeable to Profit and Loss Account.

(c) **Repairs and renewal -** In both cases, current repairs and renewals can be claimed as deduction. Any expenditure incurred for replacement of certain parts of exiting assets can be claimed as revenue – CIT vs. Mahalakshmi Textile Mills Ltd. 66 ITR 710 (SC).

(d) **Hire Charges –** Applicable only in the case of lease and fully deductible in computing taxable profits.

(e) **Taxes –** Lease of assets, if considered as sale and therefore, Sales Tax may be attracted. Aspects of set off of taxes should be considered. Whereas, in case of purchase excise as well as Sales Tax may be attracted. Similarly, aspects of set off of duty or taxes should be considered.

(f) **Tax Deducted at Source –** In payment of lease charges, care must be taken to comply the TDS prescribed under section 194 I of Income Tax Act.

(g) **Technical obsolescence –** The risk of obsolescence is avoided when assets are required on lease basis as opposed to ownership basis. If assets, which are bound to become obsolete, are purchased, there may not be any resale value also, for example electronic items such as computers, software.

(h) **Scientific Research –** In case of expenditure on scientific research, deduction shall be allowed under section 35 on any capital expenditure on plant, machinery, equipments, etc. In certain circumstances even weighted deduction for expenditure on scientific research is available. In such cases buying of an asset may be advantageous.

(i) **Closure –** In the case of any business which is intended to be carried on only for a particular period of term, it may be more feasible to avail the lease option instead of buying the asset.

(j) **Second hand or new –** The decision to buy or hire a new or second hand asset depends upon factors like the resources to be committed, condition of the asset and the differential price/rental between the two. In case of a new industrial undertaking, deduction under section 80 IA will not be available if the used plant and machinery account for more than 20% of the total value of the plant and machinery. In some cases where fiscal incentives such as capital subsidy are involved, there is a necessity to restrict the investment up to certain levels only and in such cases trade-offs may have to be exercised and purchases/ lease of second hand machinery may be restored to.

(k) Leased assets are not owned assets and therefore the asset cover to equity comes down due to increased dependence on leaser finance.

(l) Financial ratios are also distorted due to greater dependence on lease finance.

(m) Lease rentals generate regular financial commitments whereas owned assets create only one time cash outgo. This would have its own impact on the operating cashflow.

(n) The asset taken on lease is taken back by the lessor at the expiry of the lease period. To find an alternative asset at the expiry of lease period may pose several problems.

3. Retain or Replace

Repair means to restore to good condition, to renovate, to mend by replacing parts or an asset compensating loss or exhaustion. If repairs are carried out a newly acquired asset to install in the business, such expenditure in capital in nature. Repairs should be distinguished from renewal in as much as renewal means reconstruction of the premises entirely or substantially [CIT vs. Sri Rama Sugar Mills Ltd 21 ITR]

In cases where the assets are maintained in excellent conditions due to the maintenance policies pursued by the company or the sturdiness of the asset, it would be economical to retain the asset as the replacement cost may be uneconomical. This is true in cases where the inflation replacement cost of the concerned machinery building industry is very high.

Further in developing and underdeveloped countries such as ours, due to technology policy pursued, there is a possibility that we might have purchased machinery which have been removed from the manufacturer's current list and in such cases, we are left with no other alternative except to retain the current asset. The replacement in such situations would be prohibitive in terms of costs.

Repairs can result in outflow of cash in form of payment of service tax. Renewals, result in payment of indirect taxes like excise duty, sales tax. In either case, there may be a possibility of set off of such taxes that also needs to be examined.

While in retaining the asset, the full amount of repairs will be allowed as deduction as business expenditure while in case of replacing the asset, depreciation as per prescribed limit will be allowed as deduction.

'Repair' implies the existence of a thing which has malfunctioned and can be set right by effecting repairs which may involve replacement of some parts, thereby making the thing as efficient as it was before or as close to it as possible. Replacement is different from repair. Replacement implies the removal or discarding of the thing that was in use, by a different or new thing capable of performing the same function with the same, lesser or greater efficiency. The replacement of a section in a series of machines which are interconnected in a segment of the production process which together form an integrated whole may, in some circumstances, be regarded as amounting to repair when without such replacement that unit in that segment will not function. The logic cannot be extended to the entire manufacturing facility from the stage of raw material to the delivery of the final finished product - CIT v. Madras Cements Ltd. 255 ITR 243(Mad.).

Total replacement of four cement mills into one cement mill will not constitute 'repair' - Where the assessee replaced the existing four cement mills by a new cement mill at a different location, and the new mill was technologically superior and was far more efficient that the earlier four mills together, and was also capable of delivering a recognizably superior product, the expenditure on such replacement cannot be treated as 'repair' under section 31 - CIT v. Madras Cements Ltd. 255 ITR (Mad.).

Total replacement of damaged equipment is not 'repair' - Where the assessee replaced the electric control panel which was damaged and was beyond repair, by a new control panel, the expenditure on such replacement cannot be treated as 'repair' under section 31. It would be a case of capital investment and would not be a case of repair - Deputy CIT v. S.T.N. Textiles Ltd. 257 ITR (Ker.).

4. Repair/Scrap or Return

The term 'current repairs' means expenditure on buildings, machinery, plant or furniture which is not for the purpose of renewal or restoration but for preserving an already existing asset. Current repairs indicate repairs which are attended to when the need for them arises from the businessman's view and these are not allowed to be in arrears or to be accumulated. Current repairs are allowed as business expenditure in the computation of income.

Sale of scraped assets will attract VAT, Sales Tax and care should be taken to collect the same.

Sometimes it would be economical feasible to scrap the asset than to spend money in repairing it. However in such cases, the implications of section 50 have to be kept in mind as money realized on scraped asset sales will have to be reduced from WDV of the block of assets.

In cases where the machineries are obtained under a warranty, the machinery is returned to the manufacturer in case there is substandard performance. In case any repairs are carried out, the same expenditure has to be received from the manufacturer and cannot be treated as business expenditure.

5. Export or Domestic Sale

Indian companies are eligible to claim deductions of profits earned from the business of export of goods or services subject to fulfilment of certain conditions. However, these are available only for 10A [Free Trade Zones], 10AA [Special Economic Zone], 10B [Export-oriented undertakings]

The term 'profits of the business' referred in the above section is different from the term 'profit of business' referred to under the head 'profits and gains of business or profession'. The export turnover means sale proceeds received in, or brought into, India by the assessee in convertible foreign exchange, within a period of six months from the end of the previous year or within such further period where such sale proceeds are credited to a separate account maintained for the purpose by the assessee with any bank outside India with the approval of the Reserve Bank of India. It does not include freight or insurance attributable to the transportation of the goods beyond the customs station of India. The profits of the export business would be computed after claiming the deductions available as under:

Tax concession available in respect of profits and gains from projects outside India (80HHB), export profits (80HHC), services provided to foreign tourists (80HHD), export of computer software (80HHE), export or transfer of film software (80HHF) have been withdrawn from 1st April, 2005.
Moreover in case of exports risk of forex loss also exists or there may be gain in realization at times.

6. Shut Down or Continue

The income chargeable as 'profits of the business only' if the assessee carries on the business at anytime during the previous year. It is however not necessary that the business is carried on throughout the previous year or till the end of the previous year – [CIT Vs Bangalore Transport Company (1967) 66 ITR 573 (SC)].

When the assessee does not carry on the business, it therefore implies, section 28 cannot be applied and the amount that he receives cannot bear the character of profits of the business. In case of temporary suspension of business to overcome business crisis without any intention of the assessee to part with the business, it would be better to lease out the business assets and earn revenue so that the income earned is assessable as income from business and not otherwise – [CIT Vs Vikram Cotton Mills Ltd. (1988) 169 ITR 597 (SC)]. In the following cases, even though no business has been carried on by the assessee, the receipts are taxable as income from business in the year of receipt :

(a) Recovery against any loss, expenditure or trading liability earlier allowed as a deduction [section 41(1)]

(b) Balancing charge in the case of electricity companies [section 41(2)]

(c) Sale of capital asset used for scientific research [section 41(3)]

(d) Recovery against bad debts [section 4 1(4)].

(e) Amount withdrawn from special reserve [Section 41 (4A)]

(f) Receipt of discontinued business under cash system of accounting [S. I 76(3A),(4)].

(g) Sec 50

The cessation of business may occur in two ways :

(a) Where the business is no longer in existence.

(b) Where the business is in existence but has been transferred by the assessee as a going concern to another entity,

The succession and discontinuance are mutually exclusive concepts as there cannot be discontinuance where there is succession. Further if a part of the business of an assessee is dropped owing to non-profitable nature either permanently or temporarily, it will not imply that the business has been discontinued. In the case of dissolution of a firm or a liquidation of a company, sometimes the trade may be carried on even after such dissolution or liquidation. There could be other examples of discontinuance of business as under :

(a) Amalgamation of two separate and independent businesses belonging to distinct owners resulting in discontinuance of those businesses.

(b) Partition of a joint family business and the business is divided amongst the members. In this case there would be discontinuance of the old business even if some or all the members carry on their own business in the same premises and take the advantage of the old business connections.

(c) In case a firm is split tip into two different firms and the old business is also divided amongst the different firms, the original firm shall be deemed to have discontinued the business.

(d) If a professional leaves his practice, there would be discontinuance. The question whether the professional discontinued his profession or not depends on the state of his mind at the time of cessor merely because he takes to the profession once again, it cannot be said that there is no discontinuance at the time of cessor.

(e) Spin-off - The common definition of 'spin off' is when a division of a company or organization becomes an independent business. Spin off is feasible when loss making or profit making unit is separated from the main unit. For example if a manufacturing unit is going in losses, while the land property it holds, if separated from the main unit may fetch profits on sale of the same.

In all the above cases, the mischief of section 176 regarding accelerated assessment would come into play.

Profits arising out of sale of fixed assets shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

Sometimes due to change of economic circumstances, the manufacture of a product would become costlier than buying it from the open market. In case this situation continues for a long time, the assessee may have to sell the existing plant and machinery and seek an exit. In this case, there will be short-term capital gain or loss if the entire block of assets is sold or there will be a short-term capital gain if the part of the block is sold for a price more than the written down value of the block.

7. Expand or Contract

The profits and gains of any business follow the business cycle and depending upon the phase in which the particular company is positioned in the industry; there could be either an expansion or contraction of business. Depending upon the macro-economic scenario, an industry may either face an upbeat situation of rising demand for its products not only in the markets in which it is operating but also in newer markets. In case the trend is a continuing one, the owners may decide to expand the manufacturing facilities or set up manufacturing facility in newer markets. In the case of the latter, the owners may also form joint ventures with local partners. The mergers and acquisitions route may also be followed to meet the sudden upsurge in demand or to gain monopolistic status. In some other cases, outsourcing through contract manufacture may also be resorted to.

In case of recession in the industry, there will be slack in the demand for the product and the management may either take any of following alternatives :

(a) Pull out of a market by closing down the local unit.

(b) Cut down the production by reducing the number of shifts or number of working days.

(c) Discontinue the business, where there is no hope of revival of product demand

The tax implications of the above managerial alternatives are :

(a) To claim tax relief in respect of profits from new undertakings.

(b) To claim depreciation on new investments.

(c) To claim depreciation on R&D activities.

(d) To claim deduction in respect of additional manpower employed.

(e) To claim necessary relief for export of products, goods or services.

(f) To claim necessary relief in respect of location of the industry.

(g) To prepare for accelerated assessment u/s 176 in the eventuality of closing down of the unit.

8. Demerger

As per section 2(19AA) 'Demerger', in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956, by a demerged company of its one or more undertakings to any resulting company in such a manner that -

(a) All the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger.

(b) All the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger.

(c) The property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger.

(d) The resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis.

(e) The shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger.

(f) Otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company.

(g) The transfer of the undertaking is on a going concern basis.

(h) The demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

With a view to recognize the demerger slump sale and to rationalize the provisions of amalgamation a number of amendments have been made in the Income Tax Act should be considered. The effect of these provisions is that demerger would now be taxed neutral and would not attract any additional liability to tax. Further, in demerger, the tax benefit and the concession available to any undertaking would be available to the said undertaking on its transfer to the resulting company.

Under section 47(vi)(c) any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company, if -

(a) the shareholders holding not less than three-fourths in value of the shares] of the demerged foreign company continue to remain shareholders of the resulting foreign company; and

(b) such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated

Under section 72 A in the case of a demerger, the accumulated loss and the allowance for unabsorbed depreciation of the demerged company shall

(a) where such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company.

(b) where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

The above provisions should be borne in mind in case of demergers

9. New Capital Investments

In the case of any fresh investments in business arising out of expansion or diversification or takeover of a business, the tax consequences of such managerial decisions are weighed. In such cases the assessee is entitled to :

(a) Claim normal depreciation allowances.

(b) Claim additional depreciation allowances.

(c) Tax incentives in respect of export turnover.

(d) Incentives for employing additional manpower.

(e) Carry forward of unabsorbed depreciation and business losses.

(f) Tax holiday on the profits and gains of the new undertaking.

10. Accounting Standards for Taxes on Income

The Institute of Chartered Accountants of India has issued Accounting Standards in respect of accounting periods commencing on or after 01-04-2001. This Accounting Standard will be mandatory in nature. It is known as Accounting Standard (AS 22) on 'Accounting for Taxes on Income'. The various matters covered in this Accounting Standards relate to the following, inter alia, matters :

(a) Accounting for Taxes on Income.

(b) Definitions of Accounting profit (loss), taxable profit (tax loss), Tax expense provision for taxes payable, Timing differences, Permanent differences, etc.

(c) Effect of permanent and Timing Differences on Taxable profit and Accounting profit.

(d) Taxes Payable Method.

(e) Tax Effect Accounting Method, and its application.

(f) Consideration of prudence.

(g) Calculation of Deferred Tax Adjustments.

(h) Amalgamation

(i) Transitional Provisions

(j) Disclosure

(k) Examples of Timing Differences

(l) Illustration regarding Taxes payable and Tax Effect Accounting Methods.

(m) Illustration regarding Application of Tax Effect Accounting Method in case of Loss.

(n) Full Provision Method.

(o) Liability Method.

11. Tax audit of certain persons carrying on business or profession

It is provided in Section 44AB that in the following cases tax audit will be compulsory :

(a) Where the total sales, turnover or gross receipts, as the case may be in business exceed or exceeds ₹40 lakh in any previous year; or

(b) Where the gross receipt in profession exceed ₹ 10 lakh in any previous year; or

(c) Where a person carrying on the business, if the profits and gains from the business are deemed to be the profits and gains of such person u/s. 44AD / 44AE / 44AF as the case may be and has claimed his income to be lower than the profits or gains so deemed in any previous year.

Different forms to be prescribed by Rule 6G for Tax Audit Reports, which are as under :

(a) Form 3CA: Tax audit report in the case of a person who carries on business and who is required to get his accounts audited under any other law.

(b) Form 3CB: Tax audit report in the case of a person who carries on business and who is not required to get his accounts audited under any other law.

(c) Form 3CC: Tax audit report in the case of professionals.

(d) Form 3CD: Prescribed particulars in the case of (i) and (ii) above.

(e) Form 3CE: Prescribed particulars in the case of (iii) above.

The last date for furnishing of Tax Audit Report is 30th September of the Assessment year concerned for companies.

Modification of provisions regarding compulsory audit of accounts — Section 44AB:

The Finance Act, 2001 has, with effect from the assessment year 200 1-02, amended Section 44AB to provide that in the case where the amounts are required to be audited by or under any other law, it would be sufficient compliance with the provisions of the said section if the person gets the accounts audited under such law before the specified date and furnishes by that date, the report of the audit under such other law, and a further report from a Chartered Accountant in the prescribed form under Section 44AB.

12. Preference Capital vs. Debentures

Preference capital represents a hybrid form of financing. It partakes of some characteristics of equity and some attributes of debentures. It resembles equity in the way that preference divided is payable only out of distributable profits.

Payment of dividend to preference shareholders results in payment of Dividend Distribution Tax by the Company, but receipt of tax-free income by the shareholders.

Debentures are instruments for raising long-term debt capital. Debenture holders are the creditors of the company. The obligation of the company towards its debenture holders is similar to that of a borrower who promises to pay interest and capital at specified times. The specific cost of debt capital, represented by debentures, is much lower than the cost of preference or equity capital. This is because the interest on debentures is allowed as deduction, and the effective cost of debentures is much less.

Payment of interest does not call for any additional liability on the Company, and receipt of taxable income by the debenture holders. Interest also attracts TDS.

13. Evolving Capital Structure

Before setting up a new project, decision regarding the capital structure has to be taken. While opting for a particular capital structure, the following consideration are borne in mind :

(a) Servicing the capital base with consistent dividend/yield policy,

(b) Cost of capital to be raised from the market.

(c) Chargeability or otherwise of taxes i.e. direct and indirect taxes.

(d) Policy on plough back of profits for future plan towards diversification, expansion modernization and other development aspects.

(e) Cost of servicing the capital e.g. for bank finance monthly/quarterly statements are required to be furnished, in case of public issue quarterly accounts are requird to be published, etc; for which costs are required to be incurred.

Generally the means of finance selected under India conditions for a new project comprises of:-

(1) Equity share capital.

(2) Preference share capital

(3) Borrowings from financial institutions/bank-Loans.

(4) External Commercial Borrowing.

(5) Borrowings from the capital markets through debentures and debt instruments.

(6) Lease financing.

In making capital structure decision, the financial leverage plays an important role. The percentage increase in Earnings Before Tax (EBT) in relationship to percentage increase in Earnings Before Interest and Taxes (EBIT) expressed as a percentage is the financial leverage of the structure opted. This can be explained in the form of an example.

EBIT	1000
Less: Interest on securities	500
EBT	500
Financial Leverage1000/500 =2	

This would mean that any increase in EBIT would have two fold increase in EBT. So if EBIT were 1500, EBT would be 1000. Therefore it is clear that 50% increase in EBIT has resulted into 100% increase in EBT.

As a corollary to the above, a high financial leverage would result in a very high return when there is high profitability. But in case of depression, this would be counter productive as the residual net income available to shareholders may be considerably reduced and may sometimes end up in loss. The fluctuations in operating profits and debt-equity mix would indicate the safety parameters and get reflected in the financial leverage.

A capital structure is said to be optimum when it has a mixed bag of debt and equity stocks and it has the lowest weighted average cost of capital. The advantage of having an optimum capital structure is to maximise the value of assets of the company and the wealth of its owners and minimizes the cost of capital, which in turn, raises its ability to have inbuilt additional investment opportunities. At the same time a high debt equity ratio is also not prudent. A high debt equity ratio has its own advantages and disadvantages. Problem of planning capital structure is of crucial importance and has long term implications. The tax planner should properly balance risks, costs, control and tax considerations. In capital structure decisions, the cost of capital is an important consideration along with the risk factor. One of the main reasons for raising finance through borrowings (in preference over equity shares) is to increase earnings on equity share capital. But excessive use of debt capital, increase the risk of the company as is witnessed in the country.

While the interest paid on debt instruments is tax deductible [section 36(1)(iii)], the dividend paid would be construed as apportionment of profits. The interest received by the shareholder is taxable in the hands of the recipient and any ROI calculations would be on net of tax basis. The cost of raising finance through debts is deductible in the year in which it is incurred (except where it is incurred during the pre-commencement period in which case, it has to be capitalised). The cost of issue of shares is allowed as a deduction in 10 years under section 35D of Income Tax Act. Because of aforesaid provisions, corporate taxation plays an important role in determining the choice between different sources of financing.

Moreover, in case pf capital – equity or preference – the Company is liable to pay dividend distribution tax and on the other hand shareholders receive tax free dividend.

In case of ECB, possibility of forex - loss or gain – needs to be taken into account.

TAX ON DISTRIBUTED PROFITS OF A COMPANY

The amount declared, distribution or paid by a domestic company way of dividends (DDT) would be charged to additional income-tax at a flat rate of 15% (increased by surcharge @2% on I.T, 2% education cess and 1% secondary education cess on I.T. plus S.C..) in addition to normal income tax chargeable on the income of the company.

As per provisions of section 115-O a domestic company is liable to pay tax on any amount declared, distributed or paid by such company by way of dividends, whether interim or otherwise.

Notwithstanding that no income-tax is payable by a domestic company on its total income computed in accordance with the provisions of this Act, the tax on distributed profits must be paid.

The principal officer of the company and the company would be liable to pay income tax to the credit of Central Government within 14 days from the declaration, distribution, or payment of dividends whichever is the earliest. If the principal officer and the company fail to so pay the income-tax to the credit of the Central Government, he or it will be liable to pay simple interest at the rate of 1%, for every month or part of thereof on the amount of tax payable and such principal officer and the company would also be deemed to be assessee in default in respect of the amount of tax payable.

It has been clarified that no deduction under any of the provisions of the IT Act would be allowed to the company or shareholders in respect of the tax on distributed profits. The additional income-tax so paid by the company would be treated as the final payment of tax in respect of the amount distributed and no further credit for such tax would be claimed either by the company or by any other assessee. The provision is logical as the entire amount of such dividends would completely exempt from the income-tax in the hands of shareholders, under section 10(33).

TAX ON DISTRIBUTED INCOME TO UNIT-HOLDER

Chapter XlI-D includes three Sections 115R , 115S and 115T which provide for

Tax on distributed income to unit holders is applicable under section 115T. Any amount of income distributed by UTI or a Mutual Fund to its unit holders shall be chargeable to tax and such UTI or Mutual Fund shall be liable to pay additional income-tax on such distributed income at the rate of—

(i) twenty-five per cent on income distributed by a money market mutual fund or a liquid fund;

(ii) twelve and one-half per cent on income distributed to any person being an individual or a Hindu undivided family by a fund other than a money market mutual fund or a liquid fund; and

(iii) twenty per cent on income distributed to any other person by a fund other than a money market mutual fund or a liquid fund:

Such Tax shall not apply to shall apply to any income distributed,—

(*a*) by the Administrator of the specified undertaking, to the unit holders; or

(*b*) to a unit holder of equity oriented funds in respect of any distribution made from such funds

Interest and penalty applies to any default in tax payment.

INCENTIVE TO VENTURE CAPITAL AND TAX TREATMENT OF INCOME OF A VENTURE CAPITAL COMPANY OR A VENTURE CAPITAL FUND

Section 10 (*23FA*) *of the Act exempts* any income by way of dividends, other than dividends referred to in section 115-O, or long-term capital gains of a venture capital fund or a venture capital company from investments made by way of equity shares in a venture capital undertaking in respect of any investment made after the 31st day of March, 2000.

In order to claim exemption the conditions should be fulfilled. Important provisions are as under :

(i) such venture capital fund or venture capital company is approved, for the purposes of this clause, by the Central Government on an application made to it in accordance with the rules made in this behalf and which satisfies the prescribed conditions.

(ii) any approval by the Central Government shall, at any one time, have effect for such assessment year or years, not exceeding three assessment years, as may be specified in the order of approval.

(iii) “venture capital fund” means such fund, operating under a trust deed registered under the provisions of the Registration Act, 1908 (16 of 1908), established to raise monies by the trustees for investments mainly by way of acquiring equity shares of a venture capital undertaking in accordance with the prescribed guidelines;

(iv) “venture capital company” means such company as has made investments by way of acquiring equity shares of venture capital undertakings in accordance with the prescribed guidelines;

(v) “venture capital undertaking” means such domestic company whose shares are not listed in a recognised stock exchange in India and which is engaged in the—

(*i*) business of—

(*A*) software;

(*B*) information technology;

(*C*) production of basic drugs in the pharmaceutical sector;

(*D*) bio-technology;

(*E*) agriculture and allied sectors; or

(*F*) such other sectors as may be notified by the Central Government in this behalf; or

(*ii*) production or manufacture of any article or substance for which patent has been granted to the National Research Laboratory or any other scientific research institution approved by the Department of Science and Technology;

Section 10 (*23FB*)*of the Act exempts* any income any income of a venture capital company or venture capital fund *set up to raise funds for investment* in a venture capital undertaking.

In order to claim exemption the conditions should be fulfilled. Important provisions are as under :

(a) "venture capital company" means such company—

(*i*) which has been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992

(*ii*) which fulfils the conditions as may be specified, with the approval of the Central Government, by the Securities and Exchange Board of India, by notification in the Official Gazette, in this behalf;

(b) "venture capital fund" means such fund—

(*i*) operating under a trust deed registered under the provisions of the Registration Act, 1908 or operating as a venture capital scheme made by the Unit Trust of India established under the Unit Trust of India Act, 1963

(*ii*) which has been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992

(*iii*) which fulfils the conditions as may be specified, with the approval of the Central Government, by the Securities and Exchange Board of India, by notification in the Official Gazette, in this behalf; and

(c) "venture capital undertaking" means such domestic company whose shares are not listed in a recognised stock exchange in India and which is engaged in the—

(i) business of—

(A) *nanotechnology;*

(B) *information technology relating to hardware and software development;*

(C) *seed research and development;*

(D) *bio-technology;*

(E) *research and development of new chemical entities in the pharmaceutical sector;*

(F) *production of bio-fuels;*

(G) *building and operating composite hotel-*cum*-convention centre with seating capacity of more than three thousand; or*

(H) *developing or operating and maintaining or developing, operating and maintaining any infrastructure facility as defined in the* Explanation *to clause* (i) *of sub-section (4) of section 80-IA; or*

(ii) *dairy or poultry industry;*

Section	Nature of Default	Minimum Penalty	Maximum Penalty
158BFA	Undisclosed income determined by the Assessing Officer u/s.158BC(c)	100% of the tax on undisclosed income	300% of the tax on undisclosed income
221(1)	Default in making a payment of tax within prescribed time	Such amount as the Assessing Officer may impose	Tax in arrears
271(1)(b)	Failure to comply with a notice u/s. 142(1) or 143(2) or with a direction issued u/s.142(2A).	Rs.10000 for each failure	Rs. 25,000 for each failure. (upto 31.5.2001)
271(1)(c)	Concealment of the particulars of income or furnishing inaccurate particulars of income.	100% of Tax sought to be evaded.	300% of Tax sought to be evaded.
271A	Failure to keep or maintain books of A/c, document as required u/s.44AA.	Rs.25000	Rs.1,00,000
271AA	Failure to keep and maintain information and document in respect of international transaction.	a sum equal to two per cent of the value of each international transaction entered into by such person.	a sum equal to two per cent of the value of each international transaction entered into by such person.
271AAA	Penalty where search has been initiated	a sum computed at the rate of ten per cent of the undisclosed income of the specified previous year.	a sum computed at the rate of ten per cent of the undisclosed income of the specified previous year.

271B	Failure to get accounts audited u/s.44AB or to furnish such report along with return of income by due date	1/2% of Total Sales, Turnover or Gross receipts.	Rs.1,00,000
271C	Failure to deduct the whole or any part of tax u/s.192 to 195 or (w.e.f. 1.6.97) failure to pay the whole or any part of tax u/s.115 O(2) or 2nd proviso to sec. 194B.	Amount of Tax required to be deducted at source.	Š
271CA	Penalty for failure to collect tax at source	a sum equal to the amount of tax	a sum equal to the amount of tax
271D	Taking or accepting any loan or deposit in contravention of the provisions of S.269 SS Repaying of any deposit otherwise than in accordance with the provisions of Sec. 269 T	Amt. of Loan/Deposit so taken or accepted Amount of deposit so repaid.	Š Š
271F	i)Failure to furnish return of income u/s.139(1) before the end of the relevant assessment year(w.e.f. 1.4.99) ii)Failure to furnish return of income as per proviso to Sec.139(1) by the end of relevant assessment year .	Rs.5000 Rs. 5000 for each default.	Š Rs. 10,000 for each default
271FB	Penalty for failure to furnish return of fringe benefits	a sum of one hundred rupees for every day during which the failure continues.	a sum of on e hundred rupees for every day during which the failure continues.

272A(1)(a)	Refuses to answer any question put to a person regarding his assessment by an I.T. Authority.	Rs.10,000 for each default	Rs. 10,000 for each default
272A(1)(b)	Refuses to sign any statement made by a person in course of I.T. Proceeding.	Rs.10,000 for each default	Rs. 10,000 for each default
272A(1)(c)	Failure to comply with summons issued u/s.131(1)	Rs.10,000 for each default	Rs. 10,000 for each default
272AA	Failure to comply with provisions of Sec. 133B.	Any amount upto	Rs. 1000
272B	Failure to comply with the provisions of section 139A or for quoting or intimating a PAN which is false. [w.e.f. 1.6.2002]	Rs. 10,000	Rs. 10,000
272BB	Failure to comply with the provisions of section 203A (i.e. failure to obtain TAN or after obtaining failure to quote TAN in all challans, certificates and returns etc.)	Rs. 10,000	Rs. 10,000
272BBB	Failure to comply with the provisions of of sec. 206CA (i.e. failure to obtain TCAN or after obtaining failure to quote TCAN in all challans, certificates and returns etc.) (w.e.f. 1.6.2002)	Rs. 10,000	Rs. 10,000

276BB	Failure to pay to the credit of Central Government tax collected u/s. 206	3 months and fine	7 years and fine
276C(1)	Wilful attempt to evade tax penalty or interest imposable under the Act (non-cognizable as per sec. 279A)	If tax evaded exceeds Rs. 1,000, 6 months; otherwise 3 months and fine.	If tax evaded exceeds Rs. 1,00,000, 7 years; otherwise 3 years and fine.
276C(2)	Wilful attempt to evade the payment of any tax, penalty or interest (non-cognizable as per sec. 279A).	3 months and fine	3 years and fine
276CC	Wilful failure to file return of income in time u/s. 139(1), or in response to notice u/s. 142(1) or sec. 148(Non-cognizable as per sec. 279A)	If tax evaded exceeds Rs. 1,00,000; 6 months and fine In any other case, 3 months and fine. ***Note:*** No prosecution if : (i) the return is filed before the expiry of the assessment year ; or (ii) the tax payable on regular assessment, as reduced by TDS and advance tax does not exceed Rs. 3,000	If tax evaded exceeds Rs. 1,00,000, 7 years; otherwise 3 years and fine

276CCC	Wilful failure to furnish in due time the return of total income which is required to be furnished u/s. 158BC.	3 months and fine	3 months and fine
276D	Wilful failure to produce books of account and documents u/s. 142(1) or wilful failure to comply with a direction to get the accounts audited u/s. 142(2A)	Any period upto 1 year and fine of Rs. 4 for every day during which default continues.	1 year and fine of Rs. 10 every day during which default continues.
277..	Making a fal se statement in verification or delivering a f alse account or sta tement(non-cognizable as per sec.279A)	If tax evaded exceeds Rs. 1,00,000; 6 months; otherwise 3 months and fine.	If tax evaded exceedsRs. 1,00,000, 7 years; otherwise 3 years and fine.
278..	Abetment to make a false statement or declaration. (non- cognizable as per,sec. 279A)	If tax evaded exceeds Rs. 1,00,000; 6 months; otherwise 3 months and fine.	If tax evaded exceedsRs. 1,00,000, 7 years; otherwise 3 years and fine.
278A	Punishment for second and subsequent offences u/ss. 276B, 276C(1), 276CC, 277 or 278.	6 months for every offence	7 years for every offence
278B and 278C	Offences committed by companies/firms or HUFs- Criminal liability of managing director managing partner, karta or any such officer, who wilfully committed the offence for the company/firm or HUF.	Same as in the case of the company/firm/ HUF	Same as in the case of the company/firm/ HUF
280(1)	Disclosure of pa rticulars by public servants in con travention of sec. 138(2) (prosecution to be instituted with the approval of Central Government)	6 months and fine.	6 months and fine.

280(1)	servants in contravention of sec. 138(2) (prosecution to be instituted with the approval of Central Government)	6 months and fine.	6 months and fine.

If there is a reasonable cause, it can bf offered as a defense against penalty, prosecution, etc.

Reasonable cause can be reasonably said to be a cause which prevents a man of average intelligence and ordinary prudence, acting under normal circumstances, without negligence or inaction or want of *bona fides* - *Azadi Bachao Andolan* v. *Union of India* 252 ITR 471 (Delhi).

'Reasonable cause' as applied to human action is that which would constrain a person of average intelligence and ordinary prudence. It means an honest belief founded upon reasonable grounds, of the existence of a state of circumstances, which, assuming them to be true, would reasonably lead any ordinary prudent and cautious man, placed in the position of the person concerned, to come to the conclusion that the same was the right thing to do - *Woodward Governors India (P.) Ltd.* v. *CIT* 118 Taxman 433 (Delhi).

The words "reasonable cause" in the section must necessarily have a relation to the failure on the part of the assessee to comply with the requirement of the law which he had failed to comply with. *Kalakrithi* v. *ITO* 125 Taxman 97 (Mad.).

Liability of directors of private company in liquidation.

Under certain circumstances directors of private company in liquidation are liable to tax liability of the company. Care should be taken to ensure that directors are not exposed to this risk.

Section 179 provides that where any tax due from a private company in respect of any income of any previous year or from any public company of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of the private company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax.

No recovery can be made from a director if the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

Section 179 operates without regard to any contrary provision about limited liability, etc. contained in the Companies Act, 1956.

TAXATION OF TRUST

A.Public Trust u/s. 164(2) —

(i) If income is not exempt u/s. 11 or 12, income of Trust is taxable at the rates applicable to an Association of Person.

(ii) If the exemption is forfeited due to contravention of sec. 13(1)(c) or 13(1)(d), such income of trust is taxable at minimum marginal rate.

B.Private Trust (shares of beneficiaries are determinate or known) —

(i) If income does not include business Profits, the trustee is assessable at the rates applicable to each beneficiary. [Sec. 161(1)]

(ii) If income includes profits from business, the whole income is taxable at maximum marginal rate. [Sec. 161(1A)]

C.Private Trust (share of beneficiaries in determinate or unknown) [S. 164(i)] —

(i) If income does not include business profits, income is taxable at the rates applicable to an AOP if –

- none of the beneficiaries has taxable income or is a beneficiary in any other trust.
- the trust is non-testamentary trust created before 1.3.1970.
- exclusively for the relative dependents of the settle; or
- it is the only trust declared by a WILL exclusively for the benefit of any dependent relative. In any other case, income is taxable of minimum marginal rate.

(ii) If income includes business profits, the whole income is taxable at maximum marginal rate.

D.Oral Trust [Sec. 160(1)(v), Sec. 164A] : "Oral Trust" means a trust which is not declared by a duly executed instrument in writing including any wakf deed which is valid under the Mussalman wakf validating Act, 1913 and which is not deemed to be trust by virtue of explanation I to Sec. 160.

i) Income of Oral trust is taxable at maximum marginal rate.

ii) If Oral trust is declared to be a trust by furnishing a statement in writing containing purposes, particulars and details of trust, beneficiaries and property to the assessing officer within 3 months from the date of declaration of the trust, indicating the share of beneficiaries, the income of the trust is assessable in the hands of trustee at the rates applicable to beneficiaries.

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

Where property is held under trust partly for religious purposes and partly for other purposes and the individual share of the beneficiaries in the income applicable to purposes other than charitable purposes, is not known, the income-tax liability will be aggregated as follows :

(i) the tax which would be chargeable on the part of the relevant income which is applicable to charitable or religious purposes (as reduced by the income which is exempt u/s. 11 as if such part were the total income of an association of persons; and

(ii) the tax on that part of income attributable to purposes other than charitable or religious and in respect of which shares of beneficiaries are indeterminate or unknown, at the maximum marginal rate.

Where any part of income is not exempt u/s. 11 or 12 by virtue of sec. 13(1)(c) or (d), tax is charged on the relevant income at the maximum marginal rate.

Taxation of non-resident Indian

(i) Who is non-resident individual — Sec. 6

(ii) Who is non-resident Indian — An individual who is a citizen of India or a person of Indian origin not resident in India, is called non-resident Indian.

(iii) Taxation of non-resident assessees

- Provisions as applicable to resident assessees.
- Special provisions as provided in Sec. 115C to 115I.

The non-resident has an option to be assessed or not to be assessed under special provision for any assessment year. The option is to be exercised by a declaration in his return of Income for the Assessment Year.

(iv) General Provisions —

- Rate of tax Similar to resident assessees.
- Special rates of tax on Dividends, interest income from units of Mutual Fund. UTI, bonds or shares purchased in foreign currency and capital gains arising from their transfer.
- 20% of the dividends [which have not been subjected to additional Income Tax u/s 115-O] [other than dividends mentioned in clause (iv) below];
- 20% of the interest received from Government or an Indian concern on monies borrowed or debt incurred in foreign currency;
- 20% of the income received in respect of units purchased in foreign currency, of a Mutual Fund specified u/s 10(23D) or of the Unit Trust India;
- 10% of the interest or dividends [which have not been subjected to additional income tax u./s 115-O], in respect of bonds or Global Depository Receipts in an Indian company purchased in foreign currency and issued under the Foreign Currency Convertible Bonds and Ordinary shares (Through Depository Receipt Mechanism) Scheme, 1993 (commonly known as Euro Issues/Euro Bonds) or in respect of bonds or Global Depository Receipts issued against shares of a public sector company sold by the Government to the non-resident in foreign currency; and 10% of the long-term capital gains arising from the transfer of the aforesaid bonds or Global Depository receipts.

(v) Filing of return — Similar to resident assessees :

However, a non-resident shall not be required to file a return of income u/s. 139(1), if his total income consists only of income subject to special rates of tax as mentioned in rate of tax under clauses (iv) supra and the tax has been deducted therefrom at source.

Tax Planning - An Overview

Q.1. Why is tax planning necessary?

Answer. The tax paid is an addition to the cost. Just as every businessman tries to maxi-mise his profit by reducing the cost, he should also arrange his affairs in such a way, that he pays the least amount of tax. This however should be done within the four corners of law and there should be no element of fraud in it.

Q. 2. Is tax planning confined only to direct taxes?

Answer. No. The effect of other taxes like sales-tax, customs duty and excise, are to be taken into account. It is a dynamic concept and the decision once taken is not valid for all times and requires continuous reappraisal.

Q.3. Is tax planning harmful?

Answer. Tax planning is not harmful. The tax saved can always be recycled in business and not necessarily wasted in conspicuous personal expenditure. The idea behind grant of incentives is to stimu-late economy and hence there should be proper planning to make use of these incentives.

Q. 4. When should planning be done?

Answer. Planning has to be done before the income accrues or arises, i.e., at the source itself. Planning done after receipt of income is only diversion of income and may even lead to an inference of fraud.

Q. 5. What are the factors to be taken in tax planning?

Answer. The choice of taxable entity and other choice like time and place have all are common instances. Time is relevant for fixing the year of accrual. Place is relevant for fixing the residential status. The status in which the income is to be assessed, i.e., individuals, HUF firm or AOP or company is also to be considered.

Q. 6. Has tax planning any effect on the rate of tax?

Answer. Yes. As dispersal of income over different taxable entities, slab rate can be reduced .

Q. 7. What is the difference between dispersal and diversion of income?

Answer. Dispersal ensures that income accrues separately in different hands. Diversion is said to take place when money is siphoned off to other hands after accrual in one hand. The decision of the *Supreme Court in CIT* v *Sitaldas Thirakhdas* is as to what constitutes diversion as distinct from dispersal. In this case, an amount of annuity decreed by the court to be paid by son to his mother in view of his obligation was held to be dispersal, i.e., diversion by overriding title, so that he was entitled to re-duce such payment from his taxable income. While diversion by overriding title will amount to dispersal, any other diversion without title at source is a mere application of income. The decision of Supreme Court in *CIT* v *Thakar Das Bhargava* illus-trates the principle of application of income, which does not help, where a lawyer who had assigned his right to fees to a charitable institution and had not received the same was still held liable to pay tax on such fees.

Q. 8. Does tax planning include compliance within law?

Answer. Certainly. Timely filing of returns, payment of advance tax, finally tax deduction at source, etc., are all important to avoid penal interest, penalty, prosecution, etc.

Q. 9. Is method of accounting important?

Answer. Yes. It is because income for tax purposes is one which is ascertained on the basis of what is computed under ordinary principles of commercial accounting subject only to such adjustments as are specifically required by the statute.

Q.10. What is the caution necessary in tax planning?

Answer. Tax planning may be legitimate provided it is within the law. But colourable de-vices are not only dishonourable but should not be recognised by the Assessing Offi-cer. One such device is to avoid tax though not prohibited by the statute. It is not necessary that there should be a specific disapproval of every device or scheme. If they are artificial, they are prone to be rejected.[3] What is to be noted is that the de-vice should be genuine in that the income really goes to the person to whom it is in-tended and does not come back or held effectively by the devisor of the scheme.

Though the decision of the Supreme Court in *Union of India* v *Azadi Bachao An-dolan* has granted great recognition to tax planning, the warning against artificial transactions lacking in commercial credibility in *McDowell's case* is still valid.

The concessional treatment for short-term capital gains is available on such gains under section 111A. It may, however, be noticed that these concessions are available only where the transactions are on capital account and not where the shares are held as stock-in-trade.

Tax Planning - Available Areas

Q. 1. How to choose the most suitable form of organisation for tax plan-ning?

Answer. It depends on the rate of tax applicable to the organisation, business needs, risk of non-observation of formalities, ability to raise finance, etc.

Q. 2. In what way, does the choice of head of income affect tax?

Answer. Actually assessment under different heads has diverse results as regards deduction and taxability. An asset, if it is property, gets a lump sum deduction at one fourth of annual value and as a business asset it gets depreciation on cost. On sale long term capital gains arises in former case and short term capital gains in latter.

Q. 3. How to select a location for business?

Answer. Deficiencies in infrastructure have to be balanced against the tax incentives. Excise and Sales-tax implications may also prove to be of greater impor-tance.

Q. 4. How to choose a proper type of business for maximum tax benefit?

Answer. New industrial undertakings on registration under Hardware or Software Tech-nology Park Schemes or 100% Export Oriented Undertaking under section 10A or 10B would be entitled to total exemption for and up to assessment year 2010-11, the last year of available exemption being assessment year 2009- 10, subject to such concessions being available for a maximum period of ten consecutive years from the year of establishment. Exemptions for exports under various provisions under sec-tions 80HHC, 80HHE and 80HHF are on the way out, since they are being phased out so that they will no longer be available from assessment year 2005-06. Conces-sions for new industrial undertakings under sections 80IA and 80IB are available for a longer period.

Reliefs under sections 10A and 10B are now subject to fresh conditions incorpo-rating the bar against transfer of beneficial interest under section 79 and introducing the exemption proportionate to the export turnover as for section 80HHC.

A new vista of exemption has opened under section 10C now shifted to section 80-IC.

The most recent bunch of incentives offered by Special Economic Zones Act, 2005 which would require attention of those who wish to avail tax benefits.

Q. 5. What is the impact of the size of the business?

Answer. Small units gets some concession from State authorities. Dispersal amongst sepa-rate subsidiaries will give relief under certain sections.

Q. 6. Can accounting method have an impact on tax?

Answer. Yes. At present, only two methods mercantile and cash are available. For profes-sionals and money lenders cash system is preferred. Also accounting practices to reflect the correct amount of income have to be adopted so that there is no overload in some years and deficiency in others. Inventory valuation is another area of ac-counting, which has impact on tax. But it should also be borne in mind that where the statute itself determines the income, accounting method has no relevance.

Q. 7. In what way capital can be restructured for maximum benefit?

Answer. A balance between own and borrowed capital has to be achieved. When own capital is more there will be larger taxable profits and poorer after-tax return. With more borrowed capital, taxable profits are less but after-tax return on own investment is better. There should be a continuous appraisal in this behalf.

Q. 8. What is the best investment?

Answer. Choice of investment depends on the expectations of the investors. Risky investments may involve larger profit or loss. Safe investments give a lesser but steady return. Period of holding depends upon varying needs of liquidity for the investors. As between investment in shares, deposits and debentures in companies, dividends have an edge because these are not taxed in the hand of the receiver. Interest is fully taxed subject to certain deductions.

Q. 9. What should be the consideration regarding investment in plant and machinery?

Answer. Depreciation is a significant deduction from taxable income. Plant and machinery relating to generation of power and pollution control equipment, and those relating to Research and Development, etc., are eligible for 100% deduction. Plant and machin-ery can be acquired, replaced, repaired, purchased or hired or assembled with differ-ent tax consequences.

There has been drastic reduction in rates of depreciation effective from assessment year 2006-07.

Q. 10. Is there any restriction in method of valuing stock?

Answer. Accountancy text books give various methods like: cost, market value, cost or market value whichever is less, FIFO, LIFO, etc. Some value obsolete or slow-moving stocks at lesser cost. At any rate the method adopted should be regular and should not distort the profits irryiting rejection of accounts.

Q. 11. Is transfer pricing important?

Answer. Transfer pricing is important in reckoning of reliefs as well as in matters of non-resident taxation. Adoption of correct transfer pricing is a matter of concern for Revenue,but it should be equally a matter of concern for taxpayer lest the method adopted loses for himself the benefit which is otherwise available. This is all the more important in international transactions. Sections 92 to 92F may be seen.

Q. 12. What is the importance of dividend policy?

Answer. Dividend policy determines liquidity, possible impact as price of shares, credit rating, borrowing capacity, shareholder satisfaction, etc., which are matters of busi-ness policy. It also affects shareholders' tax liability. It is of importance in closely held companies particularly because even loans to substantial shareholders are treated as deemed dividends under section 2(22)(e) of the I.T. Act.

Q. 13. What are the factors to be borne in foreign collaborations?

Answer. The degree of participation of the foreign concern in Indian business, the extent of investment, duration of physical presence in India, the manner in which such participation is expected, whether by way of equity, loan, royalty, technical fees, etc., would decide liability. For the Indian partner the question whether payments made will be allowed as a deduction will be relevant. Double taxation agreements and where there is none section 91 of Income tax Act will also have relevance. The new provision introduced by Finance Act, 2001 in respect of transfer pricing in sections 92 to 92F w.e.f. 1.4.2002 would require consideration in matters of taxation of busi-ness income of non-residents.

Q. 14. Can an employee benefit from tax planning?

Answer. There is large scope for tax benefit for employees. This is done by designing a pay package taking into consideration tax-free and concessional perquisites in a manner that take-home pay is maximum. (*See* para 2.22 and also separate chapter on the sub-ject). The Central Board of Direct Taxes has been given powers to prescribe the value of any fringe benefit or amenity in such matters, where perquisite value has not been prescribed in the statute itself. Rules have since been notified. It was expected that the value of fringe benefit would be the cost to the employer. New Rules by and large adopt the cost for a number of perquisites.

Rule 3 has undergone drastic changes by Notification No.266(E) dated 28th Feb-ruary, 2005 as a step to reconcile with fringe benefit tax, wfiich would treat some of the perquisites hitherto taxable in the hands of employees under Rule 3 by a new tax, FBT in the hands of the employer, so that one has to reappraise the tax liability of the employee and the employer in the light of these developments.

Tax Planning - Amalgamation and Demergers

Q.1. There is company A which has huge loss and depreciation to be carried forward. There is another company B which is making profits. What should company A do wipe off its losses within a reasonable time by tak-ing the help of B?

Answer. One view is that the company should opt for a reverse merger with B merging with A. The loss gets reduced by the profits of B units in the coming year and loss and depreciation can be carried forward. But if already several years have elapsed and only a few years are remaining for eligible carry forward, direct amalgamation should be resorted to when there will be fresh lease of life for carry forward of losses etc. for the statutory period in the hands of the amalgamated company.

Q.2. Company A wants to amalgamate with B. The agreement is entered into on 1.4.1996. The Court however passes the decree on 10.4.1998. What is the date of amalgamation?

Answer. It is retrospective and the date of amalgamation will be 1.4.1996. But a special plea can be made before the Court to fix the date of operation of amalgamation on any other date.

Q.3. Amalgamation of companies A and B has been approved by the BIFR. CBDT refuses to allow carry forward of losses under section 72A. Is the CBDT justified?

Answer. No. According to the Supreme Court in *Indian Shaving Products Ltd.* v *BIFR,* once the approval has come from BIFR, Board cannot refuse carry forward of losses. The tax angle has no significance.

Q. 4. A certain family has four concerns in which it has controlling interest. Different members are controlling the concerns. There are disputes that one group is favoured more than others. How is this to be resolved?

Answer. Demerger is the answer. Law, with effect from A.Y.2000-2001, exempts demerger and allows the benefit of carry forward of past depreciation and unab-sorbed loss subject to conditions prescribed under section 72A. The position of law prior to A.Y.2000-01 is uncertain, but following the rationale of decision in *CIT* v *Rasiklal Maneklal (HUF)* it is possible to say that demerger does not attract tax.

Q.5. Should the character of assets as between investments and stock-in-trade be the same both for amalgamating and amalgamated company?

Answer. Answer will be in the affirmative, if the business is taken over as a going concern and carried on by the amalgamated company as held in *Devare (L.M.)* v *CIT.*

Q.6. Since there is always a time lag between appointed date under the scheme and court's order, who should be liable for tax during the interregnum?

Answer. The Supreme Court in *Marshall Sons and Company (India) Limited* v *ITO* has held that the appointed date is material and not the date of court's order, which dates back to the appointed day. Hence, amalgamated company will be liable to tax from appointed day.

Q. 7. What is the difference between amalgamation in terms of company law and income-tax law?

Answer. Any scheme of amalgamation sanctioned by the Court under section 391 by fol-lowing the procedure under Chapter **v** of the Companies Act will be recognised by company law once the order of the Court is registered with Registrar of Companies. But amalgamation has restricted meaning under section 2(1B) of the Income-tax Act, 1961 to include a merger of two or more companies involving transfer of all assets and all liabilities with 90% of voting power of amalgamating company continuing in amalgamated company. The proportion is now reduced to 75% from 90% for amal-gamation from A.Y.2000-2001.

Q. 8. Does demerger has same meaning both for company law and Income-tax law?

Answer. Demerger is recognised for exemption from A.Y.2000-2001. While demerger under section 2(19AA) has to follow the procedure under provisions of sections 391 to 394, not all demergers recognised by company law will automatically qualify for exemption. It should satisfy the following conditions:

(i) It should involve transfer of an undertaking in the sense that it is transfer of a unit, division or activity.

(ii) Transfer should be on a going concern basis.

(iii) Transfer is at book value immediately before merger.

(iv) Consideration will be met entirely by issue of shares.

(v) All assets and liabilities of the undertaking will stand transferred.

(vi) Three-fourth of the shareholders of demerged company should continue in the demerged company.

(vii) It should satisfy the conditions to be notified under section 72A(5).

Q.9. Is a slump sale an alternative to amalgamation and demerger?

Answer. Yes. It is possible for a division or unit to be sold by slump sale or split the company itself to achieve the same object, where there is substantial common interest. Amalgamation is feasible only where the entire business of the company is transferred.

Q. 10. Does the liability of shareholder get altered in amalgamation, demerger or slump sale?

Answer. No. Amalgamation, demerger or slump sale constitute taxable event for company and not the shareholder.

Q.11. What is meant by reverse merger?

Answer. Ordinarily, merger is of a prosperous company taking over a company, which is not doing well. Where the amalgamating company has carried forward losses and de-preciation, amalgamated company is permitted to avail such losses and depreciation of amalgamating company, subject to the conditions set out under section 72A of the Act. But the conditions can be by- passed, if the take over is of prosperous company by the company having losses and depreciation, so that the affluent company merges with the weaker company. This is known as reverse merger. However, in reverse merger, the losses will have to be absorbed within 8 year period while in a direct merger, where the conditions are satisfied, the losses and depreciation will be treated as those of the year of the merger, so that permissible time for set off is longer.

Q.12. Is there any way of availing the losses and depreciation of demerged company in the hands of resultant company?

Answer. Section 72A covers not only amalgamation but also demerger, so that carried forward losses and depreciation can be availed by the resultant company subject to satisfaction of conditions.

Q.13. Where there is an acquisition by way of an industrial undertaking or busi-ness as a going concern by way of slump sale, can the successor avail the losses and depreciation of the transferred industrial undertaking or business?

Answer. The law does not provide for benefit of set off of losses and depreciation, where a business is transferred by way of slump sale.

Q.14. What is written down value to be adopted for the amalgamated com-pany in cases, where the full eligible depreciation had not been availed by the amalgamating company?

Answer. Explanation (2A) to section 43(1) provides that the written down value of the amalgamating company should be the actual cost for the amalgamated company. In *CIT* v *Hindustan Petroleum Corporation Ltd.* , it was held that the actual cost of the asset need be reduced only by the unabsorbed depreciation availed (absorbed) in the . hands of the amalgamating company for purposes of "actual cost" of such transferred assets in the hands of amalgamated company, unless it satisfies the condition under section 72A. This decision was followed in *CIT* v *Kothari Industrial Corporation Ltd.*[2]. The reasoning is that the requirement of Explanation 3 under section 43(1) is to allow depreciation only what is actually allowed and what is not merely taken in the computation of income by understanding "actually allowed" as "actually availed of. The decision has not taken into consideration Explanation 7, which reads as under: "*Explanation 7.*—Where, in a scheme of amalgamation, any capital asset is transferred by the amalgamating company to the amalgamated company and the amalgamated company is an Indian company, the actual cost of the transferred capital asset to the amalgamated com-pany shall be taken to be the same as it would have been if the amalgamating company had continued to hold the capital asset for the purposes of its own business." Since written down value will have to be taken as that of the amalgamated company, the decision would run counter to this statutory provisions. There is, however, no reaction from revenue to the decisions of the High Court, which should probably work in favour of the taxpayer.

Q.15. Where the amalgamated company sells the asset obtained from amal-gamating company is the option of substituting the cost at market value on specified date available?

Answer. It has been decided that such option is available in *Harish Mahindra* v *CIT; H.F. Craig Harvey* v *CIT* and *Madura Coats Ltd.* v *CIT.* In all these cases, it was held that the amalgamated company steps into the shoes of amalgamating company, since amalgamation is not regarded as transfer. It follows, that the benefit of indexation should also be available for amalgamating company including the period of holding of the asset by the amalgamating company.

Q.16. What is the procedure for service of notice for assessment of amalgamating company, when it has ceased to exist on amalgamation?

Answer. The amalgamated company cannot avoid the tax liability of the amalgamating company. Notice of reassessment can be issued on the amalgamated company to assess or reassess the income of the amalgamating company, subject to conditions therefor.' But such assessments will be only for the period upto the appointed day of merger in respect of liability to the amalgamating company. For the period after amalgamation, the assessment has to be on the income of the amalgamated company after amalgamation, while for the period before the amalgamation, the assessment is made in the name of amalgamated company as successor to theiamalgamating company as separate assessment for period before amalgamation. paid by a company is tax paid by shareholder and accept the case for deductions for earning such dividend. Board in Circular No.9 of 2007 dated 20th December, 2007 has taken the view that Fringe Benefits Tax (FBT) borne by the employer may be treated as paid by non-resident employee, so that same reasoning should be accepted by revenue for allowing such deduction.

Tax Planning - for Corporate Sector

Q. 1. What are the main advantages in conducting business in corporate form?

Answer. A company can mobilise larger capital by assuring limited liability to the prospective shareholders so that large businesses are invariably conducted in corporate form. Ownership is transferable by transfer of shares. In view of the transparency ensured by company law regulations, published accounts, registration of charges, etc., com-panies are able to command greater resource by way of loan capital.

Q. 2. What are the disadvantages for the corporate sector?

A. Companies would suffer tax at higher rate of 35% as against maximum rate of 30% for others. In addition, shareholders effectively will have to bear 10% tax on distributed dividend levied on companies. Though companies are treated as distinct legal entities, the law does pierce the corporate veil in many circumstances so that the protection for companies, because of its separate legal existence can be ineffec-tive. Regulations under company law impose a larger burden by way of compliance-requirements for companies.

Change has been effected by Finance Act, 2002 as regards shareholder's liability. Dividends were being taxed in the hands of the company as tax on distributed divi-dend at 10/20/10 per cent under section 115-0 with effect from 1.6.1997 till 1.4.2002. But the law is back to the earlier system of tax, giving up the experiment to tax the company on distributed dividend, so that dividends which were exempt under section 10(33) will now be taxed in the hands of the shareholders. The effect of this change is that interest on borrowed capital for investment in shares will now be al-lowable against dividend income. Secondly, the concession under the Double Taxa-tion Avoidance Agreement for doubly taxed dividend can now be availed. When the companies were taxed on distributed dividend as additional tax, they could not be treated on par with tax paid by shareholder himself, so as to enable him to get benefit of Double Taxation Avoidance Agreement.

The law is back on the rails with Finance Act, 2003 substituting section 115-0 with new section with effect from 1.4.2003 restoring the earlier law levying additional tax on distributed dividend and sparing the shareholder from the tax on dividend.

Q. 3. Is it possible for a proprietary concern to be converted into a company?

Answer. It is not possible to convert a proprietary business into a company. But it is possible to form a company and thereafter take over such proprietary business. Income-tax law encourages such take over without any liability for capital gains tax by granting exemption from capital gains under section 47(xiv) of the Income-tax Act, subject to condition, that all the assets and liabilities are taken over by the company in lieu of shares issued to the proprietor and such erstwhile proprietor retains 50% interest in the company for a minimum period of five years from the date of take over. How-ever, stamp duty cannot be avoided where the proprietary business has immovable property. There could even be sales-tax implications in respect of stocks. But many State legislations provide for exemption from sales-tax when the sale is of business as a whole as a going concern.

Q. 4. Is it possible to convert a firm into a company?

Answer. There can be a transfer of the business of the firm to a company without liability for capital gains tax as there is a specific exemption under section 47(xiii) subject to the conditions that all the assets and liabilities are taken over for consideration in shares and that 50% identity of the interest would continue for a minimum period of five years. But for the exemption, there would have been liability for a slump sale of a business. Here again, stamp duty implications cannot be avoided. But then, it is possible for the firm itself to treat itself as an unincorporated company and register itself as a company under Part IX of the Companies Act, 1956, after ensuring that the partnership deed provides for fixed capital and proportionate profit sharing ratios, so as ,to enable such registration. This ensures that the assets of the firm are automati-cally vested in a company without the necessity of a formal conveyance and incur-ring incidental stamp duty, while the exemption under section 47(xiii) would still be available even if one were to deem transfer by understanding such conversion as in-volving extinguishment of rights.

Conversion of firm into a company under Part-DC route has been recognised as not constituting transfer in *CIT-v Texspin Engineering and Manufacturing Works.* This important ruling would mean that there will be no liability for capital gains for the firm even if the conditions under section 47(xiii) are not satisfied.

Income Tax Appellate Tribunal, Jodhpur Bench has ruled that incentives hitherto enjoyed by the firm prior to conversion as a company need not be lost for the remain-ing years of eligible period after conversion.

Q. 5. **What is meant by piercing the corporate veil? How does it affect a shareholder/director?**

Answer. Company is a separate legal entity with the result that the director/shareholder is a person distinct from the company, though he may be having controlling interest in the company. The primary advantage is limited liability for the directors/shareholders except where they forego such liability by personal guarantee for the debts of the company by separate agreement with lending institutions or such other persons. But where a fraud is committed by a company through its directors or substantial share-holders or where there is tax evasion or even where there are offences like cheque dishonour, the statute would pierce the corporate veil and make the persons responsi-ble for the conduct of the business of the company liable for what is technically an offence committed by the company. This is known as piercing of the corporate veil. Precedents where it has been so pierced are found in para 5.6. Corporate veil can be pierced for Revenue's benefit. But it is not possible to pierce the same for the benefit of the shareholder, since a transfer between a company and the shareholder would attract normal tax as if it were between strangers.

The statute itself provides for piercing the corporate veil in a number of occasions as it does, when it makes the shareholders of a private company liable for tax dues where he is responsible for non-recovery.

Q. 6. What is meant by dividend policy? How does it affect the tax liability of company and its shareholders?

Answer. Company has a choice of distributing dividend only to the extent to which it has decided to do so. The decision in such cases may depend upon the need to retain profits for strengthening the company on one hand and to reward the shareholders for their investment on the other. While balancing the requirements of the company and the shareholders, it has to take into consideration tax impact on both the company and the shareholders. Whether tax on distributed dividend is levied on the company as between 1.6.1997 and 1.4.2002 or whether shareholders are directly taxed, the company could take into consideration tax before deciding the distributable profits. The dividend policy is one which is dictated by perception of the management as to what constitutes the best interest of the company and its shareholders.

Q. 7. How best are the shareholders rewarded for the investment?

Answer. The immediate reward is the dividend that may be received from year to year, so that the shares form a regular source of income. It is also possible that in view of the retained profits and the good reputation which the company has earned for its good management and the prospect of increased dividend, the price of the shares may go up, so that investors are benefited even by the retained profits by way of appreciation in value of shares which they can realise, if they wish to do so by way of sale though at the cost of capital gains tax, which is at 20% flat as against normal top slab rate for Income tax at 30%.

It is also possible that the company may choose to give bonus shares by issuing share certificates with reference to its resources. But bonus shares do not give a lar-ger proportionate interest in the net worth of the company. Such shares only convert what was hitherto a possible right to dividend to a capital asset.

Company can also issue rights shares at a concessional price for existing share-holders, so that the benefit of the difference between the intrinsic value of shares and the price paid by rights shares is passed on to the shareholders. This also ensures that future shares issued to the new shareholders either at face value or at a premium does not dilute the interest of existing shareholders. It is primarily for this purpose bonus shares and rights shares are often issued prior to any substantial expansion.

Q. 8. What does one achieve by mergers, demergers, floating of subsidiaries, etc. often seen in corporate sector?

Answer. Business exigencies often require corporate restructuring. Pooling of resources often requires merger of companies either by way of vertical or horizontal integration of their businesses. More often such mergers take place to avail the benefit of set off of losses of a weak company by a prosperous one, so that in the process the weak company is brought back to health with larger resources available for the same.

Demerger enables a more convenient handling of different businesses by decen-tralisation. It is also sometimes resorted to merely for enabling transfer of a business, when the company has more than one business, when it finds that it is not viable to carry on both the businesses. Subsidiaries are floated for the same purpose of better management, where a distinctly new business is started by the company or a new activity is proposed. Tax advantages by ensuring incentives for the new industrial undertaking may more conveniently be availed by having subsidiary company. Tax laws encourage such restructuring of business by providing for tax exemptions for amalgamation, demerger and even transactions between a holding company and a wholly owned subsidiary.

Apart from this method adopted for corporate restructuring, it is also not unusual for companies to form what are known as strategic alliances, so that there is co-operation or joint venture between companies without integrating themselves by way of merger.

Q. 9. How are closely held companies treated for income-tax purposes?

Answer. The law is more favourable to companies in which public are substantially interested. Restrictions in carry forward and set off of losses as under section 79 or deeming provisions under section 2(22)(e), by which a director or substantive shareholder is made liable to be taxed even on loans or advances made by a company with accu-mulated profits, are applicable only to closely held companies. In view of the fact that companies in which public are substantially interested, as distinct from closely held companies, are only those which are either Government companies or listed companies, most of the companies classified as closely held companies are subject to closer watch because the persons interested are fewer in number. But at the same time company law would consider more regulations for companies in which public are substantially interested by providing better control for them. The recent debate over the US-64 Scheme of U.T.I throws light on the adequacy or otherwise of the existing regulations for such companies.

Q. 10. What is the real responsibility of a company director?

Answer. A managing director or executive director is fully responsible for all acts of omission or commission. Since director holds the position of a trustee of the funds of the company, he is made responsible under the law to the extent that he may be prose-cuted for the offences of the company. Other directors who are known as board di-rectors are not ordinarily responsible for the conduct of day to day affairs of the same. All the same, a director cannot avoid the responsibility altogether, because as a member of the board he is responsible, since it is the board which exercises the duty of superintendence over the affairs of the company. Unless he is able to show that he was not in charge of day to day affairs or the particular acts of omission or commis-sion has happened without his connivance, he is equally responsible for such acts. Even professional directors who may not have any stake in the company do not enjoy any immunity because failure to exercise supervision entrusted to them by the share-holders or the persons who nominated them to be directors is a responsibility which they cannot disown once they have accepted directorship. It is for this reason that an onerous burden is placed on all the directors. Companies (Amendment) Act, 2000 lays great stress on corporate governance for promoting excellence in such govern-ance by various devices like audit committees, adoption of accounting standards, small shareholder representatives, increased penalties or disqualification for non-compliance, regular attendance of directors at board meetings etc. The directors in view of section 278B have also to ensure compliance of tax obligations which they cannot ignore except at their own peril. The view that no interest is chargeable prior to 1.4.2007 is impliedly accepted by revenue by appropriate amendments to sections 234A, 234B and 234C by the Fi-nance Act, 2006 with effect from 1.4.2007. This amendment can be understood as clarificatory.

Tax credit could be carried forward initially for five years but extended to seven years from A.Y.2007-2008.

Tax Planning

Q. 1. Is it open to a company to reduce its liability for MAT by providing for income-tax rate of depreciation, or at any rate a higher depreciation other than what is provided under Schedule XIV of the Companies Act?

Answer. Company law prescribes only the minimum depreciation. There is no bar against higher depreciation to be claimed where such depreciation is considered warranted with reference to the expected life of the asset after taking credit for scrap value. Cir-cular No.2 of 1989 dated 7.3.1989 from Department of Company Affairs concedes that a higher depreciation where warranted by "a bona fide technological evaluation" justifies such higher depreciation. It can be provided with proper disclosure by way of a note forming part of annual accounts. In *Asst. CIT* v *Juicy Beverages Pvt. Ltd.* , it was pointed out that even the rates prescribed under the company law would have relevance only for determination of remuneration for management under section 350 of the Companies Act, 1956, and not for determination of income, but when this de-cision on that account held that income-tax rate should be held applicable, such a view may not be correct, since income-tax rates are more often incentive rates not always fixed with reference to the expected life of the asset as for 100% for wind-mills. Income-tax rates have been justified in some other cases also. A better course is to find justification with reference to technological considerations in an objective manner. But if there is no proper justification for the higher rate with reference to company law rates, the Assessing Officer may be justified in invoking the decision of *McDowell & Co.* v *CTO* to recompute book profits to conform to the company law rates.

The issue can now be safely treated as decided in favour of the taxpayer in *Apollo Tyres Ltd.* v *CIT* for purposes of section 115 J. Adoption of a rate not permissible under company law will rule out option to adopt any other method under section 115JAorll5JB.

The amendment by the Finance Act, 2006 ruling out extra depreciation on revaluation of assets, cannot come in the way of a claim of a larger depreciation on technical evalua-tion of the expected life of the plant and machinery for purposes of section 115JB.

Q. 2. Where there is a shift from straightline to WDV method of depreciation, larger arrears of depreciation are to be provided. This enables reduction in tax liability. Could arrears be treated as a proper charge on taxable book profits? Can an upward revision be made to enable larger depreciation?

Answer. The issue is now decided in favour of the taxpayer in *Apollo Tyres Ltd.* v *CIT* . However, from assessment year 2007-08, such extra depreciation is bound to be dis-allowed in view of the amendment authorising such disallowance.

Q. 3. Is advance tax payable with reference to MAT? Is interest under sec-tion 234B/234C chargeable where the liability is only for MAT?

Answer. After the decision of the Supreme Court in *CIT* v *Kwality Biscuits Ltd.,* there can be no liability for interest for failure to pay advance tax or on shortfall under section 115J. But then the position of law under sections 115JA and 115JB is different.

Q. 4. Extra amount payable in rupees for meeting foreign exchange loan for acquiring depreciable capital asset is treated as cost of the asset and al-lowed depreciation under section 43A. Where an assessee writes off the same in the books, can the book profits be computed by disallowing it and allowing only depreciation?

Answer. If the accounting treatment could be justified with reference to company law pro-visions and Accounting Standards, there is no reason why the amount written off to the P & L account should be disallowed. Section 43A would have no relevance in computation of book profits. Accounting treatment and company law provisions do not require the amount to be capitalised. Hence, no adjustment can be made to book profits on this account as held by the Tribunal in *Sudharshan Chemical Industries Ltd.* v *Dy. CIT* and the Bombay High Court in *CIT* v *Echjay Forgings Pvt. Ltd.*.

Q. 5. How is relief for incentives like those under section 80HHC or 80HHD to be reckoned in computation of MAT?

Answer. The manner of reckoning relief has been explained in Circular No.680 dated 21.2.1994, wherein it has been pointed out that the profits and gains of a business or profession for purposes of section 115J will only be book profits and not statutory profits. It has been pointed out therein that since the computation of taxable book profits starts with book profits as per books, there can be no doubt as to the interpre-tation that book profits should be the base for such reliefs for purposes of determina-tion of MAT liability. Since sections 115JA and 115JB *are pari materia,* the interpretation for these sections would also not be different. However, it is surprising that such an interpretation should have been questioned by Revenue on the ground that "the circular cannot be looked into before the High Court". In *CIT* v *GTN Textiles Ltd.,* wherein the High Court found against the Revenue both on this argument as well as the argument on merits. The High Court had given illustrations as to the manner of reckoning, which is consistent with the Board's own view in the circular. It follows that the set off of past unabsorbed depreciation and losses, whichever is less, will also be with reference to books and not what has been decided for statutory purposes.

The view that incentive profits authorised for MAT purposes, should be reckoned with reference to book profits has been reiterated in respect of section 115 JA by the Tribunal.

Q. 6. What is the position of depreciation on account of revaluation for MAT?

Answer. The law has since been amended to deny the assessee the benefit of higher depre-ciation consequent on revaluation of assets vide clause (iia) and (iib) inserted in Ex-planation to section 115JB(2) by the Finance Act, 2006 with effect from 1.4.2007, so that the decision in *CIT* v *Apollo Tyres Ltd.* in favour of assessee gets neutralised with effect from A.Y. 2007-2008.

Q. 7. Can book profits be reduced by making larger provision for bad/doubtful debts?

Answer. A mere provision for bad and doubtful debts would not go to reduce statutory profits especially after retrospective amendment made to section 36(l)(vii) by way of an Explanation that the deduction for bad debt cannot include any provision made in the accounts of the assessee. However, the same provision will have to be judged for purposes of MAT with reference to the disallowance of reserves or provision under Explanations (b) and (c) to section 115JB(2). If it is a reserve, it has to be disallowed under clause (b). If it is a provision, it should have been made for ascertained liabili-ties. Hence a provision for doubtful debt cannot invariably be treated as one for as-certained liabilities. But where the assessee chooses to make a provision for bad debt without writing off the debt itself, there is no reason at all why such a provision should be disallowed in computation of book profits though it gets hit by the Expla-nation to section 36(l)(vii) because the amount should not be treated as having been written off, a special requirement for allowance of bad debt in computation of statu-tory income.

The provision for bad and doubtful debts cannot be added back as settled by the Supreme Court.

Q. 8. Where the Assessing Officer makes an addition to the statutory in-come either because of unproved borrowing under section 68 or because of an inferred additional outlay on investment as unaccounted income under section 69, will such income be considered for purposes of MAT?

Answer. Section 115JB is based upon book profits. The provisions relating to computation of statutory income do not have application for the purpose of book profits. For ex-ample, disallowances under section 40A(2), 40A(3) or section 43B would have no relevance. It would, therefore, appear that deeming the income under section 68 or 69 which can be brought to tax in computation of statutory income, cannot ipso facto be treated as income liable for MAT. While this could be the general approach to such addition and similar additions like disallowance for unproved expenditure, a line may have to be drawn between what is added for lack of proof and what is positively found to be concealed income outside the books. It has to be borne in mind that preparation of annual accounts vide proviso to section 115JB(2) has to conform the accounting policy and accounting standards. It is certainly expected to be true and fair, if the addition is such as to clearly indicate concealed income of the company without its being brought to account, it can be taken that the preparation of annual accounts is incorrect and that the Assessing Officer can take into consideration the book profits as it ought to be and not the book profits as adopted at the general meet-ing. The decision may well depend upon the degree of evidence found for the addi-tion. Probably such a degree of evidence which would justify concealment penalty may well justify the addition even for purposes of MAT. But the question which is to be answered is whether while determining the book profits a detailed examination is called for. Normally books are scrutinized to compute the statutory income. Simultaneously the book profits are also determined. At this stage the Assessing Officer will decide whether there are any items discovered by scrutiny, which should go to aug-ment the book profits.

However, the addition to statutory profits even on account of what is treated as undisclosed income does not ipso facto justify addition to book profits. The decision of the Tribunal in *Sutlej Cotton Mills Ltd.* v *ACIT*[1] supports the addition in case the accounts are fraudulent or misleading, though the decision in *Apollo Tyres' case* has not admitted any such qualification. It has also not ruled out the same, so that in cases of established concealment it will be difficult to avoid the addition even for book profits.

As pointed out by the Special Bench of the Tribunal at Kolkata, computation of book profits is totally independent of the provisions relating to computation of statutory income.

Q. 9. Can wealth-tax payable by company be treated as a charge on book profits?

Answer. Section 115J(1A) disallowed only the amount paid or payable by way of Income-tax under Explanation to that section so that there could be no disallowance of Wealth- tax. It was so found in *CIT* v *Echjay Forgings Pvt. Ltd.,* since such amount would ordinarily be charged to the P&L A/c and where it is so charged the Assessing Officer has no option except to accept the same for purposes of MAT.

Amendment by way of Finance Act, 2008 extending the meaning of income-tax does not include wealth-tax.

Q.10. Set off of credit for tax paid as MAT under section 115JAA and shift from tax on book profits to tax on statutory income is sought to be given by the Assessing Officer after the credit for advance tax and tax deducted at source so that the credit is dwarfed to the net tax sparing while the credit does not become available at all where there is over payment of TDS and advance tax. This is sought to be done on the basis of the return form which provides for such adjustment of tax credit as per tax deter-mined before such adjustment. Is this right?

Answer. The tax credit under section 115JAA is secured even against tax payable under section 115JB by an appropriate amendment to section 115JAA(5) by Finance Act, 2000 with effect from 1.4.2001. Such credit is given in the computation of tax pay-able in the main part of the statute u/s. 115JA itself before adjustment for advance tax or TDS paid under section 192 for TDS and sec.219 for advance tax. Tax credit un-der section 115JAA therefore precedes other credits. The income-tax return form prescribed under a rule cannot override the law. This has been conceded by the Tri-bunal in *Chemplast Sanmar Ltd.* v *Addl. CIT* where it was pointed out that the tax credit under section 115JAA cannot depend upon tax payable with reference to tax liability which may vary according to the amount of advance tax paid or TDS or as a result of appeal, revision, rectification etc. Unutilised credit was adjusted against tax payable and does not depend upon other variable factors. For computing interest payable the shortfall has to be reckoned firstly over the MAT credit and then other adjustments. Any other view may lead to absurd results in charging interest on amount already to the credit of the taxpayer. Interest can be charged only on amount withheld. For coming to this conclusion the Tribunal followed the rationale of the decision in *CIT* v *T. T. Investments and Trades Pvt. Ltd.* . Any other inference would lead to an absurd result. Rules are meant to carry out the provisions of the Act. It cannot override the same as had been pointed out by the Supreme Court in *CIT* v *Taj Mahal Hotel* and *Central Bank of India* v *Their Workmen.*

There has been further liberalisation of the provisions for set off of MAT tax paid against regular tax by way of amendment by the Finance Act, 2006 extending the eligibility period from 5 to 7 years. But this will be effective from assessment year 2007-08, but the tax paid for assessment year 2006-07 will also qualify for such ex-tended benefit.

Q.11. What are the changes made in respect of MAT in Finance Act, 2005?

Answer. Tax credit under section 115JAA is restored from A.Y. 2006-2007.

Q. 12. How is the carried forward loss and depreciation determined when part of it has been adjusted in an earlier year?

Answer. The problem arises where there is intervening profit not fully absorbing past losses or depreciation. In *Rashtriya Ispat Nigam Ltd., In Re*[5], the dispute was whether loss or depreciation, whichever is less, should be reckoned on year to year basis in such cases. If the lesser of the two is taken in a year, such lesser amount would get exhausted sooner, so that the set off provision loses its effectiveness for the taxpayer for later years, since only remaining loss or depreciation being the lesser amount is admissible. Such an interpretation appears to be harsh in a case of a company with eroded capital not in keeping with the objective of taxing only prosperous companies with no taxable statutory income, so that there is no avoidance of tax on distributed dividend, as there is nothing to distribute. Where the Assessing Officer set off the depreciation, which was lower, on a continuing basis, the assessee would like the set off provisions to be applied afresh for each year, as though it is the first year, reducing what is already set off only against total loss including depreciation. Assessee's method is fair and consistent with the objective and probably not ruled out specifically in the statute, so that the benefit of its interpretation should be available to it. Incidentally, Circular No.495 dated 22.8.1987[6] gives an illustration for set off on year-wise basis. The interpretation placed on this Circular by the assessee was sought to be resisted on the ground that it related to sec. 115J and would not be applicable for later versions of this tax, though the sections are *pari materia.* This case relating to a public sector undertaking illustrates the inci-dence of this tax on book profits, which does not follow either the concept of distribut-able income under company law or such income on the basis of accounting principles or even the objective of the provision.

Q. 13. In the context of disallowance of Fringe Benefits Tax, would the debit to the accounts for such tax be disallowed in computation of book profits?

Answer. Disallowance is only in respect of statutory income. Since section 115JB starts with a non obstante clause making the provisions other than those in the Chapter XII-B inapplicable, it cannot be disallowed.

Q. 14. What is the treatment for deferred tax?

Answer. It is now made subject to liability for section 115JB by a retrospective amendment by the Finance Act, 2008.

Q.15. Is provision for lease equalisation charges to be treated as a provision to be added back in computation of book profits?

Answer. Provision for lease equalisation charges is being made as required by accounting practice in computation of income, so that such provision need not be treated as one for ascertained liability. Following the rationale of the decision in *CITv Apollo Tyres Ltd. ,* it has to be accepted by Assessing Officer.[2]

Q.16. Are provisions for gratuity and leave encashment to be adjusted in computation of book profits?

Answer. Merely because they are described as provisions, they could not be added back. The issue was, therefore, remanded back by the Delhi High Court to the Assessing Officer.[3]

Q.17. Is the provision for damage of stock deductible?

Answer. Provision for damaged stock ascertained by the assessee cannot be added back as it is for ascertained liability.

Q.18. Whether dividend tax under section 115-0, interest on income tax, tax penalty, could all be treated as income tax, so as to be disallowed?

Answer. Dividend tax under section 115-0 was held to be income tax to be disallowed. Interest on income tax was found to be disallowable. In this context, the amendment to section 115JB by the Finance Act, 2008 by way of insertion of Explanation 2 is to be seen. Under the Explanation the amount of income-tax shall include tax on distributed dividend under section 115-0/115R, interest, surcharge, education cess and secondary and higher education cess. Deferred tax is also taken into account, but it is only the net amount, which is so required to be taken. These amendments are made with retrospective effect from 1.4.2001.

It was followed by a Press Note. There has been a further clarification in Circular No.4 of 2004 dated 13th May, 2004 :

"It is hereby clarified that tax is required to be deducted at source under section 193 or sec-tion 195, as the case may be, only at the time of redemption of such bonds, irrespective of whether the income from the bonds has been declared by the bond-holder on accrual basis from year to year or is declared only in the year of redemption.

It is further clarified that a person, who has declared the income from a Deep Discount Bond on annual accrual basis during the term of the bond, will be entitled to make an application under section 197 of the Income-tax act, requesting the Assessing Officer to issue a certificate for no deduction of tax or deduction at a lower rate. In such a case, the assessee should furnish along with the prescribed Form No. 13, details of the income offered for tax by him from year to year. In case the assessee is not the original subscriber, and has acquired the bonds from some other person, he shall furnish the relevant particulars including the name, address and PAN, of such other person. If the Assessing Officer is satisfied that the applicant-assessee had declared his income from the bonds from year to year on accrual basis during the period the bond was held by him he shall issue a certificate allowing the tax deduction at source at such reduced rate as is justified by the total income of the applicant in the year of redemption.

Similarly, an assessee being a resident individual, who is the original subscriber of a Deep Discount Bond may furnish a declaration in Form No.15H in accordance with section 197 A, if he has been declaring income on the bond from year to year on accrual basis, and no tax is payable on his total income, including the interest accruing during that year, in the year of redemption. However, such a declaration cannot be filed by an individual other than a senior citizen availing of tax rebate under section 88B of the Income-tax Act, if the amount of accumulated interest, being paid on redemption, exceeds the maximum amount not chargeable to tax in his case".

The last circular contemplates a situation where a taxpayer may not choose to declare the annual accretion which was expected in the earlier two circulars. There is still a legal inference that in the case of such bonds there is only liability for capital gains, whether it is redeemed on maturity or realised by sale which has not been appreci-ated. However it is possible for a person who is not liable to tax to avoid tax deduc-tion at source by filing Form 15H. The issue therefore continues to be uncertain with the law and the Board's view of the matter being divergent.

It may, however, be noticed that an amendment by Finance Act, 2003 to section 10(10D) would remove exemption available for proceeds of insurance policy, where the premium paid in any year during the term of the policy exceeds 20% of the actual capital sum assured, so that the proceeds of the policy will be taxable in the hands of the employee in the year of maturity if it occurs during his lifetime. But this restriction applies only to policies issued on or after 1st April, 2003.

Tax Planning - Annuities and Deep Discount Bonds

Q. 1. Can an annuity given on termination of an agency agreement in rec-ognition of past service and for non-competition in future be assessable as income with reference to the value of the annuity.

Answer. It was held in *CIT* v *K.H. Katrak* that the yield of annuity being one to help him to survive for the period of five years when he could not compete with the principal should be treated as revenue in character and in the facts of the case as salary. Such an inference arose because annuity was also claimed to have been given in recognition of past service, though such service was rendered in the past in pursuance of an agency agreement. This decision in respect of the head of income under which the yield should be assessed is not free from doubt. However, the assumption that it is only the yield that would be assessable is consistent with the present law on the subject, if it is not commutable.

Q. 2. Why should the annuity policy be non-commutable in order that the remuneration should be postponed to years of receipts of annuity amount?

Answer. The claim that the right to receive the income had not arisen will not be possible if it is commutable.

Q. 3. Can salary be paid by way of annuities, so that employees can post-pone their liability?

Answer. The Central Board of Direct Taxes has confirmed the same treatment available for film artistes to be available for other professionals, so long as they are remunerated by non-commutable annuity. There is, however, no reason, why it should not be available for salaried employees as well notwithstanding conflicting decisions in this regard.

Q. 4. Whether annuity of all kinds is assessable as salary?

Answer. No. It is only the annuity paid by employers which is taxable as salary. Annuities paid by a person other than the employer, e.g., annuities paid under an insurance policy, are taxable as income under "Other Sources".

As noticed in para 11.2 non-commutable annuities will be taxable only as and when annuity amount is received, if remuneration is agreed to be received in such annuities as otherwise it will be tax-able in the year of receipt of annuity.

Q. 5. Should an annuity be for life or for a pre-fixed period?

Answer. An annuity in its broad sense is a series of payments made yearly or at fixed inter-vals. In its original sense it has to be for life. But that does not mean that a life interest can be treated as annuity as was pointed out in *Ahmed G.H. Ariffv CWT.* But in actual practice annuities are recognised as such even if it is for a certain period or for uncertain periods. In *CWT* v *P.K. Banerjee* it has been defined as under:

"In order to constitute an annuity, the payment to be made periodically should be a fixed or pre-determined one, and it should not be liable to any variation depending upon or on any ground relating to the general income of the fund or estate which is charged for such payment".

Annuity can be deferred so as to take effect from a future date, whether certain or uncertain, as in a case where it is linked with the death of a person.

Q. 6. If a specified sum is given in instalments over the years, could the ar-rangement be characterised as annuity?

Answer. Annual payment of a capital sum does not constitute annuity. It should ordinarily represent a return of capital and not capital itself. An annuity policy is purchase of income for the benefit of oneself or another, while payment of a specified sum in instalments is only a payment of capital sum. It has been so found in *Williamson* v *Ough, Inspector of Taxes.* It is possible for owner of a capital asset to exchange it for a perpetual annuity so that the yield from such annuity could be taxable income as was found in *CITv Kunwar Trivikram Narain Singh* .

Q. 7. What is the treatment of commuted value of annuity where such commutation is permissible?

Answer. While the yield of an annuity has revenue character, the commuted amount will be a capital receipt.

Q. 8. Can income from annuity be treated as salary especially when the employer takes out an LIC policy in the nature of annuity as an arrangement for terminal benefits? What will be the treatment of the yield of such policy?

Answer. The definition of salary under sub-section (1) of section 17 specifically includes in clause (ii) "any annuity or pension". Hence, where such annuity is awarded for past services, the income from annuity is to be treated as salary entitled to other deductions like standard deduction out of the same.

Q. 9. Whether income from annuity given in lieu of surrender of agricultural lands be treated as agricultural or non-agricultural income?

Answer. The connection with agriculture is too remote since the immediate source is annu-ity so that exemption available for agricultural income is not available for such in-come from such annuities as was held in *Maharaja Kumar Gopal Saran Narain Singh* v *CIT* . The distinction in this respect as between annuity purchased by the employer with other annuities is that the annuity for past services is squarely covered in the definition of salary under section 17(l)(ii).

Q. 10. An employer purchased single premium annuity policies from LIC in respect of a retired employee. The Assessing Officer held that premium paid was to be assessed as salary in the hands of the retired employee. Is he right?

Answer. No. Since the employee is entitled only to the income from the policy, the pre-mium paid cannot be assessed as income of the employee. It is only the income therefrom that will be assessable from year to year as was held in *CITv J.N. Vas.*

It may, however, be noticed that an amendment by Finance Act, 2003 to section 10(10D) would remove exemption available for proceeds of insurance policy, where the premium paid in any year during the term of the policy exceeds 20% of the actual capital sum assured, so that the proceeds of the policy will be taxable in the hands of the employee in the year of maturity if it occurs during his lifetime. But this restriction applies only to policies issued on or after 1st April, 2003.

The Finance Act, 2005 substituted tax rebate under section 88 by section 80C. The substituted section retains the limit of 20% of the sum assured for purposes of deduction under sub-section (3) of section 80C.

Tax Planning - Conversion of Proprrietary Business into a Firm/Company

Q.1. Where a father who is proprietor of a business takes sons as partners, are unabsorbed loss and depreciation of the individual available to the firm?

Answer. Since this is a case of conversion of individual to firm, there is no tax exemption for capital gains. In fact section 45(3) provides for tax on the basis of the value adopted for the capital asset brought in by the partners at the value recorded in the books of the firm. There is no right to set off since there is no similar provision as available under section 72A for the conversion of individual or firm's business to that of a company under section 47(xiii) and 47(xiv) read with section 72A(6) of the Act.

Q. 2. What is the consideration expected of an incoming partner?

Answer. Consideration may take several forms: (i) rendering of service, sharing in business losses and contributing capital, amount to adequate consideration; (ii) experience, on the part of the incoming partners, and their snaring in losses and liability amounts to adequate consideration.

Q. 3. Is it possible for a firm to be treated as a company?

Answer. Yes. A firm can register itself as a company under Chapter IX of the Companies Act. After registration the firm will have all the privileges of a company. There is no transfer involved and there is no need to pay stamp duty. Capital gains is also avoided.

Conversion of firm to company by Part-IX route of the Companies Act, it has been held, will not constitute transfer for purposes of capital gains in *CIT* v *Texspin Engineering and Manufacturing Works* .

Q. 4. Is conveyance deed or any other document necessary for ensuring ti-tle over the property of the firm on conversion under Part-IX of the Com-panies Act and the creditor objects to such conversion?

Answer. No other document is necessary in respect of the assets of the firm on conversion of firm into company by registration under Part-IX of the Companies Act. Section 575 of the Companies Act provides for automatic vesting of the properties of the firm as that of the company. As for the creditors, their rights are secured but all liabilities in respect of any debt obligation incurred or any contract entered into by the firm before registration are saved by section 576. Section 571 requires prior notice only in case of a firm doing banking business getting registered as a company under section 571 of the Companies Act, 1956. In other cases even such notice does not appear to be mandatory and at any rate the rights already secured in-cluding the rights of joint and several liability of the partners in their personal capac-ity should stand secured even after incorporation so that they cannot have any legiti-mate objection in view of this provision.

Q. 5. Is it necessary to redraft the partnership deed with minimum of 7 partners in case of conversion of firm into company in every case?

Answer. The need for having minimum of 7 partners in case of conversion cannot be dis-pensed with, if the object is to get registered as a limited company. Section 565(l)(b) requires that only a company consisting of 7 or more members has a right to get registered as a company under Part-IX of the Companies Act. In order to get registered as a company with limited liability it is necessary that the conditions which go with the requirement of limited liability are made part of the partnership deed itself, the main requirement being that there should be fixed capital for partners with proper sharing ratio corresponding to ratio of capital fixed for the partners. Any other clause which contradicts the concept of fixed capital, as for example, the usual clause that partners will bring in such additional capital as may be required for the purpose of business, may jeopardise registration, since capital is required to be fixed for companies with limited liability. It is in this context that a partnership firm may find it eas-ier to first get registered as a company with unlimited liability and then take steps for converting such company with unlimited liability to one of limited liability by following the procedure under section 32 of the Companies Act. It is, however, neces-sary that there should be positive share capital in either case.

Q. 6. A club run on mutuality basis registered under Societies Registration Act would like to be converted as a company limited by guarantee under section 25 of the Companies Act. Is it possible?

Answer. Any unincorporated company with 7 or more members can get itself registered. But it should be an organised entity to be capable of being described as an unincor-porated company. Partnership firms also qualify for registration as now recognised by the Press Release dated 5.8.1999 issued by the Company Law Department. Though there is no such precedent in respect of a registered society, there can be no difficulty because registered society is also an organised entity. Section 565 of the Companies Act provides for registration with limited or unlimited liability or as a company limited by guarantee. There should therefore be no difficulty in the society getting itself registered as a company. In order to be eligible to be treated as a company under section 25 of the Companies Act, it should satisfy the requirements of that section. Company under section 25 of the Companies Act should have been formed for the promotion of commerce, science, charity or any other useful object and should prohibit payment of any dividend to its members. Hence, the object of the society prior to registration should correspond to what is permissible under section 25 of the Companies Act.

While making the necessary changes in the constitution of the society prior to ap-plication for registration under Part-IX care may be taken to ensure that the objects qualify for exemption under section 11 of the Income-tax Act as well because com-panies which qualify for registration under section 25 of the Companies Act should have objects which can normally qualify for such exemption from Income-tax as well. A company registered under section 25 of the Companies Act does not automatically qualify for exemption unless the conditions under the Income-tax Act are also satisfied as may be evident from the decision in *Delhi Stock Exchange Association v CIT,* where it was found that there was absence of a clause prohibiting pay-ment of dividend in the case of the Association registered as a company, the association was not entitled to exemption under section 11 of the Income-tax Act. Section 25 of the Companies Act would also require that income should be spent only for the objects. This is also provided under section 11. Hence an association registered as a company under section 25 of the Act may also qualify for exemption. It is, however, unlikely that a mere club meant to cater to the entertainment of the members will qualify for registration under section 25 of the Companies Act and/or section 11 of the Income-tax Act.

Q.7. Is the benefit of unabsorbed loss or unabsorbed depreciation of a proprietary concern on take over by a firm within the meaning of section 47(xiv) available to the company?

Answer. Section 72A(6) would specifically provide for such right to set off unabsorbed loss and unabsorbed depreciation subject to the conditions under section 47(xiv) being complied with.

Q.8. Is it possible for two firms to merge with each other without any tax consequence?

Answer. The concept of merger or amalgamation is unknown to partnership law. Where a partnership business is taken over by another firm, there is a profit liable to capital gains tax.

Q.9. Is it possible for two firms to convert themselves as companies under Part-IX of Companies Act and thereafter for both the companies to amalgamate so as to avoid capital gains on merger of the business of the two firms?

Answer. The conversion and the later merger are two independent steps. Each should be justified by *bona fide* commercial considerations and not solely for saving tax. There is no liability at both stages, subject to conditions under the relevant provisions of law.

Effect from 1.4.2002. But the language of the provision would cast a doubt, since such transfer of interest beyond the limit has to be reckoned with reference from the date "in which the undertaking was set up" in Explanation 1. But the Explanation can be understood as covering only those established after this condition has come into the statute. Vested rights cannot get divested.

Another amendment is extension of benefit of exemption under sub-section (1A) of section 10A/10B for an industrial undertaking established in Special Economic Zones, but this concession will be available only for five consecutive years and 50% for next two assessment years.

Tax Planning-For Conversion of Firm into Company

Q. 1. Would the benefit of set off of unabsorbed depreciation and past business losses to which the firm was entitled be available, when a firm is converted into a company?

Answer. Section 72A(6) specifically provides the right to set off of accumulated losses and unabsorbed depreciation on conversion of business of the firm or that of a proprietorship to a company if the conditions required under section 47(xiii) and (xiv) are satisfied.

Q. 2. Would the benefit of unabsorbed investment allowance be available when a firm is converted into a private limited company?

Answer. The answer is yes provided the conditions prescribed under s. 32A(3) are satisfied.

Q. 3. Though capital gains on transfer of business of a firm to a company will not attract capital gains tax from A.Y. 1999-2000, will the firm be liable to pay tax under section 50 on depreciable assets?

A. In the event of severable sale, the exemption under section 47(xiii) has no applica-tion. Section 50 imposes liability for short term capital gains, whether the assessment is for A.Y. 1999-2000 or earlier years. If the transfer is as a going concern, though no specific exemption is spelt out for tax on short term capital gains under section 50, the principle that in a slump sale, there can be no inference of sale of any specific item comprised therein, should avoid any computation under section 50 alone.

Q. 4. Since gift tax is abolished, is it not open to taxpayers to transfer at cost and avoid capital gains tax?

Answer. As between a firm and a company with same identity of interest as between part-ners/directors, transfers can certainly take place at book value. As between strangers, transfer at book value will certainly provoke a suspicion, since in such a case the dif-ference between market value and apparent consideration is bound to have been con-cealed. On proof, there is vulnerability for penalty.

Q. 5. What is better, whether slump sale or severable itemised sale?

Answer. In a slump sale from A.Y. 2000-2001, there is no benefit of indexation, the differ-ence between book value and consideration is assessed. In a severable sale, the capital gains of asset has to be computed, so that in respect of long term assets, benefit of indexation is available. But where the prospect of short-term capital gains is higher because of extent of depreciable assets comprised therein in severable sale, slump sale is preferable. Hence, what is preferable will be a matter to be considered with reference to facts in each case.

Q. 6. If a slump sale is made by a firm to a company in a manner that the benefit of exemption under section 47(xiii) is availed and thereafter the company amalgamates with another company, will there be forfeiture of exemption though 50% parity of ownership may not continue?

Answer. It was once thought that amalgamation could not be transfer in view of the deci-sion of the Supreme Court in *CIT* v *Rasiklal Maneklal (HUF)'* rendered in the con-text of capital gains tax under the earlier law in which there was no exemption avail-able for amalgamation. But then the Supreme Court in a very recent decision in *CIT* v *Grace Collis* has held that the later extension of the definition of transfer to in-clude extinguishment would mean that amalgamation is also transfer, so as to make the shareholder liable for tax. Even if it falls within the definition of transfer under section 2(1B) of the Act, it may be argued that it is only for exemption for amalga-mating company and its shareholders under section 47(vi) and (vii) respectively.

Hence, even if the condition of 50% parity is maintained it may still be construed as violation of condition under section 47(xiii) of the Act and exemption may be lost.

Q. 7. Is it possible to part with some of the assets of the firm to a company without parting with the business as a whole?

Answer. It is certainly possible to do so. Tax implications will be the same as for severable sale. Even if the consideration is settled by issue of shares, capital gains cannot be avoided, since it will be treated as exchange of the assets for the shares.

Q. 8. There is a provision for exemption of conversion of proprietary busi-ness and firm's business to a company. Is there similar exemption for conversion of proprietary business into a firm?

Answer. No. In fact, there is a specific provision under section 45(3) making such conver-sion liable to capital gains tax, but such liability is on the amount credited to the transferor in the books of the firm. If the proprietor is willing to transfer the business at book value, there is no liability for capital gains tax. There is also no liability for gift tax in view of the fact that gift-tax is abolished from 1.10.1998.

Q. 9. Can revaluation of the assets before transfer by way of slump sale avoid or reduce liability to capital gains tax?

Answer. No. Revaluation does not enhance the cost. Proviso to section 50B also makes it clear that the net worth which would be cost will ignore revaluation, if any made.

Q. 10. What are the tests for inferring business to be one as a going concern or a business as a whole in contrast with severable sale? Is it possible to reduce the incidence of tax in these transactions?

Answer. In a sale of business as a whole, transferred as a going concern with all assets and liabilities, the seller will not be able to withdraw any asset while the buyer will not be able to reject any such assets of business. Similarly, the buyer cannot refuse to take over any liability. Even if it is not so strictly complied with, it may still pass muster as a slump sale, because slump sale is defined in a wider sense, since Explanation-1 to section 2(19AA) would define an undertaking to include any part of an undertak-ing or a unit or division of an undertaking or a business activity taken as a whole, while ruling out only transfer of individual assets and liabilities or for combination thereof not constituting a business activity. What is implied is that the transferred entity must be a unit capable of being sold as such, though it may be a part of a larger undertaking. Hence a slump sale under Income-tax law may be of a business activity, while for sales-tax law it may include a unit or a division but cannot possibly include a mere business activity. Where it is a unit or division, it may be capable of being considered as a separate business in some cases where all its assets and liabilities are transferred.

Tax Planning - For Partnership Firm

Q1. At the time of becoming a partner in the firm of M/s. ABC, Sri A brings in his house property as his share of capital in the firm. Does such bringing in of immovable property to the stock require registration under section 17 (1)(b) of the Registration Act?

Answer. When immovable property being admittedly of a value of more than Rs.100 was brought in by a partner of the firm as his contribution towards the assets of the partnership firm, there is no transfer at all within the meaning of the Transfer of Property Act, 1882. as there is no provision under the Partnership Act 1932 or under the Registration Act, 1908, which requires such bringing in of the property by the partner into the assets of the firm as requiring registration.

Therefore, even if a property brought in by one partner be an immovable property, no document registered or otherwise, is required for transferring the property to the partnership. *[Authority: CIT* v *Royal Amber Resorts}.*

Q. 2. An assessee entered into a partnership with a company in which the husband of the assessee was a director. The said firm was to carry on the business of purchase and sale of lands. The assessee had fifty per cent share in the said firm and the other fifty per cent belonged to the company. In terms of the deed of partnership, the assessee brought in land belonging to her valued at Rs.10 lakhs as the share of capital contribution. The company did not bring in any capital. No business in sale and purchase of land was conducted by the firm. Within three months of its formation the assessee retired from the firm and the firm was also dissolved within three months of its formation. The assets were shared and the lands were retained by the company and in consideration thereof, the assessee got shares worth Rs.10 lakhs. The Assessing Officer held that there was no genuine partnership, that the transaction had shown that the assessee had received the value of her land and the transaction of transfer of land was subject to capital gains. Whether the decision of the Assessing Officer is valid in law?

Answer. The decision of the Assessing Officer is valid in law. The true nature of the trans-action was "transfer of land" and the various steps in the process of leaving the land with the company were nothing but a device to avoid capital gains tax leviable under section 45 of the Act. Hence capital gains tax is leviable.

If a firm is formed merely to dissolve it, so as to effect a transfer by adopting the procedure under partnership law, the transaction becomes colourable and is, therefore, liable to be discarded. As long as there was an intention of dissolving the firm at the time of its formation, such inference that the transaction is colourable may well follow.

Q. 3. A business in paints and varnishes was originally carried on by Sri A in his individual capacity. In the year 1952 the business was converted into a partnership firm and the partnership deed provided that the tenancy rights in the shops in which the business was carried on vested with Sri A in his individual capacity and the other partners were not entitled to any claim therein. Even subsequently, wherever changes were made in the constitution of the firms, a provision was always made in the relevant deed declaring that Sri A was the exclusive holder of the tenancy rights. Subsequent to death of Sri A, the tenancy rights were transferred to another concern. The transferee concern paid to the firm a sum of Rs.1 lakh for the transfer of the tenancy rights.

The question is whether the surplus realised from the transfer of the tenancy rights could be considered in the assessment of the firm?

Answer. The sum of Rs. 1.80 lakhs does not belong to the firm, the amount belongs to the legal heirs of Sri A, since there has been no transfer from partner to firm.

Q. 4. Is there a gift element when a firm is converted into a company?

Answer. If the transfer is at book value when the net worth as per market value is higher, the fact that there is identity of interest as between firm in the partnership and the shareholders in the company cannot avoid the incidence of transfer so that capital gains to the extent of admitted consideration and gift-tax on short consideration with reference to fair market value cannot be avoided as was held in *Khoday Easwarsa & Sons* v *CGT.* However, tax exemption is available under section 47(xiii) for such transfers with effect from 1.4.1998. Gift-tax also stands abolished from 1.10.1998.

Q. 5. The purpose of constituting a firm was for construction and letting out godowns. The Assessing Officer had taken the view that since partnership can be only for carrying on a business, there is no business in deriving income from property and that therefore the firm is not entitled to be treated as a firm so as to require registration when registration procedure was in vogue. Even after the registration procedure has been dropped, is it possible to treat it as a firm and not required to be treated as association of persons?

Answer. Business for the purpose of partnership law is different from the concept under income-tax law, which requires income from property even in the hands of a property dealer to be treated as property income and not business income as held in *CIT* v *Chugandas & Co.* Kerala High Court in *CIT* v *George Oommen & Co.* has pointed out that the heads of income for income-tax purposes have no relevance in deciding whether there is business under partnership law. But for purposes of general law and partnership law, business has to be understood in wider sense to include every profit making activity. It was so held in *Smith* v *Anderson* . This difference was pointed out in *CIT* v *Veerabhadra Industries* .

Tax Planning - For Interest Income

Q. 1. A company has received moneys from its shareholders. It has not yet commenced business. It has also obtained loans from banks for purchase of machinery etc. The monies received from shareholders, creditors etc. are invested in short-term deposits which earn interest. It also has to pay interest on loans which is less than the interest received. Was the com-pany to pay tax on the interest received or net interest?

Answer. The Supreme Court in *Tuticorin Alkali and Chemicals and Fertilisers Ltd.'* held that the interest on deposit is to be assessed with other sources. The only debit against this is the expenditure involved in earning this income. If some of the loans taken can be related to the deposits it is possible to claim a deduction of interest paid on such loans. However, if there is no nexus between the two, i.e., if moneys borrowed but not, invested in deposits, interest on loan borrowed will not be deducted form interest earned.

However, the interest paid on loans can be capitalized as business expenditure prior to commencement of business and depreciation claimed.

The rationale of decision of Supreme Court in *CIT* v *Bokaro Steel Ltd.* would how-ever seem to offer some hope when there is nexus between interest received so as to enable treatment of the same as abatement of capital cost.

Q. 2. What difference does it make for taxation if moneys received during the course of running the business are put in short term deposit and inter-est earned thereon?

Answer. The Supreme Court in *CIT* v *Govinda Chaudhury & Son* would indicate that such interest could be assessed as business income. However, it is necessary to establish that this money is so deposited pending use for business.

Q. 3. Can different systems of accounting be adopted for receipts and payments?

Answer. No. Hybrid system is not now permitted, since section 145 as substituted with effect from A. Y. 1997-98 would rule out hybrid system for all assessees. Companies are required under company law to follow only accrual system.

Q. 4. Where interest received is less than interest paid, is it possible to carry forward the loss and set off against income in another year?

Answer. Set off is available only for business income. If receipts and payments relates to business, it is so available. It will not be available, if such income is assessable under the head "Other Sources". It can, however, be set off against other income.

Q.5. During the period, when dividend income is exempt, could the loss arising on payment of interest on borrowings for acquiring shares be treated as business loss, so as to be available for set off against other heads of income and be carried forward?

Answer. If the assessee had been an investor, neither deduction for interest paid nor treat-ment of such amount as loss was permissible, as it related to an exempt income. The position, however, is different, after dividend income became taxable in which case, the interest income is deductible against dividend income, whether it is nil or posi-tive. If the assessee were a dealer in shares, it was and continues to be deductible.

Q.6. During the period, when interest is not deductible because dividend income is exempt, could this be treated as part of the cost of the asset for purposes of capital gains tax?

Answer. Yes. It is always possible to treat such interest, which is not allowable as a deduc-tion from income, as cost of the asset for purposes of capital gains tax as had been held in *CIT*v *Mithlesh Kumari, Addl.CITv K.S.Gupta, CIT*v *MaithreyiPai Naozar Chenoy* v *CIT.*

Q. 7. What is the treatment to be accorded to discount or bonus in respect of debentures?

Answer. Discount or bonus unlike interest on debentures would be a capital receipt for the investor while it may be revenue expenditure for a dealer as was found in *Lomax, Inspector of Taxes* v *Peter Dixon & Son Ltd.* , an English decision which was ap-proved in *Madras Industrial Investment Corporation Ltd.* v *CIT* in the case of dis-count on debentures which was allowed on a spread over basis during the life of the debentures. Similar treatment was found admissible for bonus debentures in *National Engineering Industries Ltd.* v *CIT* .

Q. 8. How is the interest on sticky loans treated in the hands of the investor who follows mercantile system of accounting and in hands of the lending institutions?

Answer. Mercantile system of accounting does not create income but it is only a system of accounting which recognises right to receive income. Such right should be a real one. Where the investment has become doubtful there is no reason why interest should be recognised till the final outcome of the claim for the return of loan and interest be-comes certain. In the case of lending institution in *UCO Bank* v *CIT,* the Supreme Court has recognised that it is not necessary to credit interest on doubtful debts to P&L A/c as income even under mercantile system of accounting. This has since been followed in *Karnataka State Financial Corporation* v *CIT.*

Q.9. Is interest on amount received from bank deposit out of amounts collected from public issue taxable as business income in the case of company during the course of which it has gone for public issue for additional capital for its running business?

Answer. Since the public issue was not in the course of business and money lending was not in its line, the income was found assessable as income from other sources and not from business as in the case of *Shree Krishna Polyster Ltd.* v *Dy. CIT.*

Q.10. Where a capital receipt was not found assessable as capital gains, is it possible to treat it as a income from other sources under section 56 of the Act?

Answer. Where the amount received is on capital account and is not taxable as capital gains, it is illogical to treat it as income from other sources under section 56. Every receipt, which is not taxable or exempt cannot be brought to tax under section 56. It was so held in *CITv D.P. Sandhu Brothers, ChemburP. Ltd.*

Q.11. Where an assessee which is yet to commence business has income from fixed deposits but pays interest on money borrowed for construction project, whether such interest paid should be allowable as a deduction against interest paid?

Answer. Where the borrowing is for construction work and not for investment in fixed deposits, the amount is not deductible. It was so held in *Consolidated Fibres and Chemicals Ltd.* v *CIT* following the rationale of the Supreme Court decision in *CIT* v *Dr. V.P. Gopinathan.*

Q.12. A real estate dealer deposits the money received from co-developers in a bank and earns interest. Is the interest income from business?

Answer. Yes. The deposits are directly related to business, where they are made for obtain-ing bank guarantee, etc. The fact that it was so treated in the earlier years as business income will also be a point in favour of treatment as business income as held in *CIT* v *Dalmia Promoters Developers P. Ltd.*

Q.13. When does the liability on interest on disputed enhanced compensation arise?

Answer. Even where the assessee is able to draw part or whole of the enhanced compensation granted by the lower court, it is only subject to appeal, so that in case the State appeal is successful, the assessee would have to return the amount. Liability cannot, therefore, arise till finality is reached. The fact that section 45(5) requires such enhanced compensation to be assessed in the year of receipt cannot have application for disputed compensation and interest thereon. It is so decided also by the Karnataka High Court.

Q.14. Is commission paid to a property agent for acquiring property deductible from income from other sources?

Answer. Since income from the property is assessable only under the head "income from house property", such commission is not deductible from income from other sources.

Tax Planning - For Income from House Property

Q. 1. How is income to be computed, if a property is partly let out and partly self-occupied?

Answer. It has to be treated as two residential units and income from each unit has to be computed according to law by allocating common outgoings on a basis proportionate to area of occupation.

Q. 2. Is it necessary that the person must be a legal owner in order that the income should be computed under the head "income from property"?

Answer. No. If a person is entitled to the income under the law, such income is bound to be assessed under the head "income from property". Tax laws are generally concerned with beneficial ownership as laid down in *CIT* v *Podar Cement Pvt. Ltd.*

Q.3. Is municipal tax deductible in computation of income from: (i) self-occupied property; and (ii) where demand notice is reserved but it has not been paid?

Answer. Since income from one self-occupied property is nil, subject only to deduction of interest the question of deduction of municipal tax does not arise. For let out proper-ties, municipal tax is deductible only if it is paid during the year.

Q.4. Is deduction for repairs available, when tenant undertakes repairs under the rental agreement? What is meant by repairs?

Answer. By repairs we mean only substantial repairs as held in *CIT* v *Parbutty Churn Law* and *Sir Shadi Lai & Sons* v *CIT.* Where even substantial repairs other than normal maintenance is undertaken by tenant, annual value should get enhanced by the extent of repairs which should have been borne by the landlord so that any deduction for repairs then available to landlord will neutralise the amount added to annual rent. It would, therefore, mean that where there is specific stipulation that all repairs will be borne by tenant, there can be no deduction for repairs.

Q. 5. Is an annual charge on rent receivable on account of mortgage of property for obtaining funds for business or paying income tax deductible under section 24(1)(iv) of the Income Tax Act, 1961 ?

Answer. No. Since it is a charge created voluntarily by the assessee, it is not deductible as was held in *CIT* v *Indramani Devi Singhcmia*[1] in case of a business loan and *CIT* v *Tarachand Kalyanji* in the case of a charge created for payment of excess profit tax In the latter case, it was held that the amount is not deductible even if the charge has been created before 1st April, 1969, when such amount was deductible in law.

Q. 6. What are the conditions for deduction of unrealised rent?

Answer. Rule 4 of the Income-tax Rules as substituted by the Income-tax (Eighth Amend-ment) Rules, 2001 prescribes the conditions as under:

Unrealised rent—For the purposes of the Explanation below sub-section (1) of section 23, the amount of rent which the owner cannot realise shall be equal to the amount of rent payable but not paid by a tenant of the assessee and so proved to be lost and irrecoverable where,—

(a) the tenancy is *bona fide;*

(b) the defaulting tenant has vacated, or steps have been taken to compel him to va-cate the property;

(c) the defaulting tenant is not in occupation of any other property of the assessee;

(d) the assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfies the Assessing Officer that legal proceedings would be useless.

Q.7. Is salary paid to a caretaker deductible?

Answer. No. Only deductions specified under section 24 are deductible.

Q. 8. How is the income of co-owned property computed?

Answer. Income has to be split up between co-owners and each co-owner has to be as-sessed as his share of the income as provided under section 26 of the Act.

Q. 9. Where an assessee borrows a second loan for repaying the first loan taken for acquiring a property, will the interest on second loan be de-ductible as amount borrowed for acquiring the property?

Answer. Yes. It is so conceded in Board's Circular No. 28 dated 20th August, 1969.

Q. 10. Ground rent—whether arrears of earlier years deductible?

Answer. No. The deduction under section 24(1)(v) is confined to the ground rent of previ-ous year, and thus arrears of earlier years are not deductible.

Ground rent is no longer deductible from A.Y.2002-2003.

Q. 11. Interest deductible under section 24(1)(vi): whether simple interest or compound Interest?

Answer. Only simple interest is deductible.

Q. 12. What is the treatment given to loss from property?

Answer. Loss from property can be set off against other heads of income in the same year and to the extent unabsorbed, it will be carried forward and set off in next eight years.

Q. 13. Where municipal valuation is higher than the rent charged, what is the basis of computation of property income?

Answer. The law requires that either annual value as fixed by the local authorities or actual rent received, whichever is higher, should be treated as annual value. But where the assessee is unable to enhance the rent due to Rent Control Act, there is a case for acceptance of rent receivable as the basis. It was so held in *CIT* v *Sampathammal Chordia* .

Q.14. Are municipal taxes allowed on the basis of tax leviable for a year or on the basis of payment? If it is on the basis of what is leviable, what happens if demand for earlier years is received only during the year with the result that the payments for earlier years are made during the year?

Answer. Section 23(1) allows property tax levied by local authority on the basis of pay-ment from assessment year 1985-86 vide amendment by Taxation Laws (Amend-ment) Act, 1984 so that the controversy in the prior law is now avoided. So, the amount paid during the year, including any amount of arrears for earlier years, is de-ductible in the year of payment.

Q. 15. Where the assessee is a mutual association having a property, will the property income be covered by the principle of mutuality so as to be exempt?

Answer. Yes, it has been held that principle of mutuality applies even to income from house property in Chelmsford Club v CIT.

Q. 16. The assessee—Mrs. A is in enjoyment of the property but the right is limited only for life under a Will in her favour. Who has to pay the tax, whether she as the person in enjoyment of the property as the holder of life interest or the remainderman treated as the owner in law?

Answer. Ownership is a bundle of rights. Right to enjoy the property is also a right which is part of such ownership right. Hence it will be assessable in the hands of life inter-est owner. It has been so held in *Estate ofAmbalal Sarabhai* v *CIT.*

Q. 17. Where an assessee receives interest on deposit taken from a tenant, is it necessary to enhance the annual value by the notional interest which would have otherwise been payable?

Answer. Where actual rent received is more than the fair rent, i.e., annual value fixed by the local authorities, notional interest need not be added. It was so held in *CIT* v *J.K. Investors (Bombay) Ltd.* Where such notional interest is to be taken, as for example, where no rent is charged because of such interest free deposit, the interest or other income earned by deployment of the interest free deposit will have to be correspondingly reduced from the annual value but the law does not provide for the same. But it stands to reason that such reduction may have to be allowed, though it is doubtful whether such reasonable interpretation will be acceptable to revenue.

Q. 18. Is it open to the Assessing Officer to substitute reasonable rent where the property is let out to an associate company at a lower rate?

Answer. Since annual value is not the only criterion, it is open to the Assessing Officer to adopt a reasonable rate where it is let out at a concessional rate. It was so held in *T. V. Sundaram Iyengar & Sons Ltd.* v *CIT* .

Q. 19. Where the property is in existence for less than 12 months, is it possible to assess the income as income from property since the scheme of the Act is to assess the annual rent? Does the income escape assessment in such cases?

Answer. The argument that the property should have been held for entire 12 months to be assessable under the head 'Income from property' was accepted in *P.J. Eapen* v *CIT.* But it was held that such income will be assessable under 'Other sources'. The decision is open to doubt because there is no reason why the proportionate income should not be assessed with reference to the period of holding because such propor-tionality is recognised in section 23 where the property is let out for part of the year and used for own residence for rest of the year under section 23(2)(a)(ii). Hence, similar apportionment should be possible though the annual value is with reference to the income which the property might fetch if let out from year to year.

Q. 20. Where the deduction under section 24 exceeds the available income, can such excess be allowable?

Answer. Where the property is partly let out and partly used for own residence, the deduction under section 24(1) will be limited to the income determined under that clause under the substituted section 24 by Finance Act, 2001. with effect from 1.4.2002, there are no detailed deductions but only 30% of annual value and interest on borrowed capital subject to the limit of Rs.30,000 for self-occupied property with enhanced limit up to Rs.1.50 lakhs subject to conditions as to the date of the loan and the date of construction. Hence, there can be a loss from the property depending upon interest on borrowed capital.

It is only in respect of annual value, that there cannot be loss.

Q. 21. There is a practice of receiving deposit instead of rent. The assessee accounts for interest on such deposits as its income. Should he also ac-count for notional income from property?

Answer. The answer was against the assessee in *S.Ujjanappa* v *CIT,* where it was held that ownership confers the duty to account for notional income from such property. The issue as to whether it involves double taxation was not posed in this case. Inter-est income earned by the assessee on the deposits or notional interest when used in business could have been set off against such income. There is clearly double taxa-tion implicit in such cases. In *Webb's Agricultural & Automobile Industries* v *ITO* , a car received by way of lottery winnings brought to tax as income was held to be eligible for depreciation, though assessee had not paid for the same, because of the notional cost. This line of reasoning should avoid elimination of double taxation by setting off the two incomes one notional and the other real as between them, but the law on the subject is still nebulous.

Q.22. Is the amount of interest paid on unpaid consideration for acquiring property deductible as interest on borrowing under section 24(1)(vi) of the Income-tax Act?

Answer. In the context of similar interest on unpaid consideration for acquiring a business; the Supreme Court had held in *Bombay Steam Navigation Co. (1953) P. Ltd.* v *CIT* that such interest is not deductible under section 36(l)(iii) of the Income-tax Act, 1961. But in the same case, it was found that it can be allowed as deduction under section 37 of the Act. It is for this reason that it has felt that in absence of similar residuary clause, interest on unpaid consideration for acquiring property would not be deductible. However it was found in *CIT* v *Sunil Kumar Sharma* following *CIT* v *R.P. Goenka and J.P. Goenka* that it makes no difference, whether the buyer borrows from a third party to acquire a property or gets the necessary financial assistance from the seller of the property. It should be construed that the seller is the lender and the purchaser is the borrower. It would thus appear that such interest is deductible.

Q. 23. What is the change in respect of computation of property income by the Finance Act, 2005?

Answer. There is no change in computation of property income, but the incentive for re-payment of loan for acquiring a property is enlarged by removing the limit of Rs.20,000 in respect of such repayment and by providing such repayment as an out-right deduction from the gross total income by the new section 80C substituting sec-tion 88, subject, however, to the limit of total deduction under section 80C to Rs.l lakh. Interest payable on such loan would be admissible as deduction, if the property were let out, subject to limit of Rs.30,000 in case of self- occupation.

Q.24. If a person puts up a property on leased land, is the lease rent deductible as income from property?

Answer. There is no special provision for deduction of lease rent as was available in the pre-existing law under section 24 either as an annual charge on the property or as ground rent, but all the same, what is payable on leased land gets diverted at source and should not be part of the annual value, so that in determination of annual value, the amount should be deductible. Any other view could not be reasonable. An alternative argument may well be that if it is not deductible, income itself may not be assessable as a property income as the assessee is not the full owner of the property, so that income will be assessable as from "Other sources", so that the deduction in such a case cannot be denied, though the assessee may not be eligible for an ad hoc deduction at 30%; but only actual repairs, where it is assessable as income from other sources.

Q.25. Where a landlord undertakes to meet the expenses of watch and ward, corridor, lighting, lift, etc., are such expenses deductible from property income?

Answer. Expenses which are ordinarily borne by the tenant, but undertaken by the landlord according to terms of rental agreement will go to reduce the annual value, because the rental value of the property can only be the net income after meeting the tenant's burden.

Q.26. Where the assessee allows the property to be used by firm of which he is a partner without charging rent, is he entitled to self-occupation allowance or depreciation?

Answer. Since the firm is not a separate legal entity, the use of property by the firm should be treated as use and occupation of the property by the partner itself, so that self-occupation benefit will be available from income from such property. If the property is used for business, there is eligibility for depreciation also.

Q. 27. Where a partner allows the use of the property by the firm and charges rent for the same, would he be entitled to ad hoc deduction at 30% or depreciation of the property because of the use for business?

Answer. Since the rent is received from a firm of which he is a partner, the amount of rent receivable may not be treated as received in his capacity as landlord, but as a partner. If the property is used for business, the owner should be entitled to depreciation. It was so held in *CIT* v *Ramlubhaiya R. Malhotra* following *A.M. Ponnuranga Mudaliar* v *CIi.* The latter decision was followed in *CIT* v *Texspin Engineering and Manufacturing Works* .

Q.28. In the case where a tenant sublets the property, is the rent paid by the tenant deductible from the income from subletting?

Answer. Since the tenant is not the owner, the income should ordinarily be assessable as income from other sources, so that the rent paid should be deductible. Even if it were lease- hold property, the rent paid may have to be taken into account in determining the annual value. Contrary view taken in *CIT* v *Hemraj Mahabir Prasad Ltd.* would need review.

Q.29. Where the assessee borrows money on mortgage of his property for his daughter's marriage, is such interest paid deductible from the property income?

Answer. Merely because the loan is charged on the property, interest does not become deductible, because the amount is not borrowed for purpose of acquiring or constructing the property.

Q.30. To take advantage of mutuality principle, persons renting the hall of a club for marriage become temporary members. Is such receipt exempt from liability in the hands of the club?

Answer. No. There is no mutuality involved. Temporary membership for an ulterior Bur-pose is not permissible. The rents are taxable in the hands of the club.

Tax Planning - For Business Expenditure

Q. 1. There is a prevailing practice of a businessman taking loan of stock from another businessman and returning the same. Since he may have to pay for replacement at a higher price for return of loan of stock, can a provision made for the extra cost be deductible?

Answer. The issue had come up in *Welding Rods Manufacturing Co.* v *CIT,* where it was found that the price rise at the time of closure of accounts in respect of outstanding loan of stock could be recognised and the provision therefor would be allowed as a deduction. In coming to the conclusion the High Court followed the decision in *Calcutta Co. Ltd.* v *CIT..*

In this context, one may refer to the statutory provision in section 47(xv) in respect of capital gains on stock lending, whereby tax on capital gains is spared on such stock lending, if the guidelines issued by Securities and Exchange Board of India had been followed. The provision, however, is only for exemption from capital gains and the mere act of lending of securities in pursuance of stock lending scheme. It cannot have application for dealers in shares. Similarly, the final outcome of the transaction even in the case of an investor may have to be recognised for capital gains tax pur-poses under the law as exemption is at the stage of lending and not at the stage when the contractual obligation gets discharged.

Q. 2. Does a liability arise under excise law on show cause notice, which makes a special recognition for show cause notice, where such notice has been issued?

Answer. Notwithstanding the effect of a show cause notice, it does not create a demand for payment by itself, so as to justify the amount covered by the notice as statutory liabil-ity, on the basis of the decision in *Kedarnath Jute Mfg. Co. Ltd.* v *CIT*[3]. It was so pointed out in *CITv Morarji Goculdas Spg. & Wvg. Co. Ltd.*

Q. 3. Should the right to deduction await final result of any claim?

Answer. Courts have not taken a uniform view. Ordinarily when a final decision is awaited, deduction could be made only in the year in which the matter gets resolved as in the case of requirement of approval from the authorities following the decision in *Nonsuch Tea Estate Ltd.* v *CIT* . But in a case on converse facts, it was held that in the accrual concept in mercantile system of accounting, a mere requirement of approval, when it has become available at the time of assessment or even in appeal, such delay in approval need not bar assessment in the year of receipt as was held in *CIT* v *Jai Hind Travels (P) Ltd.* , where the concept of the doctrine of relating back was adopted for accrual system. Such a view cannot be treated as non-controversial. Deduction need not be denied, where *ex post facto* approval is a formality. It is difficult to draw a line in such cases. It is for the taxpayer to make a provision in such cases in the year of claim, so that even if it is disallowed, it can be claimed in the year of payment. Failure to make the claim in an earlier year may lose the right, if revenue decides that the claim could be allowed only in the first year.

Q. 4. Is it open to the Revenue to disallow a portion of electricity charges paid with reference to the refund claim made during the year, but given in a subsequent year?

Answer. Receipt of refund in a subsequent year cannot be taken as a ground for not allowing a deduction at the time, when it was payable as was held in *Travancore Chemical and Mfg. Co.Ltd.* v *CIT* following the decision in *CIT* v *Bharat Iron and Steel Industries* , The High Court pointed out that the need for section 41(1) to tax amounts that had been remitted or waived would not have arisen, if allowance due for an earlier year could be modified with reference to the later waiver or remission.

Q. 5. Is it possible to value stock by methods other than cost, market value, or cost or market value, whichever is lower?

Answer. Any method which is consistently followed and is not likely to distort the income and is consistent with accounting principles should be acceptable. Lower valuation for slow moving goods in the view that future carrying cost would require to be taken into consideration was approved in *India Motor Parts and Accessories P. Ltd.* v *CIT.* The method, it was pointed out, had been suggested as a proper valuation in *Industrial Accountants Hand Book* edited by Wyman P Firke of John A. Beckett. Such a view had also the approval of Delhi High Court in *CIT* v *Bharat Commerce and Industries Ltd.* .

Q. 6. How is the work in progress valued? Should the overheads be treated as part of cost?

Answer. Work-in-progress is generally valued at cost. The issue as to whether the over-heads should be taken into consideration by adoption of "on-cost" basis or whether only direct cost should be taken was considered in *Duple Motor Bodies Ltd.* v *Inland Revenue Commissioner* , where it was found that either method can be adopted but where the assessee has adopted one method, it is not open to him to change it.

Where an assessee had followed a method of accounting, which excluded over-heads in valuation of work-in-progress on the ground that the goods under manufac-ture may not result in marketable commodities, the Tribunal rejected the change mainly on the ground that there was no evidence of possible deterioration of work-in-progress. The High Court, however, found that since the assessee had followed the same method in earlier years, it was entitled to continue the same practice. The Supreme Court in *CIT* v *British Paints India Ltd.* decided on the short point that merely because a system has been consistently followed, it does not mean that Revenue is bound by it, if it finds that it is not consistent with accounting principles. If the income could xiot be rightly deduced from the system followed, it was open to the Assessing Officer to reject the same, since there is no estoppel in such matters. According to this decision, the cost ordinarily has to reckon overheads as well. The distinction between finished stock and work-in-progress was however not appreciated in this case, when it reversed the decision of the Calcutta High Court. But it is still an authority for the view that the method followed should be consistent with accounting principles. A scientific method of valuation of work-in-progress is probably only the retrievable value or a value which makes an allowance for a situation, if the goods turn out to be non-marketable. In other words, valuation at less than the cost or mar-ket value for work-in-progress should be permissible in certain lines of manufacture, where there is possible wastage before completion of the manufacture of the product, if such valuation is consistently followed.

Q. 7. An assessee had the practice ot accounting receipts from contract only when the bills raised by it were passed by the contractee. Where such a method is regularly followed, can it be rejected by the Assessing Officer?

Answer. Yes. It was so held in *CIT* v *Shaik Mohd Rowther Shipping and Agencies (P) Ltd.* , where it was pointed out that the method is not consistent with any accounting principles. The work has been done on the basis of which bills were raised. 90% of the amount was also received, the balance pending for passing of the bills. Merely because the amount received is shown as advance, it is not possible to postpone rec-ognition of revenue. The mere fact that the Assessing Officer had not disturbed the system in earlier years does not prevent him from correcting the same as the principle of *res judicata* can have no application to tax cases as was pointed out in *CITv Brit.*

Q.8. Which is the best head of income from tax point of view, where there is a possible choice?

Answer. The best head is business as it is eligible for a list of deductions and reliefs.

Q.9. A business executive has purchased and sold shares through a stock broker. Will the loss, if any, be assessable under the head "business" or "capital gain"?

Answer. The mere fact that he has purchased and sold shares through a broker does not entitle the assessee to treat the income as business income. There should be a con-tinuous activity. Moreover, if the interval between purchase and sale is short, profit will be referred under the head "short term capital gains" without any advantage.

Q.10. A piece of land acquired five years before is plotted out and sold. What is the head of income?

Answer. To treat the sale of land as a business transaction more facts are required. There should be facts to suggest that the land was converted to a business asset and dealt with as such and the sale is not just for the sake of realisation of appreciation in value.

Q.11. Can what is "accrued but not due" ever be treated as accrued for tax purposes? What is the correct treatment of interest from cumulative deposits in the hands of payer and payee?

Answer. This depends on the system of accounting. An assessee might choose with advantage to declare that income from year to year on accrual basis. However, the payer will deduct tax on the accumulated interest at the time of payment accords to section 194A in which case the assessee may have to ask for a refund.

Q.12. How far are Accounting Standards relevant in computation of business income?

Answer. Income for income-tax purposes is computed under ordinary principles of commercial accounting. Accounting Standards lay down such principles accepted by the profession and have even been made mandatory for purposes of company law. Hence they have great persuasive value.

Q.13. A taxpayer has changed his method of stock valuation. Statutory audi-tors did not agree to the change and have qualified the balance sheet. Assessing Officer relies upon the decision of Supreme Court in *British Paint's* case for rejecting the change. Is he justified in doing so?

Answer. What is required is that the change in the method of valuation should be bona fide and thereafter followed continuously.

In *Karnataka State Forest Industries Corporation Ltd.* v *CIT* High Court found that the Income-tax Officer cannot reject a change in the method of valuation of stock merely because statutory auditors objected to it.

Q.14. A firm replaces defective TV sets long after the guarantee period was over with a view to maintain goodwill of the firm. Cost of replacement is disallowed by the Assessing Officer. Is he right?

Answer. Since the outlay was incurred on grounds of commercial expediency the claim is admissible. The paragraph under "commercial expediency" (supra) would give necessary authorities for the same.

Q.15. Is a payment made to Life Insurance Corporation of India towards group gratuity fund deductible under section 36(1)(v), though it has not been routed through an approved gratuity fund?

Answer. The deduction need not be denied merely because a direct payment has been made as long as it is towards account of group gratuity fund. It was so decided in *CIT* v *Textool Co. Ltd.* In fact this would have even otherwise been allowed under sec. 37.

Q.16. Can dumpers used in contract work be classified as earth moving machinery?

Answer. Yes. They are entitled to depreciation and extra depreciation as earth moving machinery as held in *CIT* v *Abdulkarim Stone Contractor* . They are not road transport vehicles.

Q.17. What is meant by block asset?

Answer. Certain types of assets are grouped into one block and additions to the same will be treated as part of the block.

Q.18. What are the changes brought about by bringing in the concept of 'block asset' in evaluating cost for depreciation?

Answer. Each item of machineries is not separately considered for depreciation.

Where a particular capital asset or assets forming part of the block is sold, the dif-ference between the full value of the consideration on one hand and the WDV of the block asset, plus expenditure incurred in the transfer, plus value of any asset added to the block on the other hand is treated as short-term capital gains.(Sec. 50)

The idea was to give up the profit under section 41(2) as it stood then which repre-sented the amount of depreciation actually received. Earlier this amount was added as income and any excess above the depreciation was to be treated as capital gains as held in *CIT vs Artex Manufacturing Co.*

However section 41(2) has now been reintroduced with effect from 1.4.1998 but confined to power sector.

Q. 19. The assessee has a project report for a new venture carried out at the cost of Rs.5 lakhs. Assessing Officer disallows the same as the venture re-lates to a new business. Is the assessee eligible for deduction and if not, is he eligible for depreciation?

Answer. If the project report relates to an existing business for its expansion, it will be a revenue expenditure. But if it relates to a new business, it will be a capital expendi-ture eligible for depreciation as decided in *CIT* v *Harsha Tractor Ltd.'* following the decision in *Scientific Engineering House P. Ltd.* v *CIT.* After amendment to section 32(1) allowing depreciation on intangible assets from 1.4.1998, it is a matter of statu-tory right for the assessee to get depreciation not merely by treating such project report as a plant as under the pre-existing law but as an intangible asset on par with other tangible assets, so that the cost is entitled to depreciation like other intangible assets like know-how, patents, copyrights, trademarks, licence, franchise or any other business or commercial rights of similar nature.

Q.20. Where an airconditioning plant is fixed in a bus, would such airconditioner and bus be eligible for rates respectively applied to them?

Answer. Air-conditioning plant, which is an integral part of bus would not be entitled to rate of depreciation different from what is available for motor vehicles, where they are installed[1].

Q.21. Can fencing be treated as a plant?

Answer. No, it can be treated only as a building in the facts of the case[2].

Q.22. It is the normal practice of revenue to deduct all depreciation allowed including initial depreciation in arriving at the WDV. Is this correct?

Answer. According to Gujarat High Court, depreciation is referable to wear and tear. Initial depreciation being in the form of an incentive is not to be deducted.

Q.23. Where a wholly owned subsidiary company acquires depreciable assets from the holding company at market value, is it eligible for depreciation on such market value?

Answer. No. Explanation 6 to section 43(1) provides that in the case of acquisition of as-sets by a wholly-owned subsidiary from its holding company, the written down value of the holding company will be the actual cost to the subsidiary as held in *Dalmia Ceramic Industries Ltd.* v *CIT.*

Q.24. Could a road in a factory building used exclusively for industrial purpose be treated as a plant for purposes of depreciation?

Answer. Road could not be treated as a plant, but only as a building for purposes of depreciation.

Q.25. Where the assessee undertook gratuity liability of the vendor of the business as per agreement for sale, such liability is also consideration, so that it could be treated as part of the cost of assets entitled to depreciation. Is this correct?

Answer. Since the assessee has undertaken only a future liability, it cannot form part of the cost so as to be entitled to depreciation.

Q.26. Is it possible to capitalise expenditure as cost of the asset for purposes of depreciation?

Answer. Expenditure which has nexus with the asset can be treated as part of the cost of the asset. Cost of temporary electricity connection, power line and inspection fee relating thereto were held to be part and parcel of cost of machinery for purposes of depreciation.

Q.27. Are computers office equipments so as to be ineligible for investment allowance or additional depreciation?

Answer. 'Office equipment' has not been defined in the statute. What is barred is plant and machinery installed in office premises. Office premises have also not been defined. In case of a doctor, a clinic may be his office, but at the same time, it is also his place of practice. A computer is not ordinarily an office equipment like a typewriter or a duplicating machine. Computers are, therefore, eligible for investment allowance, when it was in vogue and additional depreciation.

Q.28. Lorry loaded cylinders, how classified for depreciation purposes?

Answer. Cylinders are eligible for 100 per cent, depreciation. But the Assessing Officer sought to treat it as a truck, when it was delivered after mounting it onto a truck, so as to be treated as part of truck eligible for depreciation only at 25 per cent. Since the chassis on which the cylinders were carried did not belong to the assessee and were taken only on hire, there was no justification for denying deduction for cylinders. In cylinders at 100 per cent. The same view was taken by the Madras High Court in respect of similar gas cylinders, where the argument was that the container part of the cylinders will have to be excluded, so as to limit the depreciation only to valves and regulators. This argument was found untenable following the decision of the Delhi High Court in *CIT* v *Goyal MG Gases Ltd. 's case* (supra).

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