PAPER

4

FINAL COURSE
STUDY MATERIAL
GROUP-II

DIRECT TAX LAWS & INTERNATIONAL TAXATION

MODULE 2 OF 4

[Direct Tax Laws as amended by the Finance Act, 2023]
Assessment Year 2024-25
Relevant for May, 2024 and November, 2024 Examinations

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CHAPTER 9

ASSESSMENT OF VARIOUS ENTITIES

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **compute** the total income of a company applying general provisions *vis-à-vis* special tax regimes under section 115BAA or 115BAB and determine the optimum tax liability;
- **advise** the company whether or not to opt for the special tax regime;
- **examine** whether alternate minimum tax (AMT) would be applied in the case of persons other than companies; and **compute** AMT and determine AMT credit to be carried forward;
- **compute** the total income of a firm and its tax liability; and **determine** the liability of partners of a firm and LLP on dissolution;
- **compute** total income and tax liability of a co-operative society applying general provisions *vis-à-vis* special tax regimes under section 115BAD or 115BAE and determine the optimum tax liability;
- **advise** the co-operative society whether or not to opt for the special tax regime;
- **compute** the total income of an individual, HUF, AOPs/BoIs as per the default regime under section 115BAC *vis-à-vis* normal provisions of the Income-tax Act, 1961 and determine the optimum tax liability;
- **examine** the incidence of taxation on mutual concerns.

CHAPTER OVERVIEW

Taxation of companies
- Total income and tax liability as per normal provisions of Act including MAT
- Total income and tax liability as per concessional tax regimes under section 115BAA or 115BAB, as the case may be

Special provisions relating to shipping companies

Alternate Minimum Tax for persons other than companies

Taxation of firms/LLPs and their partners

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- Default Regime u/s 115BAC
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- Taxation of HUF
- Taxation of AOPs/BOIs and their members

Taxation of Mutual Concerns

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9.1 TAXATION OF COMPANIES

(1) Meaning of 'Company' for purposes of income-tax

Under the Income-tax Act, 1961, the term "Company" has a much wider meaning than what has been given to it under the Companies Act. The company is considered as a 'person' for all purposes of assessment proceedings [Section 2(31)(iii)].

Section 2(17) of the Income-tax Act, 1961 defines a company for income-tax purposes. Accordingly, 'company' means –

(i) any Indian company as defined in section 2(26); or

(ii) any body corporate incorporated by or under the laws of a country outside India, i.e., any foreign company; or

(iii) any institution, association or body which is/was assessable or was assessed as a company for any assessment year under the Indian Income-tax Act, 1922 or for any assessment year commencing on or before 1.4.1970 under the present Act; or

(iv) any institution, association, or body, whether incorporated or not and whether Indian or non-Indian, which is declared by a general or special order of the CBDT to be a company.

Such institution, association etc. shall be deemed to be a company only for such assessment year(s) as may be specified in the CBDT's order.

(2) Classes of Companies

♦ **Domestic and Foreign Company:** Companies can be classified into two categories, viz. (1) Domestic company and (2) Foreign company.

(1) **Domestic company** means

- an Indian company **or**
- any other company, which, in respect of its income liable to tax, has made the prescribed arrangements for the declaration and payment of the dividends (including dividends on preferential shares) within India, payable out of such income [Section 2(22A)].

Indian Company [Section 2(26)] - A company has to satisfy the following two conditions so that it can be regarded as an Indian company –

(a) the company should have been formed and registered under Companies Act, 1956[1]

(b) the registered office or the principal office of the company should be in India.

The expression 'Indian Company' also includes the following provided their registered or principal office is in India:

(i) a company formed and registered under any law relating to companies formerly in force in any part of India [except Jammu and Kashmir, Goa[2], Dadra and Nagar Haveli, Daman and Diu and Pondicherry, wherein companies formed and registered under any law for the time being in force in the respective union territories are included in the definition];

(ii) a corporation established by or under a Central, State or Provincial Act (like Financial Corporation or a State Road Transport Corporation);

(iii) an institution or association or body which is declared by the CBDT to be a company under section 2(17)(iv);

Prescribed arrangements for the declaration and payment of dividends within India [Rule 27]: The arrangements referred to in sections 194 and 236 to be made by a company for declaration and payment of dividends (including dividends on preference shares) within India are as follows:

(i) The share register of the company concerned for all its shareholders shall be maintained regularly at its principal place of business within India in respect of any assessment year from a date not later than 1st April of such year.

(ii) The general meeting for passing the accounts of the previous year relevant to the assessment year and for declaring any dividends in respect thereof shall be held only at a place within India.

(iii) The dividends declared, if any, shall be payable only within India to all the shareholders.

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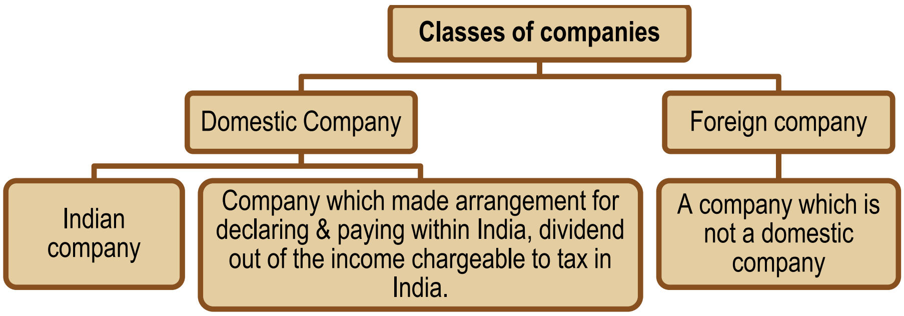
[1]The Companies Act, 2013

[2] Now State of Goa

It is obligatory for Indian companies to make the prescribed arrangements stated above; non-Indian companies will be treated as domestic companies only if they make the prescribed arrangements for the declaration and payment of dividends in India.

(2) **Foreign Company:** A company which is not a domestic company is a foreign company [Section 2(23A)].



- **Closely held and widely held Company:** Domestic companies are again divided into broad groups, viz

(1) companies in which public are substantially interested - 'Widely-held companies'

(2) companies in which public are not substantially interested - 'Closely held companies'

To determine whether a company is one in which the public are substantially interested, one has to apply the tests laid down in section 2(18). Briefly, the following companies fall under this category:

(i) A company owned by the Government (either Central or State but not Foreign) or the Reserve Bank of India (RBI) or in which not less than 40% of the shares are held by the Government or the RBI or corporation owned by that bank.

(ii) A company which is registered under section 25 of the Companies Act, 1956[3] (formed for promoting commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object and which prohibits payment of dividends to its members).

(iii) A company having no share capital which is declared by the CBDT for the specified assessment years to be a company in which the public are substantially interested.

(iv) A mutual benefit finance company which carries on its principal business of accepting deposits from its members and which is declared by the Central

[3]Section 8 of Companies Act, 2013

Government under section 620A of the Companies Act, 1956[4] to be Nidhi or a Mutual Benefit Society.

(v) A company whose equity shares (not being shares entitled to a fixed rate of dividend) carrying at least 50% of the voting power have been allotted unconditionally to or acquired unconditionally by and were beneficially held throughout the relevant previous year by one or more co-operative societies.

(vi) A company which is not a private company as defined in the Companies Act, 1956[5] and which fulfills any of the following conditions:

- its equity shares should have, as on the last day of the relevant previous year, been listed in a recognized stock exchange in India; or
- its equity shares carrying at least 50% (40% in case of an Indian company in ship construction business or in the manufacture or processing of goods or in mining or in generation or distribution of electricity or any other form of power) voting power should have been unconditionally allotted to or acquired by and should have been beneficially held throughout the relevant previous year by
  - (a) Government or
  - (b) a Statutory Corporation or
  - (c) a company in which public are substantially interested or
  - (d) any wholly owned subsidiary of company mentioned in (c).

Thus, all private limited companies will be treated as companies in which public are not substantially interested.

♦ **Relevance of the above classification:**

(1) The distinction between domestic and foreign companies is significant owing to, *inter alia*, the rates of tax.

Domestic companies are taxed at

- 25% - where total turnover or gross receipt in the previous year ***2021-22*** does not exceed ₹ 400 crore
- 30% - in any other case

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[4]Section 406 of Companies Act, 2013

[5] Section 2(68) of Companies Act, 2013

Foreign companies are be taxed at 40%. However, in respect of specified royalties and fees for technical services received from Government or an Indian concern in pursuance of an agreement, approved by the Central Government, made by the foreign company with the Government or Indian concern between 1.4.1961 and 31.3.1976 (in case of royalties) and between 1.3.1964 and 31.3.1976 (in case of FTS), the rate of tax is 50%.

Surcharge

Surcharge@7% of the tax payable is leviable in the case of domestic companies and @ 2% of tax payable in the case of foreign companies if the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore.

Surcharge@12% of the tax payable is leviable in the case of domestic companies and @5% of tax payable in the case of foreign companies if the total income exceeds ₹ 10 crore.

Option available with domestic companies to opt for concessional rates of tax specified under section 115BAA or 115BAB

Section 115BAA provides for concessional rate of tax **@22% (plus surcharge@10% and HEC@4%) for domestic companies**, subject to certain conditions, like non-availability of profit-linked deductions and investment-linked tax deduction under the Act, non-availability of deduction for contribution to research and development, additional depreciation etc.

Section 115BAB provides for concessional rate of tax **@15% (plus surcharge@10% plus HEC@4%) to new manufacturing or electricity generating domestic companies set up and registered on or after 1.10.2019, and commences manufacturing or generating electricity on or before 31.3.2024**, subject to certain conditions, like non-availability of profit-linked deductions and investment-linked tax deduction under the Act, non-availability of deduction for contribution to research and development, additional depreciation etc.

Domestic Companies **have to exercise the option** to be governed by these special provisions of the Act. The option for section 115BAB has to be exercised in the **very first year** in which the **eligible company is set up**, failing which it cannot exercise such option in the future years. However, a company eligible to exercise option u/s 115BAA can defer exercise of such option to a future year, if it is availing sizable profit-linked or investment-linked deductions or additional depreciation in the relevant previous year. However, once the company exercises such option under section 115BAA or 115BAB, as the case may be, in a year, it would continue to be governed by the special provisions u/s 115BAA or 115BAB, as the case may be, thereafter and cannot opt for regular provisions in any subsequent year.

It may be noted that companies exercising option under section 115BAA or section 115BAB are not liable to minimum alternate tax under section 115JB.

These two sections, namely sections 115BAA and 115BAB have been detailed in the upcoming paragraphs.

(2) The question as to whether a company is one in which public are substantially interested or not is relevant for application of certain provisions which are applicable only to closely held company.

There are certain special provisions which are applicable only to companies in which public are not substantially interested. Examples of such special provisions are as follows:

S. No.	Section	Provision
1	2(22)(e)	Advance or loan by a closely held company - deemed dividend
2	56(2)(viib)	Consideration received in excess of FMV of shares issued by a closely held company to be treated as income of such company, where shares are issued at a premium
3	68	Taxation of sum received by closely held company as share application money, share capital, share premium and the explanation offered by company is not satisfactory
4	79	Carry forward and set-off of losses in case of closely held companies
5	179	Liability of directors of private company

(3) 115BAB and 115BAA providing for concessional rate of tax in respect of certain domestic companies

Sections 115BAB and 115BAA provides for concessional rates of tax and exemption from minimum alternate tax (MAT) in respect of certain domestic companies. The provisions of these two new sections are tabulated hereunder –

(1)	(2)	(3)	(4)
	Particulars	**Section 115BAB**	**Section 115BAA**
1.	**Applicability**	Domestic manufacturing company/Electricity generation company	Any domestic company
2.	**Rate of tax**	15%	22%
3.	**Rate of surcharge**	10%	10%
4.	**Effective rate of tax (including surcharge & HEC)**	**17.16%** [Tax@15% (+) Surcharge@10% (+) HEC@4%]	**25.168%** [Tax@22% (+) Surcharge@10% (+) HEC@4%]
5.	**Applicability of MAT**	Not applicable	Not applicable
6.	**Manner of computation of tax liability**		
	Income on which concessional rate of tax is applicable	The rate of tax (i.e., **17.16%**) is applicable in respect of income derived from or incidental to manufacturing or production of an article or thing or generation of electricity. **[Read with point no. 11 below, wherein the rate of 34.32% (i.e., Tax@30% + surcharge@10% + HEC@4%) would be applicable in specified circumstance]**	The rate of tax (i.e., **25.168%)** is notwithstanding anything contained in the Income-tax Act, 1961, but subject to the provisions of Chapter XII, other than section 115BA and 115BAB.
	Rate of tax on income covered under Chapter XII [For example, long-term capital gains chargeable to tax u/s 112 and 112A, short-term capital gains chargeable to tax u/s 111A]	Such income would be subject to tax at the rates mentioned in the said sections in Chapter XII. Surcharge@10% would be levied on tax computed on such income. HEC@4% would be levied on the income-tax *plus* surcharge.	Such income would be subject to tax at the rates mentioned in the said sections in Chapter XII. Surcharge@10% is leviable on tax computed on such income. HEC@4% would be levied on the income-tax *plus* surcharge.

(1)	(2)	(3)		(4)
	Particulars	**Section 115BAB**		**Section 115BAA**
	Rate of tax on other income in respect of which no specific rate of tax is provided in Chapter XII	The applicable tax rate is **25.168% (i.e., tax@22%, *plus* surcharge @10% *plus* HEC@4%)**, if such income has neither been derived from nor is incidental to manufacturing or production of an article or thing or generating electricity (For example, income from house property and income from other sources). In respect of such income, **no deduction or allowance in respect of any expenditure or allowance** shall be allowed in computing such income.		The applicable tax rate is **25.168% (i.e., tax@22% *plus* surcharge@10% *plus* HEC@4%).** There is, however, **no restriction regarding claim of any deduction or allowance** permissible under the relevant provisions of the Act.
	Rate of tax on STCG derived from transfer of a capital asset on which no depreciation is allowable under the Act	The applicable rate of tax is **25.168% (i.e., tax@22%, *plus* surcharge@10% *plus* HEC@4%).** There is, however, no restriction regarding claiming of deduction or allowance in this regard.		The applicable rate of tax is **25.168% i.e., tax @22%, *plus* surcharge @10% *plus* cess@4%.** There is no restriction regarding claiming of deduction or allowance in this regard.
7.	**Conditions to be fulfilled for availing concessional rate of tax and exemption from MAT**			
	Conditions to be fulfilled for availing concessional rate of tax and exemption from MAT	(i)	The company should be **set-up and registered on or after 1.10.2019.**	No time limit specified. Both existing companies and new companies can avail benefit.
		(ii)	It should **commence manufacturing or production of an article or thing or business of generating electricity on or before 31.3.2024.**	Need not be a manufacturing or a production company
		(iii)	It should **not be formed by splitting up or the reconstruction of a business already in existence** (except in case of a company, business of	No similar condition has been prescribed

(1)	(2)	(3)		(4)
	Particulars	Section 115BAB		Section 115BAA
			which is formed as a result of the re-establishment, reconstruction or revival by the person of the business of any undertaking referred to in section 33B in the circumstances and within the period specified therein)	
		(iv)	It does **not** use any machinery or plant previously used for any purpose **[Refer Note at the end]**	No similar condition has been prescribed
		(v)	It does **not** use any building previously used as a hotel or a convention centre [meanings assigned in section 80-ID(6)] in respect of which deduction u/s 80-ID has been claimed and allowed.	No similar condition has been prescribed
		(vi)	It should **not** be engaged in any business other than the business of manufacture or production of any article or thing and research in relation to, or distribution of, such article or thing manufactured or produced by it. ***Note** – Business of manufacture or production of any article or thing does **not** include business of –* *(1) Development of computer software in any form or in any media* *(2) Mining* *(3) Conversion of marble*	No similar condition has been prescribed

(1)	(2)	(3)	(4)
	Particulars	**Section 115BAB**	**Section 115BAA**
		blocks or similar items into slabs *(4) Bottling of gas into cylinder* *(5) Printing of books or production of cinematograph films* *(6) Any other business as may be notified by the Central Govt. in this behalf.*	
		***Note** - If difficulty arises regarding fulfilment of conditions listed in (iv) to (vi) above, the CBDT may, with the approval of the Central Government, issue guidelines for the purpose of removing difficulty and to promote manufacturing or production of article or thing using new plant and machinery.* *Every guideline issued by the CBDT has to be laid before each House of Parliament, and shall be binding on the person, and the income-tax authorities subordinate to it.*	
8.	**Common conditions for both sections for availing the concessional rate of tax and exemption from MAT**	In case of a company opting for either section 115BAA or 115BAB, the total income should be computed - (i) without providing for deduction under any of the following sections:	

Section	Provision
10AA	Exemption of profits and gains derived from export of articles or things or from services by an assessee, being an entrepreneur from his Unit in SEZ.
32(1)(iia)	Additional depreciation @20%, as the case may be, of actual cost of new plant and machinery acquired and installed by manufacturing undertakings.

(1)	(2)	(3)			(4)
	Particulars	Section 115BAB			Section 115BAA
			33AB	Deduction@40% of profits and gains of business of growing and manufacturing tea, coffee or rubber in India, to the extent deposited with NABARD in accordance with scheme approved by the Tea/Coffee/Rubber Board.	
			33ABA	Deduction@20% of the profits of a business of prospecting for, or extraction or production of, petroleum or natural gas or both in India, to the extent deposited with SBI in an approved scheme or deposited in Site Restoration Account.	
			35(1)(ii)/ (iia)/(iii)	Deduction for payment to any research association, company, university etc. for undertaking scientific research or social science or statistical research.	
			35(2AA)	Deduction of payment to a National Laboratory or University or IIT or approved specified person for scientific research	
			35(2AB)	Deduction of in-house scientific research expenditure incurred by a company engaged in the business of bio-technology or in the business of manufacture or production of an article or thing.	
			35AD	Investment-linked tax deduction for specified businesses.	
			35CCC	Deduction of expenditure incurred on notified agricultural extension project	
			35CCD	Deduction of expenditure incurred by a company on notified skill development project.	
			80C to 80U	Deductions from gross total income under Chapter VI-A other than the provisions of section 80JJAA or section 80M.	
		(ii)	without set-off of any loss or allowance for unabsorbed depreciation deemed so u/s 72A, where such loss or depreciation is attributable to any of the deductions listed in (i) above [Such loss and depreciation would be deemed to have been already given effect to and no further deduction for such loss shall be allowed for any subsequent year]		

(1)	(2)	(3)	(4)
	Particulars	Section 115BAB	Section 115BAA
		(iii) by claiming depreciation u/s 32 determined in the prescribed manner (i.e., in respect of depreciation of any block of assets entitled to more than 40% shall be restricted to 40% on the written down value of such block of assets). However, additional depreciation u/s 32(1)(iia) cannot be claimed.	
		***Note* – *Additional points relevant in the context of section 115BAA*:** *(1) In case of a company opting for section 115BAA, total income should be computed without set-off of any loss carried forward or depreciation from any earlier assessment year, where such loss or depreciation is attributable to any of the deductions listed in (i) above [Such loss and depreciation would be deemed to have been already given effect to and no further deduction for such loss or depreciation shall be allowed for any subsequent year]* *(2) In the case of a person having a Unit in the IFSC, referred to in section 80LA(1A), which has exercised option for section 115BAA, deduction u/s 80LA would be allowed subject to fulfilment of the conditions specified in that section.* *(3) Since there is no time line within which option under section 115BAA can be exercised, a domestic company having brought forward losses and depreciation on account of deductions listed in (i) above may, if it so desires, postpone exercise the option under section 115BAA to a later assessment year, after set off of the losses and depreciation so accumulated.*	
9.	**Failure to satisfy conditions**	On failure to satisfy the conditions mentioned in point no. 7 and 8 above in any P.Y., the option exercised would be invalid in respect of the assessment year relevant to that previous year and subsequent assessment years; Consequently, the other provisions of the Act would apply to the person as if the option had not been exercised for the assessment year relevant to that previous year and subsequent assessment years.	On failure to satisfy the conditions mentioned in point no. 8 above in any P.Y., the option exercised would be **invalid** in respect of the assessment year relevant to that previous year and subsequent assessment years; Consequently, the other provisions of the Act would apply to the person as if the option had not been

(1)	(2)	(3)	(4)
	Particulars	**Section 115BAB**	**Section 115BAA**
		Note *– Where option exercised under section 115BAB is rendered invalid due to violation of conditions stipulated in point no.7 [(iv) to (vi)] above, such person may exercise option under section 115BAA.*	exercised for the assessment year relevant to that previous year and subsequent assessment years.
10.	**Availability of set-off of MAT credit brought forward from earlier years**	Since it is a new company, there would be no brought forward MAT credit	Brought forward MAT credit cannot be set-off against income u/s 115BAA. ***Note*** - *If a company has b/f MAT credit, it can first exhaust the MAT credit, and thereafter opt for section 115BAA in a subsequent previous year.*
11.	**Adjustments for transactions with persons having close connection**	If the Assessing Officer opines that the course of business between the company and any other person having close connection therewith is so arranged that the business transacted between them produces more than the ordinary profits to the company, he is empowered to take into account the amount of profits as may be reasonably deemed to have been derived therefrom, while computing profits and gains of such company.	No such requirement to make any adjustment
		In case the arrangement referred above involves a specified domestic transaction referred to in section 92BA, then, the amount of profits from such transaction would be determined by considering the arm's length price (ALP). **The amount, being profits in excess of the amount of the profits determined by the Assessing Officer, shall be deemed to be the income of the person.**	

(1)	(2)	(3)	(4)
	Particulars	**Section 115BAB**	**Section 115BAA**
		The income-tax on the income so deemed shall be subject to tax @ 34.32% (i.e., tax @ 30% + surcharge @10% +HEC @ 4%). ***Note*** *– The scope of "specified domestic transaction" referred to in section 92BA has been expanded to include within its ambit, any business transacted between such persons with close connection, where one such person is a company claiming benefit under section 115BAB.*	
12.	**Exercise of option by the company within the prescribed time**	The beneficial provisions of this section would apply only if option is exercised in the prescribed manner on or before the due date u/s 139(1) for furnishing **the first of the returns of income for any previous year** relevant to assessment year or any subsequent assessment year. Such option, once exercised, would apply to subsequent assessment years. Further, once the option has been exercised for any previous year, it **cannot be subsequently withdrawn** for the same or any other previous year. ***Notes*** *– (1) The option has to be exercised at the time of furnishing the* ***first of the returns of income*** *for any previous year. If a person fails to so exercise such option, it cannot be exercised thereafter for any subsequent previous year.* *(2) In case of amalgamation, the option exercised u/s 115BAB shall remain valid in the case of the amalgamated company only and if*	The beneficial provisions of this section would apply if option is exercised in the prescribed manner on or before the due date u/s 139(1) for furnishing the return of income for any previous year relevant to assessment year or any subsequent A.Y. Such option, once exercised, would apply to subsequent assessment years. Further, once the option has been exercised for any previous year, it **cannot be subsequently withdrawn** for the same or any other previous year. ***Note*** *– The option can be exercised even in a later year, but once exercised, cannot be withdrawn subsequently.*

(1)	(2)	(3)	(4)
	Particulars	**Section 115BAB**	**Section 115BAA**
		the conditions mentioned in point no. (7) and (8) are continued to be satisfied by such company.	*Further, where the person exercises option under section 115BAA, the option under section 115BA may be withdrawn.*

***Note** - For the purpose of point no.7(iv) in column (3) of the above table in relation to a company exercising option under section 115BAB, any machinery or plant which was used outside India by any other person shall not be regarded as machinery or plant previously used for any purpose, if all the following conditions are fulfilled, namely:—*

(a) such machinery or plant was not, at any time previous to the date of the installation, used in India;

(b) such machinery or plant is imported into India from any country outside India;

(c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of the Income-tax Act, 1961 in computing the total income of any person for any period prior to the date of installation of the machinery or plant by the person.

Further, where in the case of a person, any machinery or plant or any part thereof previously used for any purpose is put to use by the company and the total value of the machinery or plant or part so transferred does not exceed 20% of the total value of the machinery or plant used by the company, then, the condition specified that the company does not use any machinery or plant previously used for any purpose would be deemed to have been complied with.

(4) Minimum Alternate Tax on companies [Section 115JB]

(i) Applicability of MAT

As per section 115JB(1), in case of company (domestic or foreign), if the income-tax payable on the total income computed under the Income-tax Act, 1961 is ***less*** than, **15%** of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income-tax at the rate of **15%** (add surcharge, if applicable, i.e., 7% for domestic companies and 2% for foreign companies, where the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore, and 12% for domestic companies and 5% for foreign companies where the total income exceeds ₹ 10 crore). Further, health and education cess @ 4% shall be added on the aggregate of income-tax and surcharge.

(ii) Maintenance of statement of profit and loss [Section 115JB(2)]

(a) Every company other than a company referred to in section 115JB(2)(b) shall for the purpose of this section, prepare its statement of profit and loss for the relevant previous year in accordance with the provisions of Schedule III to the Companies Act, 2013 **[Section 115JB(2)(a)].**

(b) Insurance companies, banking companies, companies engaged in generation or supply of electricity or any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company, shall for the purposes of this section, prepare its statement of profit and loss for the relevant previous year in accordance with the provisions of the Act governing such company **[Section 115JB(2)(b)].**

(c) The section also specifies that the statement of profit and loss for the relevant previous year has to be drawn in accordance with Schedule III to the Companies Act, 2013. Further, while preparing the annual accounts-

(i) the accounting policies,

(ii) the accounting standards followed for preparing such accounts, including statement of profit and loss

(iii) the method and rates for calculating depreciation

shall be the same as have been adopted for the purpose of preparing such accounts including statement of profit and loss and laid before the company at its annual general meeting.

(d) Where the financial year adopted by the company under the Companies Act, 2013 is different from the previous year under the Income-tax Act, 1961, the accounting policies, accounting standards and methods and rates adopted for calculating depreciation shall correspond to the accounting policies followed for preparing such accounts including statement of profit and loss for the financial year.

(iii) Computation of book profit [*Explanation 1* below section 115JB(2)]

For computing the book profit, the **profit shall be increased** by the following amounts, if the amount referred in (a) to (i) is **debited to** the statement of profit and loss

(a) **Income-tax:** Income-tax paid or payable, and the provision therefor;

[It may be noted that income-tax includes –

(1) interest;

(2) surcharge;

(3) health and education cess (*Explanation 2* to section 115JB)].

(b) **Amount carried to Reserves:** Amount carried to any reserves, by whatever name called;

(c) **Provisions:** Amounts set aside to provisions for meeting liabilities other than ascertained liabilities;

(d) **Provisions for losses of subsidiary companies:** Amount of provision for losses of subsidiary companies;

(e) **Dividends:** Amount of dividends paid or proposed; or

(f) **Expenditure relatable to exempt income:** Amount of expenditure relatable to any income to which section 10 or sections 11 or 12 apply;

(fa) **Expenditure relatable to share of an assessee in the income of an AOP or BOI:** Amount of expenditure relatable to income, being share of the assessee in the income of an AOPs or BOIs, on which no income-tax is payable in accordance with the provisions of section 86;

(fb) **Expenditure relatable to income accruing to foreign company:** The amount or amounts of expenditure relatable to income accruing or arising to an assessee, being a foreign company, from –

(A) the capital gains arising on transactions in securities; or

(B) the interest, dividend, royalty, or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII i.e., section 115A

if the income-tax payable thereon in accordance with the provisions of the Act, other than the provisions of this Chapter, is at a rate less than **15%**;

(fc) **Notional loss on the units of business trust:** The amount representing-

- notional loss on transfer of a capital asset, being share of a special purpose vehicle to a business trust in exchange of units allotted by that trust; or
- notional loss resulting from any change in carrying amount of said units or
- loss on transfer of such units

(fd) **Amount of expenditure relatable to income referred under section 115BBF:** The amount or amounts of expenditure relatable to income by way of royalty in respect of patent chargeable to tax under section 115BBF;

(g) **Depreciation:** The amount of depreciation;

(h) **Deferred tax:** The amount of deferred tax and provision therefore;

(i) **Provision for diminution in the value of any asset:** The amount set aside as provision for diminution in the value of any asset.

(j) **Amount standing in the revaluation reserve:** The profit shall also be increased by the amount standing in revaluation reserve relating to the revalued asset on the retirement or disposal of such asset, in case the same is not credited to the profit and loss account.

(k) **Amount of gain arise on transfer units of business trust:** When units of business trust are actually transferred, the amount of gain on such transfer has to be added to compute the book profit, since notional gains on transfer of share of a special purpose vehicle to a business trust in exchange for the units of the business trust and notional gains resulting from change in carrying amount of such units would have been deducted to compute book profit. The amount of gain on such transfer, if any, credited to statement of profit and loss in the year of transfer will also be reduced.

In a case where the shares are carried at cost: The amount of gain has to be computed by taking into consideration the cost of shares exchanged with the units of the business trust.

In a case where the shares are carried at a value other than the cost through statement of profit and loss: The carrying amount of shares at the time of exchange would be taken into consideration for computing the amount of gain.

The profit shall be reduced by the following amounts:

(i) **Amount withdrawn from any reserve:** The amount withdrawn from any reserve or provision, if any such amount is credited to the statement of profit and loss.

However, the amount withdrawn from reserves/provisions shall not be reduced from the book profit unless the book profit of that year has been increased by those reserves/ provisions;

(ii) **Exempt income:** Amount of income to which section 10 or sections 11 or 12 apply, if such amount is credited to the statement of profit and loss;

(iia) **Depreciation:** The amount of depreciation debited to the statement of profit and loss (excluding the claim of depreciation on account of revaluation of assets);

(iib) **Amount withdrawn from the revaluation reserve:** The amount withdrawn from the revaluation reserve and credited to the statement of profit and loss, to the extent it does not exceed the amount of depreciation on revaluation of assets;

(iic) **Share of the assessee in the income of an AOPs or BOIs:** The amount of income, being the share of the assessee in the income of an AOPs or BOIs, on which no income-tax is payable in accordance with the provisions of section 86, if any such amount is credited to the statement of profit and loss;

(iid) **Income accruing to foreign company:** The amount of income accruing or arising to an assessee, being a foreign company, from, -

(A) the capital gains arising on transactions in securities; or

(B) the interest, dividend, royalty, or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII i.e., section 115A,

if such income is credited to the statement of profit and loss and the income-tax payable thereon in accordance with the provisions of the Income-tax Act, 1961 (including DTAAs), other than the provisions of Chapter XII-B, is at a rate less than **15%**.

For example, in case of foreign companies, dividend is taxable @20% as per section 115A. The adjustment in respect of dividend received by a foreign company on its investment in India and expenditure relatable thereto is required to be made for the purposes of calculation of book profit in case the tax payable on such dividend income is less than 15% on account of concessional tax rate provided in the applicable Double Taxation Avoidance Agreement (DTAA).

(iie) **Notional gain on the units of business trust:** The amount representing –

(A) the notional gain on transfer of a capital asset, being a share of a SPV to a business trust in exchange of units allotted by the business trust;

(B) notional gain resulting from any change in carrying amount of said units;

(C) gain on transfer of such units,

if any, credited to statement of profit and loss;

(iif) **Loss on transfer of units:** The amount of loss on transfer of units acquired in exchange of shares of SPV computed by taking into account the cost of the shares exchanged with the units, where the shares are carried at cost. In case shares are carried at a value other than cost through statement of profit and loss, the amount of loss on transfer of such units has to be computed by taking into account the carrying amount of the shares at the time of exchange;

(iig) **Income by way of royalty taxable under section 115BBF:** The amount of income by way of royalty in respect of patent chargeable to tax under section 115BBF;

(iih) **Brought forward loss and unabsorbed depreciation:** Aggregate amount of unabsorbed depreciation and loss brought forward in case of a –

(A) company, and its subsidiary and the subsidiary of such subsidiary, where, the Tribunal, on an application moved by the Central Government under section 241 of the Companies Act, 2013 has suspended the Board of Directors of such company and has appointed new directors who are nominated by the Central Government under section 242 of the said Act;

(B) company against whom an application for corporate insolvency resolution process has been admitted by the Adjudicating Authority under section 7 or section 9 or section 10 of the Insolvency and Bankruptcy Code, 2016.

It may be noted that loss does not include depreciation.

A company would be a subsidiary of another company if such other company holds more than half in the nominal value of equity share capital of the company.

(iii) **Brought forward loss or unabsorbed depreciation in case of other companies:** Amount of brought forward loss or unabsorbed depreciation, whichever is less, in case of other companies as per books of account.

The loss shall not include depreciation; if either the figure of brought forward loss or unabsorbed depreciation is "NIL", no deduction will be allowed from the book profit of the relevant year;

(vii) **Profits of sick industrial company:** The amount of profits of a sick industrial company (BIFR company) commencing from the previous year in which the company became sick and ending with the assessment year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses. For this purpose, "net worth" shall have the same meaning as assigned under section 3(1)(ga) of the Sick Industrial Companies (Special Provisions) Act, 1985.

(viii) **Deferred tax:** The amount of deferred tax, if any such amount is credited to the statement of profit and loss.

(iv) Computation of Book Profit for Ind AS compliant companies:

The Central Government has notified the Indian Accounting Standards (Ind AS) which are converged with International Financial Reporting Standards (IFRS) and prescribed the Companies (Indian Accounting Standards) Rules, 2015 which lay down the roadmap for implementation of these Ind AS.

As the book profit based on Ind AS compliant financial statements is likely to be different from the book profit based on existing Indian GAAP, sub-sections (2A), (2B) and (2C) of section 115JB provides the framework for computation of book profit for Ind AS compliant companies in the year of adoption and thereafter.

Adjustment in the book profit due to adoption of Ind AS

- Annual Adjustment [Section 115JB(2A) & (2B)]
- Transitional adjustments at the convergence date [Section 115JB(2C)]

I. MAT on Ind AS compliant financial statement [Section 115JB(2A)]

In case of a company whose financial statements are drawn up in compliance with the Indian Accounting Standards (Ind ASs) specified in Annexure to the Companies (Indian Accounting Standards) Rules, 2015, the following additional adjustments shall be done to the book profit as computed above in point no. (iii) as per section 115JB(2) read with *Explanation 1* -

(a) increased by all amounts credited to other comprehensive income in the statement of profit and loss under the head "Items that will not be re-classified to profit or loss";

(b) decreased by all amounts debited to other comprehensive income in the statement of profit and loss under the head "Items that will not be re-classified to profit or loss";

However, no adjustment shall be made where the amount credited or debited to other comprehensive income under the head "Items that will not be re-classified to profit or loss", in respect of —

(i) Revaluation surplus for assets in accordance with the Indian Accounting Standards 16 and Indian Accounting Standards 38; or

(ii) Gains or losses from investments in equity instruments designated at fair value through other comprehensive income in accordance with the Indian Accounting Standards 109. **[First proviso to section 115JB(2A)]**

However, the book profit of the previous year, in which such asset or investment is retired, disposed, realised or otherwise transferred, shall be increased or decreased, as the case may be, by the amount or the aggregate of the amounts as referred to in the first proviso for the previous year or any of the preceding previous years and relatable to such asset or investment **[Second proviso to section 115JB(2A)]**

The other comprehensive income (OCI) includes certain items that will permanently be recorded in reserves and hence, never be reclassified to the statement of profit and loss included in the computation of book profits. These items shall be included in book profit for MAT purposes at the point of time as specified below-

Sl. No	Items	Point of time
1	Changes in revaluation surplus of Property, Plant or Equipment (PPE) and Intangible assets (Ind AS 16 and Ind AS 38)	To be included in book profits at the time of realization/ disposal/ retirement or otherwise transferred
2	Gains and losses from investments in equity instruments designated at fair value through other comprehensive income (Ind AS 109)	To be included in book profits at the time of realization/ disposal/ retirement or otherwise transferred
3	Remeasurements of defined benefit plans (Ind AS 19)	To be included in book profits every year as the re-measurements gains and losses arise
4	Any other item	To be included in book profits every year as the gains and losses arise

(c) Increased by amounts or aggregate of the amounts debited to the statement of profit and loss on distribution of non-cash assets to shareholders in a demerger in accordance with Appendix A of the Indian Accounting Standards 10;

(d) Decreased by all amounts or aggregate of the amounts credited to the statement of profit and loss on distribution of non-cash assets to shareholders in a demerger in accordance with Appendix A of the Indian Accounting Standards 10;

> Appendix A of Ind AS 10 provides that any distributions of non-cash assets to shareholders in a demerger shall be accounted for at fair value. The difference between the carrying value of the assets and the fair value is recorded in the statement of profit and loss.
>
> Correspondingly, the reserves are debited at fair value to record the distribution as a 'deemed dividend' to the shareholders. As there is a corresponding adjustment in retained earnings, this difference arising on demerger shall be excluded from the book profits.

II. **In case of demerger [sub-section (2B)]:** In the case of a resulting company, the property and the liabilities of the undertaking or undertakings being received by it are recorded at values different from values appearing in the books of account of the demerged company immediately before the demerger, any change in such value shall be ignored for the purpose of computation of book profit of the resulting company under this section.

III. **MAT on first time adoption [Section 115JB(2C)]:**

In case of Ind AS compliant company, the book profit of the year of convergence and each of the following four previous years, shall be further increased or decreased, as the case may be, by one fifth of the **transition amount**.

> In the first year of adoption of Ind AS, the companies would prepare Ind AS financial statement for reporting year with a comparative financial statement for immediately preceding year. As per Ind AS 101, a company would make all Ind AS adjustments on the opening date of the comparative financial year. The entity is also required to present an equity reconciliation between previous Indian GAAP and Ind AS amounts, both on the opening date of preceding year as well as on the closing date of the preceding year.
>
> For the purposes of computation of book profits of the year of adoption and for adjustments, the amounts adjusted as on the opening date of the first year of adoption shall be considered.

Example: Companies which adopt IndAS with effect from 1 April 2023 are required to prepare their financial statements for the year 2023-24 as per the requirements of Ind AS. Such companies are also required to prepare an opening balance sheet as of 1st April 2022 and restate the financial statements for the comparative period 2022-23.

In such a case, the first-time adoption adjustments as of 31 March 2023 shall be considered for computation of MAT liability for previous year 2023-24 (Assessment year 2024-25) and thereafter.

Further, in this case, the five years period shall be previous years 2023-24, 2024-25, 2025-26, 2026-27 and 2027-28.

However, the book profit of the previous year in which the asset or investment referred to in sub clauses (B) to (E) of clause (iii) of the *Explanation* is retired, disposed, realised or otherwise transferred shall be increased or decreased, as the case may be, by the amount or the aggregate of the amounts referred to in the said sub-clause relatable to such asset or investment **[First proviso to section 115JB(2C)].**

Further, the book profit of the previous year in which the foreign operation referred to in sub clause (F) of clause (iii) of the *Explanation* is disposed or otherwise transferred, shall be increased or decreased, as the case may be, by the amount or the aggregate of the amounts referred to in the said sub-clause relatable to such foreign operations **[Second proviso to sub-section (2C)].**

Meaning of certain terms [*Explanation* to Section 115JB(2C)]

Clause	Term	Meaning
(i)	**Year of convergence**	the previous year within which the convergence date falls.
(ii)	**Convergence date**	the first day of the first Indian Accounting Standards reporting period as defined in the Ind AS 101.
(iii)	**Transition amount**	the amount or aggregate of the amounts adjusted in other equity (excluding capital reserve and securities premium reserve) on convergence date but not including the following: (A) Amount or aggregate of the amounts adjusted in the other comprehensive income on the convergence date which

		shall be subsequently re-classified to the profit and loss; (B) Revaluation surplus for assets in accordance with the Indian Accounting Standards 16 and Indian Accounting Standards 38 adjusted on the convergence date; (C) Gains or losses from investments in equity instruments designated at fair value through other comprehensive income in accordance with the Indian Accounting Standards 109 adjusted on the convergence date; (D) Adjustments relating to items of property, plant and equipment and intangible assets recorded at fair value as deemed cost in accordance with paragraphs D5 and D7 of the Indian Accounting Standards 101 on the convergence date; (E) Adjustments relating to investments in subsidiaries, joint ventures and associates recorded at fair value as deemed cost in accordance with paragraph D15 of the Indian Accounting Standards 101 on the convergence date; and (F) Adjustments relating to cumulative translation differences of a foreign operation in accordance with paragraph D13 of the Indian Accounting Standards 101 on the convergence date.

Transitional adjustments: Analysis		
(i)	The adjustments arising on account of transition to Ind AS from existing Indian GAAP is required to be recorded directly in Other Equity at the date of transition to Ind AS. These adjustments have to be made in the following manner:	
	(a)	The book profit of the year of convergence and the following four previous years shall be increased or decreased with the transitional adjustments recorded directly in Other Equity excluding capital reserve and securities premium reserve and excluding the amounts referred in (A) to (F) (in the definition of Transition Amount), on the convergence date.

(b) Those adjustments recorded in other comprehensive income referred in (A) above (in the definition of Transition Amount) and which would subsequently be reclassified to the profit and loss, shall be included in book profits in the year in which these are reclassified to the profit and loss, therefore these amounts are excluded from the transition amount.

(c) Those adjustments recorded in other comprehensive income referred in (B) and (C) (in the definition of Transition Amount) above and which would never be subsequently reclassified to the profit and loss shall be included in book profits as specified hereunder:

Sl. No	Items	Point of time
1	Changes in revaluation surplus of Property, Plant or Equipment (PPE) and Intangible assets (Ind AS 16 and Ind AS 38)	To be included in book profits at the time of realisation/ disposal/ retirement or otherwise transferred
2	Gains and losses from investments in equity instruments designated at fair value through other comprehensive income (Ind AS 109)	To be included in book profits at the time of realisation/ disposal/ retirement or otherwise transferred
3	Remeasurements of defined benefit plans (Ind AS 19)	To be included in book profits every year as the re-measurements gains and losses arise
4	Any other item	To be included in book profits every year as the gains and losses arise

(d) The other adjustments referred in (D), (E) and (F) (in the definition of Transition Amount) above shall be made in the following manner:

(I) **Property, Plant and Equipment (PPE) and intangible assets at fair value as deemed cost [referred in (D)(in the definition of Transition Amount) above]**

An entity may use fair value in its opening Ind AS Balance Sheet as deemed cost for an item of PPE or an intangible asset as mentioned in paragraphs D5 and D7 of Ind AS 101. In such cases the treatment shall be as under—

- The existing provisions for computation of book profits under section 115JB of the Act provide that in case of revaluation of assets, any impact on account of such revaluation shall be ignored for the purposes of computation of book profits.

			Further, the adjustments in retained earnings on first time adoption with respect to items of PPE and Intangible assets shall be ignored for the purposes of computation of book profits. • Depreciation shall be computed ignoring the amount of aforesaid retained earnings adjustment. Similarly, gain/loss on realization/ disposal/ retirement of such assets shall be computed ignoring the aforesaid retained earnings adjustment.
		II.	**Investments in subsidiaries, joint ventures and associates at fair value as deemed cost [referred in (E)(in the definition of Transition Amount) above]** An entity may use fair value in its opening Ind AS Balance Sheet as deemed cost for investment in a subsidiary, joint venture or associate in its separate financial statements as mentioned in paragraph D15 of Ind AS 101. In such cases retained earnings adjustment shall be included in the book profit at the time of realisation of such investment.
		III.	**Cumulative translation differences [referred in (F) (in the definition of Transition Amount) above]** • An entity may elect a choice whereby the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to Ind AS. Further, the gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to Ind AS and shall include only the translation differences after the date of transition. • In such cases, to ensure that such Cumulative translation differences on the date of transition which have been transferred to retained earnings, are taken into account, these shall be included in the book profits at the time of disposal of foreign operations as mentioned in paragraph 48 of Ind AS 21.
(ii)	All other adjustments to retained earnings (recorded as other equity) at the time of transition (including for example, Decommissioning Liability, Asset retirement obligations, Foreign exchange capitalisation/decapitalization, Borrowing costs adjustments etc.) shall be included in book profits, equally over a period of five years starting from the year of first time adoption of Ind AS.		
(iii)	Section 115JB of the Act already provides for adjustments on account of deferred tax and its provision. Any deferred tax adjustments recorded in Reserves and Surplus on account of transition to Ind AS shall also be ignored.		

(v) Clarifications on computation of book profit for the purposes of levy of Minimum Alternate Tax (MAT) under section 115JB of the Income-tax Act, 1961 for Ind AS compliant companies [Circular No. 24/2017[6] dated 25.07.2017]

After amendment in section 115JB for computation of book profit for the purposes of levy of Minimum Alternate Tax (MAT) for Indian Accounting Standards (Ind AS) compliant companies, CBDT received representations from various stakeholders seeking clarifications on certain issues arising therefrom.

Accordingly, the CBDT has vide this circular, clarified these issues by way of the following FAQs:

Question 1: *The profit for the period may include Marked to market (MTM) gains/ losses on account of fair value adjustments on various financial instruments recognised through profit or loss (FVTPL). A situation may arise where the losses on account of fair value adjustments could be added back in view of clause (i) of Explanation 1 to section 115JB(2) of the Act. Whether the losses on such instruments require any adjustment for computing book profits for the purposes of MAT?*

Answer: Since MTM gains recognised through profit or loss on FVTPL classified financial instruments are included in book profits for MAT computation, it is clarified that MTM losses on such instruments recognised through profit or loss shall not require any adjustments as provided under clause (i) of *Explanation 1* to section 115JB(2) of the Act. However, in case of provision for diminution/ impairment in value of assets other than FVTPL financial instruments, the existing adjustment of clause (i) of *Explanation 1* to section 115JB (2) of the Act shall apply.

It is further clarified that for financial instruments where gains and losses are recognised through Other Comprehensive income (OCI), the amended provisions of MAT shall continue to apply.

Question 2: *For the purposes of section 115JB of the Act, what shall be the starting point for computing Book profits for Ind AS compliant companies? Whether Profit before other comprehensive income [Item number XIII in Part 2 (Statement of Profit and Loss) of Division II of Schedule III to the Companies Act 2013] or Total Comprehensive Income (including other comprehensive income) [Item number XV in Part 2 (Statement of Profit and Loss) of Division II of Schedule III to the Companies Act 2013] shall be the starting point?*

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[6] *The year in the FAQs have been modified considering that the transition to Ind AS is taking place in the P.Y. 2023-24.*

Answer: Starting point for computing Book profits for Ind AS compliant companies shall be Profit before other comprehensive income [Item number XIII in Part 2 (Statement of Profit and Loss) of Division II of Schedule III to the Companies Act 2013].

Question 3: *As per Explanation to Section 115JB(2C) of the Act, the convergence date is defined as the first day of the first Indian Accounting standards reporting period as defined in Ind AS 101. The Memorandum explaining the provisions of the Finance Bill 2017 mentions that the adjustment as on the last day of the comparative period is to be considered. It may be clarified as to what would be the appropriate manner for computation of transition amount on convergence date, 1st April i.e., at the start of the day or at the end of the day?*

Answer: In the first year of adoption of Ind AS, the companies would prepare Ind AS financial statement for reporting year with a comparative financial statement for immediately preceding year. As per Ind AS 101, a company would make all Ind AS adjustments on the opening date of the comparative financial year. The entity is also required to present an equity reconciliation between previous Indian GAAP and Ind AS amounts, both on the opening date of preceding year as well as on the closing date of the preceding year. The amounts as on start of the opening date of the first year of adoption should be considered for the purposes of computation of transition amount.

For example, companies which adopt Ind AS with effect from 1st day of April 2023 are required to prepare their financial statements for the year 2023-24 as per requirements of Ind AS. Such companies are also required to prepare an opening balance sheet as of 1st day of April 2022 and restate the financial statements for the comparative period 2022-23. In such a case, the first time adoption adjustments as of 31st day of March 2023 should be considered [i.e. the start of business on 1st day of April 2023 (or, equivalently, close of business on 31st day of March 2023)] for computation of MAT liability for previous year 2023-24 (Assessment year 2024-25) and thereafter.

Question 4: As per Indian GAAP, proposed dividend was required to be recognized in the financial statements for the year for which it pertained to even though these were declared in the subsequent year. Section 115JB of the Act already provides for adjustments for dividend for computation of book profit. As per Ind AS, the amount of proposed dividend is required to be recognized in the year in which it has been declared rather than the year for which it pertains to. Accordingly, on transition to Ind AS, the amount of proposed dividend for FY 2022-23 which was recognized in profit and loss account in FY 2022-23 is required to be reversed and credited to Retained Earnings. For the computation of MAT, whether these balances would form part of the transition amount and thus be adjusted over a period of 5 years?

Answer: Adjustment of proposed dividend shall not form part of the transition amount.

Question 5: *Under Ind AS, adjustments on the transition date may have a corresponding impact on deferred taxes. Should the deferred taxes on such amounts be considered for the purpose of transition amount?*

Answer: Any deferred taxes adjustments recorded on the transition date shall be ignored for the purpose of computing Transition Amount.

Question 6: *As mentioned in Question No.1, clause (i) of Explanation 1 to Section 115JB(2) of the Act provides for adjustments for computation of book profit for the amount or amounts set aside as provision for diminution in the value of any asset. Convergence date adjustments may include adjustment for Provision for Bad and Doubtful Debts (Expected Credit Loss adjustment) at the time of transition. Whether these adjustments would form part of the transition amount referred to in section 115JB(2C) of the Act?*

Answer: Adjustments relating to provision for diminution in the value of any assets other than the ones mentioned in Question Number 1 above, shall not be considered for the purpose of computation of the Transition Amount. Therefore, adjustments relating to provision for doubtful debts shall not be considered for the purpose of computation of the transition amount.

Question 7: *Under Section 115JB of the Act, transition amount has been defined as the amount or the aggregate of the amounts adjusted in the 'Other Equity' (excluding capital reserve and securities premium reserve) on the convergence date. Whether changes in share application money on reclassification to 'Other Equity' would form part of the Transition Amount?*

Answer: Share application money pending allotment which is reclassified to Other Equity on transition date shall not be considered for the purpose of computing Transition Amount.

Question 8: *Under Ind AS, Investments in preference share is considered to be a liability and the corresponding dividend expense is debited to Profit and loss account as interest cost. Should such interest expenses on preference shares be deducted for the purpose of MAT computation?*

Answer: For the purpose of computation of MAT, profit/Transition Amount shall be increased by dividend/interest on preference share (including dividend distribution taxes) whether presented as dividend or interest.

Question 9: *How do we account for items such as equity component, if any, of financial instruments like Non-Convertible debentures (NCDs), Interest free loan etc. included in other equity as per Ind AS for the computation of transition amount under MAT?*

Answer: Items such as equity component of financial instruments like NCD's, Interest free loan etc. would be included in the Transition Amount.

Question 10: *Where revaluation/fair value adjustments have been made to items of Property, Plant & Equipment (PPE) under Ind AS, as per section 115JB of the Act, the book profit of the previous year in which the items of PPE are retired, disposed or realised shall be increased or decreased, as the case may be, by the revaluation amount relatable to such items of PPE. Whether the revaluation amount to be considered for adjustment should be the gross amount of the revaluation or the amount after adjustment of the depreciation on the revaluation amount?*

Answer: The book profit of the previous year in which the items of PPE are retired, disposed, realised or otherwise transferred shall be increased or decreased, as the case may be, by the revaluation amount after adjustment of the depreciation on the revaluation amount relatable to such asset. This has been explained by an illustration as under:

Particulars	*Erstwhile Indian GAAP*	*Ind-AS (considering fair value/ revaluation adjustment on PPE)*	*Fair Value/ Revaluation Adjustments and corresponding depreciation*
WDV/Deemed Cost as on 1 April 2021	*100*	*1000*	*900*
Depreciation @10% for F.Y. 2021-22	*10*	*100*	*90*
WDV as on 1 April 2022	*90*	*900*	*810*
Depreciation @10% for F.Y. 2022-23	*9*	*90*	*81*
WDV as on 1 April 2023	*81*	*810*	*729**
Sale value as on 1 April 2023	*900*	*900*	
Profit on sale credited to P&L	*819*	*90*	
Adjustment for MAT - revaluation amount after adjustment of the depreciation	*0*	*729**	
Profit on sale to be considered for MAT	***819***	***819***	

Question 11: *How should adjustments for service concession arrangements be treated for the purpose of computation of book profit under MAT?*

Answer: Adjustments on account of Service Concession arrangements would be included in the Transition Amount and also on an ongoing basis.

Question 12: *Existing clause (iii) of explanation to section 115JB(2) of the Act provides for deduction of lower of the amount of loss brought forward or unabsorbed depreciation as per books of account for computation of book profits. In case where, on adjustment of transition amount, the losses as per books of account gets wiped off, whether deduction for the said amount would be available for assessment year 2024-25 onwards?*

Answer: For assessment year 2024-25, the deduction of lower of depreciation or losses shall be allowed based on the position as on 31 March 2023. For the subsequent periods, the position as per books of account drawn as per Ind AS shall be considered for computing lower of loss brought forward or unabsorbed depreciation.

Question 13: *How Capital Reserves or Securities Premium existing as per old Indian GAAP reclassified to Retained Earnings/ Other Reserves on Convergence date be treated for MAT purpose.*

Answer: The Capital Reserves or Securities Premium existing as on the convergence date as per the erstwhile Indian GAAP which are reclassified to Retained Earnings/ Other Reserves under Ind AS and vice versa, shall not be considered for the purposes of Transition Amount.

It is further clarified, that even after such reclassifications, the amount of revaluation reserve shall continue to be considered as revaluation reserve for the purposes of computation of book profit and shall also include transfer to any other reserves by whatever name called or capitalised.

Question 14: *Companies which follow accounting year other than March 2024 ending for Companies Act purposes and are required to transition to Ind AS will have to prepare financial statements for MAT purposes for FY 2023-24 partly under Indian GAAP and partly under Ind AS. How should such companies compute MAT on transition to Ind AS?*

Answer: In view of second proviso to section 115JB(2) of the Act, companies will be required to follow Indian GAAP for the pre-convergence period and Ind AS for the balance period.

For example, a Company following December ending will be required to prepare, accounts for MAT purposes under Indian GAAP for 9 months upto December 2023 and under Ind AS for 3 months thereafter. The transition amount will be calculated with reference to 1st January 2024.

(vi) Adjustment in tax payable on book profit u/s 115JB(1) on account of Advance Pricing Agreement (APA) under section 92CC or secondary adjustment under section 92CE [Section 115JB(2D)]: Where there is an increase in book profit of the previous year due to inclusion of past year(s) income in books of account on account of

(1) an APA entered into by the assessee under section 92CC; or

(2) secondary adjustment, required to be made under section 92CE, and

the assessee makes an application to the Assessing Officer in this behalf, the Assessing Officer shall recompute

- the book profit of the past year or years and
- tax payable, if any, by the assessee during the previous year under section 115JB(1),

in such manner as may be prescribed.

In such case, the provisions of section 154 [i.e., rectification of mistake apparent from record] would apply; and the period of four years would be reckoned from the end of the financial year in which the said application is received by the Assessing Officer.

Accordingly, Rule 10RB(1) has been inserted to provide that the tax payable by the assessee company under section 115JB(1), for the previous year, shall be reduced by the following amount:

(A-B) – (D-C)	
A	tax payable by the assessee company under section 115JB(1) on the book profit of the previous year including the past income. However, where no tax is payable under section 115JB(1) on book profit of that previous year including past income, the value of A would be deemed to be zero.
B	tax payable by the assessee company under section 115JB(1) on the book profit of the previous year after reducing the book profit with the past income. However, where no tax is payable under section 115JB(1) on the resultant figure, the value of B would be deemed to be zero.
C	Aggregate of tax payable by the assessee company under section 115JB(1) on the book profit of those past year or years to which the past income belongs. However, where no tax is payable under section 115JB(1) on the book profit of that year or years, the tax payable for that year or years would be deemed to be zero.

D	Aggregate of tax payable by the assessee company under section 115JB(1) on the book profit of past year or years, referred to in item C, after increasing the book profit with the relevant past income of such year or years. However, where no tax is payable under section 115JB(1) on the amount so increased, the tax payable for that year or years would be deemed to be zero.
It may be noted that if the value of (A-B)-(D-C) in the formula is negative, its value would be deemed to be zero.	
Meaning of past income [Rule 10RB(2)]	Past income means the amount of income of past year or years included in the book profit of the previous year on account of an APA entered into by the assessee under section 92CC or on account of secondary adjustment required to be made under section 92CE.
MAT credit to be reduced [Rule 10RB(3)]	The tax credit allowed to the assessee under section 115JAA would be reduced by the amount which is equal to the amount of reduction that has been allowed under Rule 10RB(1).

The adjustment in the book profit shall be made only if the assessee has not utilised the credit of tax paid in any subsequent assessment year under section 115JAA.

The provisions of this sub-section have been inserted w.e.f. A.Y. 2021-22. However, these provisions would also be applicable for the A.Y. 2020-21 or any earlier assessment year. However, no interest shall be payable to such assessee on the refund arising on account of re-computation of book profits of the previous year.

(vii) Compulsory filing of return of income and furnishing of report from Chartered Accountant

The section also provides that every company to which this section applies shall furnish, a report from a chartered accountant certifying that the book profit has been computed in accordance with the provisions of this section, on or before the specified date referred to in section 44AB (i.e., one month prior to the due date for filing return of income) or in response to a notice under section 142(1)(i), [Section 115JB(4)].

(viii) Allowability of carry forward of losses

In respect of the relevant previous year, the amounts determined under the provisions of section 32(2) or section 72(1)(ii) or section 73 or section 74 or section 74A(3), shall be allowed to be carried forward [Section 115JB(3)].

(ix) Applicability of other provisions of the Act

All other provisions of the Act shall apply to every assessee, being a company mentioned in this section [Section 115JB(5)].

(x) Non-applicability of MAT [Section 115JB(5A)].

The provisions of MAT u/s 115JB shall not apply

- to any income accruing or arising to a company from life insurance business referred to in section 115B.
- a company who has exercised the option under section 115BAA or section 115BAB.

(xi) Non-applicability of MAT in respect of certain foreign companies

Explanation 4 to section 115JB(2) with retrospective effect from 01.04.2001 provides for non-applicability of levy of MAT under section 115JB in the following cases:

	Existence of DTAA with the country of residence of the foreign company	Additional condition to be satisfied for non-applicability of MAT
(i)	The foreign company is a resident of a country or a specified territory with which India has a DTAA under section 90(1) or the Central Government has adopted any agreement between specified associations for double taxation relief under section 90A(1)	It should not have a permanent establishment in India in accordance with the provisions of such Agreement
(ii)	The foreign company is a resident of a country with which India does not have an agreement of the nature referred to in clause (i) above	It is not required to seek registration under any law for the time being in force relating to companies.

Explanation 4A to section 115JB has been inserted with retrospective effect from 01.04.2001 to clarify that MAT provisions shall not be applicable to an assessee, being a foreign company, where its total income comprises solely of profits and gains from business referred to in section 44B or section 44BB or section 44BBA or section 44BBB and such income has been offered to tax at the presumptive rates specified in these sections.

(xii) Concessional rate of MAT for unit located in IFSC

In case of a company, being a unit located in International Financial Services Centre and deriving its income solely in convertible foreign exchange, the minimum alternate tax shall be chargeable at the rate of 9% instead of 15%. [Section 115JB(7)]

ILLUSTRATION 1

A domestic company, ABC Ltd., furnishes the following particulars in respect of Assessment Year 2024-25 and seeks your opinion on the application of section 115JB. You are also required to compute the total income and tax payable.

(1)	*Profits as per Statement of profit and loss as per the Companies Act, 2013*			*₹ 215 Lakhs*
(2)	*Statement of Profit and Loss includes:*			
	(a)	*Credits:*	*Dividend income from Indian companies*	*₹ 20 Lakhs*
			Excess realized on sale of land held as investment	*₹ 30 Lakhs*
	(b)	*Debits:*	*Depreciation on straight line method basis*	*₹ 100 Lakhs*
			Provision for loss of subsidiary company	*₹ 60 Lakhs*
(3)	*Depreciation allowable as per the Income-tax Rules, 1962*			*₹ 150 Lakhs*
(4)	*Short term capital gains on sale of land mentioned above as computed under Income-tax Act, 1961*			*₹ 40 Lakhs*
(5)	*Losses brought forward as per books of account and as per Income-tax Act, 1961:*			
	Business loss			*₹ 50 Lakhs*
	Unabsorbed depreciation			*₹ 60 Lakhs*

You will have to deal with this issue assuming that ABC Ltd. is not required to comply with the Indian Accounting Standards. Ignore the provisions of section 115BAA.

Note - *The turnover of ABC Ltd. for the P.Y. 2021-22 was ₹ 390 crore.*

SOLUTION

In the case of a company, it has been provided that where tax @ 15% of book profit exceeds tax on total income computed as per normal provisions, the book profit shall be deemed to be the total income for tax purposes.

It is therefore necessary to compute total income as per Income-tax Act, 1961 as well as book profits.

I. Computation of Total Income as per the normal provisions of the Income-tax Act, 1961

Particulars	₹ (in Lakhs)	
Net profit as per statement of profit and loss		215
Add: Depreciation debited to statement of profit and loss	100	
Provision for losses of subsidiary company	60	160
		375
Less: Dividend income from Indian companies	20	
Excess realized on sale of land (considered separately)	30	

Depreciation allowable as per Income-tax Rules, 1962	150	200
Business Income		175
Less: Set-off of brought forward business loss		50
		125
Capital gains (Short term capital gains)		40
Income from other sources (Dividend income chargeable to tax in the hands of shareholders)		20
		185
Less: Set-off of unabsorbed depreciation		60
Total Income as per Income-tax Act, 1961		**125**

II. Computation of book profit under section 115JB

Particulars	(₹ in Lakhs)	
Net profit as per statement of profit and loss		215
Add: Provision for loss of subsidiary		60
Depreciation as per books of account		100
		375
Less: Depreciation as per books of account	100	
Business loss which is less than unabsorbed depreciation	50	150
"Book Profit"		**225**

III. Computation of tax liability under the normal provisions of the Income-tax Act, 1961

Total income as per the Income-tax Act, 1961 is ₹ 125 lakhs,

Particulars	₹
Tax payable ₹ 125 lakhs @25% since the turnover of the company for the previous year 2021-22 ≤ ₹ 400 crore.	31,25,000
Add: Surcharge @ 7%	2,18,750
	33,43,750
Add: Health and education cess @4%	1,33,750
Total Tax payable	**34,77,500**

IV. Computation of Minimum Alternate Tax

Particulars	₹
Tax @ 15% of book profit of ₹ 225 lakhs	33,75,000
Add: Surcharge @ 7%	2,36,250
	36,11,250
Add: Health and education cess@4%	1,44,450
Minimum Alternate Tax payable	**37,55,700**

Since 15% of book profit exceeds the tax payable as per normal provisions of the Income-tax Act, 1961, the book profit of ₹ 225 lakhs would be deemed to be the total income and the tax payable on such total income shall be 15% thereof i.e., ₹ 33,75,000 *plus* surcharge @7% being ₹ 2,36,250 *plus* health and education cess @4% (of tax and surcharge) being ₹ 1,44,450. Total tax liability would be ₹ 37,55,700.

ILLUSTRATION 2

Maitri Jeans (P) Ltd. is in the business of manufacturing jeans. For the assessment year 2024-25, it paid tax@15% on its book profit computed under section 115JB. The Assessing Officer though satisfied that it is liable to pay book profit tax under section 115JB, wants to charge interest under sections 234B and 234C as no advance tax was paid during the financial year 2023-24. The company seeks your opinion on the proposed levy of interest.

SOLUTION

The issue under consideration is whether interest under sections 234B and 234C can be levied where a company is assessed on the basis of its book profit under section 115JB.

The Supreme Court, in *Joint CIT v. Rolta India Ltd. (2011) 330 ITR 470*, observed that there is a specific provision in section 115JB(5) providing that all other provisions of the Income-tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section. Section 115JB is a self-contained code pertaining to MAT, and by virtue of sub-section (5) thereof, the liability for payment of advance tax would be attracted.

According to section 207, tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219 (both inclusive), in respect of the total income of the assessee which would be chargeable to tax for the assessment year immediately following that financial year.

Under section 115JB(1), where the tax payable on total income is less than 15% of "book profit" of a company, the "book profit" would be deemed to be the total income and tax would be payable at the rate of 15%.

Since in such cases, the book profit is deemed to be the total income, therefore, as per the provisions of section 207, tax shall be payable in advance in respect of such book profit (which is deemed to be the total income) also.

Therefore, if a company defaults in payment of advance tax in respect of tax payable under section 115JB, it would be liable to pay interest under sections 234B and 234C.

Therefore, even though Maitri Jeans (P) Ltd. is assessed on the basis of its book profit under section 115JB for A.Y.2024-25, it is liable to pay advance tax. Since Maitri Jeans (P) Ltd. has not paid any advance tax during the financial year 2023-24, the levy of interest under section 234B and 234C is valid.

ILLUSTRATION 3

Sona Ltd., a resident company, earned a profit of ₹ 15 lakhs after debit/credit of the following items to its Statement of Profit and Loss for the year ended on 31/03/2024.

(i) Items debited to Statement of Profit and Loss:

No.	Particulars	₹
1.	*Provision for the loss of subsidiary*	70,000
2.	*Provision for doubtful debts*	75,000
3.	*Provision for income-tax*	1,05,000
4.	*Provision for gratuity based on actuarial valuation*	2,00,000
5.	*Depreciation*	3,60,000
6.	*Interest to financial institution (unpaid before filing of return)*	1,00,000
7.	*Penalty for infraction of law*	50,000

(ii) Items credited to Statement of Profit and Loss:

No.	Particulars	₹
1.	*Profit from unit established in special economic zone*	5,00,000
2.	*Share in income of an AOP as a member*	1,00,000
3.	*Income from units of UTI*	75,000
4.	*Long term capital gains on sale of building*	3,00,000

Other Information:

(i) *Depreciation includes ₹ 1,50,000 on account of revaluation of fixed assets.*

(ii) *Depreciation as per Income-tax Rules is ₹ 2,80,000.*

(iii) *Brought forward loss as per books of account of the company is of ₹ 10 lakhs which includes unabsorbed depreciation of ₹ 4 lakhs.*

(iv) *The AOPs, of which the company is a member, has paid tax at maximum marginal rate.*

(v) *Provision for income-tax includes ₹ 45,000 of interest payable on income-tax.*

Compute minimum alternate tax under section 115JB of the Income-tax Act, 1961, for A.Y. 2024-25, assuming that Sona Ltd. is not required to comply with the Indian Accounting Standards. Ignore the provisions of section 115BAA.

SOLUTION

Computation of "Book Profit" for levy of MAT under section 115JB for A.Y. 2024-25

Particulars	₹	₹
Net Profit as per Statement of Profit and Loss		15,00,000
Add: Net profit to be increased by the following amounts as per *Explanation 1* to section 115JB		
- Provision for the loss of subsidiary	70,000	
- Provision for doubtful debts, being the amount set aside as provision for diminution in the value of any asset	75,000	
- Provision for income-tax [As per *Explanation 2* to section 115JB, income-tax shall include, *inter alia*, any interest charged under the Act. Therefore, whole of the amount of provision for income-tax including ₹ 45,000 towards interest payable has to be added]	1,05,000	
- Depreciation	3,60,000	6,10,000
		21,10,000
Less: Net profit to be decreased by the following amounts as per *Explanation 1* to section 115JB:		
- Share in income of an AOP as a member [In a case, where AOP has paid tax on its total income at maximum marginal rate, no income-tax is payable	1,00,000	

	by the company, being a member of AOP, in accordance with the provisions of section 86. Therefore, share in income of an AOP on which no income-tax is payable in accordance with the provisions of section 86, would be reduced while computing book profit, since the same has been credited to Statement of Profit and Loss]		
-	Income from units in UTI [Income from units in UTI is taxable in the hands of the unitholders thus, the same would not be reduced while computing book profits even though it is credited in the Statement of Profit and Loss]	-	
-	Depreciation other than depreciation on revaluation of assets (₹ 3,60,000 – ₹ 1,50,000)	2,10,000	
-	Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account. [Lower of unabsorbed depreciation ₹ 4,00,000 and brought forward business loss ₹ 6,00,000 as per books of accounts has to be reduced while computing the book profit]	4,00,000	7,10,000
Book Profit			**14,00,000**

Computation of MAT liability under section 115JB

Particulars	₹
15% of book profit	2,10,000
Add: Health and education cess@4%	8,400
Minimum Alternate Tax liability	**2,18,400**

Notes:

(1) It is only the specific items mentioned under *Explanation 1* to section 115JB, which can be adjusted from the net profit as per the Statement of Profit and Loss prepared as per the Companies Act for computing book profit for levy of MAT. Since the following items are not specified thereunder, the same cannot be adjusted for computing book profit:

- Interest to financial institution (unpaid before filing of return) and
- Penalty for infraction of law

(2) Provision for gratuity based on actuarial valuation is an ascertained liability *[CIT v. Echjay Forgings (P) Ltd. (2001) 251 ITR 15 (Bom.)]*. Hence, the same should not be added back to compute book profit.

(3) As per proviso to section 115JB(6), the profits from unit established in special economic zone cannot be excluded while computing the book profit, and hence, such income would be liable for MAT.

(xiii) Set-off of credit of tax paid under section 115JB [Section 115JAA]

(1) This section provides that where tax is paid in any assessment year in relation to the deemed income under section 115JB(1), the excess of tax so paid over and above the tax payable under the other provisions of the Income-tax Act, 1961, will be allowed as tax credit in the subsequent years. However, no interest would be payable on the tax credit allowed.

(2) The tax credit is, therefore, the difference between the tax paid under section 115JB(1) and the tax payable on the total income computed in accordance with the other provisions of the Act.

(3) This tax credit is allowed to be carried forward for **15 assessment years** succeeding the assessment year in which the credit became allowable.

(4) Such credit is allowed to be set off against the tax payable on the total income in an assessment year in which the tax is computed in accordance with the provisions of the Act, other than 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.

Example:

P.Y.	MAT as per section 115JB	Tax as per regular provisions	MAT Credit Adjustment	Actual Tax Paid	MAT Credit Balance
2021-22	4,50,000	3,95,000	-	4,50,000	55,000
2022-23	4,70,000	4,10,000	-	4,70,000	1,15,000 [55,000 + 60,000]
2023-24	3,80,000	4,00,000	20,000	3,80,000	95,000

(5) Where as a result of order passed, the amount of tax payable is reduced or increased, the amount of tax credit allowed shall also be reduced or increased accordingly.

(6) In case of conversion of a private company or unlisted public company into an LLP, the tax credit under section 115JAA for MAT paid by the company under section 115JB would not be allowed to the successor LLP.

(7) Where the amount of tax credit in respect of any income-tax paid in any country or specified territory outside India, under section 90 or section 90A or section 91, allowed against the tax payable under the provisions of section 115JB(1) exceeds the amount of such tax credit admissible against the tax payable by the assessee on its income in accordance with the other provisions of this Act, then, while computing the amount of credit under this sub-section, such excess amount shall be ignored.

In other words, the amount of tax credit in respect of MAT shall not be allowed to be carried forward to subsequent year to the extent such credit relates to the difference between the amount of foreign tax credit (FTC) allowed against MAT and FTC allowable against the tax computed under regular provisions of Act other than the provisions relating to MAT.

Example:

Particulars	Tax as per regular provisions	MAT as per section 115JB
Tax amount	1,50,000	1,75,000
FTC	1,60,000	1,60,000
Deduction in respect of FTC, being lower of tax payable in India and FTC	1,50,000	1,60,000
Excess FTC allowed against MAT under section 115JB		10,000
MAT credit		25,000
MAT Credit as reduced by excess FTC allowable against MAT liability (₹ 25,000 – ₹ 10,000)		15,000

(8) A company opting for section 115BAA cannot set-off MAT credit available to it under section 115JAA from the year in which it exercises such option.

(5) Levy of additional income-tax on distributed income of a domestic company on account of buy-back of shares [Chapter XII-DA]

(i) In case of buyback of shares (whether listed or unlisted) by domestic companies, additional income-tax @20% (plus surcharge@12% and cess@4%) is leviable in the hands of the company [Section 115QA(1)].

Consequently, the income arising to the shareholders in respect of such buyback of shares by the domestic company would be exempt under section 10(34A) since the domestic company is liable to pay additional income-tax on the buyback of shares.

As per section 115QA(2), a domestic company is liable to pay additional income-tax on buy-back of shares, irrespective of the fact that no income-tax is payable by such domestic company on its total income computed in accordance with the provisions of this Act.

Taxation provisions in respect of buyback of shares and specified securities

(1)	(2)	(3)	(4)
Taxability in the hands of	**Buyback of shares (listed or unlisted) by domestic companies**	**Buyback of shares by a company, other than a domestic company**	**Buyback of specified securities by any company**
Company	Subject to additional income-tax @ 23.296%.	Not subject to tax in the hands of the company.	Not subject to tax in the hands of the company.
Shareholder/ holder of specified securities	Income arising to shareholders exempt under section 10(34A)	Income arising to shareholder taxable as capital gains u/s 46A.	Income arising to holder of specified securities taxable as capital gains u/s 46A.

[Please refer Chapter 4: Capital Gains for detailed discussion on section 46A]

(ii) Such tax should be paid to the credit of the Central Government **within 14 days from the date of payment** of any consideration for such buyback to the shareholder.

Meaning of buyback and distributed income	
Buyback	Purchase by a company of its own shares in accordance with the provisions of any law for the time being in force to companies [clause (i) of *Explanation* to section 115QA]
Distributed income	The consideration paid by the company on buy-back of shares as reduced by the amount which was received by the company for issue of such shares, determined in the manner as may be prescribed [clause (ii) of *Explanation* to section 115QA]

Accordingly, the CBDT has, vide Notification no. 94/2016 dated 17.10.2016, inserted Rule 40BB to provide the manner of determination of the amount received by the company for issue of shares being bought back in various circumstances including shares being issued under tax neutral reorganisations and in different tranches as follows:

Sub-rule No.	Circumstance	Manner of determination of amount received by the company in respect of issue of shares being bought back
2	Where **shares have been issued** by a company to any person **way of subscription**	Amount actually received by the company in respect of such share **including** any amount actually received by way of **premium**.
3	Where the company had at any time, **prior to the buy-back of the share, returned any sum** out of the amount received in respect of such share	The amount actually received in respect of such shares as **reduced by the sum so returned**
4	Where the **share has been issued** by a company under any plan or scheme **under which an employees' stock option has been granted** or as part of sweat equity shares	The **fair market value of the share** is computed in accordance of Rule 3(8), **to the extent credited to the share capital and share premium account** by the company shall be deemed to be the amount received by the company for issue of said share. "Sweat equity shares" means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called [Clause (b) of *Explanation* to section 17(2)(vi)].
5	Where the **share has been issued by a company being an amalgamated company**, under a scheme of amalgamation, in lieu of the share or shares of an amalgamating company	The amount **received by the amalgamating company** in respect of such share or shares determined in accordance with this rule, shall be deemed to be the amount received by the amalgamated company in respect of the share so issued by it.
6	Where the **Shares are issued by resulting company** under a scheme of demerger	**Amount received by the resulting company in respect of shares issued by it under a scheme of demerger:** Amount received by the — Net book value of assets transferred in a demerger

<table>
<tr><td></td><td></td><td><table><tr><td>demerged co. in respect of the original shares (determined as per this Rule)</td><td>x</td><td>------------------------
Net worth of the demerged co. immediately before demerger</td></tr></table></td></tr>
<tr><td></td><td></td><td>Amount received in respect of the original shares issued by the demerged company post demerger:
<table><tr><td>The amount received by the demerged company in respect of the original shares</td><td>(-)</td><td>the amount as so arrived under sub-rule (6).</td></tr></table></td></tr>
<tr><td>7</td><td>Where the share has been issued or allotted by the company as part of consideration for acquisition of any asset or settlement of any liability</td><td>The amount received by the company for issue of such share shall be determined in accordance with the following formula-
Amount received = A/B
Where,
A = an amount being lower of the following amounts -
<table><tr><td>(a)</td><td>Fair Market Value of the assets and liabilities as determined by a merchant banker</td><td>x</td><td>The part of consideration being paid by issue of shares
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The total consideration</td></tr><tr><td>(b)</td><td colspan="3">the amount of consideration for acquisition of the asset or settlement of the liability to be paid in the form of shares, to the extent credited to the share capital and share premium account by the company;</td></tr></table>B = the number of shares issued by the company as part of consideration:</td></tr>
</table>

8	Where the **shares have been issued or allotted by a company on succession or conversion**, as the case may be, of a firm into the company or succession of sole proprietary concern by the company	The amount received by the company for issue of shares shall be determined in accordance with the following formula- Amount received = (A-B)/C **A = book value of the assets in the balance-sheet as reduced by** any amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act and any amount shown in the balance-sheet as asset including the unamortized amount of deferred expenditure which does not represent the value of any asset; For determining book value of the assets, any change in the value of the assets consequent to their revaluation shall be ignored. **B = book value of liabilities shown in the balance-sheet, but does not include the following amounts**, namely:- (a) capital, by whatever name called, of the proprietor or partners of the firm, as the case may be; (b) reserves and surpluses, by whatever name called, including balance in profit and loss account; (c) any amount representing provision for taxation, other than amount of tax paid, as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act, if any, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto; (d) any amount representing provisions made for meeting

		liabilities, other than ascertained liabilities; and (e) any amount representing contingent liabilities, **C = number of shares issued on conversion or succession**.
9	Where the **share has been issued or allotted, without any consideration**, on the basis of existing shareholding in the company	The consideration in respect of such share shall be deemed to be "**Nil**"
10	Where the **shares have been issued on conversion of preference shares or bond or debenture, debenture-stock or deposit certificate in any form or warrants** or any other security issued by the company	The amount received by the company in respect of such instrument as so converted.
11	Where the **share being bought back is held in dematerialised** form and the same cannot be distinctly identified	The amount received by the company in respect of such share shall be the amount received for the issue of share determined in accordance with this rule on the basis of the first-in-first-out method.
12	In any other case	The face value of the share shall be deemed to be the amount received by the company for issue of the share.

(iii) No credit or deduction under the Act in respect of such income or additional income-tax:

The additional income-tax payable by the company shall be the final payment of tax on such income. No credit or deduction shall be claimed by the company or any other person in respect of such tax paid.

Further, no deduction under any provision of the Income-tax Act, 1961 shall be allowed to the company or the shareholder in respect of income, which has been subject to additional income-tax, or tax thereon.

(iv) Interest payable for non-payment of additional income-tax by the company [Section 115QB]

The principal officer of the domestic company and the company will be liable to pay simple interest on the amount of additional income-tax not paid within the specified time. Such interest is leviable at the rate of 1% for every month or part of the month on the amount of such tax not paid or short paid for the period beginning on the date immediately after the last date on which such tax was payable and ending with the date on which the tax is actually paid (Tax to be paid within 14 days from the date of payment of any consideration for such buyback to the shareholder).

(v) Deemed Assessee-in-default [Section 115QC]

The principal officer of the domestic company and the company will be deemed to be an assessee-in-default in respect of amount of tax payable by him or it, in case the additional income-tax is not paid to the credit of Central Government within the specified time. In such a case, all the provisions of the Act for the collection and recovery of income-tax would apply.

ILLUSTRATION 4

XYZ Ltd., a domestic company, purchases its own listed shares on 4th July 2023. The consideration for buyback amounted to ₹ 21 lakh, which was paid on the same day. The amount received by the company two years back for issue of such shares determined in the manner specified in Rule 40BB was ₹ 13 lakh. Compute the additional income-tax payable by XYZ Ltd. Compute the interest, if any, payable if such tax is paid to the credit of the Central Government on 29th September 2023.

SOLUTION

XYZ Ltd is liable to pay ₹ 1,86,368 as additional income-tax, which is the amount calculated @23.296% (20% plus surcharge@12% plus health and education cess@4%) on ₹ 8 lakh, being its distributed income (i.e., ₹ 21 lakh – ₹ 13 lakh).

The additional income-tax was payable on or before 18th July 2023. However, the same was paid only on 29th September 2023.

Period for which interest@1% per month or part of a month is leviable -

Period	No. of months/part of month
19th July – 18th August 2023 (whole of first month)	1
19th August – 18th September 2023 (whole of second month)	1
19th September – 29th September 2023 (part of third month)	1
Total number of months	**3**

Interest under section 115QB is payable @1% per month for 3 months on the amount of additional tax payable i.e., ₹ 1,86,300 (rounded off as per Rule 119A). Therefore, interest payable under section 115QB is ₹ 5,589.

(6) Special provisions relating to income of shipping companies

To make the Indian shipping industry more competitive, a tonnage tax scheme for taxation of shipping profits has been introduced. Tonnage tax will induce more ships to fly the Indian Flag.

Chapter XII-G, containing sections 115V to 115VZC, provides for special provisions relating to taxation of the income of shipping companies. With the introduction of tonnage tax scheme, the companies have to exercise the option to be assessed under this scheme or under the normal provisions of the Income-tax Act. The salient features of the scheme are as follows:

- A company owning at least one qualifying ship may join.
- A qualifying ship is one with a minimum tonnage of 15 tons and having a valid certificate.
- If a company is incorporated after the initial period or a company which is incorporated before the initial period but becomes a qualifying company for the first time after the initial period, this application is required to be made within three months of the date of incorporation or the date on which it becomes a qualifying company, as the case may be.

(I) Computation of Tonnage Income from Business of Operating Qualifying Ships

Computation of profits and gains from the business of operating qualifying ships [Section 115VA]

(1) A company has the option to compute the income from the business of operating qualifying ships in accordance with the provisions of this Chapter.

(2) Such income is deemed to be the income chargeable to tax under the head "Profits and gains of business or profession" in respect of such business.

Operating ships [Section 115VB]

(1) A company shall be regarded as operating a ship if it operates any ship whether owned or chartered by it.

(2) Even if only a part of the ship has been chartered in by it in an arrangement such as slot charter, space charter or joint charter, the company would be regarded as operating a ship.

(3) However, a company will not be regarded as the operator of a ship which has been chartered out on bareboat charter-cum-demise terms or on bareboat charter terms for a period exceeding three years.

(4) "Bareboat charter" means hiring of a ship for a stipulated period on terms which give the charterer possession and control of the ship, including the right to appoint the master and crew;

(5) "Bareboat charter-cum-demise" means a bareboat charter where the ownership of the ship is intended to be transferred after a specified period to the company to whom it has been chartered;

Meaning of "Qualifying company" [Section 115VC]

(1) A company will be a qualifying company if -

 (a) it is an Indian company;

 (b) the place of effective management of the company is in India;

 (c) it owns at least one qualifying ship; and

 (d) the main object of the company is to carry on the business of operating ships.

(2) The expression "place of effective management of the company" has been defined in the *Explanation* to the section to mean –

 (a) the place where the board of directors of the company or its executive directors make their decisions; or

 (b) in a case where the board of directors routinely approve the commercial and strategic decisions made by the executive directors or officers of the company, the place where such executive directors or officers of the company perform their functions.

Meaning of "Qualifying ship" [Section 115VD]

(1) A ship is a qualifying ship if

 (i) it is a seagoing ship or vessel of 15 net tonnage or more;

 (ii) it is registered –

  (a) under the Merchant Shipping Act, 1958; or

  (b) outside India in respect of which a license has been issued by the Director-General of Shipping under section 406 or 407 of the Merchant Shipping Act, 1958

 (iii) there is a valid certificate in force indicating the net tonnage of such a ship;

(2) However, the following ships are not "qualifying ships" –

 (i) a seagoing ship or vessel if the main purpose for which it is used is for the provision of goods or services of a kind normally provided on land ("seagoing ship" means a ship which is certified as seagoing by the competent authority of any country);

(ii) fishing vessels;

(iii) factory ships (which includes a vessel providing processing services in respect of processing of the fishing produce);

(iv) pleasure craft (i.e. a ship, whose primary use is for the purposes of sport or recreation);

(v) harbour and river ferries;

(vi) offshore installations;

(vii) a qualifying ship which is used as a fishing vessel for a period of more than thirty days during a previous year.

Manner of computation of income under tonnage tax scheme [Section 115VE]

(1) A tonnage tax company engaged in the business of operating qualifying ships should compute the profits from such business under the tonnage tax scheme;

(2) "Tonnage tax company" means a qualifying company in relation to which tonnage tax option is in force;

(3) "Tonnage tax scheme" means a scheme for computation of profits and gains of business of operating qualifying ships under the provisions of this Chapter.

(4) The business of operating qualifying ships giving rise to "relevant shipping income" (i.e. income referred to in section 115V-I(1)) has to be considered as a separate business, distinct from all other activities or business carried on by the company.

(5) Such profits should be computed separately from the profits and gains from any other business.

(6) The tonnage tax scheme will apply only if an option to that effect is made (in accordance with the provisions of section 115VP).

(7) The profits and gains from the business of operating qualifying ships of a company engaged in such business and –

(a) not covered under the tonnage tax scheme or,

(b) which has not made an option to that effect,

have to be computed in accordance with the other provisions of this Act.

Tonnage income [Section 115VF]

(1) "Tonnage income" means the income of a tonnage tax company computed in accordance with the provisions of this Chapter. The tonnage income has to be computed in accordance with the provisions of section 115VG given below.

(2) The income so computed is deemed to be the profits chargeable under the head "Profits and gains of business or profession".

(3) Where income is so computed under section 115VG, the relevant shipping income (referred to in section 115V-I(1)) will not be chargeable to tax.

Computation of tonnage income [Section 115VG]

(1) The tonnage income for a previous year is the aggregate of the tonnage income of each qualifying ship.

(2) The tonnage income of a qualifying ship is to be calculated on the basis of the daily tonnage income of such ship multiplied by the number of days in the previous year.

(3) In case the ship is operated by the company as a qualifying ship for only part of the previous year, the tonnage income of the ship will be calculated on the basis of daily tonnage of such ship multiplied by the number of days in part of the previous year.

(4) The daily tonnage income of a qualifying ship has to be computed as under –

Qualifying ship having net tonnage	Amount of daily tonnage income
Up to 1000	₹ 70 for each 100 tons
Exceeding 1,000 but not more than 10,000	₹ 700 plus ₹ 53 for each 100 tons exceeding 1,000 tons
Exceeding 10,000 but not more than 25,000	₹ 5,470 plus ₹ 42 for each 100 tons exceeding 10,000 tons
Exceeding 25,000	₹ 11,770 plus ₹ 29 for each 100 tons exceeding 25,000 tons

(5) "Tonnage" means the tonnage of a ship indicated in the "valid certificate" (i.e., referred to in section 115VX) and includes deemed tonnage computed in the prescribed manner.

(6) "Deemed tonnage" means the tonnage in respect of an arrangement of purchase of slots, slot charter and an arrangement of sharing of break-bulk vessel.

(7) The tonnage is to be rounded off to the nearest multiple of hundred tons. For this if the last figure that amount of tonnage is fifty or more, the tonnage shall be increased to the next

higher tonnage which is a multiple of 100, otherwise, shall be reduced to the next lower tonnage which is a multiple of 100.

(8) No deduction or set-off is allowed in computing the tonnage income under this Chapter.

ILLUSTRATION 5

Calculate tonnage income with respect to each of the following qualifying ships:

Qualifying Ships	Q1	Q2	Q3	Q4
Net Tonnage	1,020	8,563	22,368	37,525
Days for which ship operated during the P.Y.2023-24	120	70	250	100

SOLUTION

Qualifying Ships	Q1	Q2	Q3	Q4
Net Tonnage (rounded off)	1,000	8,600	22,400	37,500
Daily Tonnage (₹)	700	4,728	10,678	15,395
Days for which ship operated during the P.Y.2023-24	120	70	250	100
Tonnage Income (₹)	84,000	3,30,960	26,69,500	15,39,500

Calculation of tonnage income in case of joint operation [Section 115VH]

(1) Where a qualifying ship is operated by two or more companies –

(a) by way of joint interest in the ship or by way of an agreement for the use of the ship and

(b) their respective shares are definite and ascertainable,

the tonnage income of each such company shall be an amount equal to a share of income proportionate to its share of interest.

(2) Where two or more companies are operators of a qualifying ship, the tonnage income of each company shall be computed as if each had been the only operator, if the conditions specified in (a) and (b) of (1) above are not satisfied.

Meaning of "Relevant shipping income" [Section 115V-I]

(1) The "relevant shipping income" of a tonnage tax company means its profits from core activities and its profits from incidental activities

(2) Where the aggregate of income from incidental activities exceeds one-fourth per cent of the turnover from core activities, such excess will not form part of relevant shipping income for

the purposes of this Chapter and shall be taxable under the other provisions of this Act.

(3) The core activities of a tonnage tax company are –

(i) its activities from operating qualifying ships; and

(ii) Other ship-related activities, being,

(a) shipping contracts in respect of –

(1) earnings from pooling arrangements i.e.

(i) agreement between two or more persons for providing services through a pool or

(ii) operating one or more ships and sharing earnings or operating profits on the basis of mutually agreed terms;

(2) contracts of affreightment i.e. a service contract under which a tonnage tax company agrees to transport a specified quantity of specified products at a specified rate, between designated loading and discharging ports over a specified period.

(b) Specific shipping trades, being, -

(1) on-board or onshore activities of passenger ships comprising of fares and food and beverages consumed on board;

(2) slot charters, space charters, joint charters, feeder services, container box leasing of container shipping.

(4) The incidental activities of the tonnage tax company are the activities which are incidental to the core activities and which may be prescribed for the purpose.

(5) The Central Government can, by notification, exclude any activity under "other ship-related activities" mentioned in (3) above or prescribe the limit up to which such activities can be included in the core activities.

(6) Every notification issued under this Chapter has to be laid before each House of Parliament to make the same effective.

(7) If both Houses agree in making any modification therein, the notification will have effect in such modified form.

(8) Similarly, if both Houses agree that the notification should not be issued, then such notification will be of no effect.

(9) However, such modification or annulment will not affect anything previously done under that notification.

(10) Where a tonnage tax company operates a non-qualifying ship, then the income attributable to operation of the non-qualifying ship should be computed in accordance with the other provisions of this Act.

(11) In the following cases, the relevant shipping income is to be computed as if the transfer had been at market value of the goods and services as on the date of transfer–

  (i) Where any goods or services held for the purposes of tonnage tax business are transferred to any other business carried on by a tonnage tax company, or

  (ii) where any goods or services held for the purposes of any other business carried on by such tonnage tax company are transferred to the tonnage tax business, and

  (iii) In both the above cases, the consideration, if any, for such transfer as recorded in the accounts of the tonnage tax business does not correspond to the market value of such goods or services as on the date of the transfer,

(12) Market value in relation to any goods and services means the price that such goods or services would ordinarily fetch on sale in the open market.

(13) Where the computation of the relevant shipping income in the manner specified above presents exceptional difficulties, the Assessing Officer may compute such income on such reasonable basis as he may deem fit.

(14) If the Assessing Officer is of the opinion that owing to the close connection between the tonnage tax company and such other person or for any other reason, the affairs of the business transacted between the tonnage tax company and any other person are arranged in such a manner that the company gets more than the ordinary profits which might be expected to arise in the tonnage tax business, then he may take into account the amount of income which may be reasonably deemed to have been derived therefrom for computing the relevant shipping income.

(15) In case the relevant shipping income of a tonnage tax company is a loss, then, such loss is to be ignored for the purposes of computing tonnage income.

Treatment of common costs [Section 115VJ]

(1) Where a tonnage tax company also carries on any business or activity other than the tonnage tax business, the common costs attributable to the tonnage tax business should be determined on a reasonable basis.

(2) Where any asset, other than qualifying ship, is not exclusively used for the tonnage tax business by the tonnage tax company, depreciation on such asset has to be allocated between its tonnage tax business and other business.

(3) Such allocation of depreciation has to be done on a fair proportion to be determined by the Assessing Officer, having regard to the use of such asset for the purpose of the tonnage tax business and for the other business.

Depreciation [Section 115VK]

(1) The depreciation for the first previous year of the tonnage tax scheme has to be computed on the written down value of the qualifying ships.

(2) The written down value of the block of assets, being ships, as on the first day of the previous year, has to be divided in the ratio of the book written down value of the qualifying ships (qualifying assets) and the book written down value of the non-qualifying ships (other assets).

(3) The block of qualifying assets would constitute a separate block of assets.

(4) The manner of computing the book written down value of the block of qualifying assets and the block of other assets is as follows –

  (a) the book written down value of each qualifying asset and each other asset as on the first day of the previous year is to be determined by taking the book written down value of each asset appearing in the books of account as on the last day of the preceding previous year;

  (b) Any change in the value of assets consequent to their revaluation after 10.9.04 is to be ignored;

  (c) The book written down value of all the qualifying assets and other assets are to be aggregated;

  (d) The ratio of the aggregate book written down value of the qualifying assets to the aggregate book written down value of the other assets has to be determined.

(5) In case an asset forming part of the block of qualifying assets begins to be used for purposes other than the tonnage tax business, an appropriate portion of the written down

value allocable to such asset has to be reduced from the written down value of that block and added to the block of other assets.

(6) In case an asset forming part of the block of other assets begins to be used for tonnage tax business, an appropriate portion of the written down value allocable to such asset i.e., the amount which bears the same proportion to the written down value of the block of other assets as on the first day of the previous year as the book written value of the asset beginning to be used for tonnage tax business bears to the total book written down value of all the assets forming the block of other assets, has to be reduced from the written down value of the block of other assets and has to be added to the block of qualifying asset.

(7) Depreciation computed for the previous year on such asset mentioned in (6) shall be allocated in the ratio of number of days for which the asset was used for the tonnage tax business and for purposes other than tonnage tax business.

(8) Depreciation on the block of qualifying assets and block of other assets so created shall be allowed as if the written down value as on the first previous year has been brought forward from the preceding previous year.

(9) The expression "book written down value" means the written down value as appearing in the books of account.

Deemed deduction and set-off and carry forward of losses etc. [Section 115VL]

(1) Any loss/allowance or deduction under sections 30 to 43B relating to or allowable for any of the relevant previous years, would be deemed to have been given full effect to in that previous year itself;

(2) No set-off or carry forward of losses referred to in –

(i) sections 70(1) and 70(3); or

(ii) sections 71(1) and 71(2); or

(iii) section 72(1) or

(iv) section 72A(1),

relating to the business of operating qualifying ships of the company is permissible where such loss relates to any of the previous years when the company is under the tonnage tax scheme;

(3) No deduction under Chapter VI-A is allowable in relation to the profits and gains from the business of operating qualifying ships;

(4) In computing the depreciation allowance under section 32, the written down value of any asset used for the purposes of the tonnage tax business has to be computed as if the company has claimed and has been actually allowed the deduction in respect of depreciation for the relevant previous year.

Set-off and carry forward of losses of tonnage tax business [Section 115VM]

(1) Any losses attributable to its tonnage tax business that have accrued to a company before its entry in tonnage tax scheme can be set off only against the relevant shipping income when the company is under the tonnage tax scheme.

(2) Such losses will not be available for set off against any income other than relevant shipping income in any previous year beginning on or after the date when the company exercises its option under section 115VP.

(3) Any apportionment necessary to determine such losses should be made on a reasonable basis.

Capital gains from transfer of tonnage tax assets [Section 115VN]

(1) Profits or gains arising from the transfer of a capital asset being an asset forming part of the block of qualifying assets is chargeable to income-tax in accordance with the provisions of section 45, read with section 50.

(2) The capital gains so arising has to be computed in accordance with the provisions of sections 45 to 51.

Book profit or loss to be excluded for the purpose of section 115JB [Section 115VO]

This section seeks to exclude the book profits or loss derived from the activities of a tonnage tax company (referred to in section 115V-I(1)) for the purposes of section 115JB.

(II) Procedure for Option of Tonnage Tax Scheme

Method and time of opting for tonnage tax scheme [Section 115VP]

(1) A qualifying company may opt for the tonnage tax scheme by making an application to the Joint-Commissioner having jurisdiction over the company in the prescribed form and manner.

(2) An existing qualifying company should make an application at any time after 30th September 2004 but before 1st January 2005, which is the initial period.

(3) In case of a company incorporated after the initial period or a company incorporated before the initial period but which becomes a qualifying company for the first time after the initial period, an application can be made within three months of the date of its incorporation or the date on which it became a qualifying company, as the case may be.

(4) The Joint Commissioner, on receipt of an application for option for tonnage tax scheme, may call for such information or documents from the company as he thinks necessary in order to satisfy himself about the eligibility of the company.

(5) After satisfying himself about the eligibility of the company to make such option for tonnage tax scheme, he can either pass an order in writing approving the option for tonnage tax scheme or, if he is not so satisfied, pass an order in writing refusing to approve the option for tonnage tax scheme.

(6) A copy of such order should be sent to the applicant.

(7) An order refusing to approve the option for tonnage tax scheme can be passed only after giving the applicant a reasonable opportunity of being heard.

(8) Every order granting or refusing the approval of the option for tonnage tax scheme should be passed before the expiry of one month from the end of the month in which the application was received.

(9) Where an order granting approval for tonnage tax scheme is passed, the provisions of this Chapter will apply from the assessment year relevant to the previous year in which the option for tonnage tax scheme is exercised.

Period for which the tonnage tax option will remain in force [Section 115VQ]

(1) An option for tonnage tax scheme (after it has been approved under section 115VP(3)) would remain in force for a period of ten years from the date on which such option has been exercised.

(2) For this purpose, the option would be taken into account from the assessment year relevant to the previous year in which such option is exercised.

(3) An option for tonnage tax scheme would cease to have effect from the assessment year relevant to the previous year in which –

 (i) the qualifying company ceases to be so or

 (ii) a default is made in complying with the provisions contained in section 115VT or section 115VU or section 115VV.

(4) The tonnage tax option will also cease to have effect in case –

 (i) a company is excluded from the tonnage tax scheme under section 115VZC or

 (ii) the qualifying company furnishes to the Assessing Officer, a declaration in writing to the effect that the provisions of this Chapter may not be made applicable to it.

(5) In such a case, the profits of the company from the business of operating qualifying ships shall be computed in accordance with the other provisions of the Income-tax Act.

Renewal of tonnage tax scheme [Section 115VR]

(1) An option for tonnage tax scheme approved under section 115VP may be renewed within one year from the end of the previous year in which the option ceases to have effect.

(2) The provisions of sections 115VP and 115VQ discussed above would apply in relation to a renewal of the option for tonnage tax scheme in the same manner as they apply in relation to the approval of option for tonnage tax scheme.

Bar from opting for tonnage tax scheme in certain cases [Section 115VS]

(1) A qualifying company is not eligible to opt for the tonnage tax scheme if –

   (i) the company, on its own, opts out of the tonnage tax scheme or

   (ii) it makes a default in complying with the provisions of section 115VT or section 115VU or section 115VV or

   (iii) its option has been excluded from tonnage tax scheme in pursuance of an order made under section 115VZC(1).

(2) In such cases, the qualifying company will not be eligible to opt for tonnage tax scheme for a period of ten years from the date of such opting out or default or order, as the case may be.

(III) Conditions for Applicability of Tonnage Tax Scheme

Transfer of profits to Tonnage Tax Reserve Account [Section 115VT]

(1) A tonnage tax company is required to credit to a reserve account (called Tonnage Tax Reserve Account) an amount not less than 20% of the book profits derived from its core and incidental activities (referred to in section 115V-I(1)) in each previous year to be utilised in the manner laid down below –

   (i) The amount credited should be utilized for acquiring a new ship before the expiry of 8 years for the purposes of the business of the company; and

   (ii) Until the acquisition of a new ship, the amount can be utilized for the purposes of the business of operating qualifying ships other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India. [Sub-section (3)]

(2) A tonnage tax company may transfer a sum in excess of twenty per cent of the book profits. Such excess sum transferred should also be utilised in above manner.

(3) "Book profit" will have the same meaning as in the *Explanation* to section 115JB(2) so far as it relates to income derived from the core and incidental activities.

(4) Where the company has book profit from the business of operating qualifying ships and book loss from any other source, and consequently, the company is not in a position to create the full or any part of the reserves as required, then –

(a) the company should create the reserves to the extent possible in that previous year.

(b) The shortfall, if any, will be added to the amount of the reserves required to be created for the following previous year.

(c) Such shortfall will be deemed to be part of the reserve requirement of that following previous year.

(5) **Consequences of mis-utilisation / non-utilisation [Sub-section (4)]**

(i) Where any amount credited to the Tonnage Tax Reserve Account has –

(a) been utilized for any purpose other than that referred to in (1) above; or

(b) not been utilized for the purpose of acquiring a new ship for the purpose of the business of the company within 8 years; or

(c) has been utilized for acquiring a new ship within 8 years but such ship is sold or transferred, otherwise than in any scheme of demerger, within 3 years from the end of the previous year in which it was acquired

then, an amount which bears the same proportion to the total relevant shipping income of the year in which such reserve was created, as the amount out of such reserve so utilized or not utilized bears to the total reserve created during that year shall be taxable under the other provisions of the Act i.e.

Taxable amount =

$$\text{Relevant shipping income} \times \frac{\text{Extent of reserves unutilized or misutilised}}{\text{Total reserve created during the year}}$$

(ii) Such amount as calculated above would be taxable -

(a) in case (a) of (i) above, in the year in which the amount was so utilized; or

(b) in case (b) of (i) above, in the year immediately following the period of 8 years;

(c) in case (c) of (i) above, in the year in which the sale or transfer took place.

(iii) However, the income so taxable under the other provisions of the Act will be reduced by the proportionate tonnage income charged to tax in the year of creation of such reserves.

(6) **Shortfall in credit to Tonnage Tax Reserve Account [Sub-section (5)]**

If there is any shortfall in the amount credited to the Tonnage Tax Reserve Account, then the amount which bears the same proportion to the total relevant shipping income as the shortfall in credit to the reserves bears to the minimum reserve required to be credited, will be taxable under the other provisions of the Act i.e.,

$$\text{Taxable amount} = \text{Relevant shipping income} \times \frac{\text{Shortfall in credit to reserves}}{\text{Minimum reserve to be credited}}$$

(7) **Consequences of failure to create reserve for two consecutive previous years [Sub-section (6)]** -If the reserve required to be created is not created for any two consecutive previous years, the option of the company for tonnage tax scheme will cease to have effect from the beginning of the previous year following the second consecutive previous year in which the failure to create the reserve had occurred.

(8) **Meaning of "new ship":** A new ship includes a 'qualifying ship', which before the date of its acquisition by the qualifying company was used by any other person. However, it should not have been owned by any person resident in India before the date of such acquisition.

ILLUSTRATION 6

Dolphy Ltd., a tonnage tax company provides following information for the P.Y. 2023-24:

(i) Relevant Shipping Income - ₹ 350 lakhs

(ii) Tonnage Income - ₹ 180 lakhs

(iii) Book profits derived from core and incidental activities - ₹ 400 lakhs

Provide answers to following questions, considering each of the questions given below independently:

(a) Calculate the minimum reserve requirement of the company as per section 115VT.

(b) Calculate the taxable amount under the other provisions of the Act, if Dolphy Ltd. transferred only ₹ 66 lakhs to tonnage tax reserve account during the P.Y. 2023-24.

(c) *Calculate the taxable amount under the other provisions of the Act, if Dolphy Ltd. mis-utilised amount of ₹ 12 lakhs during P.Y. 2024-25 out of ₹ 92 lakhs transferred to tonnage tax reserve account during P.Y. 2023-24.*

SOLUTION

(a) The minimum reserve requirement of the company as per section 115VT = 20% of the book profits derived from core and incidental activities = ₹ 400 lakhs × 20% = **₹ 80 lakhs**

(b) Taxable amount under the other provisions of the Act = Relevant shipping income × Shortfall in the credit to the reserves/ Minimum reserve requirement = ₹ 350 lakhs × [(₹ 80 lakhs – 66 lakhs) / ₹ 80 lakhs)] = ₹ 350 lakhs × ₹ 14 lakhs / ₹ 80 lakhs = **₹ 61.25 lakhs**

(c) Taxable amount under the other provisions of the Act for P.Y. 2024-25 = Relevant shipping income during P.Y. 2023-24 × Extent of reserves misutilised/Total reserve created during P.Y. 2023-24 = ₹ 350 lakhs × ₹ 12 lakhs / ₹ 92 lakhs = **₹ 45.65 lakhs**

Minimum training requirement for a tonnage tax company [Section 115VU]

(1) A tonnage tax company, after its option has been approved under section 115VP(3) is required to comply with the minimum training requirement in respect of trainee officers in accordance with the guidelines framed by the Director-General of Shipping and notified in the Official Gazette by the Central Government. [Sub-section (1)]

(2) A copy of the certificate issued by the Director-General of Shipping to the effect that such company has complied with the minimum training requirement in accordance with the guidelines referred to in sub-section (1) for the previous year is required to be furnished along with the return of income.

(3) If the minimum training requirement is not complied with for any five consecutive previous years, the option of the company for tonnage tax scheme shall cease to have effect from the start of the previous year following the fifth consecutive year in which the failure to comply with the minimum training requirement occurred.

Limit for charter in of tonnage [Section 115VV]

(1) Every company which has opted for tonnage tax scheme should charter in not more than forty-nine per cent of the net tonnage of the qualifying ships operated by it during any previous year. The term "chartered in" does not include a ship chartered in by the company on bareboat charter-cum-demise terms.

(2) Such proportion of net tonnage in respect of a previous year is to be calculated based on the average of net tonnage during that previous year.

(3) The average of net tonnage is to be computed in such manner as may be prescribed in consultation with the Director-General of Shipping.

(4) Where the net tonnage of ships chartered in exceeds the limit of 49% during any previous year, the total income of such company in relation to that previous year is to be computed as if the option for tonnage tax scheme does not have effect for that previous year.

(5) Where the said limit of 49% is exceeded in any two consecutive previous years, the option for tonnage tax scheme shall cease to have effect from the beginning of the previous year following the second consecutive previous year in which the limit had exceeded.

Maintenance and audit of accounts [Section 115VW]

An option for tonnage tax scheme by a tonnage tax company will not have effect in relation to a previous year unless such company –

(i) maintains separate books of account in respect of the business of operating qualifying ships and

(ii) furnishes, the report of an accountant, in the prescribed form duly signed and verified by such accountant on or before the specified date referred to in section 44AB i.e., one month prior to the due date for filing return of income.

Determination of tonnage [Section 115VX]

(1) The tonnage of the ship shall be determined in accordance with the valid certificate indicating its net tonnage.

(2) "Valid certificate" means –

  (i) in case of ships registered in India—

    (a) having a length of less than twenty-four meters, a certificate issued under the Merchant Shipping (Tonnage Measurement of Ship) Rules, 1987 made under the Merchant Shipping Act, 1958;

    (b) having a length of twenty-four meters or more, an international tonnage certificate issued under the provisions of the Convention on Tonnage Measurement of Ships, 1969 as specified in the Merchant Shipping (Tonnage Measurement of Ship) Rules, 1987 made under the Merchant Shipping Act, 1958;

(ii) in case of ships registered outside India,

(a) a license issued by the Director-General of Shipping under section 406 or section 407 of the Merchant Shipping Act, 1958 specifying the net tonnage on the basis of Tonnage Certificate issued by the Flag State Administration where the ship is registered or

(b) any other evidence acceptable to the Director-General of Shipping produced by the ship owner while seeking permission for chartering in the ship.

(IV) Amalgamation and Demerger of Shipping Companies

Amalgamation [Section 115VY]

(1) In case of amalgamation, the provisions relating to the tonnage tax scheme would apply to the amalgamated company if it is a qualifying company.

(2) However, where the amalgamated company is not a tonnage tax company, it should exercise an option for tonnage tax scheme under section 115VP(1) within three months from the date of the approval of the scheme of amalgamation.

(3) Where the amalgamating companies are tonnage tax companies, the provisions of this Chapter would apply to the amalgamated company for such period as the option for tonnage tax scheme which has the longest unexpired period continues to be in force.

Example: If two tonnage tax companies X Ltd. and Y Ltd. are amalgamated to form a new company Z Ltd., and the option for tonnage tax scheme of X Ltd. has an unexpired period of 8 years and Y Ltd. has an unexpired period of 6 years, then the provisions of this Chapter would apply to the new company Z Ltd. for a period of 8 years.

(4) Where one of the amalgamating companies is a qualifying company on 1st October 2004 and has not exercised option for tonnage tax scheme within the initial period, then –

(i) the provisions of this Chapter will not apply to the amalgamated company and

(ii) the income of the amalgamated company from the business of operating qualifying ships has to be computed in accordance with the other provisions of the Act.

Demerger [Section 115VZ]

(1) Where in a scheme of demerger, the demerged company transfers its business to the resulting company before the expiry of the option for tonnage tax scheme, then the scheme would apply to the resulting company for the unexpired period if it is a qualifying company.

(2) The option for tonnage tax scheme in respect of the demerged company will remain in force for the unexpired period of the tonnage tax scheme if it continues to be a qualifying company.

(V) Other Provisions

Effect of temporarily ceasing to operate qualifying ships [Section 115VZA]

(1) A temporary cessation (as against permanent cessation) of operating any qualifying ship by a company would not be considered as a cessation of operating of such qualifying ship. The company would still be deemed to be operating such qualifying ship for the purposes of this Chapter.

(2) Where a qualifying company continues to operate a ship, which temporarily ceases to be a qualifying ship, then such ship will not be considered as a qualifying ship for the purposes of this Chapter.

(VI) Cases where provisions of this Chapter do not apply

Avoidance of tax [Section 115VZB]

(1) The tonnage tax scheme will not apply where a tonnage tax company is a party to any transaction or arrangement which amounts to an abuse of the tonnage tax scheme.

(2) A transaction or arrangement will be considered as an abuse if the entering into or the application of such transaction or arrangement results, or would, but for this section have resulted, in a tax advantage being obtained by –

 (a) a person other than a tonnage tax company; or

 (b) a tonnage tax company in respect of its non-tonnage tax activities.

(3) "Tax advantage" includes—

 (i) (a) the determination of the allowance for any expense or interest, or

  (b) the determination of any cost or expense allocated or apportioned,

  which has the effect of reducing the income or increasing the loss, as the case may be, from activities other than tonnage tax activities chargeable to tax.

  Such computation should be on the basis of entries made in the books of account in respect of the previous year in which the transaction was entered into; or

 (ii) a transaction or arrangement which produces to the tonnage tax company more than ordinary profits which might be expected to arise from tonnage tax activities.

Exclusion from tonnage tax scheme [Section 115VZC]

(1) Where a tonnage tax company is a party to any transaction or arrangement which amounts to an abuse of the tonnage tax scheme, the Assessing Officer has the power to exclude such company from the tonnage tax scheme, by an order in writing, after giving an opportunity of being heard to such company.

(2) However, no order to this effect can be passed without the previous approval of the Principal Chief Commissioner or Chief Commissioner.

(3) This section does not apply where the company shows to the satisfaction of the Assessing Officer that the transaction or arrangement was a bona fide commercial transaction and has not been entered into for the purpose of obtaining tax advantage under this Chapter.

Where an order has been passed by the assessing officer excluding the tonnage tax company from the tonnage tax scheme, then, the option for tonnage tax scheme shall cease to be in force from the first day of the previous year in which the transaction or arrangement was entered into.

(7) Companies under Liquidation [Sections 178]

(i) Notice to Assessing Officer: 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 as the receiver of any assets of a company

is bound under a statutory obligation to give notice of his appointment as liquidator or receiver, as the case may be. This notice may be given within thirty days of his appointment to the Assessing Officer having jurisdiction to assess the income of the company.

(ii) Information of tax due by the Assessing Officer: The Assessing Officer, in his turn is bound after making such enquiries or calling for such information as he may deem fit, to notify to the liquidator, within three months from the date of receipt of the notice of appointment, of the amount which in his opinion would be sufficient to provide for any tax which is then or likely thereafter to become payable by the company.

(iii) Restriction on liquidator to part with assets: The liquidator is debarred from parting with the assets of company and its properties in his hands until he is notified by the Assessing Officer of the amount which will be sufficient to provide for any tax which is then, or is likely thereafter, to become payable by the company except with the prior approval of

- the Principal Chief Commissioner or

- Chief Commissioner or
- Principal Commissioner or
- Commissioner

and on being so notified, shall set aside an amount equal to the amount notified.

However, the above restriction of debarring the liquidator from parting with assets or properties shall not be applicable on

- payment of the tax payable by the company,
- payment to secured creditors whose debts are entitled under law to priority of payments over the debts due to the Government on the date of liquidation and
- meeting such costs and expenses of the winding up of the company

as are, in the opinion of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or the Commissioner, reasonable.

(iv) **Consequences of failure to give notice or set aside the tax due by the liquidator:** If the liquidator fails to notify the Assessing Officer of his appointment within the time specified or fails to set aside the amount intimated by the Assessing Officer as being sufficient to provide for the tax liability of the company or parts with any of the assets or property of the company in his hands in contravention of the above provisions, he shall be personally liable for payment of the tax which the company would be liable to pay.

However, if the amount of any tax payable by the company is notified by the Assessing Officer, the personal liability of the liquidator under this sub-section shall be to the extent of such amount.

Failure to comply with the above requirement would be an offence punishable under section 276A.

Where there are more liquidators than one, their obligations and liabilities under this section are joint and several.

(v) **Overrides other laws except IBC, 2016:** The provisions of this section have the effect of over-riding anything to the contrary contained under the Companies Act or any other law for the time being in force and apply to all companies, public or private except the provisions of Insolvency and Bankruptcy Code, 2016.

(8) Liability of directors of private company [Section 179]

(i) **Liability of directors:** Where any tax due from a private company in respect of any income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was director of a private company at any time during the relevant previous year shall be jointly and severally liable for the payment of the tax unless 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.

The personal liability imposed by this section on the directors of a private company shall have the effect of over-riding any provision under the Companies Act, 2013 by which the liability of the directors is reduced or curtailed. Thus, personal liability can be imposed by the Assessing Officer on a direction even without any adjudication by a Court.

(ii) **Meaning of Tax Due:** For the purposes of this section, "tax due" includes penalty, interest, fees or any other sum payable under the Income-tax Act, 1961.

9.2 TAXATION OF OTHER ENTITIES

ALTERNATE MINIMUM TAX (AMT) [CHAPTER XII-BA–SECTIONS 115JC TO 115JF]

(i) **Applicability:** Any person other than a company, who has claimed deduction under any section (other than section 80P) included in Chapter VI-A under the heading "C – Deductions in respect of certain incomes" or under section 10AA or under section 35AD would be subject to AMT **[Section 115JEE(1)]**.

The provisions of AMT would, however, not be applicable to an individual, HUF, AOPs, BOIs, whether incorporated or not, or artificial juridical person, if the adjusted total income of such person does not exceed ₹ 20 lakh **[Section 115JEE(2)]**.

(ii) **Levy of AMT@18.5% on Adjusted Total Income:** Accordingly, where the regular income-tax payable by a person, other than a company, for a previous year computed as per the provisions of the Income-tax Act, 1961 (other than Chapter XII-BA) is less than the AMT payable for such previous year, the adjusted total income shall be deemed to be the total income of the person. Such person shall be liable to pay income-tax on the adjusted total income @ 18.5% **[Section 115JC(1)]**.

(iii) Meaning of Adjusted Total Income: "Adjusted total income" would mean the total income before giving effect to Chapter XII-BA i.e., AMT provisions as increased by the deductions claimed, if any, under –

(1) any section (other than section 80P) included in Chapter VI-A under the heading "C – Deductions in respect of certain incomes" (Section 80-IA to 80RRB);

(2) section 10AA (SEZ); and

(3) section 35AD, **as reduced** by the depreciation allowable under section 32, as if no deduction under section 35AD was allowed in respect of the asset for which such deduction is claimed.

(iv) Furnishing Report by Chartered Accountant: Such persons to whom this section applies should obtain a report in the prescribed form from a Chartered Accountant certifying that the adjusted total income and the AMT have been computed in accordance with the provisions of this Chapter. The report has to be furnished on or before the specified date referred to in section 44AB (i.e., one month prior to the due date for filing return of income), in such form as may be prescribed, from an accountant referred to in the Explanation below section 288(2), certifying that the adjusted total income and the alternate minimum tax have been computed in accordance with the provisions of this Chapter and furnish such report by that date.

(v) Levy of AMT @9%/15% of Adjusted Total Income in case of a unit located in IFSC or co-operative society:

Where the person subject to AMT	Rate of AMT on adjusted total income
- is a unit located in an International Financial Services Centre (IFSC) deriving its income solely in convertible foreign exchange or	9%
- a co-operative society	15%

(vi) Applicability of Interest and Penal provisions: Section 115JE specifically provides that "save as otherwise provided in this Chapter, all other provisions of this Act shall apply to a person referred to in this Chapter". Hence, all other provisions relating to self-assessment under section 140A, advance tax, interest under sections 234A, 234B and 234C, penalty etc. would also apply to a person who is subject to AMT.

(vii) Non-applicability of AMT provisions: *The provisions of this section shall not apply to a person*

- *a resident co-operative society opting for section 115BAD or 115BAE or*

- *where income tax payable in respect of total income of such person is computed as per section 115BAC(1A) [Section 115JC(5)].*

AMT provisions are also not applicable to Specified fund referred to in section 10(4D).

(Section 115BAC, 115BAD and 115BAE are discussed later on in this chapter)

Tax credit for AMT [Section 115JD]

(i) AMT paid in excess of the regular income-tax payable under the provisions of the Income-tax Act, 1961 for the year would be eligible for credit to be carried forward and set-off against income-tax payable in the later year to the extent of excess of regular income-tax payable under the provisions of the Act over the AMT payable in that year. The balance tax credit, if any, shall be carried forward to the next year for set-off in that year in a similar manner.

Where the amount of tax credit in respect of any income-tax paid in any country or specified territory outside India under section 90 or section 90A or section 91, allowed against the alternate minimum tax payable, exceeds the amount of the tax credit admissible against the regular income-tax payable by the assessee, then, while computing the amount of credit under this sub-section, such excess amount shall be ignored.

In other words, the amount of tax credit in respect of AMT shall not be allowed to be carried forward to subsequent year to the extent such credit relates to the difference between the amount of foreign tax credit (FTC) allowed against AMT and FTC allowable against the regular tax payable by the assessee.

(ii) AMT credit can be carried forward for set-off upto a maximum period of **15 assessment years** succeeding the assessment year in which the credit becomes allowable.

(iii) No interest shall, however, be payable on such tax credit.

(iv) If the amount of regular income-tax or AMT is reduced or increased as a result of any order passed under the Income-tax Act, 1961, the amount of tax credit allowed under section 115JD would also vary accordingly.

(v) ***The provisions of AMT credit shall not apply to a person***

- ***a resident co-operative society opting for section 115BAD or 115BAE or***
- ***where income tax payable in respect of total income of such person is computed as per section 115BAC(1A) [Section 115JD(7)].***

Tax Credit allowable even if Adjusted Total Income does not exceed ₹ 20 lakh in the year of set-off [Section 115JEE(3)]

The credit for tax paid under section 115JC shall be allowed in accordance with the provisions of section 115JD, notwithstanding the conditions mentioned in sub-section (1) or (2) of section 115JEE. Hence, even if the assessee has not claimed any deduction under section 10AA or section 35AD or Chapter VI-A under the heading "C- Deductions in respect of certain incomes" in any previous year and the adjusted total income of that year does not exceed ₹ 20 lakh, it would still be entitled to set-off his brought forward AMT credit in that year.

Related Provisions

(i) Correspondingly, under section 140A, for determination of self-assessment tax payable, tax credit claimed to be set-off in accordance with section 115JD has also to be reduced.

(ii) Such tax credit allowed to be set-off in accordance with the provisions of section 115JD has to be reduced from the amount of tax on total income determined under section 143(1) or on regular assessment, on which interest under section 234A is leviable for default in furnishing return of income.

(iii) Similarly, section 234B levies interest for default in payment of advance tax, to enable reduction of tax credit under section 115JD while computing "assessed tax".

(iv) Likewise, in section 234C levying interest for deferment of advance tax, such tax credit under section 115JD has to be reduced for computing "tax due on the returned income".

ILLUSTRATION 7

Mr. Rajesh has income of ₹ 45 lakhs under the head "Profits and gains of business or profession". One of his businesses is eligible for deduction @100% of profits under section 80-IB for A.Y. 2024-25. The profit from such business included in the business income is ₹ 20 lakhs. Compute the tax payable by Mr. Rajesh, assuming that he has no other income during the P.Y. 2023-24 and he has exercised the option to shift out of default regime under section 115BAC.

SOLUTION

Computation of regular income-tax payable under the provisions of the Act

Particulars	₹
Profits and gains of business or profession	45,00,000
Gross total Income	**45,00,000**
Less: Deduction under section 80-IB	20,00,000
Total Income	**25,00,000**

Tax payable	
Up to ₹ 2,50,000	Nil
5% on next ₹ 2,50,000	12,500
20% on next ₹ 5,00,000	1,00,000
30% on balance ₹ 15,00,000	4,50,000
	5,62,500
Add: Health and education cess@ 4%	22,500
Tax liability	**5,85,000**

Computation of Alternate Minimum Tax (AMT)

Particulars	₹
Total Income as per the regular provisions of the Income-tax Act, 1961	25,00,000
Add: Deduction under section 80-IB	20,00,000
Adjusted Total Income	**45,00,000**
AMT @ 18.5% of ₹ 45,00,000	8,32,500
Add: Health and Education Cess @ 4%	33,300
AMT liability	**8,65,800**

Since the regular income-tax payable as per the provisions of the Act is less than the AMT, the adjusted total income of ₹ 45 lakhs would be deemed to be the total income of Mr. Rajesh and he would be liable to pay tax @18.5% thereof. The tax payable by Mr. Rajesh for the A.Y. 2024-25 would, therefore, be ₹ 8,65,800.

Mr. Rajesh would be eligible for credit to the extent of ₹ 2,80,800 [₹ 8,65,800 – ₹ 5,85,000] to be set-off in the year in which tax on total income computed under the regular provisions of the Act exceeds the AMT. Such credit can be carried forward for succeeding 15 assessment years.

TAXATION OF FIRMS/LLPS AND THEIR PARTNERS

A firm is to be assessed as a unit and the share income from the firm in the hands of the partners is exempt. There is no need for registration.

(i) Meaning of Firm/LLP

Under section 2(23) of the Income-tax Act, 1961, the terms 'firm', 'partner' and 'partnership' have the same meanings respectively as have been assigned to them under the Indian Partnership Act, 1932, but the expression 'partner' also includes any other person who being a minor, has been admitted to the benefits of an existing partnership. In addition, the definitions also include the terms limited liability partnership, a partner of limited liability partnership as they have been defined in the Limited Liability Partnership Act, 2008.

A partnership is the relation between persons who have agreed to share the profits of business carried on by all or any of them acting for all. The persons who have entered into partnership with one another are called individually 'partners' and collectively a 'firm'.

Firm

- As defined under the Partnership Act, 1932
- As defined under the Limited Liability Partnership Act, 2008

A firm though not a legal person or juridical entity, is chargeable to tax as a separate entity distant from the partners and the partners are assessable as individuals and not as an association persons or body of individuals. The term 'firm' as used in the Act covers both registered and unregistered firms.

(ii) Residential Status of Firm/LLP

The residential status of a firm to be determined depending upon the fact whether or not the control and management of its affairs is exercised from within India. Even if the negligible part of the control and management is exercised from within India, the firm would be resident in India for all the purposes. For determining the residential status of a firm, it is immaterial to ascertain the residential status of partners thereof because a firm may be resident even in cases where all the partners are not resident in India and they control or manage the affairs from India.

(iii) Tax Rate of Firm/LLP

Every firm is liable to pay tax flat rate of 30% on its total income of the previous year computed in accordance with the provisions of the Act, ***plus*** surcharge @ 12% if its total income exceeds ₹ 1 crore *plus* health and education cess @4%.

Salient features of assessment of partnership firms
The following are the salient features of assessment of partnership firms: (a) The firm will be taxed as a separate entity. There will be no distinction between registered and unregistered firm.

(b) The share of the partner in the income of the firm will not be included in the hands of the partner. It will be exempt under section 10(2A).

(c) Any salary, bonus commission or remuneration, by whatever name called, which is due to or received by a partner will be allowed as a deduction subject to certain restrictions.

(d) Where a firm pays interest to any partner, the firm can claim deduction of such interest from its total income subject to certain conditions. However, the maximum rate at which interest can be allowed to a partner will be 12% per annum.

(e) The income of the firm will be taxed at a flat rate of 30% plus surcharge **@12%** if its total income exceeds ₹1 crore plus health and education cess @4%.

(iv) Assessment as firm [Section 184]

- **Conditions to be fulfilled:**

To get the status of PFAS, the firm should be evidenced by an "instrument". The word "instrument" means a document of legal nature by which any right or liability is created, limited, extended, or extinguished.

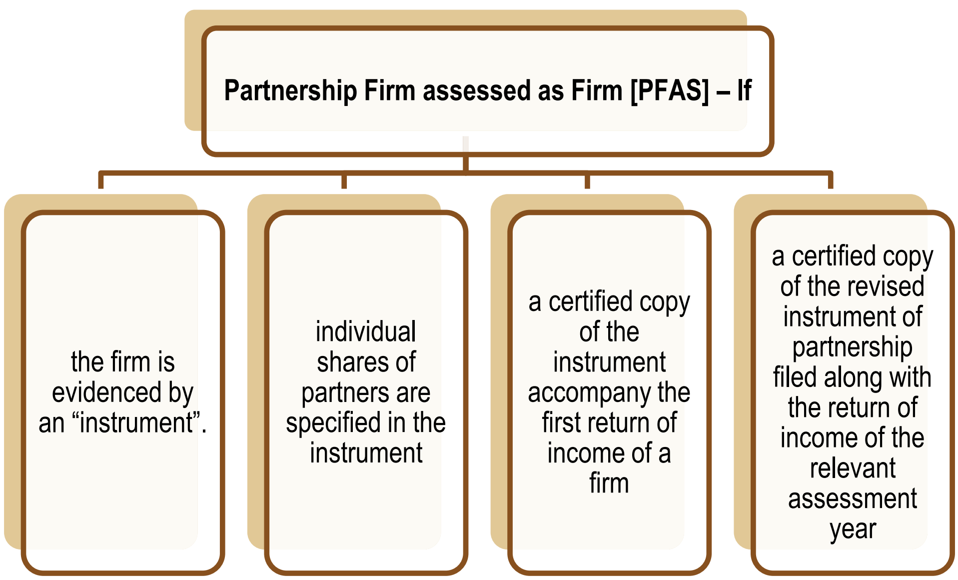
Instrument does not necessarily mean a regular partnership deed, but it may constitute any other relevant document. If the terms of a partnership are contained in a number of documents or in the correspondence between the parties, the documents or letters would constitute "instrument" for the purposes of section 184(1)(i).

The next condition is that the individual shares of partners must be specified in the instrument. A firm cannot get the status of PFAS unless the instrument of partnership specifies the individual shares of partners in the profits of the partnership. Evidence regarding the shares of partners should be available within the framework of the instrument. It should not involve searching of a number of documents.

The next condition is that a certified copy of the instrument should accompany the first return of income of a firm. As already noted, "instrument" in this sense refers not only to the partnership deed but also other documents from which the existence of partnership can be proved. Accordingly, certified copies of all documents will have to be submitted. Section 184 requires that the copy of the instrument shall be certified in writing by all partners other than minors. If, however, the return is made after the dissolution of the firm, it should be certified by all partners other than minors who were partners in the firm immediately before dissolution and by the legal representative of any such partner who is deceased. The certified copy of the instrument of partnership shall accompany the return of income of the firm of the previous year relevant to the assessment year.

If there is any change in the constitution of the firm or profit-sharing ratio during any previous year, a certified copy of the revised instrument of partnership should be filed along with the return of income of the relevant assessment year. Even if there is a change in remuneration/payment of interest to partners but there is no change in profit sharing ratio, a copy of the revised instrument of partnership should be submitted along with return to comply with the provisions of section 40(b).

Section 184(5) provides that where the firm commits any default as mentioned in section 144 *(Best Judgment assessment - Refer Chapter 15: Assessment Procedure for detailed discussion),* the firm shall be so assessed that no deduction for payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by the firm to any partner shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession". However, the interest, salary, bonus, commission or remuneration so disallowed shall not be charged to tax in the hands of the partners under section 28(v).



♦ **Computation of income of partnership firm**: While computing the income of a firm assessed as such, we have to keep in mind the following points:

(a) Remuneration is to be allowed

(b) Interest is to be allowed

(c) Unabsorbed depreciation and other losses should be provided for.

- **Remuneration paid to partners:** First let us discuss the question of deduction of remuneration to the partners. In this context we have to remember the conditions prescribed by section 37 as regards the allowability of residuary expenses. Accordingly, no capital expenditure or personal expenses will be allowed. Further the remuneration paid must be only and exclusively for the purposes of the business of the firm. Apart from the general conditions prescribed in section 37 there are certain specific conditions prescribed by section 40(b).

  They are as follows: -

  (1) Such remuneration should be paid only to the working partner.

  (2) It should be authorised by the partnership deed.

  (3) It should not pertain to a period prior to partnership deed.

  (4) It should not exceed the permissible limit.

  (1) Payment should be to a working partner:

  Explanation 4 to section 40(b) defines working partner as one who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner. This definition is very general. It seems that a partner can be a working partner in more than one firm. If a partner is employed somewhere else too, he can still be a working partner in the firm. However, in all such situations the partner must in fact be a working partner in the firm. In other words, merely because a person is working somewhere else too, such a fact does not by itself debar him from being a working partner in a firm in which he is a partner. As stated before, to be a working partner, the partner has to be actively engaged in conducting the affairs of the business or profession of the firm. Now in order to be actively engaged in conducting the affairs of the business or profession does not require either expressly or by implication that the concerned partner should be so actively engaged in conducting the business affairs on a full-time basis. A partner can be said to be actively engaged in conducting the affairs of the firm even if he devotes a part and not the whole of his working hours.

  Further, in order to be actively engaged in the affairs, a partner is not expected to be engaged in the whole of the affairs of the business of the firm, nor is he expected to know everything about the affairs of the business of the firm. For example, in a firm with many partners, one partner may be looking after purchases, another after sales and another after production and still another after administration, finance and accounts. It cannot be contended that just because they are not overall in charge, they cannot be considered as working partner.

Another significant point to be noted here is that the definition of "working partner" in *Explanation 4* contemplates an individual. Therefore, <u>a partner other than an individual (example a company) cannot be working partner.</u> An interesting situation may be considered here. When a company is a partner in a firm, a director or shareholder of the company can very well be an employee of the firm in which the company is a partner. Any salary/remuneration paid by the firm to such an employee would be totally outside the ambit of disallowance under section 40(b). This would be so because the individual who is an employee of the firm is not a partner in the firm. It is the company in which he is the director, which is the partner and, section 40(b) contemplates allowance of remuneration paid by a firm to its partners and not to other employees.

(2) <u>It should be authorised by the Partnership Deed:</u>

Any payment of salary, bonus, commission or remuneration by whatever name called to a working partner is not allowed as a deduction if the payment is not authorised by partnership deed or it is not in accordance with the terms of partnership deed. As a result, a mere general authority in the partnership deed that such and such working partners would be paid remuneration as may be agreed upon between the partners from time to lime will not be sufficient. The partnership deed will have to contain clear direction as to the quantum of remuneration to be paid to the working partners. The CBDT had, vide *Circular No. 739 dated 25-3-1996*, clarified that **no deduction under section 40(b)(v) will be admissible unless the partnership deed either <u>specifies the amount</u> of remuneration payable to each individual working partner or <u>lays down the manner</u> of quantifying such remuneration.** For example, such remuneration may be specified by way of annual fixed payment or as a certain specified percentage of the firm's book profit at the year end. It may be noted that such remuneration need not be paid on a monthly basis. An item like commission can be paid even as a percentage of sales. Remuneration also can be a yearly payment.

Now, a question arises whether the names of individual working partners should be specified in the partnership deed or whether it is sufficient if the total remuneration payable to the working partners as a whole is indicated. One opinion is that it is not necessary that the individual partners should be identified or designated. It will be sufficient to lay down an authorisation in the deed to the effect that remuneration will be payable to the class of working partners up to so and so percentage of the book profit. And further that, within such limits the working partners shall share such remuneration in any ratio as may be agreed upon. In other words, this concept gives recognition to the working partners as a class and authorising remuneration for the class rather than identifying or designating individual working partners and authorising remuneration for each individual working partner. There is nothing in the section 40(b) which prohibits this type of interpretation. However, in order to avoid litigation, it is better that the deed identifies and designates the working partners as well as the remuneration payable to them.

As a result of this stipulation, every firm constituted on or after April 1, 1992 will have to provide for an appropriate clause in its partnership deed satisfying this requirement. However, so far as the existing firms are concerned, they will have to execute a supplementary deed or a deed of change in the constitution so as to incorporate a clause within the deed of partnership relating to payment of remuneration to its working partners.

(3) It should not pertain to period prior to partnership deed:

By virtue of a further restriction contained in 40(b)(iii), such remuneration paid to the working partners will be allowed as deduction to the firm from the date of such partnership deed and not from any period prior thereto. Consequently, if for instance a firm incorporates the clause relating to payment of remuneration to the working partners by executing an appropriate deed as on July 1st, but effective from April 1st, the firm would get deduction for the remuneration paid to its working partners from July 1st onwards but not for the period from April 1st to June 30th. In other words, it will not be possible to give retrospective effect to oral agreements entered into *vis-a-vis* such remuneration prior to putting the same in a written partnership deed.

ILLUSTRATION 8

A and B entered into partnership agreement on April 1, 2023. As per the deed, each of them will be entitled to salary of ₹ 2,000 per month apart from profit. On August 1, 2023, they executed a supplementary deed by which they increased the *remuneration to ₹ 3,000 each effective from 1st April 2023. Discuss the validity of the supplementary deed.*

SOLUTION

Remuneration will be payable effective from the date of the deed which provides for the payment of such remuneration. In the given case, the original deed provides for remuneration at the rate of ₹ 2,000 for each partner from April 1, 2023 onwards. The supplementary deed is executed on August 1, 2023 increasing the limit of remuneration. Such increase in the limit of remuneration will be allowable only from 1st August 2023, being the date of supplementary deed. Hence, for the period from 1st April 2023 to 31st July 2023, the partners will be allowed remuneration only at the rate of ₹ 2,000 per month.

(4) It should not exceed the permissible limit:

As we have seen earlier, salary, bonus, commission or other remuneration may be paid to any working partner in accordance with and as authorised by the terms of the partnership deed and in relation to any period falling after the partnership deed. However, the maximum amount of such payment to all the partners during the previous year should not exceed the limits given below:-

Book Profit	Quantum of Deduction
On the first ₹ 3 lakh of book profit or in case of loss	₹ 1,50,000 or 90% of book profit, whichever is higher
on the balance of book profit	60% of book profit

Book Profit:

The permissible remuneration is to be computed as a percentage of book profit. For this purpose, we have to draw up the profit and loss account and find the net profit. This profit and loss account is to be prepared in the manner laid down in Chapter IV-D. It may be noted that Chapter IV-D contains the provisions relating to computation of income under the head 'Profits and gains of business or profession'. Further, *Explanation 3* also lays down that if while arriving at the above net profit, the remuneration paid/payable by a firm to its partners is debited to such a profit and loss account, **the aggregate of such remuneration paid/payable to the partners shall be added to the net profit in order to arrive at the book profit.**

When the Act says that the profit and loss account should be prepared in the manner laid down in Chapter IV-D, it means that only those items which are chargeable under section 28 as income will be taken into account and only deductions permissible thereunder will be allowed.

For example, rent from house property, dividend, interest on bank deposit or government securities are not chargeable as income from business or profession under section 28. Therefore, if the profit and loss account of a firm contains these receipts, they have to be excluded while calculating the net profit.

In the same way, items which are to be disallowed under the various provisions from sections 28 to 44D will have to be eliminated. It naturally follows, therefore, that brought forward business losses will not be deducted while calculating book profit.

In simple terms, 'book profit' means income computed under the head "Profits and gains of business or profession" before deduction of partners remuneration. **Accordingly, unabsorbed depreciation can be set-off under section 32(2) against such income to arrive at the book profit, but not unabsorbed business loss under section 72.**

The above table shows the upper limits up to which deduction is allowed to firm in respect of the remuneration paid to its working partners. It does not mean that a firm is prohibited from paying remuneration beyond these limits. A firm can pay remuneration to working partners beyond these limits, but it will suffer disallowance in respect of such excess under section 40(b) and consequently pay tax on it @ 30%. If a firm pays remuneration to non-working partners, the same will be the result. However, the above limits apply to the remuneration paid to the group of all working partners in a firm taken together and not to each individual partner. Finally, it may be noted that section 40(b) does not compel a firm to pay remuneration to its working partners. It is purely at the discretion of the firm. However, once a firm pays remuneration to its working partners it will be subject to the restrictive provisions of section 40(b). It is also open to a firm to pay salary only to a few working partners and not all the working partners.

- **Interest payable to partners:** So far as allowability of interest paid by a firm to its partners under section 40(b) is concerned, the following conditions have been prescribed by section 40(b):

(1) The interest payable by a firm to its partners should be **<u>authorised by and in accordance with the partnership deed</u>.**

(2) The interest payable by a firm to its partners should **<u>not be for a period falling prior to the date of such partnership deed</u>** authorizing the payment of such interest.

(3) The rate of interest payable to the partners **<u>shall not exceed 12% simple interest per annum</u>.**

An important question could be regarding the amount with reference to which this interest @12% will have to be calculated. For example, a partner may have contributed capital to the firm and in addition may also advance loan to the firm. The question would be whether the interest paid by the firm on capital would be allowable or that on the loan would be allowable. Moreover, some firms have an accounting system of maintaining current accounts of partners in addition to the capital accounts. When some balance is standing to the credit of a partner in such current account as well the question arises whether the interest paid on the balance in the current account will be allowable within the meaning of section 40(b).

In this regard, it may be noted that section 40(b) does not refer to nor does it make any distinction between the capital contributed by a partner to the firm, the loan advanced by a partner to the firm or the balance in the current account of a partner. Therefore, the **<u>interest paid by a firm to its partners on the credit balance standing in all the accounts/whether in capital account, loan account or current account, shall be allowed as deduction to the firm under section 40(b)</u>.** The idea seems to be to allow interest on the funds employed in the firm by a partner.

As it happens, many a time, a partner may have debit balance in his current account and credit balance in his capital account or loan account. The question which would arise in such a situation could be whether the interest payable to such a partner at the rate of interest authorised by and in accordance with partnership deed will be reckoned with reference to the aggregate of the credit balance in the capital account and the loan account including the debit balance in the current account or whether it should be calculated on the net balance that is the aggregate of the credit balance in the capital account and in the loan account as reduced by the debit balance in the current account. It appears that in such a situation the equitable principle would be to allow interest reckoned with reference to the net balance. Alternatively, if interest is recovered from a partner on the debit balance in his account and interest is paid to the same partner on the credit balance in his account, the net amount paid to that partner would be subjected to the provisions of section 40(b). However, interest received from one partner cannot be set-off against interest paid to another partner.

The next issue which is to be considered here is the point of time at which interest should be credited to the partners' accounts. For example, a firm may adopt a policy of crediting interest quarterly to the credit of the partners' accounts. In such a case, the firm would be paying in effect interest on interest at the year end. This would amount to compounding interest quarterly. This is not permitted under section 40(b) because what that section contemplates is simple interest and simple interest here would mean interest which is calculated yearly or annually. Paying the interest on interest credited periodically during a year would be contrary to the concept of simple interest per annum.

- **Partner in a representative capacity**: If an individual is a partner in a firm in a representative capacity (that is on behalf and for the benefit of another person) and not in his personal capacity then, interest paid by the firm to such individual in his personal capacity and not as a representative capacity will not be subject to the conditions and ceiling as prescribed for disallowance. But interest paid by the firm to such individual as representative partner or person represented shall be subject to the conditions and ceiling as prescribed *[Explanation 1 to section 40(b)]*.

Example: *X is a partner in a firm in a representative capacity for and on behalf of his HUF. Supposing the firm pays interest of ₹ 6,000 to X in his personal capacity and not in his capacity as the representative of HUF, it will be allowed as deduction and the prescribed ceiling will not apply. However, if such payment is made to X as a representative partner or if the firm has paid the interest directly to the HUF, then the payment will be subject to the conditions and ceiling as prescribed.*

- **Interest received by a non-representative partner**: If interest is paid to an individual partner who is not the representative partner and the interest received by him is on behalf of or for the benefit of another person, then such interest payment shall be allowed without applying the ceiling limits *[Explanation 2 to section 40(b)]*.

Example: *X is a partner of a firm in his individual capacity and is not a representative partner. Interest is paid by the firm to him in respect of a deposit made by his wife. This will be allowed as a deduction because such interest is received by him purely on behalf of another person.*

ILLUSTRATION 9

M/s. HIG, a firm, consisting of three partners namely, H, I and G, carried on the business of purchase and sale of television sets in wholesale and manufacture and sale of pens under a deed of partnership executed on 1.4.2013. H, I and G were partners in their individual capacity.

The deed of partnership provided for payment of salary amounting to ₹ 1,25,000 each to H and G, who were the working partners. A new deed of partnership was executed on 1.10.2023 which, apart from providing for payment of salary to the two working partners as mentioned in the deed of partnership executed on 1.4.2013, for the first time provided for payment of simple interest @ 12% per annum on the balances standing to the credit of the Capital accounts of partners from 1.4.2023.

The firm was dissolved on 31.3.2024 and the capital assets of the firm were distributed among the partners on 20.4.2024. The net profit of the firm for the year ended 31.3.2024 after payment of salary to the working partners and debit/credit of the following items to the Profit and Loss Account was ₹ 1,50,000:

(i) Interest amounting to ₹ 1,00,000 paid to the partners on the balances standing to the credit of their capital accounts from 1.4.2023 to 31.3.2024.

(ii) Interest amounting to ₹ 50,000 paid to the partners on the balances standing to the credit of their Current accounts from 1.4.2023 to 31.3.2024.

(iii) Interest amounting to ₹ 20,000 paid to the Hindu undivided family of partner H @ 18% per annum.

(iv) Payment of ₹ 25,000 towards purchase of television sets (stock in trade) made by crossed cheque on 1.11.2023.

(v) ₹ 30,000 being the value of gold jewellery received as gift from a manufacturer for achieving sales target.

(vi) Depreciation amounting to ₹ 15,000 (as per Income-tax Rules) on motor car bought and used exclusively for business purposes but registered in the name of partner 'H'.

(vii) Depreciation under section 32(1)(ii) amounting to ₹ 37,500 of new machinery bought and installed for manufacture of pens on 1.11.2023 at a cost of ₹ 5,00,000.

(viii) Interest amounting to ₹ 25,000 received from bank on fixed deposits made out of surplus funds.

The firm furnishes the following information relating to it:

(a) Closing stock-in-trade was valued at ₹ 60,000 as per the method of lower of cost or net realizable value consistently followed by it. The net realizable value of the closing stock-in-trade was ₹ 65,000.

(b) Brought forward business loss relating to the assessment year 2023-24 was ₹ 50,000.

(c) The fair market value of the capital assets as on 20.4.2024 was ₹ 20,00,000 and the cost of their acquisition was ₹ 15,00,000.

Compute the total income of M/s. HIG for the Assessment Year 2024-25.

You are required to furnish explanations for the treatment of the various items given above.

SOLUTION

Computation of total income of M/s. HIG for the A.Y. 2024-25

Particulars	₹	₹
Net profit as per profit & loss account		1,50,000
Add: Interest to partners on capital accounts for the period from 1.4.2023 to 30.9.2023 disallowed (total interest ₹ 1,00,000 but deduction limited to 6 months only hence 50% thereof is deductible and the balance is added) **[Note (i)]**	50,000	
Interest to partners on current accounts from 1.4.2023 to 31.3.2024 – not authorized by the deed, hence disallowed **[Note (ii)]**.	50,000	
100% of ₹ 25,000 paid towards purchase of television sets otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed (being stock in trade, hence disallowed) **[Note (iv)]**.	25,000	
Difference on account of valuation of closing stock-in-trade at net realisable value (₹ 65,000	5,000	

less ₹ 60,000) **[Note (ix)]** Salary paid to working partners considered separately.	2,50,000	3,80,000
		5,30,000
Less: Additional depreciation on new machinery (₹ 5,00,000 x 20%) = ₹ 1,00,000. Only 50% is allowable as deduction. **[Note (vii)]**		50,000
		4,80,000
Less: Interest received from bank on fixed deposits considered separately		25,000
		4,55,000
Less: Salary to working partners -		
(i) As per limit in section 40(b)		
On first ₹ 3,00,000 @ 90%	2,70,000	
On the balance of ₹ 1,55,000 @ 60%	93,000	
	3,63,000	
(ii) Salary actually paid	2,50,000	
Deduction allowed being (i) or (ii), whichever is less		2,50,000
		2,05,000
Less: Business loss relating to A.Y. 2023-24 set off		50,000
Income from business		**1,55,000**
Income from other sources		
Interest received from bank on fixed deposits **[Note (viii)]**.		25,000
Total Income		**1,80,000**

Notes:

(i) Interest to partners authorised by the partnership deed will be allowed as deduction only for the period beginning with the date of the partnership deed and not for any earlier period as per section 40(b)(iv). Therefore, interest paid to the partners on the balances standing to the credit of their capital accounts from 1.10.2023 alone is eligible for deduction, since the partnership deed was executed only on 1.10.2023. Interest for the period prior to 1.10.2023 is not allowed.

(ii) The partnership deed of 1.10.2023 provides for payment of interest on balances in capital accounts of partners only. As such, the interest paid on the balances standing to the credit of the current accounts of partners is not allowable under section 40(b). The Kerala High Court has, in *Novel Distributing Enterprises v. DCIT (2001) 251 ITR 704 (Ker)*, on identical facts, held that interest paid to the partners on their current account balances is not allowable.

(iii) Since H is a partner in his individual capacity, interest paid to the Hindu Undivided Family of partner H does not attract disallowance under section 40(b)(iv). Also, assuming that the provisions of section 40A(2) do not get attracted in this case, such interest shall be allowed as deduction in full even though the interest rate is more than 12% p.a.

(iv) Section 40A(3) provides for disallowances @100% of the expenditure incurred for an amount exceeding ₹ 10,000 otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed. Since the firm has made payment of ₹ 25,000 towards purchase of television sets by a crossed cheque and not by an account payee cheque, 100% of such expenditure would be disallowed.

(v) Gold jewellery valued at ₹ 30,000 received as gift from a manufacturer for achieving sales target is taxable under section 28(iv), being a benefit arising from business. Since it has already been credited to profit and loss account, no further adjustment is required.

(vi) Depreciation on motor car bought and used exclusively for the purposes of business is allowable though not registered in the name of the firm in view of the ratio of the decision of the Supreme Court in *Mysore Minerals Ltd. v. CIT (1999) 239 ITR 775*.

(vii) The firm is entitled to additional depreciation @ 20% under section 32(1)(iia) in respect of the new machinery installed for manufacture of pens. Since the new machinery is put to use for less than 180 days during the relevant previous year, the additional depreciation is restricted to 50% of the prescribed rate of 20% i.e., it is restricted to 10%. The balance additional depreciation can be claimed in the immediately succeeding financial year.

(viii) Interest received from bank on fixed deposits made out of surplus funds is assessable under the head 'Income from other sources'. Hence, it is not taken into account for the purpose of computing book-profit.

(ix) As per para 24 of ICDS II: Valuation of Inventories, closing stock has to be valued at net realizable value in the case of a dissolved firm. As such, the closing stock-in-trade of the firm has to be valued at the net realizable value of ₹ 65,000. Since it has been valued at ₹ 60,000, being the cost, the balance ₹ 5,000 has to be added.

(x) Net profit shown in the profit and loss account 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 constitutes book profit as per *Explanation 3* to section 40(b). Carry forward and set off of business loss is covered under Chapter VI. Hence, brought forward business loss relating to the assessment year 2023-24 is not considered for calculation of book-profit.

(xi) Section 9B would be attracted in the hands of M/s HIG in the A.Y. 2025-26, since capital assets are received by the partners on 20.4.2024, i.e., P.Y. 2024-25.

♦ **Computation of income of partner of a firm (PFAS)**: While computing the income of a partner including a minor partner of a firm, the following points have to be taken into consideration.

Share income exempt under section 10(2A): The partner's share in the total income of firm (PFAS) will be exempt in his hands and will not be included in his total income. His share in the total income of the firm will be calculated as follows: -

$$\text{Total income of firm} \times \frac{\text{Partner's share in profits of firm as per partnership deed}}{\text{Total profit of the firm}}$$

By virtue of this exemption, a partner of PFAS will not be taxed in respect of his share in the firm's income since the firm itself will be taxed as a separate entity @ 30%. There will be no allocation of income among the partners. On account of this exemption, he will not be entitled to set-off his share in the firm's loss against his other personal income.

Chargeability of remuneration and interest: Remuneration and interest received by a partner of a PFAS in accordance with the conditions prescribed under section 40(b) will be taxable in his hands as income from profits and gains of business or profession.

If remuneration or interest paid to a partner is disallowed in the assessment of the firm due to the fact that they are not in accordance with the conditions prescribed under section 40(b) then the partner will not be taxed in respect of the amount disallowed because in such a case the firm itself will be liable to pay tax on the amount which has been disallowed in its assessment. In other words, if the firm is given the benefit of deduction of remuneration and interest paid to a partner then the liability to tax in respect of such amount will be that of a partner. If the firm is not given the benefit of deduction because of the non-compliance with the provisions of section 40(b) then the firm itself will be liable in respect of the amount and the partner will not be taxed in respect of it in his personal assessment. It is obvious that such remuneration or interest which has been disallowed in the hands of the firm but actually received by a partner will be assumed to be his share in the income of such firm and exemption under section 10(2A) will operate.

Suppose a portion of the remuneration and interest in the assessment of the firm is disallowed since they exceed the overall ceiling limit prescribed under section 40(b), the question arises as to how to allocate such disallowance in the hands of the partner. One reasonable basis is to assume that the remuneration and interest paid to the partners concerned has been disallowed in proportion to the gross remuneration and interest paid to them and the exemption of the disallowed sum should be available to the partners in the same proportion.

♦ **Assessment of firms – Some of the important issues to be considered by the Assessing Officer while framing assessment [Circular 12/2019, dated 19.6.2019]:**

(i) While computing remuneration which is allowable to a working partner under section 40(b)(v), the term 'in accordance with the terms of the partnership deed' in clauses (ii) and (v) of section 40(b) implies that remuneration should not be undetermined or undecided. Hence, in all situations, partnership deed should form the basis for determination of remuneration payable to the working partners. Furthermore, in situations where the remuneration either so specified in the partnership deed or computed as per the method indicated therein falls short of the amount allowable under section 40(b)(v), it would be restricted to the figure computed on the basis of the partnership deed.

(ii) While computing remuneration payable to the working partners under section 40(b)(v) of the Act, the remuneration should not exceed a particular aggregate amount which is based upon the figure of 'book profit'. *Explanation 3* to section 40(b) contains definition of 'book profit' for the purposes of determination of remuneration of the partners and provides that 'book profit' shall mean the net profit, as shown in the profit & 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 deducted while calculating the net profit. Therefore, while computing 'book profit' for purposes of section 40(b)(v), all incomes such as capital gain, interest, rental income, income from other sources etc. which do not fall under the head 'Profits and gains of business or profession', should be excluded.

(iii) Under section 185, any non-compliance by the firm or its partners with provisions of section 184 may result in denial of expenses such as remuneration, interest etc. payable to the partners which are otherwise allowable under the provisions of the Act.

(iv) Where firms try to inflate the profits eligible for deduction under section 80-IA by not claiming expenditure towards remuneration, salary, interest etc. which are payable to the partners, the Assessing Officers may examine these transactions in light of provisions of section 80-IA(10) which empower Assessing Officer to re-compute profit of the eligible business after excluding the profits of the related activity/business which produced the excessive profit.

- **Treatment of losses**: If PFAS incurs any loss, the firm alone can set off and forward such losses to be set off against income of the subsequent years. The firm will not be allowed to apportion its unabsorbed losses among its partners.

- **Set off of carry forward loss in case of change in the constitution of the firm [Section 78]**: If there is a change in the constitution of the firm, the loss of a retired/deceased partner can be carried forward by the firm only to the extent that it does not exceed such partner's share in the profits of the firm of the relevant previous year.

However, it is to be carefully noted that section 78 is applicable only in case there is a change in the constitution of the firm as result of retirement or death of a partner in the previous year. In other words, it does not apply when there is a change in the profit-sharing ratio or change in the constitution because of induction of a new partner. Similarly, section 78 **will not apply to set off and carry forward of unabsorbed depreciation etc.**

> ***Example:*** *ABC & Co. is a firm with 3 partners – A, B & C having equal profit-sharing ratio. For the P.Y. 2023-24, the loss from business is ₹ 3,00,000 and unabsorbed depreciation is ₹ 1,50,000. Business loss and unabsorbed depreciation represents the amount after inter-source and inter-head set-off. C retires on 31.03.2024 from the firm. Firm can carry forward business loss of ₹ 2,00,000 (3,00,000–1,00,000) and unabsorbed depreciation of ₹ 1,50,000 for set-off against income of subsequent assessment years.*

- **Liability of partner of LLP in liquidation [Section 167C]:** This section provides for the liability of partners of LLP in liquidation. In case of liquidation of an LLP, where tax due from the LLP cannot be recovered, every person who was a partner of the LLP at any time during the relevant previous year will be jointly and severally liable for payment of such tax unless he proves that non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the LLP. This provision would also apply where tax is due from any other person in respect of any income of any previous year during which such other person was a LLP. "Tax due", for the purpose of this section includes penalty, interest or any other sum payable under the Income-tax Act, 1961.

- **Assessment in case of change in constitution, succession and dissolution of a firm [Section 187 to 189A]**

  Change in constitution of a firm: Where at the time of making an assessment under section 143 or 144 it is found that a change has occurred in the constitution of a firm, assessment shall be made on the firm as constituted at the time of making the assessment.

  Meaning of change in constitution of the firm: It means

  (a) If one or more of the partners cease to be partners (other than a case where ceases to be a partner by way of demise of the partner) or one or more new partners are admitted, in such circumstances that <u>one or more</u> of the persons who were <u>partners of the firm before the change continue as partner or partners after the change</u>.

  (b) <u>All the partners of firm continue</u> to be the partner of the firm <u>but there is a change in their profit-sharing ratio</u> or change in shares of some of them.

  Succession of one firm by another: In a case where a firm carrying on a business or profession is succeeded by another firm; separate assessment will be made on the predecessor firm and the successor firm in accordance with the provisions of section 170 [Section 188].

Liability of partners: Where any tax, penalty or other sum payable by the firm for the relevant previous year is due, then every person being a partner of a firm and the legal representative of deceased partner during the previous year shall be jointly and severally liable along with the firm in respect of such sum [Section 188A].

Dissolution of firm or discontinuance of business: Where a firm is dissolved or business or profession is discontinued by the firm, the Assessing Officer shall make an assessment of the total income of the firm as if no discontinuance or dissolution has taken place and all the provisions of the Act relating to levy of a penalty or any other sum chargeable under this Act, shall be applicable accordingly [Section 189].

Every person who was at the time of dissolution or discontinuance a partner of a firm and the legal representative of deceased partner shall be jointly and severally liable for the amount of tax, penalty or other sum payable by the firm and all the provisions of the Act shall apply accordingly. If any proceedings have commenced in respect of any assessment year before dissolution or discontinuance, the proceeding may be continued against such persons (i.e., partner and legal representative) from that stage. The liability of legal representative is limited to the extent to which the estate is capable of meeting the liability.

Tax consequences on transfer of capital asset to a partner on dissolution or reconstitution of a firm *- Section 9B deals with taxability on receipt of capital asset or stock in trade or both by a partner from a firm on dissolution or reconstitution of firm. The taxability of receipt of money or capital asset or both by a partner on reconstitution of a firm is dealt with in section 45(4). Thus, in a case of reconstitution of firm, where a partner receives capital asset from the firm, the provisions of both section 9B and 45(4) are attracted in the hands of the firm. The taxation under these two provisions has to be worked out independently.*

Tax treatment on dissolution of firm is dealt with in section 9B and is not covered under section 45(4). For details, please refer Chapter 4: Capital Gains in Module 1

ILLUSTRATION 10

Vijay Agencies, a partnership firm constituted by three partners with equal shares was dissolved on 1-03-2023 after a search. The tax liability of the firm outstanding to be paid was determined at ₹ 15 lakhs. Out of three partners, one was declared insolvent on 18-03-2024 by the Court. The Assessing Officer, for recovering the demand, attached the Bank Accounts of other two partners and could recover an *amount of ₹ 6 lakhs from the Account of one such partner. You are asked the following questions by the partners of the dissolved firm:*

(i) About the liability of each of them to pay outstanding demand.

(ii) Whether the action of Assessing Officer to attach the Bank Account of partners to recover the tax demand of the dissolved firm is justified?

SOLUTION

As per section 189(3), every person who was at the time of dissolution, a partner of the firm, shall be jointly and severally liable for the amount of tax, penalty or other sum payable and all the provisions of the Act relating to assessment of such tax or imposition of such penalty or other sum, shall apply. Therefore,

(i) the three partners (till one was declared as insolvent by the Court) are jointly and severally liable for making the payment of outstanding dues of ₹ 15 lakhs. After insolvency of one partner, the other two partners are jointly and severally liable to pay such demand.

(ii) Accordingly, the action of the Assessing Officer to attach the bank accounts of the partners for recovery of outstanding demand is correct and the amount of ₹ 6 lakhs recovered by attachment of the bank account of one of the partners is also in order.

♦ **Conversion of company into an LLP**

(i) Consequent to the Limited Liability Partnership Act, 2008 coming into effect in 2009 and notification of the Limited Liability Partnership Rules w.e.f. 1st April, 2009, the Finance (No.2) Act, 2009 had incorporated the taxation scheme of LLPs in the Income-tax Act, 1961 on the same lines as applicable for general partnerships, i.e. tax liability would be attracted in the hands of the LLP and tax exemption would be available to the partners. Therefore, the same tax treatment would be applicable for both general partnerships and LLPs.

(ii) Under section 56 and section 57 of the Limited Liability Partnership Act, 2008, conversion of a private company or an unlisted public company into an LLP is permitted. Consequently, section 47(xiiib) has been inserted under the Income-tax Act, to provide that -

(1) any transfer of a capital asset or intangible asset by a private company or unlisted public company to an LLP; or

(2) any transfer of a share or shares held in a company by a shareholder

on conversion of a company into an LLP in accordance with section 56 and section 57 of the Limited Liability Partnership Act, 2008, shall not be regarded as a transfer for the purposes of levy of capital gains tax under section 45, subject to fulfillment of certain conditions. This clause has been introduced to facilitate conversion of small private and unlisted public companies into LLPs. These conditions are as follows:

(1) the total sales, turnover or gross receipts in business of the company should not exceed ₹ 60 lakhs in any of the three preceding previous years;

(2) all the shareholders of the company immediately before conversion become partners of the LLP in the same proportion as their shareholding in the company;

(3) no consideration other than share in profit and capital contribution in the LLP arises to the shareholders;

(4) the erstwhile shareholders of the company continue to be entitled to receive at least 50% of the profits of the LLP for a period of 5 years from the date of conversion;

(5) The total value of assets as appearing in the books of account of the company in any of the three previous years preceding the previous year in which the conversion takes place, should not exceed ₹ 5 crores;

(6) all assets and liabilities of the company become the assets and liabilities of the LLP; and

(7) no amount is paid, either directly or indirectly, to any partner out of the accumulated profit of the company for a period of 3 years from the date of conversion.

(iii) However, if subsequent to the transfer, any of the above conditions are not complied with, the capital gains not charged under section 45 would be deemed to be chargeable to tax in the previous year in which the conditions are not complied with, in the hands of the LLP or the shareholder of the predecessor company, as the case may be [section 47A(4)].

(iv) Further, the successor LLP would be allowed to carry forward and set-off the business loss and unabsorbed depreciation of the predecessor company [section 72A(6A)].

(v) However, if the entity fails to fulfill any of the conditions mentioned in (ii) above, the benefit of set-off of business loss/unabsorbed depreciation availed by the LLP would be deemed to be the profits and gains of the LLP chargeable to tax in the previous year in which the LLP fails to fulfill any of the conditions listed above.

(vi) The tax credit under section 115JAA for MAT paid by the company under section 115JB would not be allowed to the successor LLP [section 115JAA(7)].

(vii) The actual cost of the block of assets in the case of the successor LLP shall be the written down value of the block of assets as in the case of the predecessor company on the date of conversion [*Explanation 2C* to section 43(6)].

(viii) The aggregate depreciation allowable to the predecessor company and successor LLP shall not exceed, in any previous year, the depreciation calculated at the prescribed rates as if the conversion had not taken place. Such depreciation shall be apportioned between the predecessor company and the successor LLP in the ratio of the number of days for which the assets were used by them [Section 32(1)(ii)].

(ix) The cost of acquisition of the capital asset for the successor LLP shall be deemed to be the cost for which the predecessor company acquired it. It would be further increased by the cost of improvement of the asset incurred by the predecessor company or the successor LLP [Section 49(1)].

(x) If the capital asset became the property of the LLP as a result of conversion of a company into an LLP, and deduction has been allowed or is allowable in respect of such asset under section 35AD, the actual cost would be taken as Nil [*Explanation 13* to section 43(1)].

However, where an asset, in respect of which deduction is claimed and allowed under section 35AD is deemed to be the income of the assessee in accordance with the provisions of section 35AD(7B) (on account of being used for a purpose other than specified business under section 35AD), the actual cost of the asset to the assessee shall be actual cost to assessee as reduced by the amount of depreciation allowable had the asset been used for the purpose of business, calculated at the rate in force, since the date of its acquisition [Proviso to *Explanation 13* to section 43(1)]

(xi) If a company eligible for deduction under section 35DDA in respect of expenditure incurred under Voluntary Retirement Scheme (one-fifth of such expenditure allowable over a period of five years) is converted into a LLP and such conversion satisfies the conditions laid down in section 47(xiiib), then, the LLP would be eligible for such deduction from the year in which the transfer took place.

(xii) If a shareholder of a company receives rights in a partnership firm as consideration for transfer of shares on conversion of a company into a LLP, then the cost of acquisition of the capital asset being rights of a partner referred to in section 42 of the LLP Act, 2008 shall be deemed to be the cost of acquisition to him of the shares in the predecessor company, immediately before its conversion [Section 49(2AAA)].

TAXATION OF CO-OPERATIVE SOCIETIES

(i) General provisions: The expression "co-operative society" means a society registered under the Cooperative Societies Act, 1912 or under any other law for the time being in force in any State for the registration of co-operative societies [Section 2(19)].

For taxation, it is treated as a separate assessable entity. The profits of any business of insurance carried on by a co-operative society are to be computed in accordance with the rules set out in the First Schedule to the Act. Apart from this, the computation of income in the case of a co-operative society should also be made in the same way under each head of income as in the case of any other assessee. Entrance fees received by a co-operative society from its members is taxable as its income from business irrespective of the nature of the business carried on by the society as was held in *Co-operative Central Bank vs. C.I.T. (1965) 57 ITR 579.*

A member of a co-operative society to whom a building or a part thereof is allotted or leased under a house building scheme of the society must be deemed to be the owner of that building or part thereof under section 27(iii). Accordingly, the co-operative society is not liable to pay tax in respect of the income from the house property even though it may be the real owner according to official records and the tenant may have taken the building on lease. But where the tenant is not a member of the society or where the house is allotted to him otherwise than under a house building scheme of the society, the society will be liable to tax in respect of the income of the house property.

(ii) **Deduction under section 80P:** Section 80P provides certain exemptions to co-operative societies. However, the exemption is not available to co-operative banks, other than primary agricultural credit societies and primary co-operative agricultural and rural development banks. *(Students may refer to the detailed discussion of this provision in Chapter 8 "Deductions from Gross Total Income".)*

(iii) **Option to exercise concessional rates of tax under section 115BAD or 115BAE:** Section 115BAA provides an option to an existing domestic company to pay tax at concessional rate of 22%, if it does not claim incentive/exemption and deduction as provided in said section. Section 115BAB provides that new manufacturing domestic companies set up on or after 01.10.2019, which commence manufacturing or production by 31.03.2024 and do not avail of any specified incentive or deductions, may opt to pay tax at a concessional rate of 15%.

On similar lines, section 115BAD was inserted w.e.f. A.Y. 2021-22 to provide that a co-operative society resident in India has the option to pay tax at 22%, subject to fulfilment of certain conditions. Further, w.e.f. A.Y. 2024-25, ***new section 115BAE has been inserted to provide an option to a new manufacturing co-operative society set up on or after 01.04.2023, which commences manufacturing or production on or before 31.03.2024 and does not avail of any specified incentive or deductions, may opt to pay tax at a concessional rate of 15%. In both cases, surcharge would be levied @ 10% on such tax. However, it may be noted that deduction u/s 80P will not be available under the concessional tax regimes.***

Sections 115BAE and 115BAD provides for concessional rates of tax and exemption from Alternate Minimum Tax (AMT) in respect of certain resident co-operative societies. The provisions of these two sections are tabulated hereunder -

(1)	*(2)*	*(3)*	*(4)*
	Particulars	***Section 115BAE***	**Section 115BAD**
1.	***Applicability***	*Co-operative society resident in India engaged in manufacturing/generation of electricity*	Co-operative society resident in India
2.	***Rate of tax***	*15%*	22%

(1)	*(2)*	*(3)*	*(4)*
	Particulars	***Section 115BAE***	**Section 115BAD**
3.	***Rate of surcharge***	*10%*	10%
4.	***Effective rate of tax (including surcharge & HEC)***	***17.16%*** *[Tax@15% (+) Surcharge@10% (+) HEC@4%]*	**25.168%** [Tax@22% (+) Surcharge@10% (+) HEC@4%]
5.	***Applicability of AMT***	*Not applicable*	Not applicable
6.	***Manner of computation of tax liability***		
	Income on which concessional rate of tax is applicable	*The rate of tax (i.e.,* ***17.16%****) is applicable in respect of income derived from or incidental to manufacturing or production of an article or thing or generation of electricity.* ***[Read with point no.11 below, wherein the rate of 34.32% (i.e., Tax@30% + surcharge@10% + HEC@4%) would be applicable in specified circumstance]***	The rate of tax (i.e., **25.168%)** is notwithstanding anything contained in the Income-tax Act, 1961, but subject to the provisions of Chapter XII, other than section 115BAE
	Rate of tax on income covered under Chapter XII *[for example, long-term capital gains chargeable to tax u/s 112 and 112A, short-term capital gains chargeable to tax u/s 111A]*	*Such income would be subject to tax at the rates mentioned in the said sections in Chapter XII. Surcharge@10% would be levied on tax computed on such income. HEC@4% would be levied on the income-tax plus surcharge.*	Such income would be subject to tax at the rates mentioned in the said sections in Chapter XII. Surcharge@10% is leviable on tax computed on such income. HEC@4% would be levied on the income-tax plus surcharge.

(1)	(2)	(3)		(4)
	Particulars	***Section 115BAE***		**Section 115BAD**
	Rate of tax on other income in respect of which no specific rate of tax is provided in Chapter XII	*The applicable tax rate is **25.168% (i.e., tax@22%, plus surcharge @10% plus HEC@4%),** if such income has neither been derived from nor is incidental to manufacturing or production of an article or thing or generating electricity (For example, income from house property and income from other sources).* *In respect of such income, **no deduction or allowance in respect of any expenditure or allowance** shall be allowed in computing such income.*		The applicable tax rate is **25.168% (i.e., tax@22% plus surcharge@10% plus HEC@4%).** There is, however, **no restriction regarding claim of any deduction or allowance** permissible under the relevant provisions of the Act.
	Rate of tax on STCG derived from transfer of a capital asset on which no depreciation is allowable under the Act	*The applicable rate of tax is **25.168% (i.e., tax@22%, plus surcharge@10% plus HEC@4%).*** *There is, however, no restriction regarding claiming of deduction or allowance in this regard.*		The applicable rate of tax is **25.168% i.e., tax @22%, plus surcharge @10% plus cess@4%.** There is no restriction regarding claiming of deduction or allowance in this regard.
7.	***Conditions to be fulfilled for availing concessional rate of tax and exemption from AMT***			
	Conditions to be fulfilled for availing concessional rate of tax and exemption from AMT	*(i)*	*The co-operative society should be **set-up and registered on or after 1.4.2023.***	No time limit specified. Both existing co-operative society and new co-operative society can avail benefit.
		(ii)	*It should **commence manufacturing or production of an article or thing or business of generating electricity on or before 31.3.2024***	Need not be engaged in a manufacturing or a production

(1)	*(2)*	*(3)*		*(4)*
	Particulars	***Section 115BAE***		**Section 115BAD**
		(iii)	*It should **not** **be formed by splitting up or the reconstruction of a business already in existence***	No similar condition has been prescribed
		(iv)	*It does **not** use any machinery or plant previously used for any purpose **[Refer Note at the end]***	No similar condition has been prescribed
		(v)	*It should **not** be engaged in any business other than the business of manufacture or production of any article or thing and research in relation to, or distribution of, such article or thing manufactured or produced by it.*	No similar condition has been prescribed
			***Note** – Business of manufacture or production of any article or thing shall include generation of electricity does **not** include business of –* *(1) Development of computer software in any form or in any media* *(2) Mining* *(3) Conversion of marble blocks or similar items into slabs* *(4) Bottling of gas into cylinder*	

(1)	(2)	(3)		(4)
	Particulars	Section 115BAE		Section 115BAD
			(5) Printing of books or production of cinematograph films (6) Any other business as may be notified by the Central Govt. in this behalf.	
8.	**Common conditions for both sections for availing the concessional rate of tax and exemption from AMT**	In case of a company opting for either section 115BAE or 115BAD, the total income should be computed -		
		(i)	without providing for deduction under any of the following sections:	
			Section	**Provision**
			10AA	Exemption of profits and gains derived from export of articles or things or from services by an assessee from unit in SEZ.
			32(1)(iia)	Additional depreciation @20%, as the case may be, of actual cost of new plant and machinery acquired and installed by manufacturing undertakings.
			33AB	Deduction@40% of profits and gains of business of growing and manufacturing tea, coffee or rubber in India, to the extent deposited with NABARD in accordance with scheme approved by the Tea/Coffee/ Rubber Board.
			33ABA	Deduction@20% of the profits of a business of prospecting for, or extraction or production of, petroleum or natural gas or both in India, to the extent deposited with SBI in an approved scheme or deposited in Site Restoration Account.
			35(1)(ii)/(iia)/(iii)	Deduction for payment to any research association, company, university etc. for undertaking scientific research or social science or statistical research.

<table>
<tr><th>(1)</th><th>(2)</th><th colspan="3">(3)</th><th>(4)</th></tr>
<tr><th></th><th>Particulars</th><th colspan="3">Section 115BAE</th><th>Section 115BAD</th></tr>
<tr><td rowspan="7"></td><td rowspan="7"></td><td rowspan="4"></td><td>35(2AA)</td><td colspan="2">Deduction of payment to a National Laboratory or University or IIT or approved specified person for scientific research</td></tr>
<tr><td>35AD</td><td colspan="2">Investment-linked tax deduction for specified businesses.</td></tr>
<tr><td>35CCC</td><td colspan="2">Deduction of expenditure incurred on notified agricultural extension project</td></tr>
<tr><td>80C to 80U</td><td colspan="2">Deductions from gross total income under Chapter VI-A other than the provisions of section 80JJAA.</td></tr>
<tr><td>(ii)</td><td colspan="3">without set-off of any loss carried forward or depreciation from any earlier assessment year, if such loss or depreciation is attributable to any of the deductions listed in (i) above [Such loss and depreciation would be deemed to have been already given effect to and no further deduction for such loss shall be allowed for any subsequent year]</td></tr>
<tr><td>(iii)</td><td colspan="3">by claiming depreciation u/s 32 determined in the prescribed manner (i.e., in respect of depreciation of any block of assets entitled to more than 40% shall be restricted to 40% on the written down value of such block of assets). However, additional depreciation u/s 32(1)(iia) cannot be claimed.</td></tr>
<tr><td colspan="4"><u>Note</u> – <u>Additional points relevant in the context of section 115BAD</u>:
(1) In the case of a person having a Unit in the IFSC, referred to in section 80LA(1A), which has exercised option for section 115BAD, deduction u/s 80LA would be allowed subject to fulfilment of the conditions specified in that section.
(2) Since there is no time line within which option under section 115BAD can be exercised, a co-operative society having brought forward losses and depreciation on account of deductions listed in (i) above may, if it so desires, postpone exercise the option under section 115BAD to a later assessment year, after set off of the losses and depreciation so accumulated.</td></tr>
</table>

(1)	*(2)*	*(3)*	*(4)*
	Particulars	***Section 115BAE***	**Section 115BAD**
9.	***Failure to satisfy conditions***	*On failure to satisfy the conditions mentioned in point no. 7 and 8 above in any P.Y., the option exercised would be* ***invalid*** *in respect of the assessment year relevant to that previous year and subsequent assessment years;* *Consequently, the other provisions of the Act would apply to the person as if the option had not been exercised for the assessment year relevant to that previous year and subsequent assessment years.*	On failure to satisfy the conditions mentioned in point no. 8 above in any P.Y., the option exercised would be **invalid** in respect of the assessment year relevant to that previous year and subsequent assessment years; Consequently, the other provisions of the Act would apply to the person as if the option had not been exercised for the assessment year relevant to that previous year and subsequent assessment years.
10.	***Availability of set-off of AMT credit brought forward from earlier years***	*Since it is a new co-operative society, there would be no brought forward AMT credit*	Brought forward AMT credit cannot be set-off against income u/s 115BAD. **Note** - If a co-operative society has b/f AMT credit, it can first exhaust the AMT credit, and thereafter opt for section 115BAD in a subsequent previous year.
11.	***Adjustments for transactions with persons having close connection***	*If the Assessing Officer opines that the course of business between the co-operative society and any other person having close connection therewith is so arranged that the business transacted between them produces more than the ordinary profits to the co-operative society, he is*	No such requirement to make any adjustment

(1)	*(2)*	*(3)*	*(4)*
	Particulars	***Section 115BAE***	**Section 115BAD**
		empowered to take into account the amount of profits as may be reasonably deemed to have been derived therefrom, while computing profits and gains of such co-operative society.	
		In case the arrangement referred above involves a specified domestic transaction referred to in section 92BA, then, the amount of profits from such transaction would be determined by considering the arm's length price (ALP). ***The amount, being profits in excess of the amount of the profits determined by the Assessing Officer, shall be deemed to be the income of the person.*** ***The income-tax on the income so deemed shall be subject to tax @ 34.32% (i.e., tax @ 30% + surcharge @10% +HEC @ 4%).*** ***Note*** *– The scope of "specified domestic transaction" referred to in section 92BA has been expanded to include within its ambit, any business transacted between such persons with close connection, where one such person is a company claiming benefit under section 115BAE.*	
12.	***Exercise of option by the co-operative society within the prescribed time***	*The beneficial provisions of this section would apply only if option is exercised in the prescribed manner on or*	The beneficial provisions of this section would apply if option is exercised in

(1)	(2)	(3)	(4)
	Particulars	**Section 115BAE**	**Section 115BAD**
		before the due date u/s 139(1) for furnishing ***the first of the returns of income for any previous year*** *relevant to assessment year or any subsequent assessment year.* *Such option, once exercised, would apply to subsequent assessment years.* *Further, once the option has been exercised for any previous year, it* ***cannot be subsequently withdrawn*** *for the same or any other previous year.* ***Note*** *– The option has to be exercised at the time of furnishing the* ***first of the returns of income*** *for any previous year. If a person fails to so exercise such option, it cannot be exercised thereafter for any subsequent previous year.*	the prescribed manner on or before the due date u/s 139(1) for furnishing the return of income for any previous year relevant to assessment year or any subsequent A.Y. Such option, once exercised, would apply to subsequent assessment years. Further, once the option has been exercised for any previous year, it **cannot be subsequently withdrawn** for the same or any other previous year. **Note** – The option can be exercised even in a later year, but once exercised, cannot be withdrawn subsequently.

Note *- For the purpose of point no.7(iv) in column (3) of the above table in relation to a co-operative society exercising option under section 115BAE, any machinery or plant which was used outside India by any other person shall not be regarded as machinery or plant previously used for any purpose, if all the following conditions are fulfilled, namely:—*

(a) such machinery or plant was not, at any time previous to the date of the installation, used in India;

(b) such machinery or plant is imported into India from any country outside India;

(c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of the Income-tax Act, 1961 in

computing the total income of any person for any period prior to the date of installation of the machinery or plant by the person.

Further, where in the case of a person, any machinery or plant or any part thereof previously used for any purpose is put to use by the co-operative society and the total value of the machinery or plant or part so transferred does not exceed 20% of the total value of the machinery or plant used by the co-operative society, then, the condition specified that the co-operative society does not use any machinery or plant previously used for any purpose would be deemed to have been complied with.

ILLUSTRATION 11

Transfer fees are received by a cooperative housing society from its incoming and outgoing members. Are such transfer fees liable to tax in the hands of the cooperative society?

SOLUTION

The issue under consideration is whether the transfer fees received by a co-operative housing society from its incoming and outgoing members is taxable or exempt on the principle of mutuality.

On this issue, the High Court, in *Sind Co-operative Housing Society v. ITO (2009) 317 ITR 47*, observed that under the byelaws of the society, charging of transfer fees had no element of trading or commerciality. Both the incoming and outgoing members have to contribute to the common fund of the assessee. The amount paid was to be exclusively used for the benefit of the members as a class.

The High Court, therefore, held that transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on account of the principle of mutuality, since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Applying the rationale of the above ruling, transfer fees received by a co-operative housing society from its incoming and outgoing members would not be liable to tax in the hands of the co-operative society.

TAXATION OF INDIVIDUALS/HUF/AOPs OR BOIs

(1) Default Tax Regime [Section 115BAC]

Individuals/ Hindu Undivided Family (HUF)/ Association of Persons (AoPs) other than a co-operative society / Body of Individuals (BoIs) and Artificial Juridical Persons have to pay tax at *concessional rates of tax provided under section 115BAC. The tax rates given under section 115BAC are the default tax rates unless the assessee exercises an option to shift out of the said regime. However, such persons have to forego certain exemptions and deductions under this regime. Alternatively, they can exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the regular provisions of the Act at the tax rates prescribed by the Annual Finance Act of that year.*

I. Concessional tax rates under section 115BAC

Individuals/ HUF/ AoPs other than a co-operative society/ BoIs or artificial judicial persons (Assessment of Individuals/ AoPs/ HUFs are discussed later on under this chapter) *other than those who exercise the option to opt out this regime under section 115BAC(6), have to pay tax in respect of their total income (other than income chargeable to tax at special rates under Chapter XII such as section 111A, 112, 112A, 115BB, 115BBJ etc.) at the following concessional rates, subject to certain conditions specified under section 115BAC(2) –*

(i)	*Upto ₹ 3,00,000*	*NIL*
(ii)	*From ₹ 3,00,001 to ₹ 6,00,000*	*5%*
(iii)	*From ₹ 6,00,001 to ₹ 9,00,000*	*10%*
(iv)	*From ₹ 9,00,001 to ₹ 12,00,000*	*15%*
(v)	*From ₹ 12,00,001 to ₹ 15,00,000*	*20%*
(vii)	*Above ₹ 15,00,000*	*30%*

II. Conditions to be satisfied for availing concessional rates of tax: *The following are the conditions to be satisfied for availing concessional rates of tax:*

S. No.	Particulars
(1)	***Certain deductions/exemptions not allowable:*** *Section 115BAC(2) provides that while computing total income, the following deductions/exemptions would not be allowed:*

Section	Exemption/Deduction
10(5)	*Leave travel concession*
10(13A)	*House rent allowance*
10(14)	*Exemption in respect of special allowances or benefit to meet expenses relating to duties or personal expenses (other than those as may be prescribed for this purpose).*
10(17)	*Daily allowance or constituency allowance of MPs and MLAs*

	10(32)	*Exemption in respect of income of minor child included in the income of parent*
	10AA	*Tax holiday for units established in SEZ*
	16	*(i) Entertainment allowance* *(ii) Professional tax*
	24(b)	*Interest on loan in respect of self-occupied property*
	32(1)(iia)	*Additional depreciation*
	33AB	*Tea/Coffee/Rubber development account*
	33ABA	*Site Restoration Fund*
	35(1)(ii),(iia),(iii) or 35(2AA)	*Deduction in respect of contribution to* *- notified approved research association/ university/college/ other institutions for scientific research [Section 35(1)(ii)]* *- approved Indian company for scientific research [Section 35(1)(iia)]* *- notified approved research association/ university/college/other institutions for research in social science or statistical research [Section 35(1)(iii)]* *- An approved National laboratory/ university/IIT/ specified person for scientific research undertaken under an approved programme [Section 35(2AA)]*
	35AD	*Investment linked tax incentives for specified businesses*
	35CCC	*Deduction in respect of expenditure incurred on notified agricultural project*
	80C to 80U	*Deductions under Chapter VI-A (other than employers contribution towards NPS under section 80CCD(2), Central Government contribution towards Agnipath Scheme under section 80CCH(2) and deduction in respect of employment of new employees under section 80JJAA).*
(2)	**Certain losses not allowed to be set-off:** While computing total income, set-off of any loss - (i) carried forward or depreciation from any earlier assessment year, if such loss or depreciation is attributable to any of the deductions referred to in (1) above; or (ii) under the head house property with any other head of income; would **not be** allowed.	
(3)	**Depreciation or additional depreciation:** Depreciation u/s 32 is to be determined in the prescribed manner. Depreciation in respect of any block of assets entitled to more than 40%, would be restricted to 40% on the written down value of such block of assets. Additional depreciation u/s 32(1)(iia), however, cannot be claimed.	

(4)	**Exemption or deduction for allowances or perquisite:** While computing total income, any exemption or deduction for allowances or perquisite, by whatever name called, provided under any other law for the time be ing force in India would not be allowed.
(5)	In case of a person having a unit in IFSC referred to in section 80LA(1A), whose income is chargeable to tax under section 115BAC(1A), deduction under section 80LA would be allowed subject to fulfilment of the conditions specified in that section.

***Additional points*:**

(i) An employee whose income is chargeable to tax under section 115BAC (1A) would be entitled for -

- *travelling allowance (i.e., allowance granted to meet the cost of travel on tour or transfer);*
- *daily allowance (i.e., allowance granted on tour or for the period of journey in connection with transfer, to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty);*
- *conveyance allowance (i.e., allowance granted to meet the expenditure incurred on conveyance in performance of duties of an office or employment of profit, where free conveyance is not provided by the employer); and*
- *exemption in respect of transport allowance granted to an employee who is blind or deaf and dumb or orthopedically handicapped with disability of the lower extremities of the body to the extent of ₹ 3,200 p.m.*

(ii) An individual, being an employee paying tax as per section 115BAC, would not be entitled for exemption of perquisite of free food and non-alcoholic beverages provided by an employer through paid vouchers.

(iii) Total income under default tax regime should be computed without set-off of any loss brought forward or depreciation from any earlier assessment year, where such loss or depreciation is attributable to any of the deductions listed in (1) above. Such loss and depreciation would be deemed to have been already given effect to and no further deduction for such loss or depreciation shall be allowed for any subsequent year.

Where income-tax on total income of the assessee is computed under this section and there is a depreciation allowance in respect of a block of asset from an earlier assessment year attributable to additional depreciation u/s 32(1)(iia), which has not been given full effect to prior to A.Y. 2024-25 and which is not allowed to be set-off in the A.Y.2024-25 due to section 115BAC, corresponding adjustment shall be made to the WDV of such block of assets as on

1.4.2023 in the prescribed manner i.e., the WDV as on 1.4.2023 will be increased by the unabsorbed additional depreciation not allowed to be set-off.

Example: *Let us consider the case of Mr. X, who carries on business of manufacturing of steel. He has unabsorbed depreciation as on 1.4.2023, which includes amount attributable to additional depreciation u/s 32(1)(iia) of P.Y.2022-23 or any earlier previous year in respect of block of plant and machinery. If he pays tax under default tax regime under section 115BAC for P.Y.2023-24 relevant to A.Y.2024-25, the amount so attributable to additional depreciation of earlier year remaining unabsorbed as on 1.4.2023 would not be eligible for set-off against current year income and no further deduction for such loss or depreciation shall be allowed for any subsequent year. Accordingly, the WDV of the block as on 1.4.2023 has to be increased by the said amount not allowed to be set-off.*

III. Time limit for exercising the option to shift out of the default tax regime

(i) In case of an assessee having no income from business or profession: *Where such individual/HUF/AoP (other than a co-operative society)/BoI or Artificial Juridical person is **not** having income from business or profession, he/it can exercise an option to shift out/opt out of the default tax regime under this section and such option has to be exercised along with the return of income to be furnished under section 139(1) for a previous year relevant to the assessment year. In effect, such individual/HUF/AoP/BoI or Artificial Juridical person can choose whether or not to exercise the option of shifting out of the default tax regime in each previous year. He may choose to pay tax under default tax regime under section 115BAC in one year and exercise the option to shift out of default tax regime in another year.*

(ii) In case of an assessee having income from business or profession: *Such individual/HUF/AoP/BoI or Artificial Juridical person having income from business or profession has an option to shift out/ opt out of the default tax regime under this section and the option has to be exercised on or before the due date specified under section 139(1) for furnishing the return of income for such previous year and once such option is exercised, it would apply to subsequent assessment years.*

Such person who has exercised the above option of shifting out of the default tax regime for any previous year shall be able to withdraw such option only once and pay tax under the default tax regime under section 115BAC for a previous year other than the year in which it was exercised.

Thereafter, such person shall never be eligible to exercise option under this section, except where such person ceases to have any business income in which case, option under (i) above would be available.

AMT liability not attracted: *Individual/HUF/AoP/BoI or Artificial Juridical person paying tax under default tax regime under section 115BAC is **not** liable to alternate minimum tax u/s 115JC. Such person would not be eligible to claim AMT credit also.*

Note: *It may be noted that in case of Individual/HUF/AoP/BoI or Artificial Juridical person not having income from business or profession, the total income and tax liability (including provisions relating to AMT, if applicable under normal provisions) may be computed every year both in accordance with the regular provisions of the Income-tax Act, 1961 and in accordance with the provisions of section 115BAC, in order to determine which is more beneficial and accordingly such person may decide whether to pay tax under default tax regime under section 115BAC or exercise the option to shift out and pay tax under normal provisions of the Act for that year.*

(2) Taxation of Individuals

The term "individual" as such has nowhere been defined in the Income-tax Act, 1961. Section 2(31), however, states that "person" *inter alia*, includes an individual. In the commonly understood sense of the term, an individual means a human being or a single person. The person may be major, minor, married or unmarried, possessing sound or unsound mind. All the same, he is assessable as an 'individual' and is liable to pay tax, if the total income earned by him during any previous year exceeds the prescribed limit exempted from tax. If an individual who is liable to pay tax for any year dies before he is assessed to tax, his executor, administrator or legal representative is treated as the individual assessee for purposes of assessment of the income of the deceased person.

(i) Tax rates

Individual assessee can pay tax at concessional rates under the default tax regime under section 115BAC (discussed above). However, he has to forego certain exemptions and deductions under this regime. Alternatively, he can exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the regular provisions of the Act at the tax rates prescribed by the Annual Finance Act of that year.

[The slab rates for A.Y. 2024-25 applicable to an Individual/HUF/AOP/BOI/ Artificial Juridical Person exercising the option of shifting out of the default tax regime are discussed in Chapter 1 in Module 1]

(ii) Assessment of a non-resident individual

The scope of deemed income taxable in the hands of a non-resident as laid down in section 5 is explained in section 9(1) which extends the liability to tax of a non-resident individual in respect of income which although not actually accruing or arising in India deemed to be so accruing or arising, assumes significance in the assessment of non-resident individual. For better understanding of the provisions of section 9, students are advised to refer to *Chapter 21 - "Non-resident Taxation in Module 4 of the Study material.*

(iii) Special concessions in the case of individuals not being citizens of India

Although basically the law of income-tax is applicable alike to both citizens and non-citizens of India, and there is no difference in the general principles for computing the total income under the Income-tax Act, 1961, however, on a consideration of the peculiar circumstances in which a foreigner might come to or live in India, certain concessions and reliefs are granted to them under section 10(6). These have been discussed in detail in *Chapter 21 – "Non-resident Taxation in Module 4 of the Study material.*

(iv) Exemptions, reliefs and concessional rates of tax available to individuals

The tax exemptions and reliefs available under the Act to individuals in respect of income chargeable to tax fall under the following categories:

(a) Income altogether excluded from the total income, and on which in consequence, no income-tax is payable [Section 10].

(b) Deductions from gross total income both in respect of income, a part of which is not chargeable to income-tax and payments made by the assessee, a part or the whole of which is deductible from the gross total income [Chapter VIA]

However, certain exemption and deductions are not available where an individual is paying tax as per the default regime under section 115BAC(1A).

(v) Rebate of tax and relief in certain cases

- **Income from association of persons or bodies of individuals:** If the assessee is a member of an association of persons or a body of individuals (other than a company, co-operative society or society) income-tax shall not be payable by him in respect of any portion of the amount receivable by him from the association or body on which tax has already been paid by the association or body at the maximum marginal rate or any higher rate [Section 86].

Further, if the total income of AOP or BOI is not chargeable to income-tax, then the share of member shall be chargeable to tax as part of his total income. Thus, in such case, the share of member shall form part of his total income.

For the purposes of this provision in the case of an association of persons which is assessable under section 67A, the members of the AOP whose shares in the income are indeterminate or unknown, will be entitled to receive equal shares in the income of the AOP and the individual share of such member will be determined accordingly.

- ***Rebate of income-tax to an individual resident in India:*** *In order to provide tax relief to the individual tax payers, section 87A provides a rebate from the tax payable by an assessee, being an individual resident in India.*

Rebate to resident individual paying tax under default tax regime u/s 115BAC

(i) *If total income of such individual* ***does not exceed ₹ 7,00,000****, the rebate shall be equal to the amount of income-tax payable on his total income for any assessment year or an amount of* ***₹ 25,000****, whichever is less.*

The amount of rebate under section 87A shall not exceed the amount of income-tax (as computed before allowing such rebate) on the total income of the assessee with which he is chargeable for any assessment year.

ILLUSTRATION 12

Mr. X aged 34 years and a resident in India, has a total income of ₹ 6,70,000, comprising his salary income and interest on bank fixed deposit. Compute his tax liability for A.Y.2024-25 under default tax regime under section 115BAC.

SOLUTION

Computation of tax liability of Mr. X for A.Y. 2024-25

Particulars	₹
Tax on total income of ₹ 6,70,000	
Tax@10% of ₹ 70,000 + ₹ 15,000 [5% of ₹ 3,00,000 i.e., from ₹ 3,00,000 to ₹ 6,00,000]	22,000
Less: Rebate u/s 87A (Lower of tax payable or ₹ 25,000)	22,000
Tax Liability	**Nil**

(ii) *If total income of such individual* ***exceeds ₹ 7,00,000*** *and income-tax payable on such total income exceeds the amount by which the total income is in excess of ₹ 7,00,000, the rebate would be as follows.*

Step 1 –** Total income (-) ₹ 7 lakhs **(A)

Step 2 -** Compute income-tax liability on total income **(B)

Step 3 -** If **B > A**, rebate under section 87A would be a **B – A.

The amount of rebate under section 87A shall not exceed the amount of income-tax (as computed before allowing such rebate) on the total income of the assessee.

ILLUSTRATION 13

Ms. Pallavi aged 32 years and a resident in India, has a total income of ₹ 7,18,000, comprising his salary income and interest on bank fixed deposit. Compute his tax liability for A.Y.2024-25 under default tax regime under section 115BAC.

SOLUTION

Computation of tax liability of Ms. Pallavi for A.Y. 2024-25

Particulars	₹	
Step 1: Total Income of ₹ 7,18,000 - ₹ 7,00,000	18,000	**(A)**
Step 2: Tax on total income of ₹ 7,18,000 Tax@10%of ₹ 1,18,000 + ₹ 15,000	26,800	**(B)**
Step 3: Since B > A, rebate u/s 87A would be B - A [₹ 26,800 - ₹ 18,000]	8,800	
	18,000	
Add: HEC@4%	720	
Tax Liability	**18,720**	

<u>Rebate to a resident individual paying tax under optional tax regime (normal provisions of the Act)</u>

*If total income of such individual **does not exceed ₹ 5,00,000**, the rebate shall be equal to the amount of income-tax payable on his total income for any assessment year or an amount of **₹ 12,500**, whichever is less.*

The amount of rebate under section 87A shall not exceed the amount of income-tax (as computed before allowing such rebate) on the total income of the assessee with which he is chargeable for any assessment year.

- **Relief from taxation in respect of income from retirement benefit account maintained in a notified country [Section 89A]:** Where a specified person has income accrued in a specified account, such income shall be taxed in such manner and in such year as may be prescribed.

Meaning of certain terms:

Terms	Meaning
Specified account	An account maintained in a notified country by the specified person in respect of his retirement benefits and the income from such account is not taxable on accrual basis but is taxed by such country at the time of withdrawal or redemption.
Notified country	A country as notified by the Central Government. So far vide Notification No. 25/2022, dated 4.4.2022, Canada, USA and UK have been notified by the Central Government.
Specified person	A person resident in India who opened a specified account in a notified country while being non-resident in India and resident in that country.

Accordingly, the CBDT has, vide Notification No.24/2022 dated 4.4.2022 inserted Rule 21AAA providing for taxation of income from retirement benefit account maintained in a notified country.

Option to be exercised by specified person - Where a specified person has income accrued in a specified account(s) during P.Y.2021-22 or thereafter, then, at the **option of the specified person**, such income would be included in the total income of the previous year relevant to the assessment year in which income from the said specified account(s) is taxed **at the time of withdrawal or redemption**, as the case may be, in the notified country. The option has to be exercised for all the specified accounts maintained by the specified person.

Exclusions from total income of specified person - Where the option has been exercised by a specified person, the total income of the specified person for the previous year in which income is taxable would **not** include the income which:

- has already been included in the total income of such specified person in any of the earlier previous years during which such income accrued and tax thereon has been paid under the Act; or
- was not taxable in India, in the previous year during which such income accrued, on account of,
  - such specified person being a non-resident, or resident but not ordinarily resident, during that previous year; or
  - application of the DTAA, if any.

Foreign tax, if any, paid on such income would be ignored for the purposes of computation of the foreign tax credit under Rule 128.

Option once exercised cannot be withdrawn - The option has to be exercised in the prescribed form, which has to be furnished electronically under digital signature or electronic verification code on or before the due date u/s 139(1). The option once exercised for a specified account(s) in respect of a previous year in the prescribed form would apply to all subsequent previous years and cannot be subsequently withdrawn for the previous year for which the option was exercised or any previous year subsequent to that previous year (except in case where the specified person becomes a non-resident in any subsequent previous year).

Consequences when specified person becomes non-resident in a subsequent previous year - In case the specified person, after exercising option in the prescribed form for any previous year, say, P.Y.2023-24, becomes a non-resident during any subsequent previous year, say, P.Y.2026-27, (referred to as the relevant previous year) then, the option exercised above would be deemed to have never been exercised with effect from the relevant previous year, i.e., from P.Y.2026-27. The income which has accrued in the specified account(s) during the previous year, beginning with the previous year in which option was exercised (P.Y.2023-24) till the previous year immediately preceding the relevant previous year (i.e., upto P.Y.2025-26) would be taxable during the previous year immediately preceding the relevant previous year (i.e., in the P.Y.2025-26). The tax on such income has to be paid on or before the due date for furnishing the return of income for the relevant previous year (due date for P.Y. 2026-27).

(vi) Rates of Surcharge Applicable to Individuals

Higher surcharge of 25% and 37% is leviable, where the total income of individuals/ HUF/AOPs/BoIs/artificial juridical persons exceeds ₹ 2 crores and ₹ 5 crores, respectively, and the individual has exercised the option to shift out of the default regime under section 115BAC. However, the higher surcharge rates would not be applicable on tax payable on dividend income or tax payable at special rates under section 111A, 112 and 112A. ***Further, where an individual is paying tax as per the default regime under section 115BAC(1A), the maximum rate of surcharge is 25% for total income exceeding ₹ 2 crores.***

[Refer to Chapter 1: Basic Concepts in Module 1 of the Study Material, containing rates of surcharge for understanding the manner of computation of surcharge on capital gains, dividend and other income components of total income]

(3) Taxation of Hindu Undivided Families

(i) Concept of HUF

A Hindu undivided family (HUF) is treated as a separate entity for the purpose of assessment under the Income-tax Act, 1961. It is included in the definition of the term "person" under section 2(31). The levy of income-tax is on "every person". Therefore, income-tax is payable by a HUF.

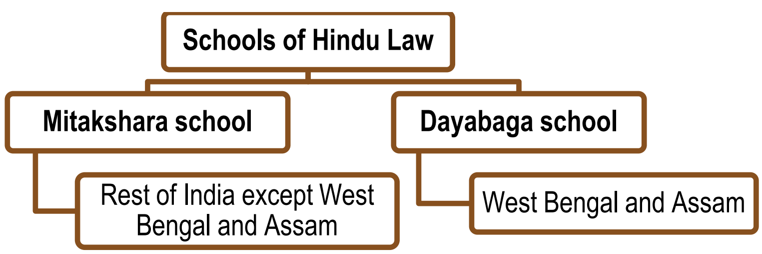
"Hindu undivided family" has not been defined under the Income-tax Act. The expression is, however, defined under the Hindu Law as a family, which consists of all males lineally descended from a common ancestor and includes their wives and daughters.

Some members of the HUF are called **co-parceners**. They are related to each other and to the head of the family. HUF may contain many members, but members within four degrees including the head of the family (Karta) are called co-parceners. A Hindu Coparcenary includes those persons who acquire an interest in joint family property by birth. Earlier, only male descendants were considered as coparceners. With effect from 6th September, 2005, daughters have also been accorded coparcenary status. It may be noted that only the coparceners have a right to demand partition.

A daughter of coparcener by birth shall become a coparcener in her own right in the same manner as the son. Being a coparcener, she can claim partition of assets of the family. The rights of a daughter in coparcenary property are equal to that of a son. However, other female members of the family, for example, wife or daughter-in-law of a coparcener are mere members of the HUF and are not eligible for such coparcenary rights.

The existence of a HUF does not arise from a contract but arises from status. There need not be more than one male member or one female coparcener w.e.f. 6th September, 2005 to form a HUF. The Income-tax Act, 1961 also does not indicate that a HUF as an assessable entity must consist of at least two male members or two coparceners.

Under the Income-tax Act, 1961, Jain undivided families and Sikh undivided families would also be assessed as a HUF.



The basic difference between the two schools of Hindu law with regard to succession is as follows:

Dayabaga school of law	Mithakshara school of law
Prevalent in West Bengal and Assam.	Prevalent in rest of India.
Nobody acquires the right, share in the property by birth as long as the head of family is living.	One acquires the right to the family property by his birth and not by succession irrespective of the fact that his elders are living.
Thus, the children do not acquire any right, share in the family property, as long as his father is alive and only on death of the father, the children will acquire right/share in the property. Hence, the father and his brothers would be the coparceners of the HUF.	Thus, every child born in the family acquires a right/ share in the family property.

(ii) Assessment of Hindu Undivided family

The income of a HUF is to be assessed in the hands of the HUF and not in the hands of any of its members. This is because HUF is a separate and a distinct tax entity.

(iii) Assessment of HUF after partition of HUF [Section 171]

There are two types of partition. They are –

(a) **Total partition –** is a partition by which the entire family property is divided amongst the coparceners. After the total partition, the HUF ceases to exist as such.

(b) **Partial partition –** is a partition which is partial as regards either the persons constituting the joint family or as regards the properties belonging to the joint family or both. In case of a partial partition as regards persons constituting the joint family, some coparceners may separate from the joint family while the others might continue to remain as part of the joint family. In case of a partial partition as regards the property, there may be a division or severance of interest in respect of some part of the estate of the joint family, while the rest of the estate may continue to remain as property of the joint family.

Effect of partial partitions made after 31st December 1978: Partial partitions after 31st December 1978 are not recognized for tax purposes. If any partial partition has been effected after 31.12.1978, then no claim of such partial partition shall be recorded by the Assessing Officer. Such family will continue to be assessed as if no such partial partition has been effected. Every member of the HUF, immediately before such partial partition, and the HUF shall be jointly and severally liable for any tax, penalty, interest, fine or other sum payable under the Act. The several liability of a member would be proportionate to the share of joint family property allotted to him on such partial partition.

When a claim of total partition of HUF has been made by any member of the HUF on behalf of the HUF, the Assessing Officer shall inquire into such claim. For this purpose, he shall give notice to all the members of the HUF. Thereafter, the Assessing Officer shall, on completion of inquiry, record a finding as to whether total partition has taken place and if so, the date when such partition was effected.

If partition has been effected in the previous year, the total income of the HUF for the previous year up to the date of partition shall be assessed as income of the HUF. Every member of the HUF, in addition to any tax for which he is separately liable, is jointly and severally liable for payment of tax on such assessed income of the HUF. The several liability of a member would be proportionate to the share of joint family property allotted to him on such partition.

If partition has been effected after expiry of previous year, the total income of the HUF for the previous year shall be assessed as income of the HUF. Every member of the HUF is jointly and severally liable for payment of tax on such assessed income of the HUF.

If partition has already taken place: If the Assessing Officer finds after completion of the assessment of a HUF that the partition has already taken place, the Assessing Officer shall proceed to recover the tax from every person who was a member of the family before the partition.

Every such member of the HUF is jointly and severally liable for payment of tax on such assessed income of the HUF.

(iv) Computation of total income of HUF

The following points should be taken into consideration while determining the total income of HUF -

(a) Income from the transfer of a self-acquired property by an individual to his HUF for inadequate consideration or conversion of the self-acquired property into property of the HUF is not considered as the income of the HUF. It would be included in the income of the individual member who transferred the property to the HUF [Section 64(2)].

(b) Section 10(2) exempts any receipt by an individual as a member of a HUF out of the family income.

(c) If a member of the HUF receives any fee or remuneration as a director or a partner in a company or firm as a consequence of the investment made in such concern out of the funds of the HUF, such fee/remuneration shall constitute income of the HUF. However, any such fee or remuneration earned by a member of a HUF as a director or partner for services rendered purely in his personal capacity, will be included in the income of the individual member and not the HUF.

(v) Tax rates

HUF can pay tax at concessional rates under the default tax regime under section 115BAC (discussed earlier). However, it has to forego certain exemptions and deductions under this regime. Alternatively, it can exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the regular provisions of the Act at the tax rates prescribed by the Annual Finance Act of that year.

[The slab rates for A.Y. 2024-25 applicable to an Individual/HUF/AOP/BOI/ Artificial Juridical Person, exercising the option of shifting out of the default tax regime are discussed in Chapter 1 in Module 1].

(vi) Rates of surcharge applicable to HUF

Higher surcharge of 25% and 37% is leviable, where the total income of individuals/ HUF/ AOPs/BOIs/artificial juridical persons exceeds ₹ 2 crores and ₹ 5 crores, respectively and the HUF has exercised the option to shift out of the default tax regime. However, the higher surcharge would not be applicable on tax payable on dividend income and tax payable at special rates under section 111A, 112 and 112A. ***Further, where an HUF is paying tax as per the default regime under section 115BAC(1A), the maximum rate of surcharge is 25% for total income exceeding ₹ 2 crores.*** *[Refer to Chapter 1: Basic Concepts containing rates of surcharge for understanding the manner of computation of surcharge on capital gains, dividends and other income components of total income].*

(vii) Conversion of separate property into property of HUF

Generally, income from self-acquired property of an individual, who is a member of a HUF will be assessed as his personal income and not as the income of the family. However, the individual can convert his separate properties into the property of the HUF. There are no legal formalities to be complied with. These principles have been upheld by various judicial rulings.

It naturally follows that once the assets belonging to the individual are impressed with the character of joint family property, the income arising therefrom, should be assessed as the income of the HUF. However, the deeming provisions of section 64(2) specifically provide that the entire income from the converted property is taxable as the income of the transferor. This provision applies not only to property converted in the above manner but also covers transfer of property by an individual, directly or indirectly, to the family otherwise than for adequate consideration, in other words, gifts. Accordingly, where an individual makes direct or indirect gift of his separate property to the Hindu Undivided family of which he is a member or if he transfers his separate property to his family for less than its fair market value, nothing would be taxable in the hands of HUF u/s 56(2)(x) and the provisions of section 64(2) will be attracted and the entire income from such separate property converted into HUF property will be included in the total income of the individual.

(viii) Business in the personal capacity of the Karta or member

Where the Karta or any member of a joint family carries on a business on his personal capacity, the income from any such business would constitute his personal income. It does not matter even if the business of the member and of the joint family are identical in nature and size. Suppose the capital for the individual's business is borrowed from the funds of the family what will be the position? Consider the following example.

Example: *A HUF consists of the Karta, his wife, two sons and daughter. The HUF runs a departmental store. One of the two sons is qualified in business administration and the other one is an automobile engineer. Together they start a garage for repairing all types of motor cars. The technical aspects are looked after by the engineer while the general administration is taken care of by the son qualified in business administration. For starting the business, the HUF has advanced an interest-free loan of ₹ 50,000. The business is yielding good profits. Now the question arises whether the income from the business should be assessed in the hands of the Hindu undivided family.*

It is obvious that the family, in providing the interest-free loan to the business of the brothers has suffered a detriment. However, the Delhi High Court has laid down the following proposition in this connection in the case of CIT vs. Charandass Khanna & Sons (1980) 123 ITR 194 (Delhi). If investment plays a minor role and it is primarily the personal efforts, specialised skill and enterprise of the individual coparceners which resulted in the new business being set up and the profits accruing, it may not essentially be said that the income belongs to the HUF. In the present case, the good profits are more due to the specialised skills acquired by the two sons in their respective fields. Of course, the capital, got from the *family as interest free loan, has its role to play but it is nevertheless a minor one. Therefore, we can say that the income from the business set up by the brothers is assessable in their hands as individuals according to the agreed rate of sharing and not as the income of the family.*

The Supreme Court has also upheld this principle in *K.S. Subbiah Pillai vs. CIT (237 ITR 11)*. It was held that remuneration received on account of personal qualification and exercise of individual exertion was assessable as individual income and not as income of HUF. The following principles have been broadly applied by the Supreme Court for determining the character of the receipt by way of remuneration paid to a coparcener:

Remuneration received on account of personal qualification and exercise of individual exertion is assessable as individual's income and not as income of HUF.

(i) when the remuneration received by the coparcener though not in form but in substance was one of the modes of return made to the family because of investment of the family funds, it has to be assessed as the income of Joint Hindu Family.

(ii) when the remuneration is not paid to the detriment of the family funds, it is assessable as the income of recipient Karta or coparcener as an individual.

(iii) when it is a compensation for the services, skill or labour of the coparcener, it has to be assessed as the income of such a coparcener in his individual capacity.

Example: *The Karta of a HUF receives salary in his capacity as a treasurer and secretary of a bank. The HUF has furnished ₹ 1,00,000 as security deposit. Decide whether the salary can be assessed as the income of the HUF.*

The position of treasurer and secretary requires considerable personal skill and integrity on the part of the incumbent. It is true that the security deposit might have been furnished by the HUF, however, since the salary is paid to the Karta primarily for the exercise of his personal skill and integrity, it is to be assessed as his individual income.

Hence, students should carefully understand the following:

(a) Where the funds of a HUF are invested in a company or a partnership firm, the dividends or share of profits are generally taxable as the income of the family. In such a case the fee, salary, commission or other remuneration received by the Karta, or any member of the family, in his capacity as director or partner would also be taxable as income of the family. The reasons for this treatment are as follows:

(1) The income is earned by the detriment to the joint family funds.

(2) It is earned with the aid of joint family funds.

(3) There is real and sufficient connection between the investment of the joint family funds and the income by way of remuneration earned.

(b) However, where the income is earned by the Karta or any other member of the family by the exercise of the personal skill, the income should be assessed in their individual hands even if some detriment is caused to the family funds, say, by way of loan, guarantee etc. whose role is only secondary.

(ix) Members of HUF in Partnership firms

A Hindu undivided family can become a partner in a firm. However, since it has no separate legal entity of its own, its Karta alone can be partner in the firm representing the family. The coparcenary has no place in the partnership.

When the Karta of Hindu undivided family enters into a partnership with strangers, the member of the family does not, *ipso facto,* become partners in that firm. They have no right to take part in its management or to sue for its dissolution. The creditors of the firm are entitled to proceed against the joint family assets including the shares of the non-partner coparceners for their debts. This is because under Hindu Law, the Karta has the right when carrying on business to pledge the credit of the joint family to the extent of its assets. The liability on the part of other members of the HUF arises by reason of their status as coparceners and not by reason of any contract of partnership by them.

Partnership between Karta representing family and Coparcener: A Karta of a HUF representing the family on the one hand, and a member of that family in his individual capacity on the other, can enter into a valid partnership. An individual coparcener, while remaining joint, can possess, enjoy and utilise in any way he likes, property which is his individual property. Therefore, when he enters into partnership with the family, he retains his share and interest in the property of the family while he simultaneously enjoys the benefit of his separate property and fruits of its investment.

(x) Salary paid to Karta for managing the family's business

If remuneration is paid to the Karta of Hindu undivided family under a valid agreement which is *bona fide* and in the interest of and expedient for the business of the family and the payment is genuine and not excessive, such remuneration would be an expenditure laid out wholly and exclusively for the purpose of the business of the family and would be allowable as an expenditure.

(xi) Salary paid to member

A Hindu undivided family can be allowed to deduct salaries paid to member of the family if the payment is made as a matter of commercial or business expediency, but the service rendered must be to the family.

(xii) Gifts to HUF

Can an outsider make a gift to HUF? Under what circumstances will a gift made by an outsider be considered as a gift to the HUF? The answers to these questions are as follows:

(a) If the HUF to which such a gift is made consists of only one coparcener, then the gifted property can be held by the members of the family only as tenants-in-common, i.e., the income arising out of such gifted property can be assessed as income in the hands of the Association of Persons (AOP).

(b) If the HUF to which such a gift is made consists of minimum two coparceners, then the gifted property can be held by the members of the family as joint tenants and the income arising out of such gifted property can be assessed as income in the hands of the joint Hindu family.

Section 56(2)(x) provides that any sum of money or value of property received by a HUF without consideration would be chargeable to income-tax under the head "Income from other sources", if the aggregate value or in case of immovable property stamp duty value of the property exceeds ₹ 50,000 during a year. However, a sum received by a HUF from its relative, i.e., a member of the HUF, is exempt. *For details, refer Chapter 5 on "Income from other sources".*

ILLUSTRATION 14

Mr. Ram (aged 56) is Karta of his HUF. The HUF consists of himself, his wife and two sons viz. Mr. C (aged 28) and Minor D (aged 16). The HUF is assessed to income tax and has business income from the year 2015-16 onwards. The business income of HUF for the year ended 31.3.2024 is ₹ 5,00,000 (computed). Mr. Ram is employed in a private company and his salary income for the same period is ₹ 6,10,000 (computed).

You are requested to answer the following treating each of them as independent situations:

(i) Mr. C gave cash gift of ₹ 1,00,000 to the HUF of Mr. Ram. What would be the total income of HUF?

(ii) *The HUF has one house property fetching rent of ₹ 10,000 per month and some movable assets. There is a proposal to make a partial partition of HUF by allotting the house property to Mr. C. Is it advisable to do a partial partition?*

(iii) *Minor D earned ₹ 70,000 by use of his special skill and talent. How would his income be taxed?*

(iv) *A car owned personally by Mr. Ram was blended with HUF during the year. It was leased out for a monthly rent of ₹ 10,000 from 1-10-2023. How would this income be taxed?*

SOLUTION

(i) Cash gift of ₹ 1 lakh by Mr. C, Ram's major son, to the HUF of Mr. Ram would not be taxable in the hands of the HUF, since gifts from a relative of the HUF does not fall within the scope of income taxable under section 56(2)(x). Since Mr. C, being Mr. Ram's son, is a member of Ram's HUF, he is a relative of the HUF. Hence, the total income of HUF would be ₹ 5 lakhs, being the business income computed.

Note - *Salary income of Mr. Ram, the Karta of the HUF, who is employed in a private company would be taxed in his individual hands, since the remuneration earned by the Karta on account of the personal qualifications and exertions and not on account of the investment of the family funds cannot be treated as income of the HUF.*

(ii) Partial partition (after 31.12.1978) is not recognized and the HUF, which has been hitherto assessed to tax, shall continue to be liable to be assessed as if no such partial partition has taken place [Section 171(9)].

The rental income in this case would continue to be assessed in the hands of the HUF, even after partial partition. Therefore, it is not advisable to do a partial partition.

(iii) Income of ₹ 70,000 earned by Minor D by use of his special skill and talent would be taxable in his individual hands. It will not be included in the hands of his parent by virtue of the exception to section 64(1A) contained in the proviso to section 64(1A).

(iv) As per section 64(2), where a member of the HUF blends his self-acquired property for inadequate consideration with the HUF, income derived therefrom is deemed to arise to the transferor-member and not to the HUF. In this case, Mr. Ram has blended his personal property (i.e., car) with the HUF.

Since there is no consideration in case of blending, the income from car computed in the prescribed manner, [which can be as per the presumptive provisions or lease rental of ₹ 60,000 (₹ 10,000 × 6 months) *less* depreciation] would be deemed as the income of Mr. Ram.

(4) Taxation of AOP/ BOI and their members

Section 2(31) defines "person" as including "association of persons" or a "body of individuals". The expression association of persons is to be understood in its ordinary sense meaning there by a group or congregation of persons. The expression association of persons is of a wider connotation and scope than that of a body of individuals. An association of persons may have as its members not only individuals (including minors) but also companies, firms, joint families and other associations. When there is a group of persons formed for the promotion of an enterprise or when co-adventures join together in a common action, they are assessable as an association of persons. Ordinarily, there can be no association of persons in business unless the members of the group join together out of their own volition or will.

In order to constitute an association of persons, the members thereof must join any common purpose or common action and the object of the association must be to produce income. Mere receipt of income by a group of members in common will not make it an association unless income is earned by its own effort in common.

The co-owners, co-legatees and joint receivers joining for a **common purpose** or action would be assessable as an association of persons. For example, if the funds of a number of beneficiaries are put together and one business is carried on with the combined resources by the trustee, guardian or administrator, the business must be regarded as a single business assessable in the hands of an association of persons. However, section 26 specifically provides an exception to the assessment of co-owners as an association of persons. According to that section, where the shares of the co-owners in respect of income from house property are defined and ascertainable, the co-owners must be assessed not as an association of persons but individually even if the property may be owned and managed and developed jointly by the co-owners.

For the purpose of assessment, it is not necessary that the association should be legally constituted. In other words, it is not necessary that there must be mutual rights and obligations amongst the members enforceable in law. The illegality, invalidity or incorrectness in the constitution of an association does not in any way affect its liability to tax or its chargeability as a unit of assessment. A partnership which is illegal or otherwise void will have to be assessed as an association of persons. The question whether there is an association of persons or not depends upon the facts and circumstances of each case.

(i) Tax Rates

An AOP/BOI can pay tax at concessional rates under the default tax regime under section 115BAC (discussed earlier). However, it has to forego certain exemptions and deductions

under this regime. Alternatively, it can exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the regular provisions of the Act at the tax rates prescribed by the Annual Finance Act of that year.

[The slab rates for A.Y. 2024-25 applicable to an Individual/HUF/AOP/BOI/ Artificial Juridical Person, exercising the option of shifting out of the default tax regime are discussed in Chapter 1 in Module 1].

(ii) Computation of total income of AOPs/BOIs

1. Computation of total income in the case of an association of persons or body of individuals will be done in the same manner as in the case of any other assessee.

2. In computing the total income, interest, salary, bonus, commission, remuneration, by whatever name called, paid to members will not be allowed [Section 40(ba)]

However, in the case of payment of interest the following provisions will apply:

Explanation 1* below section 40(ba)*: If interest is paid by an AOPs/BOIs to any member who has also paid interest to the AOPs/BOIs then only that amount of interest paid by the AOPs/BOIs will be disallowed in its assessment which is in excess of the interest paid by the member to the AOPs/BOIs i.e., net interest shall be disallowed.

Explanation 2* below section 40(ba)*: If an individual is a member of an AOPs/BOIs in a representative capacity, on behalf of or for the benefit of another person, then interest paid by the AOPs/BOIs to such individual in his personal capacity will not be taken into account for the purpose of disallowance. However, interest paid by the AOPs/BOIs to such individual or *vice-versa* as representative member or interest paid by the AOPs/BOIs directly to the beneficiary will be taken into account for the purpose of disallowance.

Explanation 3* below section 40(ba)*: If interest is paid to a member who is not a member in a representative capacity, but such interest is received by him on behalf of or for the benefit of another person the interest payment will be allowed.

♦ **Computation of tax where shares of members in AOPs/BOIs are unknown [Section 167B]**: Tax on the total income would be computed as follows:

	Circumstances	Taxability
1.	If individual share of any member is not known	Tax will be levied at the maximum marginal rate. However, if total income of any member of AOPs/BOIs is taxable at a rate higher

		than maximum marginal rate (for example, a foreign company which is a member), then total income of AOPs/BOIs shall be chargeable to tax at such higher rate of tax.
2.	If individual share of a member is known and	
	(a) total income of any member (excluding his share from AOPs/BOIs) exceeds the basic exemption limit ***[₹ 3,00,000 as per default regime under section 115BAC or ₹ 2,50,000/₹ 3,00,000/ ₹ 5,00,000 as per optional regime under normal provisions]***	The AOPs/BOIs will pay tax at the maximum marginal rate. However, if total income of any member of AOPs/BOIs is taxable at a rate higher than maximum marginal rate (for example, a foreign company which is a member), then, total income of AOPs/BOIs shall be chargeable to tax as follows: • Portion of income attributable to such member shall be taxable at such higher rate as applicable to that member. • Balance income shall be taxable at the maximum marginal rate of tax.
	(b) no member has total income (excluding his share from AOPs/BOIs) exceeding the basic exemption limit ***[₹ 3,00,000 as per default regime under section 115BAC or ₹ 2,50,000/₹ 3,00,000/ ₹ 5,00,000 as per optional regime under normal provisions]***	The AOPs/BOIs will pay tax at the as per the default regime under section 115BAC or optional regime as per normal provisions of Income-tax law applicable to an individual.

♦ **Rate of Surcharge applicable to AOP /BOI**

Higher surcharge of 25% and 37% is leviable, where the total income of AOP/BOI exceed ₹ 2 crores and ₹ 5 crores, respectively and they have exercised the option to shift out of the default tax regime.

Where an AOP is paying tax as per the default regime under section 115BAC(1A), the maximum rate of surcharge is 25% for total income exceeding ₹ 2 crores.

However, in respect of the following income, surcharge cannot exceed 15% both under the default regime and under the optional regime as per the normal provisions of the Act:

- *on tax payable at special rates under section 115AD on dividend income or short-term capital gains or long-term capital gains arising from the transfer of securities referred to in 115AD(1)(b);*

- *on tax payable on dividend income and tax payable at special rates under section 111A, 112 and 112A;*

- *where the AOP consists of only company as its member.*

[Refer to Chapter 1: Basic Concepts in Module 1 containing rates of surcharge for understanding the manner of computation of surcharge on capital gains, dividends and other income components of total income and also refer Chapter 21: Non-resident Taxation in Module 4 for the table containing the rates of surcharge applicable to AOPs/BOIs (having any income under section 115AD)]

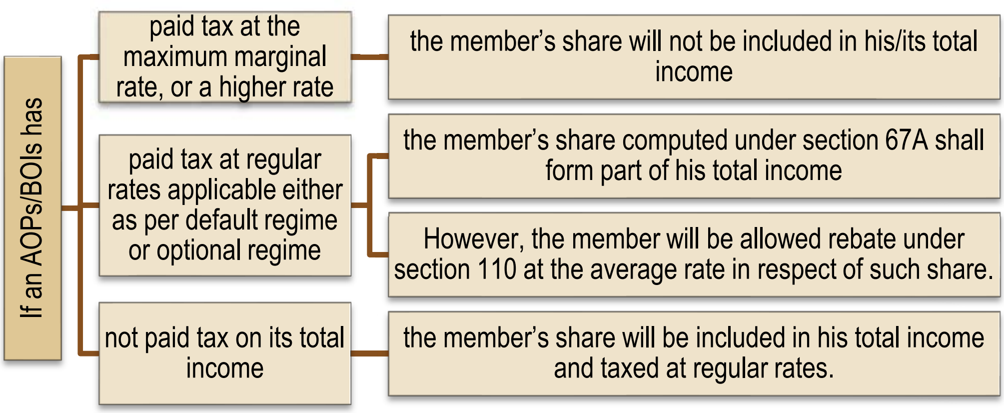
♦ **Assessment of share in the hands of member [Section 86]:**

A member's share in the total income of an AOPs/BOIs will be treated as follows:

- If an AOPs/BOIs has paid tax at the maximum marginal rate, or a higher rate, the member's share in the total income of the AOPs/BOIs will not be included in his total income.

- If the AOPs/BOIs has paid tax at regular rates applicable to an individual, the member's share in the income of the AOPs/BOIs computed under section 67A shall form part of his total income. However, the member will be allowed rebate under section 110 at the average rate in respect of such share.

- If the AOPs/BOIs has not paid tax on its total income, the member's share in the total income of the AOPs/BOIs will be included in his total income and taxed at regular rates.



- **Computation of member's share in the total income of AOPs/BOIs [Section 67A]**: A member's share in the income of an AOPs/BOIs (wherein the shares of members are determinate and known) will be computed as follows:

  (a) Any interest, salary, bonus, commission, remuneration, etc. paid to a member during the previous year will be deducted from the total income of the association or body, and the balance will be apportioned among the members in proportion to their respective shares.

  (b) If the amount apportioned to a member as per (a) is a profit, any interest, salary, etc. paid to him by the association or body during the previous year will be added to that amount and the aggregate sum will be such member's share in the income of the AOPs/BOIs.

  (c) If the amount apportioned to a member as per (a) is a loss, any interest, salary, etc., paid to him by the association or body will be deducted from the amount of loss and the balance sum will be such member's share in the income of the AOPs/BOIs.

  The share of a member in the income/loss of the AOPs/BOIs will, for the purposes of assessment, be apportioned under the various heads of income in the same manner in which income/loss of the association has been determined under each head.

  Any interest paid by a member on capital borrowed by him for the purpose of investment in the AOPs/BOIs will be allowed as deduction while computing his share of income under the head "Profits and gains of business or profession."

- **Determination of tax where total income includes income on which no tax is payable [Section 110]:**

  If the total income of an assessee includes any income on which no income-tax is payable, the assessee would be entitled to a deduction, from the amount of income-tax with which he is chargeable on his total income, of an amount equal to the income-tax calculated at the average rate of income-tax on the amount on which no income-tax is payable.

- **Share of member of an AOPs/BOIs in the income of the AOPs/BOIs to be reduced from net profit for computing book profit for levy of MAT [Section 115JB]**

  (i) Under section 115JB, in the case of a company, if the tax payable on the total income computed as per the normal provisions of the Income-tax Act, 1961 is less than **15%** of its book profit, such book profit shall be deemed to be the total income of the company and the tax payable for the relevant previous year shall be **15%** of its book profit.

(ii) *Explanation 1* below section 115JB(2) provides that the expression "book profit" means profit as shown in the statement of profit and loss account prepared in accordance with the provisions of the Companies Act or in accordance with the provisions of the relevant statute governing a company, as increased or reduced by certain adjustments, as specified thereunder.

(iii) Under section 86, no income-tax is payable on the share of a member of an AOPs/BOIs in the income of the AOPs/BOIs in certain circumstances. A company which is a member of an AOPs is also not required to pay tax in respect of its share in the income of the AOPs in such cases. However, prior to A.Y.2016-17, under section 115JB, a company which is a member of an AOPs was liable to MAT on such share also, since such income was not then excluded from the book profit while computing the MAT liability of the member. It may be noted that in a similar situation, where a company is a partner in a firm, the share in the profits of the firm is exempt in the hands of the partner as per section 10(2A) and no MAT is payable by the partner on such profits, since income to which any provision of section 10 applies, has to be reduced for computing book profit.

(iv) In order to ensure equity, clause (iic) in *Explanation 1* below section 115JB(2) has been inserted with effect from A.Y. 2016-17 to provide that the share of a member of an AOPs or BOIs, in the income of the AOPs or BOIs, on which no income-tax is payable in accordance with the provisions of section 86, should be reduced while computing book profit for levy of MAT under 115JB, if any such amount is credited to statement of profit and loss account. Consequently, clause (fa) has also been inserted in *Explanation 1* to add back the expenditures, if any, debited to the statement to profit and loss, corresponding to such income, while computing book profit for levy of MAT.

ILLUSTRATION 15

JK Associates is an Association of Persons (AOP) consisting of two members, J, aged 40 years and K, aged 37 years. Shares of the members are: 60% (J) and 40% (K). Income of the AOPs for the previous year 2023-24 is ₹ 11 lakhs.

J and K's income, other than income from AOP, amount to ₹ 2.50 lakhs and ₹ 2.90 lakhs, respectively.

Compute tax liability of the AOP assuming that J exercises the option to shift out of the default regime and the AOP and its member K pay tax under default tax regime under section 115BAC.

SOLUTION

Computation of tax of AOP is governed by section 167B. Tax on total income of AOP is computed as follows:

(i) If individual share of a member is known, and the total income of any member, excluding his share from such AOP, exceeds the basic exemption limit, then, the AOP will pay tax at the maximum marginal rate.

(ii) If individual share of a member is known and no member has total income (excluding his share from AOP) exceeding the basic exemption limit, then, the AOP will pay tax at the rates applicable to an individual.

Section 86 provides for assessment of share in the hands of members of AOP as follows:

A member's share in the total income of AOP will be treated as follows:-

(i) If an AOP has paid tax at the maximum marginal rate or a higher rate, the member's share in the total income of AOP will **not** be included in his total income and will be exempt.

(ii) If the AOP has paid tax at regular rates applicable to an individual, the member's share in the income of AOP will be included in his total income and he will be allowed rebate at the average rate of tax in respect of such share.

Tax Liability of J K Associates, AOP

Since none of the members have income, other than income from the AOP, exceeding the basic exemption limit, the AOP would be taxed at the rates applicable to an individual. Therefore, the AOP's tax liability would be follows:

₹ 3,00,000 – ₹ 6,00,000 @5%	₹ 15,000
₹ 6,00,001 – ₹ 9,00,000 @10%	₹ 30,000
₹ 9,00,001 – ₹ 11,00,000 @15%	₹ 30,000
	₹ 75,000
Add: Health & education cess @4%	3,000
Tax Liability	**78,000**

Tax Liability of J and K

Particulars	J ₹	K ₹
Share of profit from AOP	6,60,000	4,40,000
Income from other sources	2,50,000	2,90,000
Total Income (A)	**9,10,000**	**7,30,000**
Tax liability	94,500	28,000
Add: Health and Education cess @ 4%	3,780	1,120
Total tax payable (B)	**98,280**	**29,120**
Average rate of tax [B/A x 100]	10.8%	3.989%
Total tax liability	98,280	29,120
***Less*: Rebate under section 86 read with section 110 in respect of share of profit from AOP** (share in AOP x Average rate of tax)	71,280	17,552
Tax liability of members	27,000	11,568
Tax Payable (Rounded off)	**27,000**	**11,570**

TAXATION OF LOCAL AUTHORITY

(i) General meaning

The expression "local authority" has not been defined by the Income-tax Act, 1961. A local authority is a person under section 2(31) of the Income-tax Act, 1961, and thus, constitutes a separate unit of assessment. It is chargeable to tax on its total income in respect of the previous year, computed in accordance with and under the basic provisions of the Act, which apply to other taxable entities and for all purposes of the Act, this entity is included in the term 'person'. All municipal corporations, or councils, committees, panchayat boards, port trusts, district boards and other authorities legally entitled to or entrusted by the Central or State Government with the control and/or management of a municipal or local fund are covered by the expression 'local authority'.

(ii) Exemptions

Under section 10(20), the income of a local authority which is chargeable to tax under the heads 'Income from house property,' 'Capital gains' and 'Income from other sources' accruing or arising to it anywhere in or outside India and income from a trade or business carried on by it which accrues or arises to it from the supply of a commodity or service with its own jurisdiction area or from the supply of water or electricity within or outside its own jurisdictional area are totally exempt from tax.

In other words, a local authority is taxable only in respect of the income arising to it from any business carried on by it provided that such income arises from the supply of any commodity or service, not being water or electricity outside its jurisdictional area, i.e., territorial limits.

A local authority is said to be resident at the place where the control and management of its affairs are situated, and its residential status is governed by section 6(4). A local authority in India is always resident in India, except where the control and management of its affairs is exercised wholly from outside India.

(iii) Tax rate

After total income, i.e., the income of a local authority chargeable to tax has been determined, the whole of it would attract tax at the rate applicable i.e., the one prescribed by the relevant Finance Act. There is no minimum amount exempt from tax in the case of a local authority. For income tax purposes, local authority is chargeable to tax at 30% on its total income of the previous year computed in accordance with the provisions of the Act, *plus* surcharge @ 12% if its total income exceeds ₹ 1 crore *plus* health and education cess @ 4%.

TAXATION OF MUTUAL CONCERNS

(i) General principles of mutuality –

(a) The first principle of mutuality is that no person can trade with himself or make income out of himself. A mutual association arises where persons forming a group associate together with a common object and contribute monies for achieving that object and divide the surplus amongst themselves in the character. The cardinal requirement in the case of mutual association is that all the contributors to the common fund must be entitled to participate in the surplus and all the participators to the surplus must be contributors to the common fund. In other words, there must be complete identity between the contributors and the participators.

(b) The participation in the surplus need not be immediate but it may assume the shape of a reduction in the future contribution or a division of the surplus on dissolution.

(c) It does not make any difference whether the persons joining together form an association or incorporate a company because the fact of incorporation does not destroy the identity of the contributors and participators.

(d) Where there is mutuality, the fact that some members alone take advantage of the mutual enterprise would not affect the mutual character of the association.

(e) There is nothing in law which prohibits a mutual association from carrying on a trade so long as it is confined to its own members.

(f) It is not necessary that the surplus should be returned to every member of the association pro rata. The identification between the contributors and the participators should be regarded as one whole and not in relation to each individual.

(g) It is not necessary that all the activities of such an association should be mutual in character. There may be activities of a non-mutual character but the exemption from tax will apply to the surplus arising out of the mutual enterprise.

From the above principles we can conclude that one cannot trade with oneself and earn taxable profits thereby. Hence if there is a mutual concern, ordinarily there should be no tax on the profits arising out of mutual operations. But the Income-tax Act, 1961 provides for assessment of the income of a mutual concern in the following circumstances:

(1) Where the mutual concern is a mutual insurance society and the income is derived from the carrying on of any business of insurance.

(2) Where the mutual concern is a trade, professional or similar association and the income in question is derived from specific service performed for its members.

(ii) Insurance business

Under section 2(24)(vii) any surplus accruing to life as well as general mutual insurance concerns will fall within the definition of the word "income" and as such would be taxable as income from business. Section 44 expressly provides the profits and gains of any business of insurance including that carried on by a mutual insurance company or a cooperative society shall be computed not according to the provisions of the Act for computation of income under the various heads but according to the method prescribed in the Rules contained in the First Schedule to the Act.

(iii) Trade and professional associations

A trade, professional or similar association may be a mutual concern. Section 28(iii) enacts that "income derived by a trade, professional or similar association from specific services performed for its members" shall be taxable as business profits. Under section 2(24)(v) any sum chargeable under section 28(iii) is deemed to be income. The object of these provisions seems to be to tax as profit the surplus arising from specific services rendered to members by a mutual trade, professional or similar association which otherwise may not be liable to tax in view of the general principles applicable to mutual concerns.

It may carefully be noted that a trade association is not the same thing as a trading association. A trade association means an association of tradesmen or businessmen for the protection or advancement of their common interests. Again clause (iii) of section 28 taxes the profit accruing only on specific services rendered by an association to its members. Any surplus arising to a mutual association in other way e.g. from entrance fees or members' periodic subscriptions would be outside the scope of this clause and would be non-taxable on the general principles stated above.

Since the surplus arising to trade, professional or similar association during the process of advancement of the common interest of the members is not includible in the taxable income it follows that the concerned expenditure will not also be allowed. Section 44A gives a benefit in this regard. It provides that in the case of such trade associations which did not distribute any parts of its income to its members, the amount of any deficit (deficiency) (excess of expenditure incurred for the advancement of the common interest of the members of the association over receipt from the members) would be deductible from the assessable income of the association to the maximum extent of 50% of such income.

This deficiency is to be deducted in the first instance from the assessable income under the head "Profits and gains of business or profession". If the deficiency exceeds such income the balance of deficiency can be set off against assessable income from any other head. The maximum limit of 50%, however, still operates. It should be noted that any adjustment of the deficiency is permissible only after effect has been given as provided in the Act to all losses, allowances etc., for the year in question or brought forward from earlier years.

(iv) Clubs

The consensus of judicial opinion is that any surplus accruing to a members' club from the subscriptions and charges for various conveniences paid by members is not income or profit at all, nor can a social club be deemed to trade as far as its dealings with its own members are concerned. The position would be the same even though the club may be incorporated as a company or registered as a society. But a club is taxable on the profit derived from subscriptions and charges paid by non-members and on the income derived from its capital assets. Where a club is an incorporated company carrying on business it may be taxable on the money received from its members as well as non-members in the course of its business.

However, if the club is not a member's club but is a proprietary club i.e. if the club is owned by an outsider and not by the members themselves, the proprietor would be taxable on the profits earned by running the club. The position would not in any way be affected by the fact that the proprietor is a limited company and some of the shareholders are members of the club.

9.3 LIABILITY OF SUCCESSOR TO BUSINESS IN RESPECT OF TAX CHARGEABLE FROM THE PREDECESSOR [SECTION 170]

(1) **Assessment of successor and predecessor:** Where a person carrying on any business, profession, or vocation is succeeded by another person who continues to carry on that business or profession, both the successor and the person who is succeeded to (hereinafter called the predecessor) shall be assessed in the following manner:

- the predecessor in business would be assessable in respect of the income of the previous year in which succession took place upto the date of succession;
- the successor would be assessable in respect of the income of that previous year after the date of succession.

Accordingly, the income of the year in which the succession takes place is to be apportioned between the predecessor and the successor with the share of each. The income must be computed separately and each must be granted the deductions and allowance applicable to him. The assessment on each of these persons must be separate and distinct.

(2) **Assessment when predecessor cannot be found:** Where the predecessor cannot be found, the assessment of

- the income of the previous year in which the succession took place up to the date of succession and
- of the one year preceding the previous year of succession

should be made on the successor in like manner and to the same extent as it would have been made on the predecessor, and all the provisions of the Act shall apply accordingly.

(3) **Assessment or reassessment or other proceedings during the pendency of succession:** In case there is succession, the assessment or reassessment or any other proceedings, made or initiated on the predecessor during the course of pendency of such

succession, shall be deemed to have been made or initiated on the successor and all the provisions of this Act shall apply accordingly.

Meaning of the term "pendency": "Pendency" means the period

- commencing from the date of filing of application for such succession of business before the High Court or tribunal or the date of admission of an application for corporate insolvency resolution by National Company Law Tribunal (NCLT) and
- ending with the date on which the order of such High Court or tribunal or NCLT

is received by the Principal Commissioner or the Commissioner.

(4) **Recovery of sum payable by predecessor from the successor:** If the assessment has already been made on the predecessor for either or both of the years aforesaid, but the sum payable in pursuance of each assessment cannot be recovered from the predecessor or any person, the sum payable by the predecessor shall be payable and recoverable by the successor. Successor shall be entitled to recover the full amount of sum paid by him from the predecessor.

Under this section, the Assessing Officer is required to record a finding that the sum in respect of the income of the year of succession or the preceding year cannot be recovered from the predecessor, before seeking to recover such sum from the successor.

(5) **Predecessor income includes capital gain by virtue of succession:** The successor's liability to tax arises also in respect of any gain (e.g., capital gains) accruing to the pre-decessor from the transfer of the business or profession as a result of the succession. [*Explanation* to section 170].

9.4 TAX PLANNING CONSIDERATIONS IN RELATION TO BUSINESS

The scope of income liable to tax under the head "Profits and gains of business or profession" covered by sections 28 to 44D of the Income-tax Act, 1961 has been discussed earlier. The object of this part of the study material is to discuss from the angle of tax planning the various areas in which tax payer will have to take appropriate decisions to ensure that the incidence of tax in respect of his income chargeable under this head is reduced to the extent possible, by taking advantage of the various allowances, deductions and other tax concessions provided under the law.

For a new business, the spheres in which the question of tax planning is relevant are as follows:

(i) Form of the organization

(ii) Nature of the business

(iii) Financial Structure

(iv) Acquisition of plant and machinery and other fixed assets

(v) Setting up and commencement of business

Each of these aspects will be considered briefly in the following paragraphs. In addition, there is lot of scope for planning with reference to the method of accounting to be employed and the various deductions and special incentives provided under the Income-tax Act, 1961.

(1) **Form of Business Organization:** The choice of the appropriate form of business organization will have to be thought of and decided by the person who intends to carry on business or profession at the beginning itself, because a change in the form of business organization after the commencement of the business, may attract liability to tax.

A new business can be organized under any of the following forms:

(i) Sole proprietorship

(ii) Hindu undivided family

(iii) Association of persons or Body of Individuals

(iv) Partnership firm/LLP

(v) Company

(vi) Co-operative society

The selection of a particular form of organization would depend not only on the tax aspect but on other considerations also, e.g., financial requirements and resources, requirement of limited liability and many other practical considerations.

However, depending upon the taxable status and level of tax liability of the owners, a selection can be made from the various forms available for setting up a new unit.

- ***Sole Proprietorship:*** In the case of a sole proprietorship concern, one of the important tax disadvantages would be that no allowance or relief would be available to the tax payer in computing his income from business in respect of even a reasonable amount of remuneration attributable to the services rendered by him for carrying on the business. As a result, the taxable income arrived at would be a larger amount than what it would have been if it had been the case of, say, a firm paying remuneration to partners, such remuneration is allowable subject to the limits specified in section 40(b)(v). The taxable income from business would get reduced and correspondingly, the incidence of tax would also be reduced.

Under sole proprietorship, the entire income of a business unit gets assessed in the hands of the same person along with other income, while the entire loss and other allowances shall be available for set off in his hands against other income. This may have some advantage in the initial years, after which the possibility of converting it into company/firm may be considered; on such conversion, the questions of possible capital gains tax, etc., will have to be considered.

- ***Hindu Undivided Family:*** The Hindu undivided family as a unit of taxation continues to exist for the purpose of carrying on business as well and there is a large number of cases where business is carried on by the members of the family on behalf on the family. Since the law does not specifically provide for the disallowance of such expenses, it is advantageous to carry on a business through the HUF wherever possible. The income of the family is computed and first taxed in the hands of the family at the rates applicable to it. The income of the family may, thereafter, be divided amongst the members of the family and the members, in such cases, do not attract any liability to tax in view of the specific exemption granted under section 10(2) of the Income-tax Act, 1961. Thus, if a business is carried on by a Hindu undivided family, the advantages which are available in the case of a company could be fully availed of and in addition, the members of the family would not become liable to tax when they receive any portion of the family's income.

Individual or HUF having income from business or profession has an option to shift out/ opt out of the default tax regime under this section and the option has to be exercised on or before the due date specified under section 139(1) for furnishing the return of income for such previous year and once such option is exercised, it would apply to subsequent assessment years.

Such person who has exercised the above option of shifting out of the default tax regime for any previous year shall be able to withdraw such option only once and pay tax under the default tax regime under section 115BAC for a previous year other than the year in which it was exercised.

Thereafter, such person shall never be eligible to exercise option under this section, except where such person ceases to have any business income in which case, option under (i) above would be available. *(Please refer the detailed discussion on section 115BAC given in earlier paras of this Chapter)*

- ***Partnership Firm/LLP:*** All firms and LLPs will be taxed at a flat rate of 30%. If the total income exceeds ₹ 1 crore, surcharge @12% would be attracted. Further, health and education cess @4% would be applicable. There will be no basic exemption and the entire income will be taxed. In computing the taxable income of a firm, certain prescribed deductions in respect of interest and remuneration have to be allowed. The share income of a firm in the hands of the partners of the firm which is separately assessed as such is fully exempt under section 10(2A).

Note: An Individual, HUF or a partnership firm (but not an LLP), who is a resident carrying on eligible business can declare income on presumptive basis as per the provisions of section 44AD @8% of gross receipts 6% in case gross receipts are received by an account payee cheque/bank draft/use of ECS through bank account/through any other electronic mode as may be prescribed on or before the due date of filing return of income].

The prescribed electronic modes are credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [CBDT Notification No. 8/2020 dated 29.01.2020].

An assessee, being a resident in India, carrying on notified profession can declare income on presumptive basis@50% of gross receipts as per the provisions of section 44ADA. In such a case, they need not get their books of account audited as per section 44AB.

ILLUSTRATION 16

Mr. Gavaskar sought voluntary retirement from a Government of India Undertaking and received compensation of ₹ 40 lacs on 28th February, 2023. He is planning to use the money as capital for a business dealership in electronic goods. The manufacturer of the product requires a security deposit of ₹ 15 lacs, which would carry interest at 8% p.a. Gavaskar's wife is a graduate and has worked as marketing manager in a multinational company for 15 years. She now looks for a change in employment. She is willing to join her husband in running the business. She expects an annual income of ₹ 5 lacs. Mr. Gavaskar would like to draw a monthly remuneration of ₹ 40,000 and also interest @ 10% p.a. on his capital in the business. Mr. Gavaskar has approached you for a tax efficient structure of the business.

Discuss the various issues, which are required to be considered for formulating your advice. Computation of income or tax liability is not required.

SOLUTION

The selection of the form of organisation to carry on any business activity is essential in view of the differential tax rates prescribed under the Income-tax Act, 1961 and specific concessions and deductions available under the Act in respect of different entities. For the purpose of formulating advice as to the tax efficient structure of the business, it is necessary for the tax consultant to consider the following issues:

(i) In the case of sole proprietary concern, interest on capital and remuneration paid to the proprietor is not allowable as deduction under section 37(1) as the expenditure is of personal nature. On the other hand, in the case of partnership firm, both interest on capital and remuneration payable to partners are allowable under section 37(1) subject to the conditions and limits laid down in section 40(b). The partnership should be evidenced by an instrument and the individual share of partners should be specified in the instrument. Remuneration and interest should however, be authorised by the instrument of partnership and paid in accordance with such instrument. Such interest and salary shall be taxable in the hands of partners to the extent the same is allowed as deduction in the hands of the firm under section 40(b). Interest to partners can be allowed upto 12% on simple interest basis, while the limit for allowability for partners' remuneration is based on book profit under section 40(b). As per section 40(b)(v), partners' remuneration shall be allowed to the extent of aggregate of -

(a) On the first ₹ 3,00,000 of book profit or in case of loss – ₹ 1,50,000 or at the rate of 90% of book profits, whichever is more

(b) On the balance of book profit – at the rate of 60%

Note – *However, if the firm is eligible to declare presumptive taxation under section 44AD, 8% of gross receipts or 6% of gross receipts, as the case may be, would be deemed as its income. All deductions under section 30 to 37 are deemed to be allowed. No deduction is allowable, including deduction for partner's remuneration and interest on capital.*

(ii) Partner's share in the profits of firm is not taxed in the hands of the partners by virtue of section 10(2A).

(iii) If a proprietary concern is formed, the salary of Mrs. Gavaskar shall be allowed as deduction under section 37(1).

(iv) The possibility of invoking section 40A(2) cannot be ruled out as salary is payable to a relative, who is an interested person within the meaning of section 40A(2). However, it can be argued successfully that salary of ₹ 5 lacs is justified in view of her long experience as marketing manager of a multinational company and the fair market value of services to be rendered by her to the concern.

(v) An issue arises as to whether remuneration of Mrs. Gavaskar would be includible in the total income of Mr. Gavaskar. Under section 64(1)(ii), remuneration of the spouse of an individual working in a concern in which the individual is having a substantial interest shall be included in the total income of the individual. However, the clubbing provision does not apply if the spouse possesses technical or professional qualification and the income is solely attributable to the application of his or her technical or professional knowledge and experience. Further, technical or professional qualification would not necessarily mean the qualifications obtained by degree or diploma of any recognized body [*Batta Kalyani vs. CIT (1985) 154 ITR 0059 (AP)*]. The experience of Mrs. Gavaskar as a marketing manager in a multinational company for 15 years may reasonably be considered as a professional qualification for this purpose.

(vi) If Mrs. Gavaskar joins the proprietary concern or partnership concern of her husband as employee, remuneration of ₹ 5 lacs shall be taxed in her hands under the head "salary". Standard deduction u/s 16(ia) of Rs. 50,000 would be allowed.

(vii) If she joins as partner in the business, remuneration shall be taxed in her hand as business income under section 28 to the extent such remuneration is allowed in the hands of the firm under section 40(b).

(viii) For individuals, tax can be computed as per slab rates provided under the default regime under section 115BAC(1A). Alternatively, he can exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the regular provisions of the Act at the tax rates prescribed by the Annual Finance Act of that year. However, where he exercises the option of shifting out of the default regime for any previous year, he would be able to withdraw such option only once.

The surcharge rate is also depended on the total income and the highest surcharge would be 37% where total income exceeds ₹ 5 crores and the assessee has opted to shift out of the default tax regime whereas under default regime highest rate of surcharge would be 25%. Health and Education cess @ 4% on income-tax plus surcharge, if applicable, is attracted in all the cases. Whereas for partnership firms’ tax is levied at a flat rate of 30%. Surcharge @12% would be attracted only if total income exceeds ₹ 1 crore.

If a sole proprietary concern is formed, Mr. Gavaskar has an option to pay income-tax in respect of his total income (other than income chargeable to tax at special rates under Chapter XII) as per the default regime under section 115BAC or as per the optional regime under the normal provisions of Income-tax Act.

- ***Company:*** For any large venture requiring substantial investment and recourse to borrowed funds from banks and institutions, ordinarily the form of a limited company will have to be adopted. Within the company form of organisation, however, several alternatives exist. On the basis of the ownership and control, a company can either be organised as a widely held company, i.e. a company in which the public are substantially interested within the meaning of section 2(18) of the Income-tax Act, 1961. Alternatively, it can be organised as a closely held company. Depending upon the choice of the form of organisation of the company, the following important tax consequences would have to be considered from the view point of tax planning:

  (i) The provisions of section 79 regarding restrictions on carry forward of losses in the event of substantial change in the shareholding of the company also become applicable if the company is one in which the public are not substantially interested. This aspect would assume particular significance in the case of closely held companies where losses are made and shareholdings are transferred before such losses are fully absorbed.

  (ii) Also, MAT provisions are applicable to companies. It so happens that in case of companies enjoying tax holiday benefits still have to pay tax under MAT provisions, credit of which also cumulated for number of years without being used causing significant outflow of funds in the initial years.

  Thus, it can be seen that the concept of deemed dividend under section 2(22)(e) and the provisions of section 79 do not apply to a widely held company.

  Place of Effective Management (PoEM) framework is introduced to determine the tax payable by a foreign company that for all purposes is managed from India and yet does not pay tax domestically. Many Indian companies that have traditionally used holding companies and subsidiaries overseas for various reasons are assessing how they may be affected and are racing to put new structures in place before they come under scrutiny. These provisions provide for a foreign company to be a resident of India, if the company's place of effective management is in India. If a company's POEM is situated in India; it will be treated as Indian resident. Its global income will be taxable in India.

  Rate of tax: The income-tax rate on foreign companies is higher at 40% *plus* surcharge @2% (if total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore) and @ 5%, if the total income exceeds ₹ 10 crore as against 30%/25%, as the case may be (*plus* surcharge @7%, if total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore and @12%, if total income exceeds ₹ 10 crore) on domestic companies.

Concessional Tax Regimes under section 115BAA and section 115BAB: Section 115BAA provides for concessional rate of tax @22% (*plus* surcharge@10% and HEC@4%) for domestic companies, subject to certain conditions, like non-availability of profit-linked deductions and investment-linked tax deduction under the Act, non-availability of deduction for contribution to research and development, additional depreciation etc.

Section 115BAB provides for concessional rate of tax @15% (*plus* surcharge@10% plus HEC@4%) to new manufacturing or electricity generating domestic companies set up and registered on or after 1.10.2019, and commences manufacturing on or before 31.3.2024, subject to certain conditions, like non-availability of profit-linked deductions and investment-linked tax deduction under the Act, non-availability of deduction for contribution to research and development, additional depreciation etc.

Domestic Companies have to exercise the option to be governed by these special provisions of the Act. The option for section 115BAB has to be exercised in the very first year in which the eligible company is set up, failing which it cannot exercise such option in the future years. However, a company eligible to exercise option u/s 115BAA can defer exercise of such option to a future year, if it is availing sizable profit-linked or additional depreciation in the previous year. However, once the company exercises such option under section 115BAA or 115BAB, as the case may be, in a year, it would continue to be governed by the special provisions u/s 115BAA or 115BAB, as the case may be, thereafter and cannot opt for regular provisions in any subsequent year.

It may be noted that companies exercising option under section 115BAA or section 115BAB are not liable to minimum alternate tax under section 115JB.

These two sections, namely sections 115BAA and 115BAB have already discussed earlier in detail in this chapter.

ILLUSTRATION 17

ABC Ltd., a pharmaceutical company incorporated in year 2015-16, purchased a new plant and machinery for ₹ 10 lakhs on 01-04-2023. The total income of the company for Assessment Year 2024-25 before allowing additional depreciation in respect of new plant and machinery is ₹ 20 lakhs. ABC Ltd. has not opted for the concessional tax regime under section 115BAA or 115BA so far. Compute the tax liability of ABC Ltd. for A.Y. 2024-25 assuming its turnover for the previous year 2021-22 was ₹ 350 crores. Ignore the provisions of MAT.

SOLUTION

Computation of tax liability of ABC Ltd. for A.Y. 2024-25 under regular provisions of the Act

Particulars	₹
Total Income before allowing additional depreciation	20,00,000
Less: Additional Depreciation u/s section 32(1)(iia)[₹10 lakh x 20%]	2,00,000
Total Income	18,00,000
Applicable Tax Rate (since turnover of P.Y. 2021-22 ≤ ₹ 400 crores)	25%
Tax payable	4,50,000
Add: Health & Education cess@4%	18,000
Tax Liability	**4,68,000**

Computation of tax liability of ABC Ltd. for A.Y. 2024-25 under section 115BAA

Particulars	₹
Total Income before allowing additional depreciation	20,00,000
Less: Additional Depreciation u/s section 32(1)(iia) [not allowable as deduction while computing income u/s 115BAA]	-
Total Income	20,00,000
Applicable Tax Rate	22%
Tax payable	4,40,000
Add: Surcharge@10%	44,000
	4,84,000
Add: Health & Education cess@4%	19,360
Tax Liability	5,03,360

Since tax payable as per the regular provisions of the Act is lower than the tax payable under the provisions of section 115BAA, it would be beneficial for ABC Ltd. not to opt for section 115BAA.

- ***Co-operatives:*** The co-operative form of business organisation, i.e., a co-operative society would also be advantageous from the tax angle and, in addition to the general benefits flowing from the co-operative form the society, can claim deduction in respect of the reasonable amount of remuneration payable to the members of the society for their services rendered, including the amount of commission, if any, payable to them and the interest on the deposits or loans given by them. The co-operative society is entitled to a further tax benefit arising from section 80P under which the income of a co-operative society is exempted from tax under different circumstances depending upon the nature of the income and/or the amount thereof. In addition to the various tax concessions which are available to all assessees, the co-operative society stands to gain substantially by virtue of the special benefits available to it under section 80P. The profits of the society remaining after payment of tax would be distributed by it amongst its members in the form of dividends subject to the relevant legislation.

However, it may be noted that benefit under section 80P has been withdrawn in respect of all co-operative banks, other than primary agricultural credit societies (i.e. as defined in Part V of the Banking Regulation Act, 1949) and primary co-operative agricultural and rural development banks (i.e. societies having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities). This is for the purpose of treating co-operative banks at par with other commercial banks, which do not enjoy similar tax benefits.

Concessional tax regimes under section 115BAD and section 115BAE: Section 115BAD provide that a co-operative society resident in India has the option to pay tax at 22%, subject to fulfilment of certain conditions. ***Further, w.e.f. A.Y. 2024-25, new section 115BAE has been inserted to provide an option to a new manufacturing co-operative society set up on or after 01.04.2023, which commences manufacturing or production on or before 31.03.2024 and does not avail of any specified incentive or deductions, may opt to pay tax at a concessional rate of 15%.*** In both cases, surcharge would be levied @ 10% on such tax.

Sections 115BAE and 115BAD provides for concessional rates of tax and exemption from Alternate Minimum Tax (AMT) in respect of certain resident co-operative societies.

From the above analysis of various forms of the organisation and their treatment for income-tax purposes, it may be appreciated that the provisions of the taxation laws have a considerable influence on the entrepreneurs in their choice of particular form of the organisation that they should establish.

(2) **Nature of the business:** Besides the form of organisation, the choice of the nature of the business also calls for appropriate planning with reference to the various special benefits available under the taxation laws to the particular kinds of industries which are not available to other kinds. Some of these benefits are of such a substantial nature that they constitute one of the major factors in the determination of the nature of the business.

Broadly, business for this purpose may be divided into two categories - trading and manufacturing business. There could be a third category involving combination of both. Deduction is available under section 10AA to units established in SEZ. Deduction is available to newly units established in Special Economic Zones during P.Y. 2020-21 where letter of approval, required to be issued in accordance with the provisions of the SEZ Act, 2005, has been issued on or before 31st March, 2020 and the manufacture or production of articles or things or providing services has begun on or before 31st March, 2021 or such other date after 31st March, 2021, as notified by the Central Government. In such case, the SEZ has deemed to have commenced manufacture or production in the P.Y.2019-20 and would be eligible for benefit of deduction under section 10AA.

A taxpayer carrying on manufacturing or industrial activities would be in a position to avail of the various concessions such as depreciation allowance, benefit of amortisation under sections 32, 35ABA, 35ABB, 35D and 35E.

Tax holiday benefit under section 80-IAC would be available in case of eligible start-up, under section 80-IBA in case of developing and building housing projects and under section 80LA in case of offshore banking unit and IFSC located in Special Economic Zone.

Section 35AD of the Act also extends investment linked tax deduction to taxpayers with respect to the capital expenditure incurred for setting up and operation of specified businesses.

While deciding the nature of the business, the benefit of tax exemption or concessional treatment available in respect of certain types of income such as agricultural income, new industrial undertakings, ships, business of repairs to ocean going vessels, business of exploration, etc. of mineral oils, etc. should also be taken into account.

(3) Sources of Funds or Financial Structure: Broadly speaking, the choice in the matter of financing a new unit or business would be between capital and borrowings. New units being set up by existing units or companies would have the possibility of using retained profits. In the case of a company, the means of finance are as follows:

(i) Share capital.

(ii) Debentures.

(iii) Other borrowed moneys.

(iv) Generation of funds through profits.

While the return on share capital is a charge on the profits after tax, the return on loans to the lenders is a charge on the profits before tax. Thus, recourse to borrowings would offer a tax advantage which will be reflected in a higher rate of return on the owner's capital.

(4) Acquisition of 'Fixed Assets': Apart from other considerations relevant in the context, the consequences may require a careful choice between buying or leasing some or more of the fixed assets. Assets can be bought or hired. If these are bought and are depreciable, e.g., building, plant and machinery and furniture, the assessee can claim depreciation on the cost over the years. The entire cost can be claimed as deduction against the profit. If hired, however, the charge for hire becomes an admissible deduction. Having regard to the fact that the acquisition of an asset requires a larger immediate outlay than what is necessary in the case of hiring, the company may opt for hiring in some cases rather than for straight acquisition. For example, taking the business premises on rent rather than purchasing the same may be a better proposition.

But in the case of plant and machinery, two additional considerations may arise. New plant and machinery in certain industries may enable a company to claim deduction on account of depreciation and additional depreciation which may outweigh other considerations. Similarly, if there can be a new industrial undertaking, substantial tax benefits may be available by way of tax holiday benefit, etc. but that would require employment of new plant and machinery to a large extent. These considerations are out and out tax considerations which may prompt an assessee to make two choices—(i) not to hire plant and machinery but to purchase them and (ii) not to purchase second hand plant and machinery but to purchase them new.

In appropriate cases, the assessee may go in for second hand imported plant and machinery, satisfying the conditions laid down. In cases where an assessee opts to go for old plant and machinery, the limit regarding the use of old plant and machinery, as laid down in Section 80-IAC should be taken into consideration. Difficulties may arise in applying the 20% limit for the value of old plant or machinery for the purpose of section 80-IA etc. since the concept of value to be adopted for this purpose has not been spelt out in the law and it is not clear whether such value should refer to the cost or market value or the written down value as per books or as per income-tax records. Particular care will have to be taken while planning for such a situation.

The assessee engaged in the specified business mentioned in section 35AD can avail the benefit of deduction of capital expenditure incurred wholly and exclusively of the purpose of such specified business. Capital expenditure incurred prior to commencement of business shall be allowed as deduction during the previous year in which the assessee commences operation of the specified business if, such expenditure incurred is capitalized in the books of accounts of the assessee on the date of commencement of its operation. However, such deduction is not available in respect of capital expenditure incurred on acquisition of any land, goodwill or financial instrument. In case the deduction under this section is claimed, no deduction shall be allowed under Chapter VI-A under "Deduction in respect of certain incomes" in relation to the specified business for the same or any other assessment year.

Interest on borrowed capital

Under clause (iii) of section 36(1), deduction of interest is allowed in respect of capital borrowed for the purposes of business or profession in the computation of income under the head "Profits and gains of business or profession". As per the proviso to section 36(1)(iii), any amount of interest paid, in respect of capital borrowed for acquisition of an asset for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.

ICDS IX on Borrowing Costs deals with the treatment of borrowing costs. It requires borrowing costs which are directly attributable to the acquisition, construction or production of a qualifying asset to be capitalized as part of the cost of that asset.

Qualifying asset has been defined to mean –

- land, building, machinery, plant or furniture, being tangible assets;
- know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets;
- inventories that require a period of twelve months or more to bring them to a saleable condition.

This ICDS requires capitalization of specific borrowing costs (in respect of funds borrowed specifically for the purpose of acquisition, construction or production of a qualifying asset) and general borrowing costs. In case of qualifying assets being tangible and intangible assets, the capitalization shall commence from the date on which funds were borrowed and cease when such asset is first put to use.

This ICDS also provides the formula for capitalization of borrowing costs when funds are borrowed generally and used for the purpose of acquisition, construction or production of a qualifying asset. For this restricted purpose, a qualifying asset shall be such asset that necessarily require a period of 12 months or more for its acquisition, construction or production. In this case, the capitalization of borrowing costs shall commence from the date on which funds were utilized.

(5) **Setting up and commencement of production:** Setting up of business in the context of the Income-tax Act, 1961 is a concept entirely confined to that Act. It is not the same as the commencement of the business and these two concepts have been clearly distinguished for income-tax purpose. Between the date of the setting up and date of commencement, there may be an interregnum during which the assessee may be incurring expenses of a revenue nature.

Under the taxation laws, the expenditure incurred prior to the date of setting up is not normally admissible for income-tax purposes. But if those are incurred on and from the date of setting up, but before commencement of the business, they may be allowed as deduction for tax purposes provided of course they are revenue in nature and are incurred wholly and exclusively for the purposes of business.

It is now practically well settled by various judicial rulings that a business is set up as soon as it is ready to commence production and it is not necessary that actual production should be so commenced. Thus, in the case of a company established for manufacturing cement, the business is set up as soon as acquiring of limestone is commenced even if at that time the plant and machinery may not have been installed so that actual manufacturing operations may commence.

A tax planner should accordingly fix the setting up date in such a manner that the company gets the maximum scope for allowability of expenses incurred contemporaneously to the date of setting up remembering that if those are incurred prior to the setting up date those are inadmissible as direct deductions while, if such expenses are of a revenue nature and they are wholly and exclusively incurred for business purpose, and are incurred subsequent to the date of setting up, they will be admissible as normal deductions. The following examples may be noted:

(a) Such expenditure may be allowed as revenue expenditure. Expenditure by way of brokerage, legal charges, etc. for arranging long term loans, interest on borrowing— *India Cement Ltd. vs. CIT 60 ITR 52 (SC).*

(b) Such expenditure may form part of the cost of assets on which depreciation may be available – *Challapalli Sugars Ltd. vs. CIT 98 ITR 167 (SC).*

In this context, the provisions of *Explanation 8* to Section 43(1) to the effect that any interest paid or payable in connection with the acquisition of an asset, which is relatable to any period after such asset is first put to use cannot be capitalised, are relevant.

(c) Such expenditure may constitute preliminary expenditure and may be eligible for amortisation over a five year period under section 35D.

(d) Such expenditure, if being of a capital nature and if not falling under any of the three categories noted above may be disallowed and there may not be relief either on account of depreciation or amortisation.

(6) Tax planning for business deductions — Some general considerations: There are several matters which affect the assessee's ability to deduct various expenses for income-tax purposes. Some of the principal considerations to be borne in mind planning for business deductions, are given below:

Successful tax planning for business deductions pre-supposes a clear and thorough understanding of the various statutory provisions governing the deductions and an awareness of the statutory rights as well as various restrictions and conditions governing such rights. The general considerations applicable to tax planning in the field of business deductions, revolve round their-

(a) allowability.

(b) year of allowability

(c) extent of allowability (disallowing provisions if any), and

(d) carry-forward to future years.

Often, the question of expenditure being capital or revenue and the consequences attaching to the likely treatment eventually may also be an important part of the tax planning exercise. This aspect has been discussed at a later stage.

One of the important aspects of tax planning would be to see that the maximum deduction or allowance is obtained in the earliest possible time for the purpose of determination of taxable income. Therefore, while deciding about incurring of capital and revenue expenditure, the assessee should consider the tax treatment of such expenditures and the period within which the benefit of deduction or amortisation would be obtained so that he can estimate and work out cash flow position over a period of time. While tax considerations play a major role in investment decisions, the general principles of financial management and their effect on investment decisions should not be ignored.

The tax planner should keep in mind the advantage arising out of minimising the expenditure, especially in the initial years of a business, so that the profits may be maximised and the assessee may be in a position to avail of the various tax incentives like depreciation as also the tax holiday provisions.

Normally, deduction for expenditure is allowable in the year in which it is incurred or paid depending on the method of accounting followed, viz, mercantile or cash. In other words, the expenditure to be claimed as deduction should be claimed in the relevant year. Where the assessee follows the cash system of accounting, the allowance in respect of expenses would be available only when the moneys in respect of them are actually paid by the assessee. Whereas in the case of mercantile system of accounting, if a business liability has definitely arisen in the accounting year, a deduction should be allowed. Where accounts are kept on a mercantile basis, if an expenditure is claimed on the ground that it is legally deductible, it can be claimed in the year in which the liability for the expenditure is incurred even though the payment itself is made in a subsequent year. If an assessee following mercantile system fails to claim an expense in the year in which it accrues he loses the right to claim it as a deduction altogether. He cannot claim or make any attempt to reopen the accounts of the earlier year to which the expense relates.

The Supreme Court's decision in *C.I.T. vs. Gemini Cashew Sales Corporation (1967) 65 ITR 643* emphasizes the principle that if the liability to make the payment has arisen during the previous year, it must be appropriately regarded as the expenditure of that year and merely because the payment in respect of the expenditure is made in the subsequent year, the assessee would not be entitled to claim deduction in respect thereof in the subsequent year. As pointed out earlier, this is subject to the provisions of section 43B.

Normally, deduction can be claimed by the assessee only in respect of those expenses and losses which have been actually incurred by the assessee during the previous year, i.e. after the business is set up. However, there are some exceptions to this rule and a tax planner should be aware of the exceptions and make use of them in appropriate cases. For example, expenditure incurred on scientific research before the commencement of the business — capital or revenue during the three years immediately preceding the commencement of the business and coming within the scope of the *Explanation* to sections 35(1)(i) and 35(1)(ii), capital expenditure incurred prior to commencement of specified business allowed as deduction in the year of commencement of business, in case capitalized under section 35AD, preliminary expenses incurred before commencement of the business and coming within the scope of section 35D, expenditure on prospecting for minerals coming within the scope of section 35E, are cases where the assessee could claim deduction in respect of the expenditure even though the expenditure was not incurred during the previous year.

Similarly, the expenditure in respect of which deduction is claimed by the assessee should not be in the nature of capital expenditure. This is again subject to the statutory exceptions contained in provisions like section 35 and 35AD. Again, subject to the statutory exceptions, the expenditure should be incurred wholly and exclusively for the purpose of the business.

Various other expenses incurred prior to the commencement of commercial operations may, in appropriate cases, be accumulated and capitalised by being spread over the cost of various assets constructed or acquired during the pre-production period. If this is done on a proper basis, the cost of the various assets including the indirect expenses capitalised can be depreciated for tax purposes to the extent that the cost relates to assets which are themselves depreciable for income-tax purposes. This is a matter which the tax planner should bear in mind in order to ensure that expenses incurred during the construction period are properly accounted and allocated.

Specific deductions under the Income-tax Act, 1961

The Income-tax Act, 1961 lists several specific deductions. A deduction falling under each category is allowable subject to the conditions and limitations, if any which may be specified. At times the restrictive conditions apply to expenditure which is prima facie suspect as, for example, transactions with relatives or associates or within the same group coming within the scope of section 40A(2). While planning for business deductions, due regard must be had to these limitations.

In addition to the specific provisions the omnibus provision in section 37 also enables an assessee to claim deduction in respect of expenditure laid out 'wholly and exclusively for the purpose of the business' the tax planner has to take into consideration the principles emerging from the innumerable relevant judicial rulings while availing of the facility of deduction under this provision. Any expenditure incidental to business, may be deducted except those prohibited by any provision of the Act.

Ordinarily, an expenditure which is specifically provided for should be claimed under the relevant section rather under the omnibus provision. To justify the deduction under the residual clause, all that is required is that the expenditure must have been incurred wholly and exclusively and it is not necessary to prove that the expenditure was also incurred 'necessarily' or 'reasonably". The expenditure must have been incurred 'for the purpose of business'. These words are wider than the phrase "for the purpose of earning profits". A specific quid *pro quo* is not essential. It is not necessary to show that the expenditure resulted in commensurate benefit or advantage either during the same year or subsequently.

An expenditure is liable to be disallowed if it is either of a personal nature or of a capital nature. The question whether a particular expenditure is of a personal nature must be judged by reference to the assessee himself and not any other person.

***Capital or Revenue**:* Generally speaking, an expenditure is regarded as being of a capital nature, if it results in the acquisition of an asset or of an advantage or benefit of an enduring nature.

- The test with regard to the nature of the expenditure-capital or revenue - is to be applied with reference to its purpose rather than its effect. The test must be applied by reference to the assessee himself and not any other person. For instance, a company must be obliged to construct pipelines for the purpose of its business but under conditions whereby the pipelines ultimately become the property of a municipal corporation rather than the company itself. In such a case, although the pipelines undoubtedly constitute tangible assets the expenditure may not be regarded as of a capital nature, since the assets do not belong to the company but to some other person. There are many judicial rulings to support this view. A leading case that maybe referred to in this context is *Lakshmiji Sugar Mills Co. P. Ltd. vs. CIT (1971) 82 ITR 376 (SC)].*

- If the purpose of the expenditure is to secure a commercial advantage, rather than acquisition of a capital asset, it is likely to be allowed as revenue expenditure even though the advantage may endure for an indefinite period. However, this rule is by no means inflexible or capable of universal application. Conversely, if the purpose of the expenditure is the acquisition of an advantage or benefit of an enduring nature the expenditure is liable to be treated as capital expenditure even if the period or durability of the asset acquired as the result of the expenditure is very short. For example, if a company making shoes acquires knives and lasts, whose life is only three years, the expenditure may nevertheless be regarded as capital expenditure.

- In applying the various case laws on the subject of distinction between capital and revenue, it should be recognised that circumstances do change and the law normally keeps pace with such changing circumstances. The expenditure that was regarded as capital expenditure resulting in long-term benefit during the relatively *laissez faire* days of the 19th century may not perhaps, be regarded as capital expenditure in the context of the rapid technological changes which are the feature of industrial life today. The decision of the Supreme Court in *Shahzada Nund & Sons vs. CIT 108 ITR 358* also supports this view. A tax planner would do well to keep track of the various cases reported from time to time so as to keep himself informed of the trend of judicial thinking in this regard.

In this context, the requirements spelt out in the various income computation and disclosure standards have also to be kept in mind while considering the point in time of deductibility of expenditure.

- ***Expenditure specifically allowed:*** The Income-tax Act, 1961 specifically allows many types of expenditure such as depreciation, expenditure on scientific research, expenditure on know-how, preliminary expenses, bad debts etc. The Act prescribes several conditions and restrictions for the allowance of such expenditure. The tax-planner should take care to see that all the prescribed conditions are complied with so that deductions may not be denied.

  Note - A company opting for the special provisions under section 115BAA or 115BAB would, however, not be eligible to claim deduction on account of, *inter alia*, additional depreciation and contribution for scientific research to companies/research association/IITs.

- ***Other business expenses:*** As already explained earlier, section 37(1) deals with the various items of expenses which are otherwise not covered by the provisions of Section 30 to 36 of the Income-tax Act, 1961 and specifically provides that all expenses which are incurred wholly and exclusively (though not necessarily) for the purpose of the business or profession carried on by the assessee would be deductible in computing the assessee's business income. In order to qualify for deduction under this provision, the following important conditions will have to be fulfilled:

  (i) The expenditure should have been incurred by the assessee in the ordinary course of his business or profession;

  (ii) The expenditure should be of a revenue nature and should not be of capital nature;

  (iii) The expenditure should not be of a personal nature;

  (iv) The expenditure should not be covered by any other provisions of sections 30 to 36 for purposes of allowance and it should not also be covered by any of the provisions of disallowance contained in sections 40 to 44D; and

  (v) The expenditure should not be one which is in the nature of an appropriation of income or diversion of profits by an overriding title. It should not also be one in respect of which deduction is permissible under Chapter VI-A of the Income-tax Act, 1961 from the gross total income of the assessee.

- ***Commercial expediency:*** The concept of 'commercial expediency' helps a tax payer in insisting that a reasonable view is taken of his right to deduct normal expenditure. The trend in judicial thinking has also recognised this concept. This concept reflects the fact that it is virtually impossible for the legislation to list all possible deductions to which an assessee would be entitled in computing his taxable income and therefore the fact that a business has to be run by the assessee himself under normal commercial conditions must be recognised in determining the allowability of certain expenditure. The test of commercial expendiency should be applied from the point of view of a normal prudent businessman, by reference to modern concepts of business responsibility and not by reference to the subjective standards of the revenue department.

  A claim on the ground of commercial expediency is subject to the under-noted conditions and limitations:

  (a) If the expenditure is covered by one of the express provisions in the Act, it must conform to the requirements stipulated therein.

(b) An expenditure which is expressly disallowed under the Act cannot be claimed on grounds of commercial expediency.

(c) An expenditure cannot be claimed on grounds of commercial expediency if it is improper or illegal. It may be commercially expedient to pay a bribe or incur a penalty but this does not mean that the bribe or penalty would be normally deductible for tax purposes.

There is also a distinction between a payment made for a violation or breach of law and payment made for a breach of contract. Courts have taken the view that where the payments are not in the nature of penalties for infraction of any law but made in pursuance of the exercise of an option given in a particular scheme and where the assessee opts for it out of commercial expediency and business consideration, it could be allowed as deduction.

(7) **Tax planning in case of losses:** The provisions of sections 70, 71 and 72 of the Income-tax Act, 1961 regulate the manner in which losses incurred in the business carried on by any tax payer will have to be dealt with for tax purposes. The consideration to be given by tax payers in the matter of taking the full benefit of set-off of losses permissible under the law is as important as the considerations for tax planning which are taken into account in regard to business expenses or claiming the maximum allowances and deductions particularly in view of the fact that the provisions of set-off of losses offer valuable scope for planning.

Under section 73, losses incurred in speculation business are to be set off only against the income from the business of speculation, if any, which the assessee may derive in the same year or in the subsequent four years. In view of the prohibition in the matter of set-off of losses incurred in speculation business, it would be in the interest of the assessee to avoid indulging in the business of speculation if it is likely to result in losses and there is no possibility of setting it off against future speculation profits within the specified period. Where the business of speculation carried on by the assessee is not profitable, he could discontinue the business of speculation in the same line so that the quantum of losses could be reduced and the assessee could resort to speculation in any other profitable field thereby taking the benefit of exception provided under the law.

The Supreme Court, in *CIT vs. Shantilal P. Ltd. (1983) 144 ITR 57,* held that a transaction cannot be described as a 'speculative transaction' within the meaning of section 43(5), where there is a breach of a contract and on a dispute between the parties, damages are awarded as compensation by an arbitration award. However, where there is no dispute and damages on a pre-determined basis are payable under the contract, without actual delivery of the goods contracted for, the transaction would be a speculative one. If any loss arises out of such a speculative transaction, such speculation loss would not be available for adjustment against other business profits, if any.

Loss from specified business referred to in section 35AD can be carried forward indefinitely under section 73A for set-off against income from the same or any other specified business. Such loss cannot, however, be set-off against income from non-specified business or income under any other head.

The assessee should exercise his right of set off of brought forward loss at the first available opportunity. The Madras High Court, in *Tyresoles (India) vs. CIT [1963] 49 ITR 515,* held that where losses sustained are not set off against the profits of the immediately succeeding year or years, they cannot be set off against profits at a later date. This has been followed by the Punjab and Haryana High Court in *B.C.S. Kartar Chit Fund and Finance Co. (P.) Ltd. vs. CIT [1989] 79 CTR (P & H) 232.* Hence, as a matter of proper tax planning, the assessee should exercise the right under section 72 in the immediately succeeding year/years when the profits allow such a set off.

It is also significant to note that, under section 79, a closely held company will be entitled to claim the benefit of carry forward and set-off of losses, only if shares carrying at least 51% of the voting power is held on the last day of the previous year by the same persons who held such shares on the last day of the previous year in which the loss was incurred. In case of a closely held company, being an eligible start up referred to in section 80-IAC, the loss incurred in any year prior to the previous year (say, in P.Y.2019-20) can be carried forward for set-off against the income of the relevant previous year (i.e., P.Y.2023-24), if shares carrying at least 51% of the voting power is held on the last day of the previous year (i.e., as on 31.3.2024) by the same persons who held such shares on the last day of the previous year in which the loss was incurred (i.e., as on 31.3.2020). In the alternative, all shareholders of such company holding shares carrying voting power on the last day of the previous year in which the loss was incurred (i.e., as on 31.3.2020), should continue to hold those shares on the last day of the previous year in which the loss is to be set-off (i.e., as on 31.3.2024) and such loss should have been incurred during the ten years beginning from the date of incorporation of such company. This benefit will not be denied, if the change has occurred on account of death of a shareholder or on account of transfer by a shareholder to his relative by way of a gift. This benefit will also not be denied if the change in shareholding of an Indian company, which is a subsidiary of a foreign company, is the result of an amalgamation or demerger. However, this is subject to the condition that 51% shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or resulting foreign company. Further, the benefit of carry forward and set-off would not be denied to accompany, where a change in the shareholding takes place in a previous year pursuant to a resolution plan approved under the Insolvency and Bankruptcy Code, 2016, after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner.

It should be kept in mind that section 79 applies to carry forward and set off of losses and not to the benefit of deduction in respect of unabsorbed depreciation.

Loss Returns: In the context of discussion on losses it would be relevant to point out that the tax planner would do well to keep in mind the implications of the provisions of section 139(3) read with section 80.

If an assessee is to get the benefit of the determination of the loss and its carry forward under section 72(1) or 73(2) or 73A(2) or 74(1) or 74A(3), he should file a return voluntarily within the period specified in section 139(1).

However, filing of return within the period specified in section 139(1) is not necessary for carry forward of loss from house property under section 71B and unabsorbed depreciation.

Section 80AC stipulates compulsory filing of return of income on or before the due date specified under section 139(1) as a pre-condition for availing benefit of deductions under any provision of Chapter VI-A under the heading "C.-Deductions in respect of certain incomes".

9.5 OTHER PROVISIONS RELATED TO VARIOUS ENTITIES

(1) Tax on income from life insurance business

Section 115B provides for a concessional rate of tax for taxing the profits and gains derived from the business of life insurance. Under these provisions, in the case of an assessee whose total income includes any profits and gains derived from the business of life insurance computed in accordance with the First Schedule to the Income-tax Act, 1961, the income-tax payable shall be the aggregate of -

(i) the amount of income-tax calculated on the **income from life insurance business** included in total income at the rate of **12½%** and

(ii) the amount of income-tax with which the assessee would have been chargeable had the total income of the assessee been reduced by the amount of profits and gains from the life insurance business.

Income accruing or arising to a company from life insurance business referred to in section 115B would not be subject to MAT. [Section 115JB(5A)].

Taxation of income/loss of non-life insurance business: Rule 5 of the First Schedule to the Income-tax Act, 1961 provides that the profits and gains of non-life insurance business would be the profit before tax and appropriations as disclosed in the profit and loss account prepared in accordance with the provisions of the Insurance Act, 1938 or the IRDA Act, 1999, subject to following adjustment -

- expenditure or allowances not allowable under sections 30 to 43B,
- any provision for diminution in the value of investment debited to profit and loss account has to be added back,
- any gain or loss on realization of investments not credited or debited to profit and loss account, shall be added or deducted, as the case may be, and
- reserve for unexpired risk as prescribed shall be allowed.

(2) Special Rates of tax in respect of certain specified income or assets

♦ **Tax on income from GDRs purchased in foreign currency or capital gains arising from transfer of such GDRs [Section 115ACA]**

(i) **Eligible assessee [Section 115ACA(1)(a)/(b)]-**This section applies to resident individuals who are employees of an Indian company engaged in specified knowledge based industry or service, or employee of its subsidiary engaged in specified knowledge based industry or service.

(ii) **Eligible income and special rate of tax [Section 115ACA(1)(a)/(b)] -** Where the total income includes the following income namely –

(a) income by way of dividends in respect of Global Depository Receipts of an Indian company engaged in specified knowledge based industry or service, purchased by an eligible assessee in foreign currency issued in accordance with such employees' stock option scheme as the Central Government may specify in this behalf,

(b) income by way of long-term capital gains arising from the transfer of the aforesaid Global Depository Receipts,

then the same will be taxed at the rate of 10%.

(iii) **No deduction is allowed [Section 115ACA(2)]-** In the case of the aforesaid resident employee, no deduction shall be allowed under any provisions of this Act, where the gross total income consists only of income by way of dividend from Global Depository Receipts.

However, where the gross total income includes dividend income or long term capital gain from such Global Depository Receipts, the deduction under any provisions of the Act shall be allowed only on that portion of gross total income which does not include such income from the Global Depository Receipts.

(iv) **No benefit of first and second proviso of section 48 [Section 115ACA(3)]-** The first and second provisos to section 48 relating to the computation of capital gains shall not apply in case of transfer of Global Depository Receipts of an Indian company purchased by the resident employee in foreign currency. In other words, no indexation will be available even if the assets are long term capital assets.

(v) **Meaning of certain terms:**

S. No.	Term	Meaning
1.	**Global Depository Receipts**	Any instrument in the form of a depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India or in an International Financial Services Centre and issued to investors against the issue of – (i) ordinary shares of issuing company, being a company listed on a recognized stock exchange in India; or (ii) foreign currency convertible bonds of issuing company; (iii) ordinary shares of issuing company, being a company incorporated outside India, if such depository receipt or certificate is listed and traded on any International Financial Services Centre
2.	**Specified knowledge-based industry or service**	(i) information technology software; (ii) information technology service; (iii) entertainment service; (iv) pharmaceutical industry; (v) bio-technology industry; and (vi) any other industry or service, as may be notified by the Central Government
3.	**Subsidiary**	The term includes subsidiary incorporated outside India

4.	**Information technology service**	Any service which results from the use of any information technology software over a system of information technology products for realising value addition
5.	**International Financial Services Centre [IFSC]**	An IFSC which has been approved by the Central Government under section 18(1) of the SEZ Act, 2005. As per section 18(1), the Central Government may approve the setting up of an IFSC in a SEZ prescribe the requirements for setting up and operation of such Centre. The Central Government shall approve only one IFSC in a SEZ.
6.	**Overseas Depository Bank**	A bank authorised by the issuing company to re-issue Global Depository Receipts against issue of Foreign Currency Convertible Bonds or ordinary shares of the issuing company.

♦ **Concessional Taxation Regime for royalty income in respect of patent developed and registered in India [Section 115BBF]**

(i) The Finance Act, 2016 introduced a concessional taxation regime for royalty income from patents for the purpose of promoting indigenous research and development and making India a global hub for research and development.

(ii) The purpose of the concessional taxation regime is for encouraging entities to retain and commercialise existing patents and for developing new innovative patented products.

(iii) Further, this beneficial taxation regime will incentivise entities to locate the high-value jobs associated with the development, manufacture, and exploitation of patents in India.

(iv) The nexus approach has been recommended by the OECD under Action Plan 5 in Base Erosion and Profit Shifting (BEPS) project. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership. The provisions of section 115BBF are accordingly in line with such approach.

(v) **Concessional rate of tax -** Section 115BBF provides that where the total income of the eligible assessee includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be **taxable at the rate of 10% (plus applicable surcharge and cess).** For this purpose, developed means at-least 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

(vi) **No expenditure is allowed -** No deduction for any expenditure or allowance in respect of such royalty income shall be allowed under the Act.

(vii) **Option of concessional rate to be exercised before due date under section 139(1) -** The eligible assessee has to exercise the option for taxation of income by way of royalty in respect of a patent developed and registered in India in accordance with the provisions of section 115BBF in the prescribed manner, on or before the due date specified under section 139(1) for furnishing the return of income for the relevant previous year.

(viii) **Not eligible to opt for concessional taxation under this section for 5 assessment years -** Where an eligible assessee opts for taxation of income by way of royalty in respect of a patent developed and registered in India for any previous year in accordance with section 115BBF, and the assessee offers the income for taxation for any of the five assessment years relevant to the previous year succeeding the previous year not in accordance with section 115BBF(1),then the assessee shall not be eligible to claim the benefit of section 115BBF for five assessment years subsequent to the assessment year relevant to the previous year in which such income has not been offered to tax in accordance with section 115BBF(1).

(ix) **Non-applicability of MAT provisions -** Further, the amount of income by way of royalty in respect of patent chargeable to tax under section 115BBF would not be subject to MAT under section 115JB. The same would be reduced while arriving at the book profit. Consequently, the related expenditure would be added back for arriving at the book profit.

(x) **Meaning of certain terms**

S. No.	Term	Meaning
1	**Eligible assessee**	Eligible assessee means: • A person resident in India,

		• who is the true and first inventor of the invention and • whose name is entered on the patent register as the patentee in accordance with Patents Act, 1970. Eligible assessee **includes:** every such person, being the true and the first inventor of the invention, where more than one person is registered as patentee under Patents Act, 1970 in respect of that patent.
2	**Royalty**	"Royalty", in respect of a patent, means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains" or consideration for sale of product manufactured with the use of patented process or the patented article for commercial use) for the— (1) transfer of all or any rights (including the granting of a licence) in respect of a patent; or (2) imparting of any information concerning the working of, or the use of, a patent; or (3) use of any patent; or (4) rendering of any services in connection with the activities referred to in (1) to (3) above.
3	**Lumpsum**	"Lump sum" includes an advance payment on account of such royalties which is not returnable

(3) Tax on income from transfer of Carbon credits [Section 115BBG]

(i) Carbon credits is an incentive given to an industrial undertaking for reduction of the emission of GHGs (Green House gases).

(ii) A reduction in emissions entitles the entity to a credit in the form of a Certified Emission Reduction (CER) certificate. The CER is tradable and its holder can transfer it to an entity which needs Carbon Credits to overcome an unfavourable position on carbon credits.

(iii) To bring clarity on the issue of taxation of income from transfer of carbon credits and to encourage measures to protect the environment, section 115BBG provides that where the total income of the assessee includes any income from transfer of carbon credit, such income shall be taxed at a concessional rate of **10%** (plus applicable surcharge and cess)

(iv) **No expenditure is allowed -** No expenditure or allowance in respect of such income shall be allowed under the Act.

(v) **Meaning of "Carbon credits":** Carbon credits in respect of one unit shall mean reduction of one ton of carbon dioxide emissions or emissions of its equivalent gases which is validated by the United Nations Framework on Climate Change and which can be traded in market at its prevailing market price.

SIGNIFICANT SELECT CASES

1.	***ITO v. Venkatesh Premises Co-operative Society Ltd. (2018) 402 ITR 670 (SC)***	
	Issue	**Decision**
	Are non-occupancy charges, transfer charges, common amenity fund charges received by co-operative societies from its members exempt on the basis of the doctrine of mutuality?	The doctrine of mutuality is based on the common law principle that a person cannot make a profit from himself. Accordingly, the transfer charges, non-occupancy charges common amenity fund charges and other charges received by a co-operative society from its members are exempt owing to application of the doctrine of mutuality.
2.	***CIT v. Govindbhai Mamaiya (2014) 367 ITR 498 (SC)***	
	Issue	**Analysis and Decision**
	Where land inherited by three brothers is compulsorily acquired by the State Government, would the resultant capital gain be assessed in the status of "Association of Persons" (AOP) or in their individual status?	Three brothers inherited a property consequent to demise of their father. A part of this bequeathed land was acquired by the State Government and compensation was paid for it. In this case, the property in question came to the assessees' possession through inheritance i.e., by operation of law. It is not a case where any 'association of persons" was formed by volition of the three brothers. Further, even the income earned in the form of interest is not because of any business venture of the three assessees, but is the result of the act of the Government in compulsorily acquiring the said land. Thus, the basic test to be satisfied for making an assessment in the status of AOP is absent in this case. Hence, the income from asset inherited by the legal heirs is taxable in their individual hands and not in the status of AOP.
3.	***Joint CIT v. Rolta India Ltd. (2011) 330 ITR 470 (SC)***	
	Issue	**Analysis and Decision**
	Can interest u/s 234B and 234C be levied where a company is assessed on the basis of book profits u/s 115JB?	Section 115JB(5) provides that all other provisions of the Income-tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section. Section 115JB is a

		self-contained code pertaining to MAT, and by virtue of sub-section (5) thereof, the liability for payment of advance tax would be attracted. Therefore, if a company defaults in payment of advance tax in respect of tax payable u/s 115JB, it would be liable to pay interest under sections 234B and 234C.
4.	***Madras Gymkhana Club v. DCIT (2010) 328 ITR 348 (Mad.)***	
	Issue	**Analysis and Decision**
	Would the interest earned on surplus funds of a club deposited with institutional members satisfy the principle of mutuality to escape taxability?	The assessee-club providing facilities like gym, library, etc., to its members earned interest from fixed deposits which it had made by investment of its surplus funds with its corporate members. Interest earned from investment of surplus funds in the form of fixed deposits with institutional members does not satisfy the principle of mutuality and hence cannot be claimed as exempt on this ground. The interest earned is, therefore, taxable.
5.	***Sind Co-operative Housing Society v. ITO (2009) 317 ITR 47 (Bom)***	
	Issue	**Analysis and Decision**
	Can transfer fees received by a co-operative housing society from its incoming and outgoing members be exempt on the ground of principle of mutuality?	Transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business. Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

6.	***CIT v. Anil Hardware Store (2010) 323 ITR 368 (HP)***	
	Issue	**Analysis and Decision**
	In a case where the partnership deed does not specify the remuneration payable to each individual working partner but lays down the manner of fixing the remuneration, would the assessee-firm be entitled to deduction in respect of remuneration paid to partners?	The manner of fixing the remuneration of the partners has been specified in the partnership deed. In a given year, the partners may decide to invest certain amounts of the profits into other ventures and receive less remuneration than that which is permissible under the partnership deed, but there is nothing which debars them from claiming the maximum amount of remuneration payable in terms of the partnership deed. The method of remuneration having been laid down; the assessee-firm is entitled to deduct the remuneration paid to the partners u/s 40(b)(v)
7.	***CIT v. Trans Asian Shipping Services (P) Ltd (2016) 385 ITR 637 (SC)***	
	Issue	**Analysis and Decision**
	Can income derived by an Indian shipping company from slot charter arrangement in other ships be computed applying the special provisions under Chapter XII-G of the Income-tax Act, 1961, relating to Tonnage Tax Scheme, in spite of non-fulfillment of the condition of holding a valid certificate in respect of such ships indicating its net tonnage in force?	The requirement of producing a certificate would not apply when entire ship is not chartered and the arrangement pertains only to purchase of slots, slot charter etc. The legal fiction created by section 115VG(4) is to be given proper meaning. Accordingly, income from slot charter arrangement in other ships can be computed applying the special provisions under Chapter XII-G. ***Note:*** *As per section 115VG(4), for the purposes of Chapter XII-G, the tonnage shall mean the tonnage of a ship indicated in the certificate referred to in section 115VX and includes the deemed tonnage computed in the prescribed manner. The manner has been prescribed in Rule 11Q of the Income-tax Rules, 1962.* *Further, the Explanation to section 115VG(4) provides that for the purposes of this sub-*

		section, 'deemed tonnage' shall be the tonnage in respect of an arrangement of purchase of slots, slot charter and an arrangement of sharing of break-bulk vessel. *Rules 11Q(1) provides that for the purpose of Explanation to section 115VG(4), deemed tonnage in respect of an arrangement of purchase of slots and slot charter shall be computed on the following basis:* *2.5 TEU = 1 Net Tonnage (1NT)* *Where TEU is Twenty-foot Equivalent Unit (Container of this size)*
8.	***CIT v. Metal and Chromium Plater (P) Ltd. [2019] 415 ITR 123 (Mad)***	
	Issue	**Analysis and Decision**
	Should capital gains exempt under section 54EC, which forms part of the net profit in the statement of profit and loss of the assessee-company, be taken into account for calculation of tax on book profits as per section 115JB?	Capital gains which forms part of the net profit in the statement of profit and loss of the assessee-company, in respect of which exemption under section 54EC is available while computing total income under the regular provisions of the Income-tax Act, 1961, should not be taken into account for calculation of minimum alternate tax on book profits under section 115JB. ***Note –*** *The following is an extract of Circular No.13/2001 dated 9.11.2001, issued by the CBDT at the time of insertion of section 115JB in the Income-tax Act, 1961 -* *"It may be emphasised that the new provision of section 115JB is a self-contained code. Sub-section (1) lays down the manner in which income-tax payable is to be computed. Sub-section (2) provides for computation of "book profit". Sub-section (5) specifies that save as otherwise provided in this section, all other provisions of this Act shall apply to every assessee, being a company mentioned in that section. In other words, except for substitution of tax payable under the provision and the*

		manner of computation of book profit, all the provisions of the tax including the provision relating to charge, definitions, recoveries, payment, assessment, etc., would apply in respect of the provisions of this section." *The CBDT Circular clarifies that except for substitution of tax payable under the provision and manner of computation of book profit, all other provisions relating to charge, definitions, recoveries, payment, assessment, etc., would apply in respect of section 115JB. Therefore, "book profit" for levy of MAT has to be computed in the manner laid down under section 115JB i.e., by making the adjustments as specified in the Explanations contained therein to the net profit as per the statement of profit and loss. This implies that exemptions and deductions available under the regular provisions of the Act would not be available unless expressly provided for in the Explanations to section 115JB [For example, income exempt under section 10, 11 and 12 of the Income-tax Act, 1961 have to be deducted while computing book profit for levy of MAT, if credited to the statement of profit and loss, by virtue of specific provision in clause (ii) of Explanation 1 below section 115JB(2)]. Therefore, it appears that the intent of sub-section (5) is to make applicable other provisions like payment of advance tax, interest under sections 234B and 234C, return filing, penal and prosecution provisions under the Income-tax Act, 1961 etc. to a case where tax is computed under section 115JB. The Madras High Court has, however, in this case interpreted sub-section (5) of section 115JB to also permit adjustment for exemption under section 54EC while computing MAT, even though the same is not expressly provided for in the Explanations to section 115JB.*

TEST YOUR KNOWLEDGE

Questions

1. *XYZ Ltd. is engaged in the manufacture of textile since 01-04-2009. Its Statement of Profit & Loss shows a profit of ₹ 700 lakhs after debit/credit of the following items:*

   (a) Depreciation calculated on the basis of useful life of assets as per provisions of the Companies Act, 2013 is ₹ 50 lakhs.

   (b) Employer's contribution to EPF of ₹ 2 lakhs and Employees' contribution of ₹ 2 lakhs for the month of March 2024 were remitted on 30th June, 2024.

   (c) The company appended a note to its Income Statement that industrial power tariff concession of ₹ 2.5 lakhs was received from the State Government and credited the same to Statement of P & L.

   (d) The company had provided an amount of ₹ 25 lakhs being sum estimated as payable to workers based on agreement to be entered with the workers union towards periodical wage revision once in 3 years. The provision is based on a fair estimation of wages and reasonable certainty of revision once in 3 years.

   (e) The company had made a provision of 10% of its debtors towards bad and doubtful debts. Total sundry debtors of the company as on 31-03-2024 was ₹ 200 lakhs.

   (f) A debtor who owed the company an amount of ₹ 40 lakhs was declared insolvent and hence, was written off by debit to Statement of Profit and loss.

   (g) Sundry creditors include an amount of ₹ 50 lakhs payable to A & Co, towards supply of raw materials, which remained unpaid due to quality issues. An agreement has been made on 31-03-2024, to settle the amount at a discount of 75% of the outstanding. The amount waived is credited to Statement of Profit and Loss.

   (h) The opening and closing stock for the year were ₹ 200 lakhs and ₹ 255 lakhs, respectively. They were overvalued by 10%.

   (i) Provision for gratuity based on actuarial valuation was ₹ 500 lakhs. Actual gratuity paid debited to gratuity provision account was ₹ 300 lakhs.

   (j) Commission of ₹ 1 lakhs paid to a recovery agent for realization of a debt. Tax has been deducted and remitted as per Chapter XVIIB of the Act.

(k) The company has purchased 500 tons of industrial paper as packing material at a price of ₹ 30,000/ton from PQR, a firm in which majority of the directors are partners. PQR's normal selling price in the market for the same material is ₹ 28,000/ton.

<u>Additional Information</u>:

(i) There was an addition to Plant & Machinery amounting to ₹ 50 lakhs on 10-06-2023, which was used for more than 180 days during the year. Additional depreciation has not been adjusted in the books.

(ii) Normal depreciation calculated as per Income-tax Rules, 1962 is ₹ 80 lakhs.

(iii) The company had credited a sub-contractor an amount of ₹ 10 lakhs on 31-03-2023 towards repairing a machinery component. The tax so deducted was remitted on 31-12-2023.

(iv) The company has collected ₹ 7 lakhs as GST from its customers and paid the same on the due dates. However, on an appeal made, the High Court directed the Department to refund ₹ 3 lakhs to the company. The company, in turn, refunded ₹ 2 lakhs to the customers from whom the amount was collected and the balance of ₹ 1 lakh is still lying under the head "Current Liabilities".

Compute total income and tax liability for A.Y. 2024-25. Ignore MAT provisions and the provisions of section 115BAA.

***Note** - The turnover of XYZ Ltd. for the P.Y.2021-22 was ₹ 405 crore.*

2. *Parik Hospitality Limited is engaged in the business of running hotels of 3-star category. The company's Statement of Profit and Loss for the previous year ended 31st March 2024 shows a profit of ₹ 152 lakhs after debiting or crediting the following items:*

(a) Payment of ₹ 0.25 lakh and ₹ 0.30 lakh in cash on 3rd December 2023 and 10th December 2023, respectively, for purchase of raw corn to Mr. Raja, an agriculturist, and Mr. Khalid, a spice trader for purchase of masala used for corn products, respectively.

(b) Contribution towards employees' pension scheme notified by the Central Government under section 80CCD for a sum of ₹ 3 lakhs calculated at 12% of aggregate of basic salary and dearness allowance (forming part of retirement benefits) payable to the employees in terms of employment.

(c) *Payment of ₹ 6.50 lakhs towards transportation of various materials procured by one of its hotels to M/s. Bansal Transport, a partnership firm, without deduction of tax at source. The firm opts for presumptive taxation under section 44AE and has furnished a declaration to this effect. It also furnished its Permanent Account Number in the tender document.*

(d) *Profit of ₹ 12 lakhs on sale of a plot of land to Avimunya Limited, a domestic company, the entire shares of which are held by the assessee company. The plot was acquired by Parik Hospitality Limited on 1st June 2022.*

(e) *Contribution of ₹ 2.50 lakhs to Indian Institute of Technology with a specific direction for use of the amount for scientific research programme approved by the prescribed authority.*

(f) *Expense of ₹ 10 lakhs on foreign travel of two directors for a collaboration agreement with a foreign company for a brewery project to be set up. The negotiation did not succeed, and the project was abandoned.*

(g) *Fees of ₹ 1 lakh paid to independent directors for attending Board meeting without deduction of tax at source under section 194J.*

(h) *Depreciation charged ₹ 10 lakhs.*

(i) *₹ 10 lakhs, being the additional compensation received from the State Government pursuant to an interim order of Court in respect of land acquired by the State Government in the previous year 2021-22.*

(j) *Dividend received from a foreign company ₹ 5 lakhs in which it holds 15% of the equity share capital.*

Additional information:

(i) *As a corporate debt restructuring, the bank has converted unpaid interest of ₹ 10 lakhs upto 31st March 2023 into a new loan account repayable in five equal annual installments. The first installment of ₹ 2 lakhs was paid in March 2024 by debiting new loan account.*

(ii) *Depreciation as per Income-tax Act, 1961 ₹ 15 lakhs.*

(iii) *The company received a bill for ₹ 2 lakhs on 31st March 2024 from a supplier of vegetables for supply made in March 2024. The bill was omitted to be recorded in the books in March 2024. The bill was paid in April 2024 and the necessary entry was made in the books then.*

(iv) Dividend of ₹ 7 lakhs is distributed on 25.09.2024 to its shareholders.

Compute total income of Parik Hospitality Limited for the Assessment Year 2024-25 indicating the reason for treatment of each item assuming that the company is not eligible for deduction u/s 35AD. Ignore the provisions relating to minimum alternate tax and the provisions of section 115BAA.

3. *Hyper Ltd., engaged in diversified activities, earned a profit of ₹ 14,25,000 after debit/credit of the following items to its statement of profit and loss for the year ended on 31.3.2024:*

		₹
(a)	*Items debited to Statement of Profit and Loss*	
	Provision for loss of subsidiary	*85,000*
	Provision for income-tax demand	*1,05,000*
	Depreciation	*3,60,000*
	Interest on deposit credited to buyers on 31.3.2024 for advance received from them, on which tax was deducted in April 2024 and was deposited on 31.7.2024	*1,00,000*
(b)	*Items credited to Statement of Profit and Loss*	
	Long term capital gain on sale of equity shares on which securities transaction tax was paid at the time of acquisition and sale	*3,60,000*
	Income from units of UTI (Gross)	*75,000*

The company provides the following additional information:

(i) Depreciation includes ₹ 1,50,000 on account of revaluation of fixed assets.

(ii) Depreciation allowable as per Income-tax Rules is ₹ 2,80,000.

(iii) Brought forward Business Loss/Unabsorbed Depreciation:

F.Y.	***Amount as per books***		***Amount as per Income-tax***	
	Loss ₹	***Depreciation ₹***	***Loss ₹***	***Depreciation ₹***
2020-21	*2,50,000*	*3,00,000*	*2,00,000*	*2,50,000*
2021-22	*Nil*	*2,70,000*	*1,00,000*	*1,80,000*
2022-23	*3,50,000*	*3,15,000*	*1,20,000*	*2,10,000*

You are required to:

(i) *compute the total income of the company for the assessment year 2024-25 giving the reasons for treatment of items and*

(ii) *examine the applicability of section 115JB of the Income-tax Act, 1961, and compute book profit and the tax credit to be carried forward.*

Assume the tax rate applicable to Hyper Ltd for the P.Y. 2023-24 is 30%. Ignore the provisions of section 115BAA.

4. *The profit as per the Statement of profit and loss of XYZ Ltd., an Indian company, for the year ended 31.3.2024 is ₹ 190 lakhs arrived at after making the following adjustments:*

	Particulars	₹ (in lakhs)
(i)	Depreciation on assets	100
(ii)	Reserve for currency exchange fluctuation	50
(iii)	Provision for tax	40
(iv)	Proposed dividend	120

Following further information are also provided by company:

(a) *Provision for tax includes ₹ 2 lakhs of interest payable on income-tax.*

(b) *Depreciation includes ₹ 40 lakhs towards revaluation of assets.*

(c) *Amount of ₹ 50 lakhs credited to statement of P & L was drawn from revaluation reserve.*

(d) *Balance of statement of profit and loss shown in balance sheet at the asset side as at 31.3.2023 was ₹ 30 lakhs which includes unabsorbed depreciation of ₹ 10 lakhs.*

Compute the book profit under section 115JB for the year ended 31.3.2024.

5. *Mr. Harish, aged 66, running business as a proprietor furnishes the particulars of his income for the year ended 31.03.2024 as under:*

(a) *Net Profit of ₹ 3,65,500 from the wholesale business of textiles and fabrics arrived at after charge of following expenses in the Profit & Loss Account:*

(i) *Personal travelling expenses of ₹ 12,750.*

(ii) *Purchase of furniture for shop on 13.6.2023 of ₹ 25,000 but charged in shop expenses.*

(b) He owns a house with two floors constructed with the financial assistance of HDFC, out of which ground floor is used by him for self-use and first floor was let out on rent for ₹ 8,500 p.m. from April 2023. The municipal tax paid for the whole house was of ₹ 2,500 and interest paid on housing loan for the construction was ₹ 52,000. Both the floors of the house are identical.

(c) He deposited insurance premium on the life of self of ₹ 12,500, wife ₹ 13,500, son and daughter of ₹ 28,000, repaid housing loan of ₹ 50,000 and paid ₹ 55,000 by credit card for health insurance of himself and his family.

Compute the total income and the amount of tax payable by Mr. Harsh on such income for the Assessment Year 2024-25 assuming that he has exercised the option to shift out of the default tax regime under section 115BAC.

6. *PQR LLP, a limited liability partnership set up a unit in Special Economic Zone (SEZ) in the financial year 2019-20 for production of washing machines. The unit fulfills all the conditions of section 10AA of the Income-tax Act, 1961. During the financial year 2022-23, it has also set up a warehousing facility in a district of Tamil Nadu for storage of agricultural produce. It fulfills all the conditions of section 35AD. Capital expenditure in respect of warehouse amounted to ₹ 75 lakhs (including cost of land ₹ 10 lakhs). The warehouse became operational with effect from 1st April 2023 and the expenditure of ₹ 75 lakhs was capitalized in the books on that date.*

   Relevant details for the financial year 2023-24 are as follows:

Particulars	₹
Profit of unit located in SEZ	40,00,000
Export sales of above unit	80,00,000
Domestic sales of above unit	20,00,000
Profit from operation of warehousing facility (before considering deduction under Section 35AD).	1,05,00,000

   Compute income tax (including AMT under Section 115JC) payable by PQR LLP for Assessment Year 2024-25.

7. *Victory Polyfibres, a partnership firm, has earned a gross total income of ₹ 300 lakhs for the year ended 31-3-2024. The firm has not undertaken any international transaction or specified domestic transaction during the said year.*

The above income includes a profit of ₹ 220 lakhs from an undertaking having a turnover of ₹ 80 crores. This is the fifth year and deduction under section 80-IA is available to the extent of ₹ 200 lakhs.

There are some grey areas in the taxation workings and hence, the assessee is contemplating to file the return of income on 7-12-2024, after seeking clarifications from tax experts.

Advise the assessee-firm by working out the total income and tax payable, where the return is filed on 31-10-2024 or when the same is filed on 7-12-2024.

What is the practical solution as regards obtaining clarifications, which might or might not have an impact on the total income? You may ignore interest under section 234A, 234B, 234C and 234F while making the computation in support of your advice.

8. *T and Q are individuals, aged 28 years and 30 years respectively, who constitute an Association of Persons, sharing profit and losses in the ratio of 2:1. For the accounting year ended 31st March 2024, the Profit and Loss account of the business is as under:*

			Figures are in ₹ '000s
Cost of goods sold	*4,250*	*Sales*	*4,900*
Remuneration to:		*Dividend from Indian companies*	*25*
T	*130*	*Long term capital gains (computed)*	*640*
Q	*170*		
Employees	*256*		
Interest to:			
T	*48.3*		
Q	*35.7*		
Other expenses	*111.7*		
GST penalty due	*39*		
Net profit	*524.3*		
	5,565		***5,565***

Additional information furnished:

(i) *Other expenses included:*

(a) *wrist watches costing ₹ 2,500 each were given to 12 dealers, who had exceeded the sales quota prescribed under a sales promotion scheme;*

(b) *employer's contribution of ₹ 6,000 to the Provident Fund for the month of November, 2023 was paid on 14th January 2024.*

(c) ₹ 30,000 was paid in cash to an advertising agency for publicity.

(ii) Outstanding GST penalty was paid on 15th October 2024. The penalty was imposed for non-filing of returns and statements by the due dates.

T and Q had, for this year, income from other sources of ₹ 3,60,000 and ₹ 2,32,000 respectively.

Required to:

(i) Compute the total income of the AOPs for the assessment year 2024-25; and

(ii) Discuss the tax implication for that year in the hands of the individual members.

9. The assessee, Pandey Co-operative Housing Society, is a registered co-operative housing society, formed with the objective of maintaining the property owned by it, to effect repairs and maintenance of the common property of the members, and to confer to the members, the usual rights and privileges. For the assessment year 2024-25, the assessee has received ₹ 3 lakhs as transfer fees from the transferor members and like amount from the transferees, who at the time of transfer, were not members of the society. Discuss the eligibility to tax the aforesaid receipts in the hands of the assessee.

10. M/s. Beta & Co., a partnership firm in India, is engaged in development of software and providing IT enabled services through two units, one of which is located in a notified Special Economic Zone (SEZ) in Noida (commenced operations from 01.04.2011) and the other located in a domestic tariff area (DTA). The particulars relating to previous year 2023-24 furnished by the assessee are as follows:

Total Turnover: SEZ unit ₹ 210 lakhs; DTA unit ₹ 90 lakhs

Export Turnover: SEZ unit ₹ 150 lakhs; DTA unit ₹ 50 lakhs

Profit: SEZ unit ₹ 50 lakhs; DTA unit ₹ 40 lakhs.

Amount debited to Statement of Profit and Loss and credited to Special Economic Zone Re-Investment Reserve Account ₹ 20 lakhs.

Considering that the firm has no other income during the year, compute the tax payable by the firm for the A.Y. 2024-25 by integrating, analysing and applying the relevant provisions of income-tax law.

11. Lambda Ltd. is engaged in the manufacture of fabrics since 01-04-2012. Its Statement of Profit and Loss for the previous year ended 31st March, 2024 shows a profit of ₹ 750 lakhs after debiting or crediting the following items:

(a) Depreciation charged on the basis of useful life of assets as per Companies Act is ₹ 52 lakhs.

(b) Industrial power tariff concession of ₹ 4.80 lakhs, received from Maharashtra State Government was credited to Statement of profit and loss.

(c) The company had provided ₹ 18 lakhs, being sum fairly estimated as payable with reasonable certainty, to workers on agreement to be entered with the workers union towards periodical wage revision once in every three years.

(d) Dividend received from a US company ₹ 12 lakhs.

(e) Loss ₹ 17 lakhs, due to destruction of a machine worth ₹ 24 lakhs by fire due to short circuit and ₹ 3 lakh received as scrap value. The insurance company did not admit the claim of the company on charge of gross negligence.

(f) Provision for gratuity based on actuarial valuation was ₹ 320 lakhs. Actual gratuity paid debited to gratuity provision account was ₹ 160 lakhs.

(g) Advertisement charges ₹ 2.30 lakhs, paid by cheque for advertisement published in the souvenir of a political party registered with the Election Commission of India.

(h) Long term capital gain ₹ 3 lakhs on sale of equity shares on which Securities Transaction Tax (STT) was paid at the time of acquisition and sale.

Additional Information:

(i) Normal depreciation computed as per Income-tax Rules is ₹ 71 lakhs (after giving effect to the scrap value).

(ii) GST ₹ 8 lakhs collected from its customers was paid by the company on the due dates. On an appeal, the High Court directed the GST department to refund ₹ 3 lakhs to the company. The company in turn refunded ₹ 2 lakhs to the customers from whom it was collected and the balance ₹ 1 lakh is still lying under the head "Current Liabilities".

Compute the total income of Lambda Ltd. for the A.Y. 2024-25 by analyzing and applying the relevant provisions of income-tax law. Briefly explain the reasons for treatment of each item. Ignore the provisions relating to Minimum Alternate Tax. Assume that the company has not opted for section 115BAA.

12. *X, Y and HUF of Z (represented by Z) are partners with equal shares in profits and losses of a firm, M/s Popular Cine Vision, which is engaged in the production of TV serials and telefilms.*

The earlier partnership deed did not authorise payment of remuneration or interest to partners. The partnership deed was revised by the partners on 1st June 2023 to authorise payment of remuneration of ₹ 1 lac per month to each working partner and simple interest at 15% per annum on partners' capital. X, Y and Z are actively associated with the affairs of the firm.

The Profit & Loss Account of the firm for the year ended 31st March 2024 shows a net profit of ₹ 10 lakhs after debiting/crediting the following:

(a) *Interest amounting to ₹ 5 lakhs each was paid to partners on the balances standing to their capital accounts from 1stJune, 2023 to 31st March 2024.*

(b) *Remuneration to the partners including partner in representative capacity ₹ 30 lakhs.*

(c) *Interest amounting to ₹ 2 lakhs paid to Z on loan provided by him in his individual capacity at 16% interest.*

(d) *Royalty of ₹ 5 lakhs paid to partner X, who is a professional script writer, for use of his scripts as per agreement between the firm and X. The same is authorized by partnership deed.*

(e) *Two separate payments of ₹ 18,000 and ₹ 15,000 made in cash on 1st February, 2024 to Altaf, a hairdresser, against his bill for services rendered in January, 2024 and two payments of ₹ 19,000 and ₹ 10,000 made in cash on 1st February and 2nd February, 2024, respectively, to Priyam, an assistant cameraman, against her bill for services provided in January, 2024.*

(f) *Amount of ₹ 5 lakhs provided in the books on 31st March 2024 as liability for remuneration to Shreya, a film artist and a non-resident. Tax deducted at source under section 195 from the amount so credited was paid on 3rd June 2024.*

(g) *Amount of ₹ 6 lakhs provided as gratuity for the year on the basis of actuarial valuation. Gratuity actually paid to one retired employee during the year is ₹ 1.50 lakhs.*

(h) *Interest of ₹ 1.20 lakhs received on income-tax refund under section 244(1A) in respect of A.Y. 2023-24.*

Compute the total income of the firm for the assessment year 2024-25 stating the reasons for treatment of each item.

13. *The following are the particulars relating to two Indian companies, namely, Alpha Ltd. and Beta Ltd., which are subject to tax audit u/s 44AB, for A.Y.2024-25 –*

Particulars	Alpha Ltd.	Beta Ltd.
Date of setting up/ registration	1.4.2019	1.11.2023
Main object	Manufacture of steel	Manufacture of leather
Place	Vaishali, Bihar	Ranipet, Tamil Nadu
Turnover of P.Y. 2021-22	₹ 251 crores	-
Turnover of P.Y. 2022-23	₹ 401 crores	-
Turnover of P.Y. 2023-24	₹ 270 crores	₹ 120 crores
Value of new plant and machinery installed and put to use on 1.11.2023	₹ 8 crore	₹ 5 crore
Gross Total Income of P.Y.2023-24	₹ 5 crore	₹ 3 crore
No. of new employees employed on the date of setting up/registration the company	50	750
No. of new employees employed as on 1.4.2021	750	-
Monthly emoluments to 750 employees employed in the respective companies as mentioned above, by ECS through bank account:		
250 employees	₹ 20,000 per employee	₹ 21,000 per employee
250 employees	₹ 25,000 per employee	₹ 25,000 per employee
250 employees	₹ 28,000 per employee	₹ 27,000 per employee

From the above details -

(i) Compute the tax liability of Alpha Ltd. and Beta Ltd. for A.Y.2024-25, assuming that Alpha Ltd. has not opted for any concessional rates earlier and they both avail the beneficial tax rates under the special provisions of the Income-tax Act, 1961 in the P.Y. 2023-24 by fulfilling the conditions specified thereunder. Assume that the gross total income reflects the computation under the special provisions.

(ii) Would it be beneficial for Alpha Ltd. to opt for beneficial tax rates in P.Y. 2023-24 instead of paying tax under regular provisions of the Income-tax Act, 1961? Examine.

Answers

1. **Computation of Total Income of XYZ Ltd. for the A.Y.2024-25**

Particulars	Amount (₹)	
Profits and Gains from Business and Profession		
Profit as per Statement of profit and loss		7,00,00,000
Add: **Items debited but to be considered separately or to be disallowed**		
(a) Depreciation as per Companies Act, 2013	50,00,000	
(b) Employees' contribution to EPF	2,00,000	
[Since employees' contribution to EPF has not been deposited on or before the due date under the PF Act, the same is not allowable as deduction as per *Explanation 2* below to section 36(1)(va). Since the same has been debited to Statement of profit and loss, it has to be added back for computing business income].		
(b) Employer's contribution to EPF	Nil	
[As per section 43B, employers' contribution to EPF is allowable as deduction since the same has been deposited on or before the due date of filing of return under section 139(1). Since the same has been debited to Statement of profit and loss, no further adjustment is necessary]		
(d) Provision for wages payable to workers	Nil	
[The provision is based on fair estimate of wages and reasonable certainty of revision, the provision is allowable as deduction, since ICDS X requires 'reasonable certainty for recognition of a provision, which is present in this case. As the provision has been debited to Statement of profit and loss, no adjustment is required while computing business income]		
(e) Provision for doubtful debts [10% of ₹ 200 lakhs]	20,00,000	
[Provision for doubtful debts is allowable as deduction under section 36(1)(viia) only in case of banks, public financial institutions, state financial corporations, state industrial investment corporations and non-banking financial corporations. Such provision is not allowable as deduction in the case of a manufacturing company. Since the same		

	has been debited to Statement of profit and loss, it has to be added back for computing business income]		
(f)	**Bad debts written off**	Nil	
	[Bad debts write off in the books of account is allowable as deduction under section 36(1)(vii). Since the same has already been debited to Statement of profit and loss, no further adjustment is required]		
(i)	**Provision for gratuity**	2,00,00,000	
	[Provision of ₹ 500 lakhs for gratuity based on actuarial valuation is not allowable as deduction as per section 40A(7). However, actual gratuity of ₹ 300 lakhs paid is allowable as deduction. Hence, the difference has to be added back]		
(j)	**Commission paid to recovery agent for realization of a debt.**	Nil	
	[Commission of ₹ 1 lakh paid to a recovery agent for realisation of a debt is an allowable expense under section 37 as per *DCIT v. Super Tannery (India) Ltd. (2005) 274 ITR 338 (All)*. Since the same has been debited to Statement of profit and loss, and tax has been deducted at source, no further adjustment is required]		
(k)	**Purchase of paper at a price higher than the fair market value**	10,00,000	
	[As per section 40A(2), the difference between the purchase price (₹ 30,000 per ton) and the fair market value (₹ 28,000 per ton) multiplied by the quantity purchased (500 tons) has to be added back since the purchase is from a related party, a firm in which majority of the directors are partners, at a price higher than the fair market value]		
AI(vi)	**GST not refunded to customers out of GST refund**	1,00,000	2,83,00,000
	[The amount of GST refunded to the company by the Government is a revenue receipt chargeable to tax under section 41(1). Deduction can be claimed of amount refunded to customers *[CIT v. Thirumalaiswamy Naidu & Sons (1998) 230 ITR 534 (SC)]*. Hence, the net amount of ₹ 1,00,000 (i.e., ₹ 3,00,000 minus ₹ 2,00,000) would be chargeable to tax]		
			9,83,00,000

Less: **Items credited but to be considered separately/ permissible expenditure and allowances**		
(k) Industrial power tariff concession received from State Government	Nil	
[Any assistance in the form of, *inter alia*, concession received from the Central or State Government would be treated as income as per section 2(24)(xviii). Since the same has been credited to Statement of profit and loss, no adjustment is required].		
(g) Discount given by Sundry Creditors for supply of raw materials	Nil	
[Discount of 75% given by Sundry Creditors for supply of raw materials is taxable under section 41(1). Since the same has already been credited to Statement of profit and loss, no further adjustment is required]		
AI(ii) Depreciation as per Income-tax Act, 1961	80,00,000	
(h) Over-valuation of stock [₹ 55 lakhs × 10/110]	5,00,000	
[The amount by which stock is over-valued has to be reduced for computing business income. ₹ 50 lakhs, being the difference between closing and opening stock, has to be adjusted to remove the effect of over-valuation]		
AI(i) Additional Depreciation	10,00,000	
[Additional depreciation@20% is allowable on ₹ 50 lakhs, being actual cost of new plant & machinery acquired on 10.06.2023, as the same was put to use for more than 180 days in the P.Y.2023-24.]		
AI(iii) Payment to a sub-contractor where tax deducted last year was remitted after the due date of filing of return	3,00,000	98,00,000
[30% of ₹ 10 lakhs, being payment to a sub-contractor, would have been disallowed under section 40(a)(ia) while computing the business income of A.Y.2023-24, since tax deducted was remitted after the due date of filing of return. However, the same is allowable in A.Y.2024-25, since the remittance has been made on 31.12.2023]		
Total Income		**8,85,00,000**

Computation of tax liability of XYZ Ltd. for A.Y.2024-25

Particulars	₹
Tax @30% on the above total income (since the turnover exceeded ₹400 crore in the P.Y. 2021-22)	2,65,50,000
Add: Surcharge @ 7% (since total income exceeds ₹1 crore but less than ₹ 10 crore)	18,58,500
	2,84,08,500
Add: Health and Education cess @ 4%	11,36,340
Total tax liability	**2,95,44,840**

2. Computation of Total Income of Parik Hospitality Ltd. for the A.Y.2024-25

Particulars	Amount (₹)	
Profit as per Statement of profit and loss		1,52,00,000
***Add:* Items debited but to be considered separately or to be disallowed**		
(a) Payment to middleman for purchase of raw corn etc. in an amount exceeding ₹10,000	30,000	
[Under section 40A(3), disallowance is attracted in respect of expenditure for which cash payment exceeding ₹ 10,000 is made on a day to a person. Payment of ₹ 25,000 to farmer for purchase of corn is covered by exception under Rule 6DD. However, payment of ₹ 30,000 to spice trader is not covered under the exception - *CBDT Circular 27/2017 dated 3/11/2017*].		
(b) Contribution towards employees' pension scheme in excess of 10% of salary disallowed under section 40A(9)	50,000	
[Contribution to the extent of 10% of salary (basic salary + dearness allowance, if it forms part of pay for retirement benefits) is allowable as deduction under section 36(1)(iva). In this case, 2% is in excess of 10% i.e., Rs.3,00,000 x 2/10, would be disallowed]		
(c) Payment to transport contractor without deduction of tax at source	-	
[Since the contractor opts for presumptive taxation under section 44AE and furnished a declaration to this effect, tax is not required to be deducted at source under section 194C in respect of payment to transport contractor].		

(e) Contribution to IIT for scientific research [Contribution to IIT for scientific research programme approved by the prescribed authority qualifies for deduction @100% under section 35(2AA). Since the amount of contribution has already been debited to the statement of profit and loss, there is no further adjustment required].	-	
(f) Expenses on foreign travel of two directors for a collaboration agreement which failed to materialize [Where expenditure is incurred for a project not related to the existing business and the project was abandoned without creating a new asset, the expenses are capital in nature as per *Mc Gaw-Ravindra Laboratories (India) Ltd. v. CIT (1994) 210 ITR 1002 (Guj.).* Brewery project is not related to the existing business of running three - star hotels]	10,00,000	
(g) Fees paid to directors without deducting tax at source [30% of ₹1 lakh] [Disallowance @ 30% would be attracted under section 40(a)(ia) for non-deduction of tax at source from director's remuneration on which tax is deductible under section 194J]	30,000	11,10,000
		1,63,10,000
Less: **Items credited but to be considered separately/ Expenditure to be allowed**		
(d) Profit on sale of plot of land to 100% subsidiary [Profit on sale of plot of land taxable or otherwise under the head "Capital Gains". Since this amount has been credited to the statement of profit and loss, the same has to be deducted for computing business income].	12,00,000	
(h) & AI(ii) Depreciation [Depreciation allowable under the Income-tax Act, 1961 is ₹ 15 lakhs whereas the depreciation as per books of account debited to the statement of profit and loss is ₹ 10 lakhs. Hence, the additional amount of ₹ 5 lakhs has to be deducted while computing business income]	5,00,000	
(i) Additional compensation received from State Government [Additional compensation is taxable or otherwise under the head "Capital Gains". Since the compensation has been credited to the statement of profit and loss, the same has to be deducted while computing business income]	10,00,000	

(j) Dividend received from foreign company [Dividend received from foreign company is taxable under the head "Income from other sources". Since the said dividend has been credited to the statement of profit and loss, the same has to be deducted while computing business income]	5,00,000	
AI(i) Interest paid during the year [Conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose section 43B. The amount of unpaid interest converted into a new loan will be allowable as deduction only in the year in which such converted loan is actually paid. Since ₹ 2 lakhs has been paid in the P.Y.2023-24, the same is allowable as deduction]	2,00,000	
AI(iii) Purchases omitted to be recorded in the books [Since the purchase is made in March, 2024 (i.e., P.Y.2023-24), in respect of which bill of ₹ 2 lakhs received on 31.3.2024 has been omitted to be recorded in the books in that year, it has to be deducted to compute the business income *[Kedarnath Jute Manufacturing Company Ltd. v. CIT (1971) 82 ITR 363 (SC)]*. It is logical to assume that the company is following mercantile system of accounting].	2,00,000	36,00,000
Income under the head "Profits and Gains of Business or Profession"		**1,27,10,000**
Capital Gains		
Profit on sale of plot of land to 100% subsidiary [Short-term capital gains arise on sale of plot of land held for less than 24 months. However, in this case, since the transfer is to a 100% subsidiary company and the subsidiary company is an Indian company, the same would not constitute a transfer for levy of capital gains tax as per section 47(iv).].	-	
Additional compensation received from State Government [Since the additional compensation has been received pursuant to an interim order of the Court, the same would be deemed as income chargeable to tax under the head "Capital Gains" in the year of final order as per section 45(5).]	-	

Income from Other Sources		
Dividend received from foreign company [Dividend received from a foreign company is chargeable to tax under the head "Income from other sources".]		5,00,000
Gross Total Income		**1,32,10,000**
Less: **Deduction under Chapter VI-A**		
Deduction u/s 80M in respect of inter-corporate dividends [to the extent of dividend distributed by it on or before the due date specified u/s 139(1) of filing return of income]		5,00,000
Total Income		**1,27,10,000**

3. Computation of total income of M/s Hyper Ltd. for the A.Y. 2024-25

Particulars	₹	₹
Profit as per Statement of Profit & Loss		14,25,000
Add: **Items disallowed/considered separately**		
Provision for loss of subsidiary [since it is not wholly and exclusively for the purpose of business of the assessee]	85,000	
Provision for income-tax [disallowed under section 40(a)(ii)]	1,05,000	
Interest on deposit credited to buyers on 31.3.2024 and tax deducted in April 2024 which was deposited on 31.7.2024 [30% disallowed under section 40(a)(ia) since tax is deducted only in the next year].	30,000	
Depreciation debited to statement of profit and loss [only depreciation calculated as per the Income-tax Rules, 1962 is allowable as deduction]	3,60,000	5,80,000
		20,05,000
Less: **Items credited but not includible under business income or are exempt under the provisions of the Act**		
Long-term capital gain on sale of equity shares on which securities transaction tax was paid, since it is not a business income.	3,60,000	
Income from units of UTI, since it is not a business income.	75,000	4,35,000
		15,70,000
Less: Depreciation (allowable as per the Income-tax Rules, 1962)		2,80,000
		12,90,000

Less: Set-off of brought forward business loss and unabsorbed depreciation		
Brought forward business loss under section 72	4,20,000	
Brought forward depreciation under section 32	6,40,000	10,60,000
Income from business		**2,30,000**
Capital Gains		
Long term capital gain on sale of equity shares on which securities transaction tax was paid at the time of acquisition and sale		3,60,000
Income from Other Sources		
Income from units of UTI		75,000
Total Income		**6,65,000**
Tax on LTCG exceeding ₹ 1 lakh @ 10% of ₹ 2,60,000		26,000
Tax on other income of ₹ 3,05,000 @ 30%		91,500
		1,17,500
Add: Health and Education cess @ 4%		4,700
Tax Payable as per the Income-tax Act, 1961		**1,22,200**

Computation of Book Profit under section 115JB

Particulars	₹	₹
Profit as per Statement of Profit & Loss		14,25,000
Add: **Net Profit to be increased by the following amounts as per *Explanation 1* below section 115JB(2)**		
Provision for loss of subsidiary	85,000	
Provision for income-tax	1,05,000	
Depreciation debited to statement of profit and loss	3,60,000	5,50,000
		19,75,000
Less: **Net Profit to be reduced by the following amounts as per *Explanation 1* below section 115JB(2)**		
Depreciation debited to statement of profit and loss (excluding depreciation on account of revaluation of fixed assets) (i.e., ₹ 3,60,000 – ₹ 1,50,000)	2,10,000	

Brought forward business loss or unabsorbed deprecation as per books of account, whichever is less, taken on cumulative basis	6,00,000	8,10,000
Book Profit		**11,65,000**
15% of book profit		1,74,750
Add: Health and Education cess @4%		6,990
Minimum Alternate Tax u/s 115JB		**1,81,740**

In case of a company, it has been provided that where income-tax payable on total income computed as per the provisions of the Act is less than 15% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 15% thereof plus health and education cess @4%.

Accordingly, in this case, since income-tax payable on total income computed as per the provisions of the Act is less than 15% of book profit, the book profit of ₹ 11,65,000 is deemed to be the total income and income-tax is payable @ 15% thereof plus health and education cess @4%. The tax liability, therefore, works out to be ₹1,81,740.

Computation of tax credit

Particulars	₹
Tax on book profit under section 115JB	1,81,740
Less: Tax on total income computed as per the other provisions of the Act	1,22,200
Tax credit to be carried forward under section 115JAA [can be carried forward for 15 assessment years succeeding A.Y. 2024-25]	**59,540**

4. Computation of book profit of XYZ Ltd. for the year ended 31.3.2024

Particulars	₹	₹
Profit as per Statement of Profit & Loss		1,90,00,000
***Add:* Net profit to be increased by the following amounts as per *Explanation 1* below section 115JB(2)**		
Depreciation on assets debited to Statement of P& L	1,00,00,000	
Reserve for currency exchange fluctuation, since the amount carried to any reserve, by whatever name called, is to be added back	50,00,000	
Provision for tax **(See Note below)**	40,00,000	
Proposed dividend	1,20,00,000	3,10,00,000
		5,00,00,000

***Less:* Net profit to be decreased by the following amounts as per *Explanation 1* below section 115JB(2)**		
Depreciation other than depreciation on revaluation of assets (₹ 100 lakhs - ₹ 40 lakhs)	60,00,000	
Withdrawal from revaluation reserve restricted to the extent of depreciation on account of revaluation of assets (₹ 50 lakhs or ₹ 40 lakhs, whichever is less)	40,00,000	
Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account. Unabsorbed depreciation ₹ 10 lakhs and brought forward business loss ₹ 20 lakhs – whichever is less	10,00,000	1,10,00,000
Book profit		**3,90,00,000**

Note – For the purpose of section 115JB, book profit means the profit as per the statement of profit and loss prepared in accordance with Schedule III to the Companies Act, 2013, as adjusted by certain additions/deductions as specified. One of the adjustments is to add back income-tax paid or payable, and the provisions therefor. *Explanation 2* after sub-section (2) of section 115JB clarifies that income-tax includes, *inter alia*, interest on income-tax. Therefore, the entire provision of ₹ 40 lakhs for income-tax is added back for computing book profit for levy of minimum alternate tax.

5. **Computation of total income and tax payable by Mr. Harish for the A.Y. 2024-25 under the normal provisions of the Act**

Particulars	₹	₹
Income from house property		
Self-occupied portion (50%)		
Annual Value under section 23(2)	Nil	
Less: Deduction under section 24(b)		
Interest on housing loan [₹ 52,000 × 50%]	26,000	(26,000)
Let-out portion (50%)		
Income of let out portion being rent of ₹ 8,500 p.m. received for 12 months[1]		
Gross Annual Value under section 23(1) (₹ 8,500 × 12)	1,02,000	
Less: 50% of municipal taxes paid allowable in respect of		

[1] Rent received has been taken as the GAV in the absence of other information.

rented out portion (i.e., 50% of ₹ 2,500)	1,250	
Net Annual Value (NAV)	1,00,750	
Less: **Deduction under section 24**		
30% of NAV under section 24(a)	30,225	
Interest on housing loan under section 24(b)	26,000	44,525
		18,525
Profits and gains of business or profession		
Net profit as per profit and loss account of wholesale business of textiles and fabrics	3,65,500	
Add: Expenses charged in profit and loss account either not allowable or to be considered separately -		
Personal travelling expenses of proprietor	12,750	
Purchase of furniture wrongly debited to shop expenses	25,000	
	4,03,250	
Less: Depreciation on furniture @10% on ₹ 25,000	2,500	4,00,750
Gross Total Income		**4,19,275**
Less: **Deduction under Chapter VI-A**		
Under section 80C - Life insurance premium		
Self	12,500	
Wife	13,500	
Son and daughter	28,000	
- Housing loan repaid	50,000	
	1,04,000	
Under section 80D [Medical insurance premium]		
Mediclaim insurance premium of ₹ 55,000 [maximum deductible is ₹ 50,000 where it covers a resident senior citizen]	50,000	1,54,000
Total Income		**2,65,275**
Total Income (rounded off)		**2,65,280**
Tax on total income of ₹ 2,65,280 (The basic exemption limit for senior citizen is ₹ 3,00,000 for A.Y.2024-25 under the normal provisions of the Act)		Nil

6. Computation of total income and tax liability of PQR LLP for A.Y.2024-25 (under the regular provisions of the Income-tax Act, 1961)

Particulars	₹	₹
Profits and gains of business or profession		
Unit in SEZ		40,00,000
Profit from operation of warehousing facility	1,05,00,000	
Less: Deduction under section 35AD **[See Note (1) below]**	65,00,000	
Business income of warehousing facility chargeable to tax		40,00,000
Gross Total Income		**80,00,000**
Less: Deduction under section 10AA **[See Note (2) below]**		32,00,000
Total Income		**48,00,000**
Computation of tax liability (under the normal/regular provisions)		
Tax @ 30% on ₹ 48,00,000		14,40,000
Add: Health and Education cess @ 4%		57,600
Total tax liability		**14,97,600**

Computation of adjusted total income of PQR LLP for levy of Alternate Minimum Tax

Particulars	₹	₹
Total Income (as computed above)		**48,00,000**
Add: Deduction under section 10AA		32,00,000
		80,00,000
Add: Deduction under section 35AD	65,00,000	
Less: Depreciation under section 32		
On building @10% of ₹ 65 lakhs[2]	6,50,000	58,50,000
Adjusted Total Income		**1,38,50,000**
Alternate Minimum Tax @18.5%		25,62,250
Add: Surcharge@12% (since adjusted total income > ₹ 1 crore)		3,07,470
		28,69,720
Add: Health and Education cess@4%		1,14,789
		29,84,509
Tax liability under section 115JC (rounded off)		**29,84,510**

[2]Assuming the capital expenditure of ₹ 65 lakhs is incurred entirely on buildings

Since the regular income-tax payable is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income and tax is leviable @18.5% thereof *plus* surcharge @ 12% and cess @4%. Therefore, the tax liability is ₹ 29,84,510.

AMT Credit to be carried forward under section 115JD

	₹
Tax liability under section 115JC	29,84,510
Less: Tax liability under the regular provisions of the Income-tax Act, 1961	14,97,600
	14,86,910

Notes:

(1) Deduction @ 100% of the capital expenditure is available under section 35AD for A.Y.2024-25 in respect of specified business of setting up and operating a warehousing facility for storage of agricultural produce which commences operation on or after 01.04.2009.

Further, the expenditure incurred, wholly and exclusively, for the purposes of such specified business, shall be allowed as deduction during the previous year in which it commences operations of specified business if the expenditure is incurred prior to the commencement of its operations and the amount is capitalized in the books of account of the assessee on the date of commencement of its operations.

Deduction under section 35AD would, however, not be available on expenditure incurred on acquisition of land.

In this case, since the capital expenditure of ₹ 65 lakhs (i.e., ₹ 75 lakhs – ₹ 10 lakhs, being expenditure on acquisition of land) has been incurred in the F.Y. 2022-23 and capitalized in the books of account on 1.4.2023, being the date when the warehouse became operational, ₹ 65,00,000, being 100% of ₹ 65 lakhs would qualify for deduction under section 35AD.

(2) **Deduction under section 10AA in respect of Unit in SEZ =**

$$\text{Profit of the Unit in SEZ} \times \frac{\text{Export turnover of the Unit in SEZ}}{\text{Total turnover of the Unit in SEZ}} \text{ x } 100\%$$

$$₹\ 40{,}00{,}000 \times \frac{₹\ 80{,}00{,}000}{₹\ 1{,}00{,}00{,}000} \text{ x } 100\ \% = \mathbf{₹\ 32{,}00{,}000}$$

7. As per section 80AC, while computing the total income of an assessee of a previous year ***(P.Y.2023-24, in this case)*** relevant to any assessment year ***(A.Y.2024-25, in this case)***, any deduction is admissible, *inter alia,* under section 80-IA, such deduction shall not be allowed unless it furnishes a return of income for such assessment year on or before the 'due date' specified in section 139(1).

Since the turnover of the partnership firm has exceeded the prescribed threshold limit in the previous year 2024-25, it would be subject to audit under section 44AB, in which case the 'due date' of filing its return of income for A.Y.2024-25 would be 31st October, 2024 as per section 139(1).

Computation of total income and tax liability of M/s. Victory Polyfibres for A.Y. 2024-25

I. Where the firm files its return of income on 31st October 2024:

Particulars	₹ in lakhs
Gross Total Income	300.00
Less: Deduction under section 80-IA	200.00
Total Income	**100.00**
Tax liability@ 30%	30.00
Add: Health and Education cess@4%	1.20
Regular income-tax payable	**31.20**

Computation of Alternate Minimum Tax payable [Section 115JC]

Particulars	₹ in lakhs
Total Income	100.00
Add: Deduction under section 80-IA	200.00
Adjusted Total Income	**300.00**
Alternate Minimum Tax (AMT) @ 18.5% on ₹ 300 lakhs	55.50
Add: Surcharge@12% (Since adjusted total income > ₹ 1 crore)	6.66
	62.16
Add: Health and Education cess@4%	2.49
Total tax payable (AMT)	**64.65**

Since the regular income-tax payable by the firm is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income of the firm for P.Y.2023-24 and it shall be liable to pay income-tax on such total income @ 18.5% **[Section 115JC(1)]**. Therefore, the tax payable for the A.Y. 2024-25 would be ₹ 64.65 lakhs.

Tax credit for Alternate Minimum Tax [Section 115JD]

	₹ in lakhs
Total tax payable for A.Y.2024-25 (Alternate Minimum Tax)	64.65
Less: Regular income-tax payable	31.20
To be carried forward for set-off against regular income-tax payable (upto a maximum of fifteen assessment years).	33.45

II. Where the firm files its return of income on 7th December 2024:

Where the firm files its return on 7-12-2024, it would be a belated return under section 139(4). Consequently, as per section 80AC, deduction under 80-IA would not be available. In such circumstances, the gross total income of ₹ 300 lakhs would be the total income of the firm.

Particulars	₹ in lakhs
Income-tax @ 30% of ₹ 300 lakhs	90.000
Add: Surcharge @12% (since total income exceeds ₹ 1 crore)	10.800
Income-tax (plus surcharge)	100.800
Add: Health and Education cess @ 4%	4.032
Total tax liability	**104.832**

Practical solution regarding obtaining clarifications:

The practical solution regarding obtaining clarifications would be to file the return of income under section 139(1) on or before the 'due date', i.e., 31.10.2024, and claim deduction under section 80-IA. In such a case, the firm can claim deduction of ₹ 200 lakhs under section 80-IA. Thereafter, consequent to the clarifications obtained, if any change is required, it can file a revised return under section 139(5) by 31.12.2024 which would replace the original return filed under section 139(1). A revised return filed under section 139(5) would replace the original return filed under section 139(1).

If the firm files the return of income under section 139(1) on or before 31.10.2024, its tax liability would stand reduced to ₹ 64.65 lakhs, as against ₹ 104.832 lakhs to be paid if return is furnished after due date. Further, it would also be eligible for tax credit for alternate minimum tax under section 115JD to the extent of ₹ 33.45 lakhs. Therefore, the firm is advised to file its return of income on or before 31.10.2024.

8. (i) Computation of total income of the AOP for A.Y.2024-25

Particulars	₹
Profit & gains of business **(See Working Note below)**	3,12,300

Long term capital gain	6,40,000
Income from other sources - Dividend from Indian companies	25,000
Total income	9,77,300

Working Note - Computation of profits and gains of business

Particulars	₹	₹
Net profit as per profit & loss account		5,24,300
Add: Inadmissible payments		
Interest to members T & Q (₹ 48,300 + ₹ 35,700)	84,000	
Advertising [Disallowance under section 40A(3) (100% of ₹ 30,000 being a cash payment)]	30,000	
Remuneration to members T & Q (₹ 1,30,000 + ₹1,70,000)	3,00,000	
GST penalty **(See Note 3 below)**	39,000	4,53,000
		9,77,300
Less: Income not taxable under this head		
Long term capital gain	6,40,000	
Dividend from Indian companies	25,000	6,65,000
Profits and gains of business		**3,12,300**

Notes:

1. Since the employer's contribution to PF has been paid during the previous year itself, it is allowable as deduction.

2. Penalty imposed for delay in filing GST return is not deductible since it is on account of infraction of the law requiring filing of the return within the specified period. – *CIT v. Ratanchand Bholanath (S.S) (1986) 160 ITR 500 (M.P.)*

(ii) Tax implication in the hands of members T & Q for the A.Y. 2024-25

Members of the AOPs have to pay tax on their total income taking into account savings/ investments etc.

Since one of the members has total income excluding share from AOP more than the basic exemption limit, the AOPs will be chargeable to tax at the maximum marginal rate.

Since the AOPs is taxed at maximum marginal rate, the share income of members is not taxable in their hands individually as per section 86.

9. Transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality where the predominant activity of such co-operative society is maintenance of property of the society. It was so held by the Bombay High Court in *Sind Co-op Housing Society v. ITO (2009) 317 ITR 47*.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Therefore, ₹ 6 lakhs received as transfer fees by Pandey Co-operative Housing Society from its transferor members and its transferees, is not chargeable to tax.

10. Computation of total income and tax liability of M/s. Beta & Co., a partnership firm, as per the normal provisions of the Act for A.Y. 2024-25

Particulars		₹ (in lakhs)
Business income (before deduction under section 10AA)		
SEZ Unit		50.00
Add: Amount debited to SEZ Re-investment Reserve		20.00
		70.00
DTA Unit		40.00
Gross Total Income		110.00
Less: Deduction u/s 10AA		
= ₹ 70 lakhs × ₹ 150 lakhs/₹ 210 lakhs = 50 × 50% (being the 13th year)	25.00	
Amount credited to SEZ Re-investment Reserve Account	20.00	
whichever is less is deductible		**20.00**
Total Income		**90.00**
Tax on total income@30%		27.00
Add: Health and Education Cess@4%		1.08
Tax liability (as per normal provisions)		**28.08**

Computation of Adjusted total income and Alternate Minimum tax of M/s. Beta & Co., a partnership firm, as per the provisions of section 115JC for A.Y.2024-25

Particulars	₹ (in lakh)
Total income as per the normal provisions	90.00

Add: Deduction under section 10AA	20.00
Adjusted total income	110.00
Tax@18.5% of Adjusted Total Income	20.350
Add: Surcharge @12% as the adjusted total income is > ₹ 1 crore	2.442
	22.792
Add: Health and Education cess @4%	0.912
Alternate Minimum Tax as per section 115JC	**23.704**

Since the tax payable as per the normal provisions of the Act is more than the alternate minimum tax payable, the total income as per normal provisions shall be liable to tax and the tax payable for A.Y. 2024-25 shall be ₹ 28.08 lakhs.

11. Computation of Total Income of Lambda Ltd. for the A.Y. 2024-25

	Particulars	Amount (₹)	
I	**Profits and gains of business and profession**		
	Net profit as per the statement of profit and loss		7,50,00,000
	***Add:* Items debited but to be considered separately or items of expenditure to be disallowed**		
	(a) **Depreciation as per Companies Act**	52,00,000	
	(c) **Provision for wages payable to workers**	-	
	[Since the provision is based on a fair estimate of wages payable with reasonable certainty, the provision is allowable as deduction. ICDS X requires a reliable estimate of the amount of obligation and 'reasonable certainty' for recognition of a provision, which is present in this case.		
	As the provision of ₹ 18 lakhs has been debited to statement of profit and loss, no adjustment is required while computing business income]		
	(e) **Loss due to destruction of machinery by fire**	17,00,000	
	[Loss of ₹ 17 lakhs due to destruction of machinery caused by fire is not deductible since it is capital in nature.		
	Since the loss has been debited to statement of profit and loss, the same is required to added back while computing business income]		

	(f) **Provision for gratuity** [Provision of ₹ 320 lakhs for gratuity based on actuarial valuation is not allowable as deduction. However, actual gratuity of ₹ 160 lakhs paid is allowable as deduction. Hence, the difference has to be added back to income [₹ 320 lakhs (-) ₹ 160 lakhs]	1,60,00,000	
	(g) **Advertisement in souvenir of a political party** [Advertisement charges paid in respect of souvenir published by a political party is not allowable as deduction from business profits of the company. Since the expenditure has been debited to statement of profit and loss, the same has to be added back while computing business income]	2,30,000	2,31,30,000
			9,81,30,000
	Add: **Income taxable but not credited to statement of profit and loss**		
	AI(ii) **GST not refunded to customers out of GST refund received from State Govt.** [The amount of GST refunded to the company by the Government is a revenue receipt chargeable to tax. Out of the refunded amount of ₹ 3 lakhs, the amount of ₹ 2 lakh stands refunded to customers would not be chargeable to tax.[3] The balance amount of ₹ 1,00,000 lying with the company would be chargeable to tax]		1,00,000
			9,82,30,000
	Less: **Items credited to statement of profit and loss, but not includible in business income/ permissible expenditure and allowances**		
	(b) **Industrial power tariff concession received from State Government** [Any assistance in the form of, *inter alia*, concession received from the Central or State Government would be treated as income. Since the same has been credited to	-	

[3]*CIT v. Thirumalaiswamy Naidu & Sons (1998) 230 ITR 534 (SC)*

	statement of profit and loss, no adjustment is required]		
	(d) **Dividend received from US company** [Dividend received from foreign company is taxable under "Income from other sources". Since the same has been credited to the statement of profit and loss, it has to be deducted while computing business income]	12,00,000	
	(e) **Scrap value of machinery** [Scrap value of machinery, being capital in nature, has to be reduced from WDV of machinery. Since the same has been credited to the statement of profit and loss, it has to be deducted while computing business income]	3,00,000	
	(h) **Long term capital gains on sale of equity shares** [The taxability or otherwise of long-term capital gain on sale of equity shares has to be considered while computing income under the head "Capital Gains". Since such capital gains has been credited to statement of profit and loss, the same has to be reduced to arrive at the business income.]	3,00,000	
	AI(i) **Depreciation as per Income-tax Rules, 1961**	71,00,000	89,00,000
	Profits and gains from business and profession		**8,93,30,000**
II	**Capital Gains**		
	Long term capital gain on sale of equity shares [Long term capital gains in excess of ₹ 1 lakh (i.e., ₹ 2 lakh, being ₹ 3 lakh – ₹ 1 lakh) on sale of equity shares on which STT is paid at the time of acquisition and sale would be taxable@10% u/s 112A, without indexation benefit.]		3,00,000
III	**Income from Other Sources**		
	Dividend received from foreign company [Dividend received from a foreign company is chargeable to tax under the head" Income from other sources"]		12,00,000
	Gross Total Income		**9,08,30,000**

	Less: **Deduction under Chapter VI-A**		
	Under section 80GGB [Contribution by a company to a registered political party is allowable as deduction, since payment is made otherwise than by cash. Expenditure incurred by an Indian company on advertisement in souvenir published by such political party tantamount to contribution to such political party.]		2,30,000
	Total Income		**9,06,00,000**

12. Computation of Total Income of M/s. Popular Cine Vision for the A.Y.2024-25

Particulars	₹	₹
Profits and Gains from Business or Profession		
Net Profit as per Profit & Loss A/c		10,00,000
Add: Expenses disallowed or considered separately:		
Interest to partners in excess of 12% **(Note 1)**	3,00,000	
Disallowance under section 40A(3) for aggregate cash payment exceeding ₹ 10,000 in a single day **(Note 5)**	52,000	
Provision for gratuity **(Note 7)**	4,50,000	
Partners' Remuneration	30,00,000	
Royalty paid to Partner X **(Note 4)**	5,00,000	43,02,000
		53,02,000
Less: Interest on income-tax refund **(Note 8)**		1,20,000
Book Profit		**51,82,000**
Less: Partners' remuneration allowable under section 40(b)(v)		
(i) As per limit prescribed in section 40(b)		
On first ₹ 3,00,000 90%	2,70,000	
On the balance ₹ 48,82,000 60%	29,29,200	
	31,99,200	
(ii) Remuneration actually paid or payable		
(₹ 1,00,000 × 10 months × 3 partners) +		
(Royalty ₹ 5 lakhs)		
(i) or (ii) whichever is less, is deductible	35,00,000	31,99,200
		19,82,800

Income from other sources		
Interest on income-tax refund		1,20,000
Gross Total Income		**21,02,800**
Deductions under Chapter VI-A		Nil
Total Income		**21,02,800**

Notes:

1. As per section 40(b), simple interest at 12% p.a. to partners relating to the period after the date of partnership deed is allowable. Excess interest @ 3% paid from 1st June 2023 to 31st March 2024 is to be disallowed. Excess interest of 3% being ₹15,00,000 x 3/15 = ₹ 3,00,000.

2. Even though Z is a partner in a representative capacity, he is still a partner. Therefore, remuneration to Z should also be subject to the limits prescribed in section 40(b). This view finds support from the decision of the Supreme Court in the case of *Rashik Lal & Co. vs CIT (1998) 229 ITR 458 (SC).*

3. As per *Explanation 1* to section 40(b), where an individual is a partner in a firm in representative capacity, the provisions of section 40(b) shall not apply to any interest payable by the firm to such individual in his personal capacity. Z represents his HUF in the firm. However, Z gave the loan in his individual capacity. Hence, assuming that the provisions of section 40A(2) do not get attracted in this case, such interest shall be allowed as deduction in full even though the interest rate is more than 12% p.a.

4. It may be noted that the limits specified under section 40(b)(v) are applicable in case of payment of salary, bonus, commission, or remuneration, by whatever name called, to a working partner. From a plain reading of the section, it is clear that any remuneration, by whatever name called, paid to a working partner, is subject to the limits laid down in section 40(b)(v). Therefore, the royalty of ₹ 5 lakhs paid to partner X would also be subject to the limits laid down in section 40(b)(v). Hence, the same has to be added back for computing book profits.

5. Section 40A(3) provides for disallowance of any expenditure in respect of which the actual payment exceeding ₹ 10,000 is made otherwise than by an account payee cheque, account payee bank draft or use of ECS through bank account or through such other electronic mode as may be prescribed in a single day to a person. Hence, the payments of ₹ 18,000 and ₹ 15,000 in cash on 1.2.2024 to Altaf, a

hairdresser, shall be disallowed, since the aggregate payment of ₹ 33,000 exceeds the limit of ₹ 10,000.

The payment of bill of the assistant cameraman of ₹ 19,000 on 1st February is also liable for disallowance under section 40A(3) since the aggregate payment in cash on a single day has exceeded ₹ 10,000.

6. As per section 40(a)(i), any sum payable to a non-resident shall not be allowed as deduction, if tax has not been deducted at source or after deduction, has not been paid on or before the due date specified under section 139(1). Tax deducted from the amount of remuneration credited to payee's account on 31st March 2024 has to be deposited latest by 31st July 2024/ 31st October 2024 (as the case may be). The firm has paid the tax on 3rd June 2024 and hence, the remuneration shall be allowed. Since the same is already debited to profit and loss account, no further adjustment is made.

7. As per section 40A(7), any provision made for payment of gratuity to employees on their retirement or on termination of employment for any reason is disallowed. However, gratuity of ₹ 1.50 lakhs paid to retired employees is allowable as deduction. Hence, the balance provision of ₹ 4.50 lakhs (i.e., ₹ 6 lakhs – ₹ 1.50 lakhs) is to be disallowed.

8. Interest on income-tax refund is assessable under the head "Income from other sources".

13. (i) Computation of tax liability of Alpha Ltd. and Beta Ltd. under the special provisions of the Income-tax Act, 1961

Particulars	Alpha Ltd. ₹	Beta Ltd. ₹
Gross Total Income	**5,00,00,000**	**3,00,00,000**
Less: Deduction u/s 80JJAA		
Alpha Ltd - [(₹ 20,000 x 12 x 250) + (₹ 25,000 x 12 x 250)] x 30%	4,05,00,000	
Beta Ltd – [(₹ 21,000 x 5 x 250) + (₹ 25,000 x 5 x 250)] x 30%		1,72,50,000
Total Income	**95,00,000**	**1,27,50,000**
Computation of tax liability		
Tax@22% on ₹ 95,00,000 [As per section 115BAA]	20,90,000	

Tax@15% on ₹ 1,27,50,000 [As per section 115BAB]		19,12,500
Add: Surcharge@10%	2,09,000	1,91,250
	22,99,000	**21,03,750**
Add: Health and Education cess@4%	91,960	84,150
Total tax liability	**23,90,960**	**21,87,900**

Notes -

(1) Beta Ltd. is a manufacturing company set up on or after 1.10.2019 but before 31.3.2024, hence, it would be eligible to opt for section 115BAB, and avail benefit of concessional rate of tax@15% plus surcharge@10% and HEC@4%. Alpha Ltd. is eligible to opt for special provisions under section 115BAA, as per which the rate of tax would be 22% plus surcharge@10% and HEC@4%.

(2) Both Alpha Ltd. and Beta Ltd. are eligible to claim deduction u/s 80JJAA, which is a permissible Chapter VI-A deduction while computing total income under section 115BAA and 115BAB.

In case of Alpha Ltd, 30% of the additional employee cost of new employees employed in the P.Y. 2021-22, can be claimed as deduction u/s 80JJAA for P.Y.2023-24. Out of 750 employees, 250 employees whose emoluments are ₹ 20,000 p.m., 250 employees whose emoluments are ₹ 25,000 p.m. qualify as additional employees and 250 employees whose emoluments exceed ₹ 25,000 p.m. do not qualify as additional employees.

In case of Beta Ltd, 750 new employees are employed on 1.11.2023, being the date of setting up, for which 30% of additional employee cost can be claimed as deduction. Beta Ltd. is engaged in manufacture of leather, and hence it would be entitled for deduction u/s 80JJAA in the P.Y. 2023-24, since the eligible employees have been employed for more than 150 days in that year. Thus, 30% of the additional employee cost of 250 employees whose emoluments are ₹ 21,000 p.m. and 250 employees whose emoluments are ₹ 25,000 p.m. qualify as additional employees, can be claimed as deduction u/s 80JJAA for P.Y.2023-24.

(ii) Computation of tax liability of Alpha Ltd. as per the regular provisions of the Act

Particulars	Alpha Ltd. ₹
Gross Total Income (computed under the special provisions)	5,00,00,000
Less: Additional Depreciation [10% of ₹ 8 crore, since the plant and machinery has been put to use for less than 180 days in the P.Y.2023-24]	80,00,000
Gross Total Income (computed under the regular provisions of the Act)	**4,20,00,000**
Less: Deduction u/s 80JJAA	
[(₹ 20,000 x 12 x 250) + (₹ 25,000 x 12 x 250)] x 30%	4,05,00,000
Total Income	**15,00,000**
Computation of tax liability	
Tax@25% on ₹ 15,00,000 [Since turnover of P.Y.2021-22 is less than ₹ 400 crore]	3,75,000
Add: Surcharge (Not applicable, since total income is less than ₹ 1 crore)	Nil
	3,75,000
Add: Health and Education cess@4%	15,000
Total tax liability	**3,90,000**

Since the tax liability under the regular provisions of the Act is ₹ 3,90,000 *vis-à-vis* tax liability of ₹ 23,90,960 computed under section 115BAA, it is not beneficial for Alpha Ltd. to opt for the special provisions under section 115BAA for A.Y.2024-25. Hence, Alpha Ltd. should **not** opt for the special provisions under section 115BAA for A.Y.2024-25.

CHAPTER 10

ASSESSMENT OF TRUSTS AND INSTITUTIONS, POLITICAL PARTIES AND OTHER SPECIAL ENTITIES

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **identify** the inclusions in the definition of "charitable purpose", to appreciate whether a trust or institution would qualify for the benefit of exemption under sections 11 and 12;
- **appreciate** the conditions to be fulfilled by a trust or institution to claim benefit of exemption under section 11 or under section 10(23C);
- **appreciate** the procedure to be followed for approval/registration of a trust or institution;
- **analyse** the special provision under section 13, which specifies scenarios when a trust or institution shall not be eligible to claim exemption under section 11 or section 12
- **examine** the special provisions relating to taxability of anonymous donations received by a trust or institution;
- **examine** the special provision relating to taxability of certain specified income of a trust or institution under section 115BBI
- **appreciate** the special provisions for taxability of accreted income of certain trusts and institutions;
- **identify** the income of political parties which are exempt from tax and the conditions to be satisfied to avail the exemption;
- **examine** the conditions to be satisfied by an electoral trust to avail exemption in respect of voluntary contributions received by it;
- **examine** the special provisions relating to taxation of business trusts, securitisation trusts and investment fund and **compute** the tax liability in the hands of such trusts/fund and the unit holders/investors.

CHAPTER OVERVIEW

- Taxation Regime of Charitable/ Religious trusts [First Regime and Second Regime]
- Taxation of Discretion-ary Trusts
- Special Provisions relating to Political Parties & Electoral Trusts [Sections 13A & 13B]
- Taxation Regime of Securiti-sation trust and investors [Section 115TA to 115TCA]
- Taxation of Business Trusts and unitholders [Section 115UA]
- Taxation of Investment funds and its unit holders [Section 115UB]

10.1 INTRODUCTION

Non-profit organisations in India cater to socio-economic and other needs of common people in the country. Hence, the Government encourages such organisations with philanthropic objective by providing tax exemptions subject to compliance of certain conditions. In this chapter, we will be discussing the income tax exemptions and related aspects of trusts and institutions engaged in charitable activities, political parties, electoral trusts and other special entities such as securitization trusts, business trusts and investment funds.

Chapter III of the Income-tax Act,1961, which covers incomes that are exempt from tax, also contains the provisions pertaining to exemption in respect of charitable trusts and institutions, political parties, electoral trusts and exemptions in respect of income of special entities like securitization trusts, business trusts and investment fund.

A) Charitable or religious trusts/institutions can avail income-tax exemption under two different independent regimes.

   - The first regime pertains to the exemption available under section 10(23C), which *inter alia* exempts income received by any person on behalf of university, or other educational institution or any hospital.

   - The second regime pertains to the exemption under section 11 that provides for exemption in respect of income derived from property held under trust wholly for charitable or religious purposes.

Therefore, a trust or institution can choose to opt for an exemption either under the first regime i.e., under section 10(23C) or the second regime i.e., under section 11, as it deems appropriate depending on its objects and activity.

It is noteworthy that the broad features and conditions for availing exemption under both regimes are largely similar. The Finance Act, 2022 made significant amendments to ensure harmonization and consistency in the exemption provisions under both the regimes. Prior to these amendments, there were inconsistencies and gaps in both regimes, wherein certain conditions stipulated for availing exemption under section 11 were absent in section 10(23C). Therefore, the Finance Act 2022 has rationalised the same by ensuring that there is a level playing field between the two alternate regimes.

Exemption provisions in respect of charitable or religious trusts	
University or other educational institution, hospital or other medical institution, other fund or institution for charitable purposes, any trust or institution wholly for public religious purposes or wholly for religious and charitable purposes **[Section 10(23C) – First Regime]**	Trust for charitable or religious purposes **[Sections 11 to 13 – Second Regime]**

B) Political Party and Electoral Trust

Section 13A exempts certain categories of income derived by a political party and section 13B exempts voluntary contributions received by electoral trusts.

C) Securitisation Trust, Business Trust and Investment Fund

The Income-tax Act, 1961 provides pass through status to certain entities such as Securitisation Trusts, Business Trusts and Investment Fund in respect of certain incomes. Such incomes are taxable in the hands of unitholders/investors. Exemption provisions in respect of certain incomes in the hands of these entities and unitholders are contained in Chapter III of the Income-tax Act, 1961. Further, the Income-tax Act, 1961 also contains special provisions relating to Securitization trust, Business Trusts and Investment Fund under Chapter XII-EA, XII-FA and XII-FB, respectively.

General Discussion on Trusts

Non-Profit Organisations intending to carry on charitable or religious activities are normally set up either as a trust or a society or a company registered under section 8.

Trust is the most common and preferred legal form. Therefore, before considering the income-tax exemption provisions governed under section 10(23C) or section 11 to 13, let us see briefly what exactly the term trust signifies, the types of trusts and the manner of their creation. Though this aspect of the topic does not strictly fall within the purview of income-tax, such a general knowledge would be useful in understanding the provisions of tax laws relating to charitable trusts.

Meaning of certain terms

Trust	• is an obligation annexed to the ownership and arising out of a confidence reposed in and accepted by the owner if declared and accepted by him for the benefit of another or of another and the owner.
Author of the trust	• the person who reposes or declares the confidence
Trustee	• the person who accepts the confidence
Beneficiary	• the person for whose benefit the confidence is accepted
Trust property	• the subject matter of the trust
Beneficial interest or interest of the beneficiary	• is his right against the trustees or owner of the trust property
Instrument of trust	• the instrument, if any, by which trust is declared

Trusts can be broadly classified into two groups - Public and Private.

Types of Trusts

- Public Trust [Sections 11 to 13]
- Private Trust
  - Specific
    - Beneficiaries & shares of beneficiaries specified
  - Discretionary
    - Beneficiaries or shares of beneficiaries not specified

Distinction between a public and private trust

The distinction between a public and private trust is that, whereas in the former, the beneficiaries are the general public or a class thereof, in the latter they are specific persons. While in the former, the beneficiaries constitute a body which is incapable of ascertainment, in the latter they are persons who are ascertained or capable of being ascertained. Generally private trusts are formed for the convenience of individuals and families. The private trust does not enjoy any tax exemption.

Private trusts are governed by the Indian Trust Act, 1882. This Act does not apply to the following:

(i) The rules of Mohammedan law as to waqf;

(ii) The mutual relations of the members of undivided family as determined by any customary or personal law;

(iii) Public or private religious or charitable endowments; and

(iv) Trust to distribute prizes taken in war among the captors.

On the other hand, Public trusts are constituted mainly for the benefit of the public at large. There are three requirements for creation of a public trust.

There are three requirements for creation of a public trust. They are

(i) a declaration of trust which is binding on the settlor,

(ii) setting apart definite property and depriving himself of the ownership, and

(iii) a statement of objects for which the property is thereafter to be held. In the case of a private trust also, more or less similar requirements exist.

Public trust enjoys tax exemption under the Income-tax Act subject to compliance of certain conditions, that are discussed in detail in this chapter.

10.2 CHARITABLE OR RELIGIOUS TRUSTS AND INSTITUTIONS

1. Exemption in respect of income of universities, hospitals, educational institutions, medical institutions etc. [Section 10(23C)] – First Regime

Exemption is available under section 10(23C) is in respect of any income received by any person on behalf of the certain funds and institutions. In particular, the exemption available under first regime is with regard to income of universities, educational institutions, hospitals and other medical institutions covered under sub-clauses (iiiab), (iiiac), (iiiad), (iiiae), (iv), (v), (vi) and (via) of section 10(23C). The brief summary of the exemptions available is encapsulated in the following table:

Section	Activity Scope	Exemption Conditions
10(23C)(iiiab)	Education	Wholly or substantially financed by the Government.
10(23C)(iiiac)	Medical	Wholly or substantially financed by the Government
10(23C)(iiiad)	Education	Aggregate annual receipts do not exceed **five crore rupees**
10(23C)(iiiae)	Medical	Aggregate annual receipts do not exceed **five crore rupees**
10(23C)(iv)	Charitable purpose, which is important for India & its states	Approval to be obtained from the prescribed authority.
10(23C)(v)	Wholly for public religious purposes or wholly for public religious & charitable purposes	
10(23C)(vi)	Education, whose aggregate annual receipts exceed five crore rupees	Approval to be obtained from the prescribed authority
10(23C)(via)	Medical, whose aggregate annual receipts exceed five crore rupees	

Broadly, exemption of any income received by any person on behalf of universities, educational institutions, hospitals and other medical institutions under section 10(23C) is available in the following manner:

(1) Universities or Educational Institutions or Hospitals or Medical Institutions substantially financed by the Government:

- any university or other educational institution **wholly or substantially financed by the Government** which exists solely for educational purposes and not for profit [Sub-clause (iiiab)];
- any hospital or other institution **wholly or substantially financed by the Government**, which exists solely for philanthropic purposes and not for profit and which exists for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of convalescing persons or persons requiring medical attention or rehabilitation [Sub-clause (iiiac)];

If the government grant to a university or other educational institution, hospital or other institution during the relevant previous year **exceeds 50% of the total receipts** (including any voluntary contributions), of such university or other educational institution, hospital or other institution, as the case may be, then, such university or other educational institution, hospital or other institution shall be considered as being **substantially financed by the Government** for that previous year [Rule 2BBB].

(2) Universities or Educational Institutions or Hospitals or Medical Institutions whose annual receipts not exceed ₹ *5* crore:

- any university or other educational institution existing solely for educational purposes and not for profit and its **aggregate annual receipts do not exceed ₹ 5 crore** [Sub-clause (iiiad)];
- any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of convalescing persons or persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for profit, if its aggregate annual receipts **do not exceed the prescribed limit of ₹ 5 crore** [Sub-clause (iiiae)];
- Where a person has receipts from an institution specified in sub-clause (iiiad) as well as from an institution specified in sub-clause (iiiae), **whose combined receipts exceeds ₹ 5 crores, then, the said person shall not be eligible for exemption** under the respective sub-clauses (iiiad) & (iiiae).

(3) Universities or Educational Institutions or Hospitals or Medical Institutions or Specified Charitable Institutions exempted subject to certain conditions:

- **any other fund or institution for charitable purposes approved by the Principal Commissioner or Commissioner** having regard to the objects of the fund or institution and its importance throughout India or throughout any State or States [Sub-clause (iv)];
- **any trust (including any other legal obligation) or institution wholly for public religious or wholly for public religious and charitable purposes approved by the Principal Commissioner or Commissioner** having regard to ensure the income applies for the objects of the fund or institution [Sub-clause (v)];
- any other university or educational institution existing solely for educational purposes and not for purposes of profit and which may be approved by the Principal

Commissioner or Commissioner other than referred in (1) and (2) above [Sub-clause (vi)];

- any other hospital, or other medical institution other than referred in (1) and (2) above approved by the Principal Commissioner or Commissioner [Sub-clause (via)].

***Note -** The conditions and norms for availing the exemption under section 10(23C)(iv), (v), (vi) & (via) [First regime] are largely similar as those for availing exemption under section 11 to 13 [Second Regime]. Henceforth, in this chapter, reference to First regime would refer to section 10(23)(iv)/(v)/(vi)/(via). The comparative table of the corresponding provisions under the First and Second regime are given under para 10.3, which will help students co-relate the relevant provisions under the First regime with the provisions of sections 11 to 13 under the Second Regime discussed later on in this Chapter.*

ILLUSTRATION 1

An educational institution having annual receipts of ₹ 3.80 crore during the P.Y. 2023-24, has availed exemption under section 10(23C)(iiiad). The Assessing Officer has denied the exemption on the grounds that the educational institution has not made any application to the prescribed authority for approval under the said section 10(23C)(iiiad). Examine the action of the Assessing Officer in denying the exemption.

SOLUTION

As per section 10(23C)(iiiad), income of any university or other educational institution existing solely for educational purposes and not for purposes of profit would be exempt if the aggregate annual receipts of such university or educational institution do not exceed ₹ 5 crore. Therefore, the exemption available under this section can be availed without making any application to the prescribed authority.

Therefore, the action of the Assessing Officer in denying the exemption to the educational institution is not correct.

ILLUSTRATION 2

A not for profit trust undertakes philanthropic activities through an educational institution and a hospital. During the P.Y. 2023-24, the trust had annual receipts of ₹ 3 crore from its educational institution and ₹ 4 crore from the hospital. During the P.Y. 2023-24, it desires to avail exemption under section 10(23C)(iiiad) and 10(23C)(iiiae), as the individual threshold under each of the sub-clauses, is less than ₹ 5 crore. Can it do so? Examine.

SOLUTION

As per *Explanation* below to section *10(23C)(iiiae),* it has been clarified that the limit of annual receipts of ₹ 5 crore is qua 'taxpayer' and not qua 'activity'. Therefore, if the aggregate annual receipts from educational activity and medical activity exceeds ₹ 5 crores, then, exemption under sub-clause (iiiad) and (iiiae) cannot be availed by the trust.

Since, in the present case, the aggregate annual receipt of ₹ 7 crores (₹ 3 crores of educational institution and ₹ 4 crores from hospital) exceeds the threshold of ₹ 5 crores, exemption under section 10(23C)(iiiad) and (iiiae) cannot be availed, even though the individual receipts from educational institution and hospital have not exceeded ₹ 5 crores.

2. Charitable or Religious Trusts and Institutions [Sections 11 to 13] - Second Regime

The second regime of exemption is available under the Section 11. The second regime is more exhaustive in scope as it is available for any philanthropic organisation involved in charitable or religious purposes. The second regime is more popular and widely adopted by non-profit organisations. It is imperative to note that an assessee can opt to avail exemption only under one of the regime depending upon its objects and purpose. An overview and specifics pertaining to the second exemption regime is provided below.

Overview

Section 11	• **Exclusion of the following income from total income of the trust:** • Income derived from property held under trust wholly or partly for charitable and religious purposes, applied for such purposes; **and** • Income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust
Section 12	• Income derived by a trust from voluntary contributions (other than corpus donations) deemed to be income derived from property held under trust for the purposes of section 11; • Value of medical and educational services made available to specified persons deemed to be income of the trust running a hospital or medical or educational institution notwithstanding the provisions of section 11(1).
Section 12A	• prescribes the conditions for availing the benefits u/s 11 and 12.
Section 12AB	• prescribes the procedure framework for registration with the income-tax authorites to avail the exemption u/s 11 & 12 .
Section 13	• enumerates the circumstances under which the exemption available u/s 11 and 12 will be denied

3. First and Second Regime – A Comparison

In the following table, Column (2) mentions the relevant provisos in section 10(23C) [under the first regime under sections 10(23C)(iv)/(v)/(vi)/(via)] and Column (3) mentions the corresponding provisions under the second regime under sections 11 to 13. Column (4) contains the subject matter of the relevant provision pertaining to both regimes.

(1)		(2)	(3)	(4)
Sl. No.		First Regime [Section 10(23C)(v)/(v)/(vi)/(via)]	Second Regime [Sections 11 to 13]	
		Relevant proviso to section 10(23C) and the Explanations thereto	Corresponding provision in the Second regime [Sections 11 to 13]	Subject matter (in brief)
(1)		***1st proviso***	***12A(1)(ac)***	Application to PC or Commissioner for approval/ registration of trust/institution and the time limits for making such application
(2)		***2nd proviso***	***12AB(1)***	Grant of approval/passing an order of registration of trust/ institution or rejection of the application by PC or Commissioner and period of validity of approval/registration
(3)		3rd proviso		
	(i)	Explanation 1	11(1)(d)	Corpus donations not to be included in income subject to investment in forms and modes specified in section 11(5)
	(ii)	Explanation 1A [Applies only in case of section 10(23C)(v)]	Explanation 3A to section 11	Conditions for treatment of voluntary contribution received for renovation or repair of temple/ church/mosque etc. (where they form part of property held under trust) as corpus donation, at the option of the trust

	(iii)	Explanation 1B [Applies only in case of section 10(23C)(v)]	Explanation 3B to section 11	Deemed income in the year of violation of conditions mentioned in Sl. No. (3)(ii) above.
	(iv)	***Explanation 2 and its clauses (i), (ii) and (iii)***	***Explanation 4 to section 11 and its clauses (i), (ii) and (iii)***	Amount spent out of – – corpus donations excluded from total income or – loan or borrowing not to be treated as application for charitable purposes [Clause (i) and (ii)] ***Amount credited or paid out of current year income of the trust to fund/trust/institution by way of donation other than corpus donation would be allowed as application to the extent of 85% of such amount paid or credited.***
	(v)	Explanation 3 and its first proviso	11(2) and its first proviso	Conditions stipulated for treating the amount accumulated or set apart beyond 15% as deemed application
	(vi)	Explanation 4	11(3)	Deemed income in case of non-fulfilment of conditions in Sl. No. (3)(v) above and the previous year in which taxable
	(vii)	Explanation 5	11(3A)	Application to A.O. to permit application of accumulated income for other purposes in line with the objects of the trust or institution
		Proviso	Proviso	A.O. cannot allow application of such accumulated income by way of amount credited or paid to another trust or institution
(4)		7th proviso	11(4A)	Maintenance of separate books of accounts in case of carrying on of business incidental to the objects of the trust or institution

				for claiming exemption of income from such business
(5)		8th proviso	1st proviso to section 12A(2)	Where an application is made under Sl. No. (1) above, the relevant A.Y. from which the exemption provisions would apply
(6)		9th proviso	12AB(3)	Time limit for passing order granting approval/registration under Sl. No. (2) above.
(7)		10th proviso	12A(1)(b)	Requirement to maintain prescribed books of account and get the same audited and furnish audit report on or before the specified date.
(8)		12th proviso	Explanation 2 to section 11(1)	Contribution towards the corpus of another trust or institution out of current year income not to be treated as application of income
(9)		13th proviso	Explanation 3 to section 11(1)	Disallowances under sections 40(a)(ia) and 40A(3) and (3A) to apply in determining the amount of application
(10)		14th proviso	Explanation to section 11(2)	Contribution to any trust or institution out of accumulated income not to be treated as application of income
(11)		15th proviso	12AB(4)	PC/Commissioner to call for documents or information in case he notices specified violations or on receipt of reference from A.O. or selection of case as per risk management strategy of CBDT; and pass an order cancelling or refusing to cancel approval/registration of trust on or before the specified date/time limit.

	(i)	Explanation 1	12AB(5)	Meaning of "specified date"/time limit
	(ii)	***Explanation 2***	***Explanation to section 12AB(4)***	Meaning of "specified violation"
(12)		16th proviso	13(7)	Anonymous donation referred to in section 115BBC to be included in total income.
(13)		18th proviso [Relevant only for section 10(23C)(iv) and (v)]	13(8)	Inclusion of income of trust or institution having object of advancement of any object of general public utility in total income, if it carries on activity in the nature of trade commerce or business for consideration and the aggregate receipts from such activity exceeds 20% of total receipts.
(14)		19th proviso	11(7)	Exemptions under section 10 [except section 10(1)] not to apply to trust or institution approved u/s 10(23C) or registered under section 12AA/12AB
		Explanation	***First Proviso to section 11(7)***	If trust or institution approved u/s 10(23C) or registered u/s 12AA/12AB is notified ***u/s 10(23EC)*** or u/s 10(46) or ***u/s 10(46A)***, the approval u/s 10(23C) or registration u/s 12AA/12AB, as the case may be, would become inoperative from the date of notification ***u/s 10(23EC) or*** u/s 10(46) ***u/s 10(46A)***.
(15)		***20th proviso***	***12A(1)(ba)***	Return of income to be furnished in accordance with section 139(4C)/(4A) ***within the time allowed u/s 139(1) or 139(4).***

(16)		21st proviso	13(1)(c)	Income applied for benefit of person referred to in section 13(3) to be deemed income of the trust or institution in the previous year of application [after taking into account the provisions of sections 13(2)/(4)/(6)].
(17)		22nd proviso	13(10)	In case of non-maintenance of books of account or failure to get them audited or failure to file return of income or inclusion of income in total income due to carrying on of activities in the nature of trade, commerce, business (refer point 13 above), income to be computed as per normal provisions after allowing deduction of revenue expenditure subject to certain conditions stipulated thereunder.
		Explanation	Explanation	Disallowances under sections 40(a)(ia) and 40A(3) and (3A) to apply in determining the amount of revenue expenditure deductible
(18)		23rd proviso	13(11)	In computing income under regular provisions as per Sl. No. 17 above, no deduction in respect of any expenditure or allowance or set-off of any loss shall be allowed to the assessee under any provision of the Act.
(19)		Explanation 1 to section 10(23C)	11(6)	If acquisition of asset has been claimed as application, then, no deduction for depreciation is allowable.
(20)		Explanation 2 to section 10(23C)	Explanation 5 to section 11(1)	Excess application of an earlier previous year not allowed to be

				set-off or claimed as deduction or allowance while calculation of income required to be applied or accumulated in the relevant previous year.
(21)		Explanation 3 to section 10(23C)	Explanation to section 11	Sum payable by a trust or institution to be considered as application of income during the P.Y. in which such sum is actually paid by it, irrespective of the method of accounting regularly employed by it.
		Proviso	Proviso	If such sum is already claimed as application in any earlier previous year, it will not be allowed as application again in any subsequent P.Y. on payment basis.

Note – The provisions indicated in bold and italics in columns (2) and (3) in the table above represent the provisions amended by the Finance Act, 2023. It may be noted that in certain provisions mentioned in the table above, there may be some differences between the corresponding provisions in the first and second regime. The same have been brought out at the relevant places in the course of discussions in the ensuing paragraphs in this chapter relating to the provisions in the second regime [i.e., sections 11 to 13]. The above table will help you co-relate the corresponding provisions in the first regime [Section 10(23C)(iv)/(v)/ (vi)/(via)].

4. Income of Charitable Trusts and Institutions

I. Income from property held under trust

Subject to the provisions of sections 60 to 63, the income of a religious or charitable trust or institution, to the extent specified in the Act, is exempt from tax when certain prescribed conditions are fulfilled. The relevant income does not even form part of the total income of the trust or institution.

Income from property held for charitable or religious purposes in India [Section 11(1)]- The following income shall **not** be included in the total income of the previous year of the person in receipt of the income:

(a) Income derived from property held under trust wholly for charitable or religious purposes to the extent such income is applied in India for such purpose. Further, a minimum 85% of the income derived to be applied for charitable or religious purpose.

(b) Income derived from property held under trust in part only for such purpose, to the extent such income is applied in India for such purposes.

(c) Income derived from property held under trust,

- created on or after 1.4.1952 for charitable purpose which tends to promote international welfare in which India is interested to the extent to which such income is applied to such purpose outside India. This does not cover religious trusts.

- trust for charitable or religious purposes, created before 1.4.1952, to the extent to which such income is applied for such purposes outside India.

In both the cases, the CBDT should have, by general or special order, directed that such income shall not be included in the total income of the person in receipt of such income.

(d) Income in the form of voluntary contributions made with a **specific direction that they shall form part of the corpus** of the trust or institution*.*

Such voluntary contributions received as corpus must be invested or deposited in one or more of the forms or modes specified in section 11(5) maintained specifically for such corpus, for claim of exemption.

II. **Voluntary Contributions [Section 12]-** Any voluntary contribution received by a trust created wholly for charitable or religious purposes or by an institution established wholly for such purposes shall, for the purposes of section 11, be deemed to be income derived from property held under trust wholly for charitable or religious purposes. However, corpus donations (i.e., contributions made with a specific direction that they shall from part of the corpus of the trust or institution) shall not be treated as income, provided they are invested in the modes specified under section 11(5) [Section 12(1)].

The value of any services, being medical or educational services, made available by any charitable or religious trust running a hospital or medical institution or an educational institution, to any person referred under section 13(3), would be deemed to be income of such trust or institution derived from property held under trust wholly for charitable or religious purposes during the previous year in which such services are so provided and shall be chargeable to income-tax.

III. Income should be applied for charitable or religious purposes - One of the primary objectives of providing exemption under section 11 is that the income of the NPO should be applied wholly towards charitable or religious purpose. The income-tax act has not defined the term religious purpose. The shorter Oxford English Dictionary defines the term as follows:

"Devoted to religion; exhibiting the spiritual or practical effects of religion, following the requirements of religion; pious, godly, devout".

However, with regards to the definition of the term 'Charitable Purpose'**,** section 2(15) states that 'charitable purpose' includes-

- relief of the poor,
- education,
- yoga,
- medical relief,
- preservation of environment (including watersheds, forests and wildlife) & preservation of monuments or places or objects of artistic or historic interest and
- the advancement of any other object of general public utility.

Advancement of any other object of general public utility: The definition of "charitable purpose" includes "any other object of general public utility" The question arises as to what is an object of "general public utility". This expression has not been defined anywhere in the Act.

In *CIT v. Gujarat Maritime Board (2007) 295 ITR 561*, the Supreme Court observed that the Gujarat Maritime Board was established for the predominant purpose of development of minor ports within the State of Gujarat, the management and control of the Board was essentially with the State Government and there was no profit motive. The assessee, Gujarat Maritime Board, was under a legal obligation to apply its income which was directly and substantially from the business held under trust for the development of minor ports in Gujarat. Therefore, the Supreme Court held that the assessee was entitled to be registered as "charitable trust" under section 12A.

A number of entities functioning on commercial basis claim exemption of their income either under section 10(23C) or section 11 on the foundation that they are charitable institutions. This is based on the contention that they are engaged in the "advancement of an object of general public utility" as is included in the fourth part of the present definition of "charitable purpose". There were many decisions rendered in the past supporting the view that if unconnected business is held under a trust for promoting the object of general public utility and if profits are used for promoting such objects, income thereof shall be exempt, for example, the decision of the Supreme Court in *CIT v. Madras Stock Exchange Ltd. (1981) 130 ITR 184*. However, such a claim in respect of an activity carried out on commercial basis, goes against the basic intention of the provision.

"Advancement of any other object of general public utility" would not be a charitable purpose: In order to limit the ambit of the phrase "advancement of any other object of general public utility", section 2(15) provides that "the advancement of any other object of general public utility" would not be a charitable purpose if it involves the carrying on of –

(a) any activity in the nature of trade, commerce or business or,

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

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

Thus, the "advancement of any other object of general public utility" shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity, unless,-

(1) such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; **and**

(2) the aggregate receipts from such activity or activities, during the previous year, **does not exceed 20% of the total receipts**, of the trust or institution undertaking such activity or activities, for the previous year.

Therefore, in effect, "advancement of any other object of general public utility" would continue to be a "charitable purpose", if the activity in the nature of trade, commerce or business is undertaken in the course of actual carrying out of such advancement of any other object of general public utility **and** the aggregate receipts from any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business does not exceed 20% of the total receipts of the trust or institution undertaking such activity or activities, for the previous year.

ILLUSTRATION 3

An institution having its main object as "advancement of general public utility" received ₹ 30 lakhs in aggregate during the P.Y.2023-24 from an activity in the nature of trade. The total receipts of the institution, including donations, was ₹ 140 lakhs. It applied 85% of its total receipts from such activity during the same year for its main object i.e., advancement of object of general public utility.

(i) What would be the tax consequence of such receipt and application thereof by the institution?

(ii) Would your answer be different if the institution's total receipts had been ₹ 150 lakhs (instead of ₹ 140 lakhs) in aggregate during the P.Y.2023-24?

(iii) What would be your answer if the main object of the institution is "relief of the poor" and the institution receives₹ 30 lakhs from a trading activity, when its total receipts are ₹ 140 lakhs and applies 85% of the said receipts for its main object?

SOLUTION

(i) As the main object of the institution is "advancement of object of general public utility", the institution will lose its "charitable" status for the P.Y.2023-24, since it has received ₹ 30 lakhs from an activity in the nature of trade, which exceeds ₹ 28 lakhs, being 20% of the total receipts of the institution undertaking that activity for the previous year. The application of 85% of such receipt for its main object during the year would not help in retaining its "charitable" status for that year. The institution will lose its charitable status and consequently, the benefit of exemption of income for the P.Y.2023-24, irrespective of the fact that its approval is not withdrawn or its registration is not cancelled.

(ii) If the total receipt of the institution is ₹ 150 lakhs, and the institution receives ₹ 30 lakhs in aggregate from an activity in the nature of trade during the P.Y.2023-24, then it will not lose its "charitable" status since receipt of upto 20% of the total receipts of the institution in a year from such activity is permissible. The institution can claim exemption subject to fulfilment of other conditions under sections 11 to 13. Further, such activity should also be undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(iii) The restriction regarding carrying on a trading activity for a cess, fee or other consideration will not apply if the main object of the institution is "relief of the poor".

Therefore, receipt of ₹ 30 lakhs from a trading activity by such an institution will not affect its "charitable" status, even if it exceeds 20% of the total receipts of the institution. The institution can claim exemption subject to fulfilment of other conditions under sections 11 to 13.

ILLUSTRATION 4

***"Save Wild Life"** an institution having its main object as 'preservation of wildlife', used the entire income derived from an activity in the nature of trade for its main object during the previous year ended on 31.03.2024. Would such utilization of its income be treated as utilisation for "charitable purpose"? Examine. Would your answer be different, if the main object of the institution is "advancement of object of general public utility"?*

SOLUTION

Section 2(15) defines "charitable purpose" to include relief of the poor, education, yoga, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. However, the "advancement of any other object of general public utility" shall not be a charitable purpose, if the institution is carrying on any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income derived from such activity.

Therefore, preservation of wildlife is included in the definition of "charitable purpose" under section 2(15). Further, an institution having the preservation of wildlife as its main object would not be subject to the restrictions which are applicable to the "advancement of any other object of general public utility". Such institution would continue to retain its "charitable" status, even if it derives income from an activity in the nature of trade.

However, if an institution having its main object as "advancement of any other object of general public utility", derives income from an activity in the nature of trade during a financial year, it would lose its "charitable" status for that year, even if it applies such income for its main objects.

It may be noted that if the receipts from such activity does not exceed 20% of the total receipts in that year, then, the institution would not lose its "charitable" status, even if its main object is "advancement of any other object of general public utility", if such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

Circular No.11/2008 dated 19.12.2008

Exemption under section 11 in case of an assessee claiming both to be a charitable institution as well as a mutual organisation

The proviso to section 2(15) will apply only to entities whose purpose is advancement of any other object of general public utility i.e., the last limb of the definition of charitable purpose contained in section 2(15). Hence, such entities will not be eligible for exemption under section 11 or under section 10(23C), if they carry on commercial activities. Whether such an entity is carrying on an activity in the nature of trade, commerce or business is a question of fact which will be decided based on the nature, scope, extent and frequency of the activity.

There are industry and trade associations who claim exemption from tax under section 11 on the ground that their objects are for charitable purpose as these are covered under any other object of general public utility. Under the principle of mutuality, if trading takes place between persons who are associated together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to the persons forming such association is not chargeable to tax. In such cases, there must be complete identity between the contributors and the participants.

Therefore, where industry or trade associations claim to be both charitable institutions as well as mutual organizations and their activities are restricted to contributions from and participation of only their members, these would not fall within the purview of the proviso to section 2(15) owing to the principle of mutuality. However, if such organizations have dealings with non-members, their claim to be charitable organizations would be governed by the additional conditions stipulated in the proviso to section 2(15).

In the final analysis, however, whether the assessee has, for its object, the advancement of any other object of general public utility is a question of fact. If such assessee is engaged in any activity in the nature of trade, commerce or business or renders any service in relation to trade, commerce or business, it would not be entitled to claim that its object is charitable purpose. In such a case, the object of general public utility will be only a mask or a device to hide the true purpose which is trade, commerce or business or the rendering of any service in relation to trade, commerce or business. Each case would, therefore, be decided on its own facts and no generalization is possible.

Circular No.395, dated 24.9.1984– Promotion of sports and games is considered to be a charitable purpose within the meaning of section 2(15). Therefore, an association or institution engaged in the promotion of games and sports can claim exemption under section 11.

A trust will be treated as a charitable trust under section 2(15) even if its object involves the carrying on of an activity for profit. Such a trust will not be denied exemption under section 11 on the ground that its objects are non-charitable.

IV. **Charitable trust engaged in business activity-** Section 11(4A) provides that the exemption under the respective regime, would be available in respect of income, being profits and gains from business activity if ––

(a) such business is incidental to the attainment of the objects of the trust/institution; and

(b) separate books of account are maintained by such trust/institution in respect of such business.

Cases where trust property consists of a business undertaking -Section 11(4) clarifies that for the purposes of section 11, property held under trust may consist of a business undertaking so held. If that be so, the trustees may claim that the income of such undertaking enjoys exemption under section 11. Section 11(4) provides that -

(a) The Assessing Officer shall have the power to determine the income of the undertaking in accordance with the provisions of the Act relating to assessment, and

(b) Where the income determined by the Assessing Officer is in excess of that shown in the books of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious purposes.

ILLUSTRATION 5

NSN, a charitable educational trust approved under section 10(23C)(vi), is running a school. It operates a stationery shop outside the school campus. A sum of ₹ 75 lakhs has been derived as net income from such business activity, which has been applied towards the objectives of the trust in providing education. The trust maintains separate books of accounts for the business activity. Examine the taxability of application of the income, if the income so derived relates to the previous year 2023-24.

SOLUTION

The trust objective of providing education is a charitable purpose as per section 2(15). The trust in the given case runs a stationery shop business, whose income is applied towards the objectives of the trust. In this case, the business income from the stationery shop will be eligible to avail exemption in respect of profits and gains of business, if such business is incidental to the attainment of the objectives of the trust and separate books of account are maintained in respect of such business.

Therefore, in the given case, the profit from the business shall be eligible for exemption under section 11, assuming that the said business is incidental to the attainment of the objects of the trust (i.e., education) and books of account for such business activity is maintained separately.

5. Conditions for availing exemption under First Regime and Second Regime

Conditions for availing exemption under both the regimes i.e., section 10(23C)(iv)/(v)/(vi)/(via) are largely similar. It is essential to satisfy the following conditions for availing exemption under these regimes:

(I) Approval/Registration for claiming exemption

The primary condition for a trust or institution or fund to avail exemption in both the regimes, is that the trust or institution must be approved under section 10(23C) or registered under section 12AB, as the case may be. Failure to register will deprive tax exemption for such trust or institution.

The procedure for obtaining approval/registration for exemption to a trust or fund or institution had undergone a significant change from April 1st, 2021. Prior to the change in the approval/ registration procedure, a taxpayer desirous of availing exemption under this section must submit an application to the Commissioner of Income-tax, within a specified time limit. The Commissioner, on detailed verification and enquiry, will grant approval/registration or refusal of the exemption application. This process was time consuming and also paved way for prolonged litigation.

- The primary objective for overhauling of the registration process is to align with the tax administration's digitalization initiatives and providing certainty to the taxpayers. Therefore, to streamline and simplify the approval/registration process through the use of technology, the approval/registration process has undergone an overhauling with effect from 1st April 2021, which is applicable for incumbent organisations that are already registered and also for organisations desiring to avail the exemption u/s 10(23C) or under section 12AB for the first time.

- The salient features of the new process are filing of applications in online mode, allotment of a unique registration number for a trust or fund or institution, validity of approval/registration for a certain prescribed time limit, introduction of provisional registration, lesser time limit for the income-tax authority to grant their approval for the exemption, registration etc.
- Some of the key aspects of the change in the approval/registration procedure is that the approval/registration process is made online and the approvals are valid only for a certain time period. Closure to the expiry of the approval time limit, the taxpayer must apply for renewing the exemption approval/registration. Failure to renew the exemption approval will not entitle the taxpayer to avail the exemption any further.
- The manner for grant of approval along with the relevant timelines under the first regime i.e., section 10(23C) are encapsulated below in Table A and procedure for registration under the second regime i.e. under section 12AB in Table B:

Table A: Procedure & Timelines for seeking approval under section 10(23C)(iv)/(v)/(vi)/(via)[1]

First proviso to section 10(23C) (1)	Case (2)	Time limit for making the application (3)	Time limit for passing order by the Principal Commissioner or Commissioner [Second proviso to section 10(23C)] (4)	Validity Period (5)	Approval granted is applicable from (6)
Clause (i)	Reapproval of the institutions or funds which were already approved prior to 1.4.2021	Within three months from April 1, 2021[2] in Form No. 10A	within 3 months from the end of the month in which application was received [Clause (i)]	Five years	the A.Y. from which approval was earlier granted to it

[1] *For detailed study of procedure, manner and form applicable for making application for approval or provisional approval, students are advised to refer Rule 2C of the Income-tax Rules, 1962 available at https://incometaxindia.gov.in/Pages/rules/income-tax-rules-1962.aspx*

[2] *As per the provision, the effective date for making application is 30.06.2021. However, this date was extended upto 30.09.2023 vide Circular No. 6/2023, dated 24.05.2023..*

Clause (ii)	Renewal of approval whose period of 5 years is set to expire	at least six months prior to expiry of the period of 5 years, in Form No. 10AB	within 6 months from the end of the month in which application was received after satisfying himself about the genuineness of activities and compliance of requirements under other laws, as are material for the purpose of achieving its objects. For this purpose, the PC or C shall call for such documents or information and make inquiries as he thinks necessary. If not satisfied, pass an order in writing rejecting such application and also cancelling its approval after giving opportunity of being heard. [Clause (ii)]	Five years	the A.Y. immediately following the F.Y year in which such application is made
Clause (iii)	Provisionally approved fund/trusts etc. for final approval.	(i) at least six months prior to expiry of the period of the provisional approval **or** (ii) within six months of commencement of its activities whichever is earlier, in Form No. 10AB ***Note*** *– In cases where the above time limit expires before 30.9.2023, the last date has been extended to 30.9.2023.*			the first of the A.Y. for which fund/ trust etc. was provisionally approved
Clause (iv)	In any other case **[See Note below]**	At least one month prior to the commencement of the P.Y. relevant to the A.Y. from which the approval is sought in Form No. 10A.	Approval within one month from the end of the month in which the application is made. The approval shall be provisional. [Clause (iii)]	Three years	the A.Y. for which approval is sought in Form 10A, where the application is filed within the stipulated time limit[3]

[3] The CBDT Circular 6/2023 dated 24.5.2023 clarifies that the provisional approval shall be effective from the assessment year relevant to the previous year in which the application is made. However, it appears that the intent is to make the same applicable from the assessment year for which the approval is sought, provided the application is filed within the time limit mentioned in Column (3).

Note – With effect from 1.10.2023, a trust which has already commenced its activities and has not availed any exemption under first regime or second regime so far need not first apply for provisional approval in Form 10A. It can at any time after the commencement of such activities directly apply for final approval in Form 10AB for any P.Y. ending on or before the date of such application. The PC or C after following the compliances stipulated in Column (4) [Corresponding to clause (iii) of the first proviso], can grant approval within 6 months from the end of the month in which application is received. If not satisfied, he can pass an order in writing rejecting such application after affording it a reasonable opportunity of being heard. For such trust/fund/ institution, approval would be valid for 5 years. This will fall within the scope of clause (ii) of Second proviso to section 10(23C). Exemption under first regime is applicable from the A.Y. immediately following the F.Y year in which such application is made.

Thus, w.e.f. 1.10.2023, only the trusts/funds/institutions which have not commenced activities are required to get provisional approval and will fall within the scope of clause (iii) of the second proviso to section 10(23C).

Table B: Procedure & Timelines for availing exemption under section 12AB read with section 12A(1)(ac)[4]

Section 12A(1)(ac) (1)	Case (2)	Time limit for making the application (3)	Time limit for passing order by the PC/ Commissioner [Section 12AB(3)] (4)	Validity Period (5)	Registration granted is applicable from (6)
Clause (i)	Re-registration of the institutions or funds which were already	Within three months from April 1, 2021[5] in Form No. 10A	Order to be passed within 3 months from end of the month when	Five years [Section 12AB(1)(a)]	A.Y. from which registration was earlier granted [Proviso to

[4] For detailed study of procedure, manner and form applicable for making application for registration or provisional registration, students are advised to refer Rule 17A of the Income-tax Rules, 1962 available at https://incometaxindia.gov.in/Pages/rules/income-tax-rules-1962.aspx

[5] As per the provision, the effective date for making application is 30.06.2021. However, this date is extended upto 30.09.2023 vide Circular No. 6/2023, dated 24.05.2023..

	registered under section 12A/section 12AA. prior to 1.4.2021		application was made.		section 12A(2)]
Clause (ii)	Renewal of registration for trust/ institution already registered under section 12AB and whose period of 5 years is due to expire.	at least six months prior to the expiry of the five-year validity in Form No. 10AB.	within 6 months from the end of the month in which application was received after satisfying himself about the genuineness of activities and compliance of other laws, as are material for the purpose of achieving its objects. For this purpose, the PC or C shall call for such documents or information and make inquiries as he thinks necessary. If not satisfied, pass an order in writing rejecting such application and also cancelling its registration after giving opportunity of being heard.	Five years (if approved) [Section 12AB(1)(b)]	A.Y. immediately following the F.Y. in which application is made [Section 12A(2)]
Clause (iii)	Final registration where a trust/ institution is provisionally registered	At least six months prior to the expiry of the provisional registration **or** within six months of commence-ment of activities, which is earlier, in Form No. 10AB. ***Note*** – *In cases where the above time limit expires before 30.9.2023, the last date has been extended to 30.9.2023.*			First of the A.Y. for which it was provisionally registered [Proviso to section 12A(2)]
Clause (iv)	To revive inoperative registration of trust/ institution on	At least six months prior to the commence-ment of the AY from which the			A.Y. immediately following the F.Y. in which application is

	account of grant of approval u/s 10(23C) or 10(46) as provided in first proviso to section 11(7)	said registration is sought to be made operative in Form No. 10AB.			made [Section 12A(2)]
Clause (v)	The trust or institution has adopted or undertaken modifications of the objects which do not conform to the conditions of registration.	Within a period of thirty days from the date of the said adoption or modification, in Form No. 10AB			A.Y. immediately following the F.Y. in which application is made [Section 12A(2)]
Clause (vi)	In any other case (for e.g., first time applications) ***[See Note below]***	At least one month prior to the commence-ment of the previous year relevant to the assessment year in which the registration is sought in Form No. 10A.	Within one month from the end of the month in which the application is made order to be passed for provisional registration without detailed enquiry.	Three years [Section 12AB(1)(c)]	the A.Y. for which registration is sought in Form 10A, where the application is filed within the stipulated time limit[6]

Note – With effect from 1.10.2023, a trust which has already commenced its activities and has not availed exemption under first regime or second regime for any P.Y. ending on or before the date of such application, need not first apply for provisional registration in Form 10A. It can at any time after the commencement of such activities directly apply for final registration in Form 10AB. The PC or C after following the compliances stipulated in Column (4) [corresponding to clause (iii) of Section

[6] The CBDT Circular 6/2023 dated 24.5.2023 clarifies that the provisional registration shall be effective from the assessment year relevant to the previous year in which the application is made. However, it appears that the intent is to make the same applicable from the assessment year for which the registration is sought, provided the application is filed within the time limit mentioned in Column (3).

12A(1)(ac)], can grant approval within 6 months from the end of the month in which application is received. If not satisfied, he can pass an order in writing rejecting such application after affording it a reasonable opportunity of being heard. For such trust/fund/institution, registration would be valid for 5 years [Section 12AB(1)(b)]. Exemption under section 11 and 12 is applicable from the A.Y. immediately following the F.Y year in which such application is made.

Thus, w.e.f. 1.10.2023 only the trusts/funds/institutions which have not commenced activities are required to get provisional registration and will fall within the scope of section 12AB(1)(c).

ILLUSTRATION 6

A public trust has commenced its activities of providing "relief to poor" in the year 2022-23. The trust intends to claim benefits of sections 11 and 12 from A.Y. 2024-25. It approaches you in October, 2023. Advise the trust as to the time limit for making an application for registration, time limit for granting approval by the Principal Commissioner or Commissioner and the period for which the approval is valid.

SOLUTION

In order to avail the exemption under section 11, the trust has to obtain registration under section 12AB read with section 12A(1)(ac). From 1.10.2023, the trust which has already commenced its activities can directly apply for final registration. In the present case, the trust has to apply for registration after commencing its activities but on or before 31.3.2024 to avail the exemption for A.Y. 2024-25. Accordingly, the time limit for making application, time limit for granting registration and period of validity would be as follows:

S. No	Particulars	Time Limit
1	Registration application to be filed online as prescribed under Rule 17A	Application for final registration to be made in Form 10AB at any time after the commencement of such activities.
2	Grant of registration by the Principal Commissioner or Commissioner	Grant registration within 6 months from the end of the month in which application was received after satisfying himself about the genuineness of activities and compliance of other laws, as are material for the purpose of achieving its objects. For this purpose, the PC or C shall call for such documents or information and make inquiries as he thinks necessary.

		If not satisfied, pass an order in writing rejecting such application after giving opportunity of being heard.
3	Validity period of the approval	Registration is valid for five years effective from the A.Y. immediately following the F.Y. in which application is made.

ILLUSTRATION 7

Help All, a trust created on 1st April 2022 for providing relief to the poor, applied for registration under section 12AB on 28th February 2023. The Commissioner denied registration on the ground that the trust had not commenced any charitable activity, due to which he could not satisfy himself about the genuineness of the trust. Is the ground for denial of registration by the Commissioner justified in this case? Discuss.

SOLUTION

Section 12AB read with section 12A(1)(ac)(vi) provides that in case of a trust seeking registration for first time, provisional registration will be provided for a period of three years without detailed enquiry by the prescribed income-tax authority even in cases where activities of the entity are yet to begin. This is one of the key feature of the new registration process that benefits the taxpayer, wherein provisional registration is accorded.

Hence, in the new registration regime, the Commissioner cannot deny registration on the ground that activities have not commenced. The Commissioner can make detailed enquires and call for information when the trust applies to convert its provisional registration into a final registration as stipulated under section 12A(1)(ac)(iii) read with section 12AB.

(II) Cancellation of Registration/approval [Section 12AB(4) & (5)]

The Principal Commissioner of Income-tax (PCIT) or Commissioner Income-tax (CIT) can cancel registration or provisional registration or approval or provisional approval of a trust or an institution granted under either the first regime i.e., section 10(23C) or under the second regime i.e., section 11 read with section 12AB.

Situations in which registration/approval can be cancelled

The registration can be cancelled in the following situations:

- The PCIT or CIT has **noticed the occurrence of one or more specified violations** during any previous year; or
- The PCIT or CIT **has received a reference from an Assessing Officer** under the

second proviso to section 143(3) for any previous year **to withdraw the approval or registration due to occurrence of a specific violation**; or

- The case of the institution has been selected in accordance **with risk management strategy,** formulated by the CBDT from time to time for any previous year.

Procedure for cancellation

The PCIT or CIT in this regard shall

- **call for such documents or information from the trust or institution**, or make such inquiry as he thinks necessary in order to satisfy himself about the occurrence or otherwise of any specified violation;
- **pass an order in writing, cancelling the registration or approval of such trust or institution**, after affording a reasonable opportunity of being heard, for such previous year and all subsequent previous years, if he is satisfied that one or more specified violations have taken place;
- **pass an order in writing, refusing to cancel the registration** or approval of such trust or institution, if he is not satisfied with the occurrence of one or more specified violations;
- **forward a copy of the order** cancelling the registration or refusing to cancel the registration **to the Assessing Officer and to such trust or institution**.

Time limit for passing the order

The order cancelling or refusing to cancel registration has to be passed **before the expiry of a period of six months, from the end of the quarter in which the first notice is issued by the PCIT or CIT**, calling for any document or information, or for making any inquiry.

Meaning of Specified Violation: Specified violation

(a) where any income derived from property held under trust, wholly or in part for charitable or religious purposes, **has been applied, other than for the objects of the trust or institution**; or

(b) the trust or institution has **income from profits and gains of business which is not incidental** to the attainment of its objectives **or separate books of account are not maintained** by such trust or institution in respect of the business which is incidental to the attainment of its objectives; or

(c) the trust or institution has **applied** any part of its income from the property held under a trust for **private religious purposes**, which does not enure for the benefit of the public; or

(d) the trust or institution established for charitable purpose created or established after the commencement of this Act, has **applied** any part of its income for the benefit of any **particular religious community or caste**; or

(e) any activity being carried out by the trust or institution—

(i) is not genuine; or

(ii) is not being carried out in accordance with all or any of the conditions subject to which it was registered; or

(f) the trust or institution **has not complied with the requirement of any other law**, and the order, direction or decree, by whatever name called, holding that such non-compliance has occurred, has either not been disputed or has attained finality.

(g) the application for approval under first regime or registration under second regime is not complete or it contains false or incorrect information. [This is considered as specified violation w.e.f. 1.4.2023]

> ***Note –*** *Cancellation procedure for approval granted under first regime is similar as prescribed above for second regime. However, the situations mentioned in (c) and (d) are mentioned only in the case of a trust or institution registered under section 11.*

(III) Mandatory filing of return:

In order to avail of exemption under any of these regimes, the entities approved under first regime and entities registered under second regime are required to file the return of income under section 139(4C) or under 139(4A), respectively ***within the time allowed under section 139(1) [i.e., on or before the due date of filing return of income] or section 139(4) [upto 31st December of the relevant assessment year],*** if the total income without giving effect to the provisions of

– section 10, in case of first regime approved entities or

– section 11 and 12 in case of second regime approved entities,

exceeds the maximum amount which is not chargeable to income-tax.

(IV) Maintenance of Books of account & Other Documents and Audit of accounts:

With effect from A.Y. 2023-24, where the total income of the trust or institution or fund referred under these two regimes without giving effect to the provisions of section 10(23C)(iv)/(v)(vi)(via) or section 11 and 12, as the case may be exceeds the maximum amount which is not chargeable to income-tax in any previous year, such entities shall

– keep and maintain books of account and other documents in such form and manner and at such place,

– get the accounts audited by a chartered accountant and the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such prescribed particulars, should be furnished on or before the specified date i.e., one month prior to the due date for filing return of income.

> ***Rule 16CC and Rule 17B prescribe that the report of audit of the accounts of a trust or institution is required to be furnished in***
>
> *(a) Form No. 10B where -*
>
> *(I) the total income of such trust or institution, without giving effect to the provisions of 10(23C)(iv)/(v)(vi)(via) or sections 11 and 12, exceeds ₹ 5 crores during the previous year; or*
>
> *(II) such trust or institution has received any foreign contribution during the previous year; or*
>
> *(III) such trust or institution has applied any part of its income outside India during the previous year;*
>
> *(b) Form No. 10BB in other cases.*

The term "books or books of account" as defined under section 2(12A) includes ledgers, day-books, cash books, account-books and other books, **whether kept in the written form or in electronic form or in digital form or as print-outs of data stored in such electronic form or in digital form** or in a floppy, disc, tape or any other form of electro-magnetic data storage device.

Prescribed books of account and documents

Rule 17AA prescribes the following books of account and other documents to be maintained by the entities under both the regimes:

(a) books of account, including the following, namely: -

(i) cash book;

(ii) ledger;

(iii) journal;

(iv) copies of bills, whether machine numbered or otherwise serially numbered, wherever such bills are issued by the assessee, and copies or counterfoils of machine numbered or otherwise serially numbered receipts issued by the assessee;

(v) original bills wherever issued to the person and receipts in respect of payments made by the person;

(vi) any other book that may be required to be maintained in order to give a true and fair view of the state of the affairs of the person and explain the transactions effected;

(b) books of account, as referred in clause (a), for business undertaking referred in section 11(4);

(c) books of account, as referred in clause (a), for business carried on by the assessee other than the business undertaking referred in section 11(4);

(d) other documents for maintaining,

(i) record of all the projects and institutions run by the person

(ii) record of income of the person during the previous year, in respect of-

(I) voluntary contribution containing details of name of the donor, address, permanent account number (if available) and Aadhaar number (if available);

(II) income from property held under trust referred to under section 11 along with list of such properties;

(III) income of fund or institution or trust or any university or other educational institution or any hospital or other medical institution other than the contribution referred in items (I) and (II);

(iii) record of the following, out of the income of the person during the previous year, namely:-

(I) application of income, in India,

(II) amount credited or paid to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in first and second regime;

(III) application of income outside India;

(IV) deemed application of income;

(V) income accumulated or set apart which has not been applied or deemed to be applied containing details of the purpose for which such income has been accumulated;

(VI) money invested or deposited in the forms and modes specified in section 11(5);

(VII) money invested or deposited in the forms and modes other than those specified in section 11(5);

(iv) record of the following, out of the income of the person of any previous year preceding the current previous year, namely -

(I) application out of the income accumulated or set apart containing details of year of accumulation, amount of application during the previous year out of such accumulation, name and address of the person to whom any credit or payment is made and the object for which such application is made;

(II) application out of the deemed application of income;

(III) application, other than the application referred in item (I) and item (II), out of income accumulated during any preceding previous year containing details of year of accumulation, amount of application during the previous year out of such accumulation, name and address of the person to whom any credit or payment is made and the object for which such application is made;

(IV) money invested or deposited in the forms and modes specified in section 11(5);

(V) money invested or deposited in the forms and modes other than those specified in section 11(5);

(v) record of voluntary contribution made with a specific direction that they shall form part of the corpus.

(vi) record of contribution received for the purpose of renovation or repair of temple, mosque, gurdwara, church or other place notified under section 80G(2)(b) which is being treated as corpus as referred section 10(23C) or in section 11(1).

(vii) record of loan or borrowings

(viii) record of properties held by the assessee

(ix) record of specified persons, as referred to in section 13(3) and transactions undertaken by the fund or institution or trust with such specified persons.

Place of maintenance of books of account and other documents

The books of account and other documents shall be kept and maintained by the trust/ institution at its registered office.

Such books of accounts may be kept at such other place in India as the management may decide by way of a resolution and where such a resolution is passed, these entities should, within seven days thereof, intimate the jurisdictional Assessing Officer in writing giving the full address of that other place and such intimation shall be duly signed and verified by the person who is authorized to verify the return of income under section 140.

Time period

These books of account and other documents shall be kept and maintained for a period of ten years from the end of the relevant assessment year.

However, where the assessment in relation to any assessment year has been reopened under section 147 within the period (3 years or 10 years from the end of relevant assessment year, as the case may be) specified in section 149, the books of account and other documents which were kept and maintained at the time of reopening of the assessment shall continue to be so kept and maintained till the assessment so reopened has become final.

V. Application of Income – Key Considerations under both regime: We have seen that the exemption is limited to the extent to which such income is applied. Is it necessary that the entire income should be so applied? The Act gives a concession here. It is possible to claim the exemption even if the trust or institution applies only 85% of the income derived from the trust property for the purpose of the trust, during the relevant previous year.

An accumulation not exceeding 15% of the income from such property is permissible. For computing this 15%, voluntary contributions referred to in section 12 shall be deemed to be part of the income. Therefore, in order to avail exemption under both regimes minimum 85% of the income has to be applied towards the object of the N PO. In other words, 85% of income must be applied during the previous year for the purposes for which the trust has been created. The balance of 15% can be freely accumulated or set apart for application to charitable or religious purposes in India. Some relevant considerations for determining application of income are discussed below:

(A) **Inability to apply in full 85% of the income -** It is clear from the above discussion that free accumulation not exceeding 15% of income[7] from property is permissible. Hence, the balance 85% must be applied during the previous year for the purposes for which the trust has been created. However, it is possible that the trust is unable to apply the minimum of 85% of its income during the previous year due to either of the following reasons.

(1) The whole or any part of the income has not been received during that year. (For e.g., if the assessee follows accrual basis of accounting wherein the income has been recognised but not received)

(2) Any other reason (For e.g., late receipt of the income making it impossible to spend it before the end of the year)

- In the first situation, wherein the whole or any part of the income has not been received during that year, the period of application is extended to cover the previous year in which the income is actually received and the previous year immediately following the year. However, the amount which may be so claimed to have been so applied during the subsequent previous year cannot exceed the amount of the income which had not been received earlier but received during a subsequent previous year.

- In the second case, the period of application is extended to the previous year immediately following the previous year in which the income was derived.

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[7]As per the Supreme Court ruling in *CIT v. Programme for Community Organisation (2001) 116 Taxman 608,* 15% of gross receipts would be eligible for accumulation under section 11(1)(a).

Example 1

During the previous year ending 31st March, 2024, a charitable trust earned an income of ₹ 1,00,000 but it received only ₹ 60,000 in that year. The balance of ₹ 40,000 is received during the previous year 2024-25.

	₹
Total income earned during the P.Y.2023-24	*1,00,000*
Less: Permissible accumulation @15% of ₹ 1,00,000	*15,000*
Balance 85% of income derived to be applied during P.Y.2023-24	*85,000*
Less: Amount deemed to be applied would be the amount not received during the P.Y. 2023-24	*40,000*
Amount to be applied in the P.Y. 2023-24	*45,000*
Balance amount received in P.Y.2024-25 to be applied in the P.Y.2024-25 or P.Y.2025-26.	*40,000*
***Note -** Since this amount of ₹ 40,000 is received during the P.Y. 2024-25, this can be applied in the P.Y.2024-25 or in the P.Y.2025-26.*	

Example 2

A trust receives a sum of ₹ 50,000 on 30th March, 2024. Its previous year ends on 31-3-2024.

It is obvious that it is impossible to apply the requisite sum within one day. Therefore, it has been provided that such sum can be applied at any time during the immediately following previous year i.e., up to 31-3-2025

(B) **Procedural Formalities:** For exercising an option for availing the extended period for application in the above two situations [Clause (2) of *Explanation 1* to section 11(1)] - To avail the facility of the extended period of application of income, the trust has to exercise an option in writing that the income applied later as **prescribed may be deemed to be income applied to the relevant charitable purposes during the previous year in which the income was derived.** Such option has to be exercised ***at least 2 months before the due date for filing return of income specified under section 139(1).***

The income so deemed to have been applied shall, however, not be taken into account in calculating the amount of income applied to such purposes, during the previous year in which the income is actually received or during the immediately following previous year, as the case may be.

Thus, in ***Example 1*** given above, the amount of ₹ 40,000 received subsequently in the previous year 2024-25 and applied to charitable purposes in the previous year 2024-25, will, by virtue of the option exercised by the trust, be deemed to be applied for charitable purposes in the previous year 2023-24 itself. **Therefore, such an amount will not be taken into consideration in determining the amount of income applied for charitable purposes in the previous year 2024-25.**

Section 11(1B) also provides that where the income for which an option has been exercised as discussed above, is not actually applied, it is to be treated as the income of-

- the previous year immediately following the previous year in which the income was received in case of first situation or
- the previous year immediately following the previous year in which it was derived, in case of second situation.

Note: The option for availing the benefit for extended period for application of income in the two situations mentioned above is not available to trust or institution availing exemption under the first regime i.e., section 10(23C).

(C) Amounts not treated as application of income or not allowable as deduction

(i) **Amount credited or paid out of income of any trust by way of corpus donation not to be considered as application [*Explanation 2* to section 11(1)]-** Any amount credited or paid, out of income derived from property held under trust, to any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in section 10(23C)(iv)/(v)/(vi)/(via) or other trust or institution registered under section 12AA or 12AB, as the case may be, being contribution with a specific direction that it shall form part of the corpus, shall not be treated as application of income for charitable or religious purpose [*Explanation 2* to section 11(1)].

(ii) ***Only 85% of the amount credited or paid by way of donation (other than corpus donations) to another trust or institution out of current year income would be considered as application [Explanation 4(iii) to section 11(1)]:*** *Any amount credited or paid by way of donation, other than corpus donations, to any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in*

10(23C)(iv)/(v)/(vi)/(via) or other trust or institution registered under section 12AB, as the case may be, out of current year income shall be treated as application for charitable or religious purposes only to the extent of ***85% of such amount credited or paid.***

(iii) Amount credited or paid, out of accumulated income of any trust, to any trust or institution registered under section 12AA/12AB or referred to in section 10(23C)(iv)/(v)/(vi)/ (via), not considered as application of income *[Explanation* to section 11(2)]

Any amount credited or paid, out of income derived from property held under trust, which is not applied, but is accumulated or set apart, to any trust or institution registered under section 12AA/12AB, or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv)/(v)/(vi)/(via) of section 10(23C), shall **not** be treated as application of income for charitable or religious purpose, either during the period of accumulation or thereafter.

Note – Any contribution to another trust or institution out of accumulated income will not be treated as application. Contribution to another trust or institution towards corpus will not be deemed as application even if it is out of current year income.

(iv) Provisions of sections 40(a)(ia), 40A(3) and 40A(3A) apply in case of application of income by trust [*Explanation 3* to section 11(1)] – In case where an expenditure is incurred on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or after deduction, has not been paid on or before the due date under section 139(1), 30% of sum paid would not be treated as application of income in that year. The same would be, however, be treated as application in the year in which tax is deducted and paid..

Likewise, where the trust incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque/ bank draft/ ECS or through such other prescribed electronic mode [Credit card, debit card, net banking, IMPS (Immediate Payment Services), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Fund Transfer), BHIM (Bharat Interface for Money) Aadhar Pay], exceeds ₹ 10,000, the same would not be considered as application of income.

(v) **Income received for repairs and renovation of temples, mosques etc. [*Explanation 3A* to section 11(1)** - This provision would apply where the property held under a trust or institution includes any temple, mosque, gurdwara, church or other place notified under section 80G(2)(b).

In such a case, any sum received as a voluntary contribution by such trust or institution for the purpose of renovation or repair of such temple, mosque, gurdwara, church or other place, may, at its option, be treated as forming part of the corpus of the trust or the institution, provided such corpus is:

(a) applied by the trust or institution only for the purpose for which contribution was made;

(b) not utilised for making contribution or donation to any person;

(c) separately identifiable; and

(d) invested or deposited in the forms and modes specified in section 11(5).

However, in case such trust or institution has violated any of the above conditions, such sum treated as corpus will be deemed as income of the previous year during which violation takes place.

(vi) **Corpus donations utilised by fund/trust/institution towards its objects shall not be treated as application of income –** Under both the exemption regimes, corpus donations received by a fund/trust/institution etc. are exempt from income, if the corpus donations are received with a specific direction that they shall form part of the corpus and the said corpus contribution is invested in any of the modes specified under section 11(5) [Section 11(1)(d].

Therefore, corpus donations being exempt income, any application made from corpus donation shall **<u>not</u>** be treated as application of income [*Explanation 4(i) to section 11(1)].*

However, the amount not so treated as application thereof, shall be treated as application for charitable or religious purposes in the previous year in which the amount is invested or deposited back, into one or more of the forms or modes specified in section 11(5) maintained specifically for such corpus, from the income of that year and to the extent of such investment or deposit, subject to the satisfaction of conditions which are required to be satisfied in case of application for charitable or religious purposes. These conditions are as follows:

(1) Application should be in India except with the approval of the Board in accordance with the provisions of section 11(1)(c).

(2) Application should not be by way of donation to the corpus of another trust or institution.

(3) TDS, if applicable, should be deducted on such application.

(4) Application whereby payment or aggregate of payments made to a person in a day does not exceed ₹ 10,000 otherwise than by way otherwise than by an account payee cheque/ bank draft/ ECS or through such other prescribed electronic mode [Credit card, debit card, net banking, IMPS (Immediate Payment Services), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Fund Transfer), BHIM (Bharat Interface for Money) Aadhar Pay].

(5) Carry forward and set off of excess application is not allowed.

(6) Application is allowed in the year in which it is actually paid.

(7) Application should not directly or indirectly benefit any person referred to in section 13(3) and the income of the trust or institution should not enure any benefit to such person.

(8) If the trust or institution invests or deposits back the amount into corpus within 5 years of application from the corpus, only then such investment/ depositing back into corpus will be allowed as application for charitable or religious purposes.

Note - *No application would be allowed for amount invested or deposited back in modes specified under section 11(5), where application was made out of corpus on or before 31.3.2021.*

ILLUSTRATION 8

XYZ Charitable Trust is an educational institution registered under section 12AB of the Income-tax Act. During the Financial Year 2023-24, the trust receives a corpus donation of ₹ 25 lakhs with a specific direction that the corpus fund should be utilised for setting up a science laboratory. The trust intends to set up the lab only during P.Y. 2025-26 and will utilize the funds only during that financial year. In this regard, the trust wants to understand whether the corpus donations are exempt u/s 11(1)(d) of the Income-tax Act, 1961

SOLUTION

As per section 11(1)(d), voluntary contributions made with a specific direction that they shall form part of the corpus of the trust is an exempted income. However, in order to avail the exemption by the trust, such corpus donations must be invested or deposited in one or more of the forms or modes specified in section 11(5). Failure to deposit the same in the prescribed modes, will result in inclusion of corpus donation as an income of the XYZ Charitable trust.

(vii) Application out of loan/borrowings not to be treated as application of income - Application for charitable or religious purposes, from any loan or borrowing, shall not be treated as application of income for charitable or religious purposes [*Explanation 4(ii)* to section 11(1)].

However, the amount not so treated as application or part thereof, shall be treated as application in the previous year in which the loan or borrowing or part thereof is repaid from the income of that year to the extent of such repayment subject to satisfaction of conditions which are required to be satisfied in case of application for charitable or religious purposes. These conditions are as follows:

1. *Application should be in India except with the approval of the Board in accordance with the provisions of section 11(1)(c).*
2. *Such application should not be in the form of corpus donation to another trust.*
3. *TDS, if applicable, should be deducted on such application.*
4. *Application whereby payment or aggregate of payments made to a person in a day does not exceed ₹ 10,000 otherwise than by way of an account payee cheque/ bank draft/ ECS or through such other prescribed electronic mode [Credit card, debit card, net banking, IMPS (Immediate Payment Services), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Fund Transfer), BHIM (Bharat Interface for Money) Aadhar Pay].*
5. *Carry forward and set off of excess application is not allowed.*
6. *Application is allowed in the year in which it is actually paid.*

7. *Application should not directly or indirectly for the benefit of any person referred to in section 13(3) and the income of the trust or institution should not enure any benefit to such person.*

8. *Repayment of loan is made within a period of 5 years from the end of the previous year in which such application was made from loan or borrowing.*

> ***Note*** - *Application from any loan or borrowing made on or before 31.3.2021 will not be treated as application. This is because upto 31.3.2021, the amount applied out of loan or borrowing was allowed as application. Hence, at the time of repayment, it cannot be claimed as application once again.*

(viii) No set off or deduction allowable of any excess application of earlier previous year [*Explanation 5* to section 11(1)] – No set off or deduction or allowance of any excess application of any of the year preceding the previous year shall be made for computation of income required to be applied or accumulated during the previous year. For example, excess application in A.Y. 2023-24 cannot be reduced to determine the income to be applied or accumulated during the P.Y. 2023-24 (A.Y. 2024-25).

(ix) No deduction for depreciation where cost of asset has been claimed as application of income – Income for the purposes of application under section 11 shall be determined without allowing any deduction or allowance for depreciation or otherwise, in respect of any asset, the cost of acquisition of which has been claimed as an application of income under this section in the same or any other previous year [Section 11(6)].

ILLUSTRATION 9

MSO Foundation, a registered charitable institution set up on 1st April, 2022 is engaged in providing education in hotel management. The organization acquires a building in July 2023 for using the same for holding classes and office activities. It has approached you for your opinion on its eligibility to claim the cost of the building and also depreciation thereon in the current year and the subsequent year. Advise the institution indicating the reasons.

Would your advise change, if building has been acquired out of loan taken in July 2023 from bank, to be repaid in installments over a period of 7 years?

SOLUTION

15% of income from property held for charitable purposes is exempt from tax under section 11. The remaining 85% of such "income" would be exempt if it is "applied" for charitable purposes in India.

Application of the amount can be for revenue or capital purposes. As long as the expenditure is incurred out of income earned by the trust and for the purposes of carrying on the objects of the trust, it would be treated as application of income even if such expenditure is for capital purposes. Therefore, since the building is acquired by the organization for holding classes and office activities, which is for the purposes of carrying on the objects of the charitable institution i.e., for providing education in hotel management, the cost of the building would be treated as application of income.

However, section 11(6) provides that where the cost of building is claimed as application, no other deduction for depreciation or otherwise would be allowed as an application of income in respect of such asset for the same or any other previous year.

If building has been acquired out of loan taken from bank, then, cost of building cannot be claimed as application. Repayment of loan would be treated as application in the year of repayment to the extent of amount repaid for a period of 5 years from the end of the previous year in which building was acquired. The repayment made upto 31.3.2029 would be eligible to be treated as application in the respective year of repayment. Repayment made thereafter i.e., from 1.4.2029 cannot be treated as application.

Alternatively, since cost of building is not claimed as application, depreciation on such building can be claimed as deduction. However, if deduction in respect of depreciation is claimed, then, it is possible to take a view that repayment of loan may not be eligible to be treated as application.

(x) ***Expenditure allowed only on actual payment basis*** **–** Previously, the term "application" included expenses that accrued during the year, even if they are not actually paid. However, with effect from A.Y. 2022-23, any sum payable by any trust or institution shall be treated as application of income only in the previous year when such sum is actually paid by it. This is irrespective of the previous year in which the liability to pay such sum was incurred or method of accounting regularly employed by it. Thus, expenditure is allowed as application only when the payment is actually made and not when the liability is incurred [Explanation to section 11].

However, where during any previous year, any sum has already been claimed to have been applied by the trust or institution, such sum would not be allowed as application in any subsequent previous year based on actual payment.

For example, if a trust has incurred ₹ 2,00,000 in the P.Y. 2020-21 and claimed the same as application of income in that year and subsequently, the actual payment is made in the P.Y. 2023-24. Since such sum was already claimed as application in the P.Y. 2020-21, the same would not be allowed as application in the P.Y. 2023-24, on the basis of actual payment.

ILLUSTRATION 10

VPS Foundation, a charitable institution registered under section 12AB set up on 1st August 2022 is engaged in providing education in sports management. The Foundation follows accrual basis of accounting and during the previous year 2023-24, has accrued staff's salary expenses pertaining to the month of March 2024 amounting to ₹ 5 lakhs. The salary was paid during the first week of April 2024. KS, the tax advisor of the foundation has advised them that the salary expenses provided for in the accounts will not be treated as an application of income for the previous year 2023-24. Examine.

SOLUTION

Upto Assessment Year 2021-22, an expenditure could be regarded as an application of income even if it was not actually paid. However, effective from assessment year 2022-23, *Explanation* to section 11 provides that any sum payable by an institution shall be considered as an application of income only in the previous year in which such sum is actually paid by it. This is irrespective of the previous year in which the liability to pay such sum is incurred by the institution according to the method of accounting regularly employed by it. Therefore, the tax advisor's statement is correct.

(D) Instances where capital gains would be deemed to have been applied for charitable purposes [Section 11(1A)]

(a) **Transfer of a capital asset held under trust wholly for charitable or religious purposes [Section 11(1A)(a)]-** Where the whole of the net consideration from the transfer of the capital asset is utilised for acquiring a new capital asset which is held under trust wholly for charitable or religious purposes, the entire amount of capital gains arising from the transfer would be deemed to have been applied for charitable or religious purposes. If, however, only a part of the net consideration is utilised in acquiring the new capital asset, the amount of capital gains deemed to have been utilised for charitable or religious purposes shall be equal to the excess of the proceeds utilised over the cost of the asset transferred.

Example 3

Original cost of capital asset transferred	*₹ 1,00,000*
Consideration for which it is transferred	*₹ 1,50,000*
Situation 1 Cost of new capital asset acquired	*₹ 1,50,000*
Situation 2 Cost of new capital asset acquired	*₹ 1,20,000*

Amount that will be deemed to have been applied for charitable purposes.

Situation 1 ₹ 50,000

Situation 2 ₹ 20,000

(b) Transfer of a capital asset held under trust in part only for charitable and religious purposes [Section 11(1A)(b)] - Where only a part of a capital asset has been transferred, only the "appropriate fraction" of the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes. Where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of the appropriate fraction of such capital gain will be deemed to have been so applied. In any other case, the exemption will be limited to so much of the appropriate fraction of the amount utilised for acquiring the new asset as exceeds the appropriate fraction of the cost of the transferred asset.

"Appropriate fraction" means the fraction which represents the extent to which the income derived from the capital asset transferred was applicable to charitable or religious purposes before such transfer.

Example 4

A capital asset is being held under trust. Two-thirds of the income derived from such capital asset are being utilised for the charitable purposes of the trust. The asset is being transferred.

Cost of transferred asset	*₹ 1,20,000*
Net consideration	*₹ 1,80,000*
Cost of new asset acquired	*₹ 1,50,000*
Capital gains	*₹ 60,000 [₹ 1,80,000 – ₹ 1,20,000]*
Appropriate fraction 2/3rd	

Income represented by 'appropriate fraction' = 2/3rd of ₹ 60,000 = ₹ 40,000

Since the entire net consideration has not been utilised in acquiring the new asset, the amount deemed to have been utilised for charitable purpose will be (2/3rd of ₹ 1,50,000) – (2/3rd of ₹ 1,20,000) = ₹ 1,00,000 – ₹ 80,000 = ₹ 20,000.

Note – There is no provision akin to section 11(1A) in the first regime under section 10(23C).

VI. Accumulation of Income:

Conditional accumulation - Under both regimes, application of income derived from property held under trust for charitable purposes in India is the main condition for grant of exemption to trust or institution in respect of income derived from property held under such trust. In case such income cannot be applied during the previous year, the same can be accumulated and applied for such purposes, subject to satisfaction of the conditions provided therein.

Both regimes permit accumulation of 15% of the income indefinitely by the trust or institution. However, 85% of income can only be accumulated for a period not exceeding 5 years subject to the conditions that such person submits the prescribed form i.e., Form 10 to the Assessing Officer and the money so accumulated or set apart is invested or deposited in the specified forms or modes.

As per section 11(2), the conditions for accumulation are as follows:

(1) such person should furnish a statement in the prescribed form (Form 10) and in the prescribed manner to the Assessing Officer, stating the purpose for which the income is being accumulated or set apart and the period for which the income is being accumulated or set apart, which shall, in no case, exceed five years.

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

(2) the money so accumulated or set apart should be invested or deposited in the modes specified in section 11(5).

(3) the statement in Form 10 should be filed at least 2 months prior to the due date of filing return of income specified under section 139(1).

As per section 13(9), in case the statement in Form 10 is not submitted on or before the due date under section 139(1), then, the benefit of accumulation would not be available and such income would be taxable at the applicable rate. Further, the benefit of accumulation would also not be available if return of income is not furnished on or before the due date of filing return of income specified in section 139(1).

Note – *Section 11(2) stipulates the conditions for accumulation, on fulfillment of which the income so accumulated or set apart would not be included in the total income of the previous year of the trust. The condition stipulated in clause (c) of Section 11(2) is that the statement in Form 10 has to be furnished at least 2 months prior to the due date of filing of return of income u/s 139(1). However, as per section 13(9), the income accumulated would not be excluded from total income if Form 10 is not submitted on or before the due date under section 139(1). Section 13(9) permits exclusion of accumulated income from total income of the previous year, if Form 10 is filed on or before the due date under section 139(1). CBDT Circular No.6/2023 dated 24.5.2023 clarifies that the statement of accumulation in Form No. 10 is required to be furnished at least two months prior to the due date of furnishing return of income so that it may be taken into account while auditing the books of account. However, the accumulation/deemed application shall not be denied to a trust as long as the statement of accumulation/deemed application is furnished on or before the due date of furnishing the return as provided in section 139(1).*

Consequences on failure to satisfy the conditions of accumulation [Section 11(3)]

Where the accumulated income of the trust -

(a) is applied to purposes other than charitable or religious purposes or to the objects for which first regime entities are established; then such income shall be deemed to be the income of such person in the concerned previous year in which it is so applied.

(b) ceases to be accumulated or set apart for application; then such income shall be deemed to be the income of such person in the previous year in which the income ceases to be so accumulated or set apart.

(c) ceases to remain invested or deposited in any of the forms or modes specified in section 11(5); then such income shall be deemed to be the income of such person in the previous year, in which the income ceases to remain invested or deposited as per modes in section 11(5).

(d) is not utilised for the purpose for which it is accumulated or set apart during the period specified under the statement for accumulation; such income shall be deemed to be income of such person of the previous year being the last previous year of the period for which the income is so accumulated or set apart.

(e) is credited/paid to any trust or fund or institution registered under section 12AA/12AB/section 10(23C)(iv)/(v)/(vi)/(via); such income shall be deemed to be income in the previous year when it is so credited or paid.

As per section 11(3A), where due to circumstances beyond the control of the person in receipt of the income, any income invested or deposited cannot be applied for the purpose for which it was accumulated or set apart, the Assessing Officer may, on an application made to him in this behalf, allow such person to apply such income for such other purpose in India as is specified in the application by such person and as is in conformity with the objects of the trust.

However, the Assessing Officer shall not allow application of such income by way of payment or credit to any trust or fund or institution registered under section 12AA/12AB/section 10(23C)(iv)/(v)/(vi)/(via).

In case of a trust or institution which has deposited its income in forms or modes specified under section 11(5) is dissolved, the Assessing Officer may allow application of such income by way of payment or credit to a trust or institution registered under section 12AA/12AB or fund or trust or institution referred to section 10(23C)(iv)/(v)/(vi)/(via) [This provision is mentioned only with reference to the second regime].

ILLUSTRATION 11

A charitable institution registered under section 12AB of the Income-tax Act, 1961 filled in Form No.10 for seeking permission to accumulate unapplied income under section 11(2) of the Act for the objects of the institution and submitted it to the Assessing Officer along with the resolution for accumulation. The Assessing Officer found that the objects for which accumulation was sought were not particularised in as much as they covered the entire range of objects of the institution. Can the Assessing Officer deny the benefit of accumulation in such a case?

SOLUTION

Section 11(2) permits a charitable trust or institution to accumulate its unspent income where 85% of the income is not applied or is not deemed to have been applied to charitable or religious purposes in India during the previous year. The institution or trust has to specify, in the statement furnished to the Assessing Officer, the purpose for which the income is being accumulated or set apart and the period for which such income is to be accumulated or set apart.

In the given case, the assessee institution sought the permission of the Assessing Officer to accumulate unapplied income for the objects of the institution. The institution had not stated any objects in particular for which the unspent income was sought to be accumulated or set apart. In *Bharat Krishak Samaj vs. Deputy Director of Income-tax (Exemption) (2008) 306 ITR 153 (Del.)*, it was held that it is not necessary for a charitable trust to particularize each and every object for which accumulation is sought. It is enough if the assessee seeks permission for accumulation for the objects of the trust. Therefore, the Assessing Officer cannot deny the benefit of accumulation in such a case.

ILLUSTRATION 12

A charitable institution registered under section 12AB of the Income-tax Act, 1961 for the previous year ended 31 March 2024, filled in Form No.10 for seeking permission to accumulate unapplied income for a period of five years under section 11(2) of the Act for the objects of the institution and submitted it to the Assessing Officer along with the resolution for accumulation. The charitable institution could not utilise the accumulated income within the period of five years. Examine the consequences of the same for the charitable institution with regards to the accumulated income.

SOLUTION

Section 11(3) provides for consequences when an assessee registered under section 12AB fails to satisfy the conditions of 11(2) accumulation. In this regard, the charitable institution has not utilised the accumulated income of P.Y. 2023-24 within a period of five years as specified in Form 10. Hence, by virtue of section 11(3), the said income will be deemed to be the income of the charitable institution of the previous year, being the last previous year of the period for which the income accumulated is not utilised. Hence, the said income will be taxable in the 5th year as it is the last previous year of the period of accumulation.

Modes specified in section 11(5):

(1) Investment in Government Saving Certificates.

(2) Deposits with Post Office Savings Banks.

(3) Deposit with Scheduled banks or Co-operative Banks.

(4) Investment in units of the Unit Trust of India.

(5) Investment in Central or State Government Securities.

(6) Investments in debentures issued by or on behalf of any company or corporation. However, both the principal and interest thereon must have been guaranteed by the Central or the State Government.

(7) Investment or deposits in any public sector company.

Where an investment is made in the shares of any public sector company and such public sector company ceases to be a public sector company, the investment so made shall be deemed to be an investment made for a period of three years from the date of such cessation and in the case of any other investment or deposit, till the date of its maturity.

(8) Investment in bonds of approved financial corporation providing long term finance for industrial development in India and eligible for deduction under section 36(1)(viii).

(9) Investment in bonds of approved public companies whose principal object is to provide long-term finance for construction or purchase of houses in India for residential purposes and eligible for deduction under section 36(1)(viii).

(10) Deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India.

"Long-term finance" means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years.

"Urban infrastructure" means a project for providing potable water supply, sanitation and sewerage, drainage, solid waste management, road, bridges and flyovers or urban transport.

(11) Investment in immovable property excluding plant and machinery, not being plant and machinery installed in a building for the convenient occupation thereof.

(12) Deposits with Industrial Development Bank of India.

(13) **Any other mode of investment or deposit as may be prescribed. Rule 17C specifies the following other modes:**

(i) Investments in units issued under any scheme of mutual fund referred to in section 10(23D);

(ii) Any transfer of deposits to Public Account of India;

(iii) Deposits made with an authority constituted in India 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;

(iv) investment by way of acquiring equity shares of a 'depository';

(v) investment by a recognized Stock Exchange, in the equity shares of a company promoted by it to acquire the membership rights of other stock exchanges, where at least 51% of the paid-up share capital is held by the Stock Exchange and the balance is held by its members;

(vi) investment made by a person, authorised under section 4 of the Payment and Settlement Systems Act, 2007, in the equity share capital or bonds or debentures of a company —

(A) which is engaged in operations of retail payments system or digital payments settlement or similar activities in India and abroad and is approved by the Reserve Bank of India for this purpose; and

(B) in which at least 51% of equity shares are held by National Payments Corporation of India.

(vii) investment made by a person, authorised under section 4 of the Payment and Settlement Systems Act, 2007, in the equity share capital or bonds or debentures of Open Network for Digital Commerce Ltd, being a company incorporated under section 7(2) read with section 8(1) of the Companies Act, 2013, for participating in network based open protocol models which enable digital commerce and interoperable digital payments in India;

(viii) investment by way of acquiring equity shares of an incubatee by an incubator;

(ix) investment by way of acquiring shares of National Skill Development Corporation;

(x) investment in debt instruments issued by any infrastructure finance company registered with RBI;

(xi) investment in Stock Certificate as defined in of Sovereign Gold Bonds Scheme, 2015.

ILLUSTRATION 13

A charitable trust derives its income from the business of providing mineral water to various companies situated in Software Technology Park in Hyderabad. A sum of ₹ 30 lakhs has been derived as net income from such business activity, which has been applied for the object of general public utility. The total receipts of the trust during the P.Y. 2023-24 was ₹ 140 lakhs.

Examine the taxability of application of the income, if the income so derived relates to the previous year 2023-24. Would your answer be different, if the trust runs a school in a backward district and applies the profits from the business for such school's activity?

SOLUTION

In the first case, net income from the business of supplying mineral water to various companies i.e., ₹ 30 lakhs is not eligible for exemption under section 11, since the receipt from such activity exceeds 20% of total receipts (i.e., 20% of ₹ 140 lakhs) during the year. This is because "advancement of any object of general public utility" would not be a charitable purpose if it involves carrying on of any activity in the nature of trade, commerce or business, for example, supply of mineral water for a consideration, as in this case. It is immaterial that the net income from such business is applied for the object of general public utility. On the other hand, where the trust runs a school in a backward district, this restriction is not applicable. The reason is that the restriction contained in section 2(15) is applicable only to the last limb of the definition of "charitable purpose" i.e. advancement of object of general public utility. It does not affect the other limbs of the definition viz. "relief of the poor", "education", "medical relief" etc.

Section 11(4) clarifies that "property held under trust" includes a business undertaking so held. As per section 11(4A), exemption can be availed in respect of profits and gains of business, if such business is incidental to the attainment of the objectives of the trust and separate books of account are maintained in respect of such business. Therefore, in the second case, the profit from the business shall be eligible for exemption under section 11, assuming that the said business is incidental to the attainment of the objects of the trust (i.e., education) and books of account for such business activity is maintained separately.

VII. No claim for exemption under section 10 permissible where trust has been granted registration/approval for availing exemption under section 11 or under section 10(23C)

Where a trust or an institution or fund has been granted registration/approval for purposes of availing exemption under second regime, and the registration is in force for a previous year, then, such trust or institution cannot claim any exemption under any provision of section 10 [other than exemption of agricultural income under section 10(1)].

Prior to 1st June 2020, the organisation registered u/s 12AA could also avail approval u/s 10(23C) or 10(46) and thus, could avail tax exemption under either of the two sections. However, with effect from 1 June 2020, the registration granted for availing exemption under section 11 would become inoperative from the date on which the trust or institution is approved under section 10(23C) or is notified ***under section 10(23EC)*** or under section 10(46) ***or under section 10(46A)*** [First proviso to section 11(7)].

The trust or institution, whose registration has become inoperative, may apply to get its registration operative under section 12AB subject to the condition that on doing so, the approval under section 10(23C) or notification under ***section 10(23EC)/10(46) or 10(46A)***, as the case may be, to such trust or institution shall cease to have any effect from the date on which the said registration becomes operative and thereafter, it shall not be entitled to exemption under section 10(23C) ***or under section 10(23EC) or section 10(46) or section 10(46A), as the case may be*** [Second proviso to section 11(7)]

Where a fund or institution or trust referred in first regime under section 10(23C)(iv)/(v)/(vi)/(via) has been approved or provisionally approved by the Principal Commissioner or Commissioner and the approval is in force for any P.Y., then, no exemption can be claimed under any other provisions of section 10 [other than section 10(1)].

Likewise, w.e.f., 1.4.2022, where a trust or institution or fund is notified under section 10(46) or ***section 10(46A),*** the approval or provisional approval granted under first regime under section 10(23C)(iv)/(v)/(vi)/(via) would become inoperative from the date of such notification issued under section 10(46) ***or 10(46A).***

6. Denial of Exemption [Section 13]

(A) Income not eligible for exemption under sections 11 and 12

In the following situations, income of a trust, fund or institution will not be eligible for availing exemption under section 10(23C) (iv)/(v/(vi)/(via) or Section 11 as the case may be.

(a) Income from property held under a trust for private religious purposes - Where the property is held under a trust for private religious purposes, no part of the income will be exempt under section 11, if it does not ensure for the benefit of the public [Section 13(1)(a)].

(b) Income from trust established for benefit of any particular religious community or caste -Where a trust set up for charitable purposes or a charitable institution has been established for the benefit of any particular religious community or caste, the income thereof will not be eligible for exemption under section 11. However, a trust or institution created or established for the benefit of scheduled caste, backward classes, scheduled tribes or women and children shall not be treated as a trust or institution created or established for the benefit of a religious community or caste within the meaning of section 13(1)(b).

Note: The situations referred to in (a) & (b) on non-availability of exemption are with reference to only income under the second regime.

(c) Income of trust enuring for the benefit of any person referred to in section 13(3) [Section 13(1)(c)] Where any part of the income or property of trust or the institution enures directly or indirectly for the benefit of any person referred to in section 13(3), then such part of the income shall not be eligible for exemption and the said income will taxed at 30% under Section 115BBI.

With effect from A.Y. 2023-24, such part of income or property would not be eligible for exemption and would be taxed under section 115BBI at 30%. Further, to avoid income of the trusts or institutions to be used for the benefit of specified persons under section 13(3), penalty is leviable under 271AAE on the amount of income provided as a benefit.

Penalty for providing benefit to person referred in section 13(3) [Section 271AAE]

If during any proceeding under this Act, it is found that any person, being any fund or institution or trust referred under section 10(23C)(iv)/(v)/(vi)/(via) or any trust or institution referred to in section 11 applied income of the trust or institution, directly or indirectly, for the benefit of any person referred to in section 13(3), the Assessing Officer may direct such fund or trust or institution to pay penalty equal to -

(i) 100% of the aggregate amount of income so applied, where the violation is noticed for the first time during any previous year; and

(ii) 200% of the aggregate amount of income so applied, where violation is noticed again in any subsequent previous year.

Non-applicability of relaxation u/s 56(2)(x)

The provisions of section 56(2)(x) are not attracted in the hands of the recipient who receives any sum of money or property from a trust or institution approved u/s 10(23C) or registered u/s 12AA or 12AB.

However, this relaxation is not available where sum of money or property has been received by specified persons under section 13(3).

(d) Deposit or investment of funds in impermissible modes [Section 13(1)(d)] -Any income of a trust or institution, if –

(1) its funds are invested or deposited otherwise than in the forms or modes specified in section 11(5);

(2) it holds shares in a company other than -

   (i) a public sector company; or

   (ii) shares prescribed as a form or mode of investment under section 11(5)(xii).

However, these restrictions do not apply in respect of :

(a) any assets forming part of corpus of the trust as on 1-6-1973.

(b) any accretion to the corpus shares mentioned in (a) above by way of bonus shares allotted to the trust.

(c) debentures issued by or on behalf of any company or corporation and acquired by the trust before March 1, 1983.

(d) any asset not covered under section 11(5), where such asset is held for not more than one year from the end of the previous year in which such asset is acquired.

(e) any funds representing the profits and gains of business. However, where a trust has any other income in addition to profits and gains of business, such relaxation of the restriction will be denied unless the trust keeps separate accounts for the business [This is applicable only for the second regime].

Note – Under the first regime, the 3rd proviso to section 10(23C), requiring investment or deposit of funds in forms or modes specified under section 11(5), contains similar exclusions [mentioned in (a), (b), (c) and (d) above]. In addition, voluntary contributions received and maintained in the form of jewellery, furniture or any other article as the Board may specify, are also excluded from the applicability of this requirement under the first regime]

(B) Prohibited use or application -We have noted above that when any part of the income or any property of the trust whenever created, is, during the previous year, used or applied directly, for the benefit of any person referred to in section 13(3), the denial of exemption operates. Section 13(2) specifies a few particular instances where the income or the property is to be deemed to have been used for the benefit of a person referred to in section 13(3). It should be noted that those particular instances do not in any way restrict the general meaning of the expression "used or applied for the benefit of a person". The provisions of section 13(2) are as follows:

The income or the property of the trust or institution or any part of such income or property is to be deemed to have been used or applied for the benefit of a person referred to in section 13(3) in the following cases:

(a) **Loan without adequate interest or adequate security -** If any part of the income or the property of the trust or institution is or continues to be lent to any person referred to in section 13(3) for any period during the previous year without either adequate security or adequate interest or both.

(b) **Allowing use of property without adequate rent -**If any land, building or other property of the trust or institution is or continues to be, made available, for the use of any person referred to in section 13(3) for any period during the previous year without charging adequate rent or other compensation.

(c) **Excess payment for services -** If any amount is paid out of the resources of the trust or institution to any of the persons referred to in section 13(3) for services rendered to the trust or institution but such amount is in excess of a reasonable sum payable for such services.

(d) **Inadequate remuneration for services rendered -** If the services of the trust or institution are made available to any person referred to section 13(3) without adequate remuneration or other compensation.

(e) **Excess payment for purchase of property -** If any share, security or other property is purchased by or on behalf of the trust or institution from any person referred to in section 13(3) during the previous year for a consideration which is more than adequate.

(f) **Inadequate consideration for property sold -** If any share, security or other property is sold by or on behalf of the trust or institution to any person referred to in section 13(3) during the previous year for a consideration which is less than adequate.

(g) **Diversion of income or property exceeding ₹ 1,000 -** If any income or property of the trust or institution is diverted during the previous year in favour of any person referred to in section 13(3) provided the aggregate value of such income and property diverted exceeds ₹ 1,000.

(h) **Investment in substantial interest concerns** - If any funds of the trust or institution are, or continue to remain, invested for any period during the previous year in any concern in which any person referred to in section 13(3) has a substantial interest.

Section 13(4) provides some respite where the aggregate of the funds invested in the said concern does not exceed five per cent of the capital of that concern. In such a case, the exemption under section 11 or 12 will be denied only in relation to such income as arises out of the said investment. Exemption will not be denied to the remaining income only due to this reason.

(C) Prohibited category of persons - Section 13(3) gives the list of persons, use or application of the income or property of a trust for whose direct or indirect benefit results in a denial of the exemption contemplated in section 11 for a charitable or religious trust or institution. The said persons are:

(1) The author of the trust or the founder of the institution.

(2) Any person who has made a substantial contribution to the trust or institution, that is, any person whose total contribution up to the end of the relevant previous year exceeds ₹ 50,000.

(3) Where the author, founder or the person is a HUF, any member of the family.

(4) Any trustee of the trust or manager (by whatever name called) of the institution.

(5) Any relative of any such author, founder, person, member, trustee or manager as referred to above.

(6) Any concern in which any of the persons referred to in clauses (1) to (5) above has a substantial interest.

Relative - The expression "relative", in relation to an individual, means -

(a) spouse of the individual;

(b) brother or sister of the individual;

(c) brother or sister of the spouse of the individual;

(d) any lineal ascendant or descendant of the individual;

(e) any lineal ascendant or descendant of the spouse of the individual;

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

(g) any lineal descendant of a brother or sister of either the individual or the spouse of the individual;

Substantial interest in a concern - Section 13(2)(h), section 13(3) and section 13(4) refers to cases where a person has a substantial interest in a concern. These references occur where the "Prohibited use or application" and "Prohibited category of persons" have been described. The circumstances in which a person shall be deemed to have a substantial interest in a concern, have been laid down in *Explanation 3* to section 13.

Circumstances when a person is deemed to have substantial interest in a concern

Where the concern is a company

If equity shares carrying 20% or more of voting power are beneficially owned by such person or partly by such person and partly by one or more of the other persons referred to in section 13(3) at any time during the P.Y.

In any other case

If such person is entitled, or such person and one or more of the person referred to in section 13(3) are entitled in the aggregate, to receive 20% or more profit of such concern at any time during the P.Y.

(D) Exemption not to be denied to charitable trusts providing educational or medical facilities to specified persons [Section 13(6)]- A charitable or religious trust running an educational institution or a medical institution or a hospital shall not be denied the benefit of exemption under section 11 merely due to the reason that the benefit of educational or medical facilities have been provided to the specified persons referred to in section 13(3). However, the value of such facilities provided to such specified persons either free of cost or at a concessional rate would be deemed to be the income of the trust. Such income would not be eligible for exemption under section 11.

(E) Anonymous donations [Section 13(7)]-The exemption provisions contained in both regimes shall not be applicable in respect of any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of that section. For example, section 11(1)(d) provides that any income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of such trust/institution for the relevant previous year.

However, if a trust or institution established wholly for charitable purposes receives an anonymous donation with a specific direction that the donation shall form part of the corpus of the trust or institution, such anonymous donation would not be exempt by virtue of section 11(1)(d). It would be taxable at 30% as provided in section 115BBC.

(F) Exemption to be denied to a charitable trust having its main object as "advancement of any other object of general public utility" if its trading receipts exceed the specified threshold irrespective of withdrawal of approval or cancellation of registration or rescindment of notification [Section 13(8)]

(a) Under both regimes, income of any charitable trust or institution is exempt if such income is applied for charitable purposes in India and such institution is registered under second regime or approved under first regime.

(b) The definition of "charitable purpose" under section 2(15) provides that the advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity, unless,-

(1) such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; and

(2) the aggregate receipts from such activity or activities, during the previous year, does not exceed 20% of the total receipts, of the trust or institution undertaking such activity or activities, for the previous year .

(c) Thus, a charitable trust or institution pursuing "advancement of object of general public utility" may be a charitable trust in one year and not a charitable trust in another year depending on the percentage of receipts from commercial activities *vis-à-vis* its total receipts.

(d) Therefore, no exemption would be available to a trust or institution for the previous year in which the receipts from commercial activities exceed 20% of the total receipts of that year. However, this temporary excess in one year may not be treated as altering the very nature of the trust or institution so as to lead to cancellation of registration or withdrawal of approval or rescinding of notification issued in respect of trust or institution.

(e) Therefore, there is need to ensure that if the purpose of a trust or institution does not remain charitable in a previous year on account of the commercial receipts exceeding the specified percentage of total receipts, then, such trust or institution would not be entitled to get benefit of exemption in respect of its income for that previous year in which the commercial receipts exceed the specified percentage of total receipts. The denial of exemption would be compulsory by operation of law and would not be dependent on any approval being withdrawn or registration being cancelled or a notification being rescinded.

(f) Accordingly, section 13(8) ensures that such trust and institution does not get benefit of tax exemption under section 11 or 12 in the year in which its receipts from commercial activities exceed the specified percentage of total receipts, whether or not the registration or approval granted or notification issued is cancelled, withdrawn or rescinded in respect of such trust or institution.

(G) Non-submission of statement in prescribed form and non furnishing of return of income on or before the due date of filing return of income under section 139(1) [Section 13(9)]- In case the statement in Form 10 is not submitted and return of income is not filed on or before the due date of filing return of income under section 139(1), then, the benefit of accumulation would not be available and such income would be taxable at the applicable rate. Further, the benefit of accumulation would also not be available if return of income is not furnished on or before the due date of filing return of income specified in section 139(1).

Note – *Section 11(2) stipulates the conditions for accumulation, on fulfillment of which the income so accumulated or set apart would not be included in the total income of the previous year of the trust. The condition stipulated in clause (c) of Section 11(2) is that the statement in Form 10 has to be furnished at least 2 months prior to the due date of filing of return of income u/s 139(1). However, as per section 13(9), the income accumulated would not be excluded from total income if Form 10 is not submitted on or before the due date under section 139(1). Section 13(9) permits exclusion of accumulated income from total income of the previous year, if Form 10 is filed on or before the due date under section 139(1). CBDT Circular No.6/2023 dated 24.5.2023 clarifies that the statement of accumulation in Form No. 10 is required to be furnished at least two months prior to the due date of furnishing return of income so that it may be taken into account while auditing the books of account. However, the accumulation/deemed application shall not be denied to a trust as long as the statement of accumulation/deemed application is furnished on or before the due date of furnishing the return as provided in section 139(1).*

7. Manner of computation of income of a trust violating certain conditions [Sections 13(10) & (11)]

(i) Consequences of failure to comply with stipulated conditions: With effect from A.Y.2023-24, if a trust or an institution violates certain stipulated conditions, the income shall be chargeable to tax after allowing deduction for expenditure (other than capital expenditure) incurred in India for the objects of the trust/ institution.

The following are the violations:

- It has receipts from trade, commerce etc. while advancing the object of general public utility, in excess of 20% of total receipt;
- It fails to maintain prescribed books of account;
- It fails to get its books of account audited and furnish audit report on or before the specified date;
- It fails to file return of income under section 139(4A) (or 139(4C), as the case may be, for the first regime trust) within the time ***stipulated under section 139(1) or 139(4).***

(ii) Conditions to be fulfilled for claim of deduction of revenue expenditure: The deduction for revenue expenditure incurred is subject to fulfilment of the following conditions:

(a) such expenditure is not from the corpus standing to the credit of the trust or institution as on the end of the financial year immediately preceding the previous year relevant to the assessment year for which income is being computed;

(b) such expenditure is not from any loan or borrowing;

(c) there is no claim of depreciation on those assets, whose acquisition cost has been claimed as application of income in any previous year; and

(d) such expenditure is not in form of any contribution or donation to any person.

(iii) Disallowances: While determining the amount of expenditure allowable as deduction, the following points need to be considered:

(a) Capital expenditure is not allowed as a deduction.

(b) Disallowance under sections 40(a)(ia), on account of non-deduction of tax or non-payment of tax deducted at source on or before the due date of filing of return, would be attracted

(c) Disallowance of expenditure in respect of cash payment in excess of ₹. 10,000 under section 40A(3) and 40A(3A) would be attracted .

(d) no deduction in respect of any expenditure or allowance or set-off of any loss shall be allowed to the assessee under any other provision of this Act.

8. Anonymous donations received by Charitable Trusts/Institutions to be subject to tax [Section 115BBC]

(i) As per the provisions of the Income-tax Act, 1961, tax exemption under section 10(23C) and section 11 are available to certain entities, as briefed in the table below, on fulfillment of the conditions prescribed under the relevant sections –

Entity	Applicable section
Charitable or religious trusts/institutions	11
Universities and other educational institutions	10(23C)(iiiad) and (vi)
Hospitals and other medical institutions	10(23C) (iiiae) and (via)
Notified funds or institutions established for charitable purposes	10(23C)(iv)

Notified trusts or institutions established wholly for public religious purposes or wholly for public religious and charitable purposes	10(23C)(v)

(ii) As per section 115BBC anonymous donations received by the above entities are taxed at 30%.

(iii) In order to provide relief to these trusts and institutions and to reduce their compliance burden, an exemption limit has been introduced, and only the anonymous donations in excess of this limit would be subject to tax@30% under section 115BBC.

(iv) The exemption limit is the higher of the following –

(1) 5% of the total donations received by the assessee; or

(2) ₹ 1 lakh.

(v) The total tax payable by such institutions would be –

(1) tax@30% on anonymous donations exceeding the exemption limit as calculated above; and

(2) tax on the balance income i.e., total income as reduced by the anonymous donations which have been subject to tax@30% under section 115BBC**.**

(vi) The following table illustrates the calculation of anonymous donations liable to tax @30% under section 115BBC –

I	II	III	IV	V	VI
Situation	**Total donations during the year (₹)**	**Anonymous donations received during the year (₹)**	**Exemption [5% of total donations or ₹ 1,00,000, whichever is higher] (₹)**	**Anonymous donations taxable@30% (₹)**	**Donations subject to tax at normal rates# (₹)**
A	15,00,000	4,00,000	1,00,000	3,00,000	12,00,000
B	30,00,000	7,00,000	1,50,000	5,50,000	24,50,000
C	40,00,000	10,00,000	2,00,000	8,00,000	32,00,000

It is possible to take a view that the remaining donations reflected in Column VI which are taxable at normal rates would be eligible for application of income and thereby, the benefit of exemption under section 11 can be claimed in respect of such donations.

(vii) For this purpose**, "anonymous donation"** means any voluntary contribution referred to in section 2(24)(iia), where the person receiving such contribution does not maintain a record of the identity indicating the name and address of the person making such contribution and such other particulars as may be prescribed.

Section 115BBC does not apply to trust or institution wholly for religious purposes.

(viii) However, the above provision does not apply to a trust or institution created or established wholly for religious purposes.

(ix) Further, anonymous donations to trusts/institutions created or established wholly for religious and charitable purposes (i.e., partly charitable and partly religious institutions/trusts) would be taxed only if such anonymous donation is made with a specific direction that such donation is for any university or other educational institution or any hospital or other medical institution run by such trust or institution. Other anonymous donations received by such trusts/institutions are not taxable.

(x) Section 13(7) provides that the exemption provisions contained in section 11 or section 12 shall not be applicable in respect of any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of that section.

(xi) For example, section 11(1)(d) provides that any income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution and deposited or invested in modes specified u/s 11(5), shall not be included in the total income of such trust/institution for the relevant previous year. However, if a trust or institution established wholly for charitable purposes receives an anonymous donation with a specific direction that the donation shall form part of the corpus of the trust or institution, such anonymous donation would not be exempt by virtue of section 11(1)(d). It would be taxable at 30% as provided in section 115BBC.

(xii) Similarly, section 10(23C) provides that any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of the said section shall be included in the total income. Consequently, sections 10(23C) and 13 provide that any income by way of any anonymous donation which is taxable under the provisions of section 115BBC shall not be excluded from the total income of the trust or institution.

ILLUSTRATION 14

The following trusts claim that anonymous donations received by them during the financial year 2023-24 are not liable to tax under section 115BBC:

(i) A charitable trust referred to in section 11 which applied the entire amount of anonymous donations for purposes of the trust during the relevant financial year.

(ii) A trust established wholly for religious purposes which applied 85% of the amount of anonymous donations for the purposes of the objects of the trust during the relevant financial year.

Examine the validity of the claim made by the trusts.

SOLUTION

(i) Section 115BBC provides for levy of tax @ 30% on anonymous donation received by, *inter alia*, charitable trusts or institutions referred to in section 11 in the following manner:

(a) the amount of income-tax calculated @30% on the aggregate of anonymous donations received in excess of 5% of the total donations received by the assessee or one lakh rupees, whichever is higher; and

(b) the amount of income-tax with which the assessee would have been chargeable had his total income been reduced by the aggregate of the anonymous donations received in excess of 5% of the total donations received by the assessee or ₹ 1 lakh, as the case may be.

Further, section 13(7) provides that the exemption provisions contained in sections 11 and 12 shall not be applicable in respect of any anonymous donation liable to tax under section 115BBC. As such, application of the anonymous donations received by the charitable trust for charitable purposes does not confer any exemption from tax. Therefore, the claim for non-taxability under section 115BBC of anonymous donations received by the charitable trust is not valid in law.

However, a view may be taken that anonymous donation upto higher of 5% of total donations or ₹ 1 lakh, which is taxable at normal rates would be eligible for application of income and thereby, the benefit of exemption under section 11 would apply.

(ii) Section 115BBC(2) provides that the provisions contained in section 115BBC(1) relating to the taxability of anonymous donations are not applicable to any trust or institution created or established wholly for religious purposes. As such, the trust established wholly for religious purposes is not liable to be taxed in respect of the anonymous donations received by it. Therefore, the claim made by the trust is valid in law. The application or non-application of such anonymous donation for the purposes of trust during the relevant financial year is not germane to the issue of taxability under section 115BBC.

9. Taxation of specified income of NPOs chargeable to tax by charitable trusts/institutions [Section 115BBI]

(i) Rate of tax on Specified Income

As per section 115BBI specified income of a trust/institution availing exemption under the first regime [section 10(23C)(iv)/(v)/(vi)/(via))] or second regime [Section 11], would be chargeable at the rate of 30%.

(ii) No deduction for expenditure or allowance

Further, no deduction in respect of any expenditure or allowance or set-off of any loss would be allowed under any provisions of the Income-tax Act, 1961 while computing specified income.

(iii) Meaning of "Specified Income"

"Specified income" means:

(a) income accumulated or set apart in excess of 15% of the income, where such accumulation is not allowed under any specific provision of the Income-tax Act, 1961.

(b) deemed income on account of violation of certain conditions stipulated for accumulation of income under section 11(3) and corresponding provision in section 10(23C).

(c) deemed income on account of violation of deemed application provisions specified under 11(1B) read with *Explanation 1* below to section 11(1).

(d) any income which is not exempt under section 10(23C) or section 11 on account of funds of the trust or institution invested otherwise in the forms and modes specified under section 11(5)

(e) any income which is applied for the benefit of any specified prohibited person referred to in section 13(3).

(f) any income derived from a property held under trust for a charitable purpose which tends to promote international welfare in which India is interested to the extent to which such income is not applied towards charitable purposes outside India.

ILLUSTRATION 15

SR Trust is a registered charitable trust under section 12AB. During the P.Y.2023-24, the trust had applied ₹ 5 lakh for the benefit of the trustee and ₹ 3 lakh for the benefit of Mr. Satish, who has donated ₹ 3 lakh to the trust upto 31.3.2024. Also, an amount of ₹ 2 lakh set apart in the P.Y.2021-22 by the trust for charitable purposes u/s 11(2) has been utilized in the P.Y.2023-24 for making donation to another registered charitable trust with similar object as SR Trust. What is the amount of "specified income" liable to tax@30% under section 115BBI for A.Y. 2024-25?

SOLUTION

Section 115BBI provides for levy of tax @ 30% on certain "specified income" of a trust. Section 115BBI defines "specified income" to include income which has been applied for the benefit of prohibited persons u/s 13(3), which includes, *inter alia*, trustee of the trust and a person who has made substantial contribution to the trust (i.e., whose total contribution upto 31.3.2024 is more than ₹ 50,000). Specified income also includes deemed income on account of violation of certain conditions stipulated in section 11(3) for accumulation of income. Donation to another charitable trust out of accumulated income is one such violation. Accordingly, "specified income" of SR Trust liable to tax@30% under section 115BBI for A.Y. 2024-25 would be ₹ 10 lakh [₹ 5 lakh (amount applied for the benefit of the trustee) + ₹ 3 lakh (amount applied for the benefit of Mr. Satish) + ₹ 2 lakh (donation made to another trust out of accumulated income of an earlier previous year].

10. Tax on accreted income of certain trusts and institutions [Chapter XII-EB]

(1) Background for introduction of Exit Tax

(i) As per section 2(24), "income" includes any voluntary contribution received by a charitable trust or institution or a fund.

(ii) Sections 11 and 12 and section 10(23C)(iv)/(v)/(vi)/(via) provide exemption to trusts or institutions or funds or education institutions or hospitals in respect of income derived from property held under trust and voluntary contributions, subject to the conditions stipulated thereunder.

(iii) The exemption is subject to the condition that the income derived from property held under trust should be applied for charitable purposes; and where such income cannot be applied during the previous year, it has to be accumulated and invested in the modes prescribed and applied for such purposes in accordance with specified conditions.

(iv) If the accumulated income is not applied in accordance with the conditions provided in the said section within a specified time, then such income is deemed to be taxable income of the trust or the institution. Section 12AA or 12AB or section 10(23C) (iv) /(v)/ (vi)/ (via) provides for registration/approval of the trust or institution which entitles them to be able to get the benefit of sections 11 and 12 and section 10(23C) (iv) /(v)/ (vi)/ (via). It also provides the circumstances under which the registration can be cancelled. Section 13 of the Act provides for the circumstances under which exemption under section 11 or 12 or section 10(23C) (iv) /(v)/ (vi)/ (via) in respect of whole or part of income would not be available to a trust or institution or funds or education institutions or hospitals.

(v) A society or a company or a trust or an institution carrying on charitable activity may –

(1) voluntarily wind up its activities and dissolve; or

(2) merge with any other charitable or non-charitable institution; or

(3) convert into a non-charitable organization.

There is, however, no specific provision in the income-tax law as to how the assets of such a charitable institution should be dealt with.

(vi) Under section 11, certain amount of income of prior period can be brought to tax on failure of certain conditions. However, there is no provision in the Income-tax Act, 1961, which ensure that the corpus and asset base of the trust accreted over a period of time, with promise of it being used for charitable purpose, continues to be utilised for charitable purposes and is not used for any other purpose.

(vii) Consequently, it is always possible for charitable institutions to transfer assets to a non-charitable institution.

(viii) In order to ensure that the benefit conferred over a period of time by way of exemption is not misused and to plug the gap in law that allows the charitable trusts having built up corpus/wealth through exemptions being converted into non-charitable organisation with no tax consequences, Chapter XII-EB imposes additional income-tax in the nature of an exit tax when the organization is converted into a non-charitable organization or gets merged with a non-charitable organization or does not transfer the assets to another charitable organisation.

(ix) Upto A.Y.2022-23, the provisions of the Chapter XII-EB comprising of sections 115TD, 115TE and 115TF were made applicable to only the trusts or institutions under the second regime. With effect from A.Y. 2023-24, the provisions of Chapter XII-EB also extended to trusts or institutions or fund approved under first regime.

For this purpose, term "specified person" has been inserted to include within its ambit the trust or institution under first regime and provisions of section 115TD, 115TE and 115TF has been amended.

(x) For the purposes of section 115TD, 115TE and 115TF, "Specified person" means

(a) any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in section 10(23C)(iv)/(v)/ (vi)/(via); or

(b) a trust or institution registered under section 12AA or section 12AB.

(2) Salient Features:

	Section	Provision
(i)	115TD(1)	**<u>Circumstances where levy of tax on accreted income is attracted</u>**: The accreted income of a ***specified person*** shall be taxable at the maximum marginal rate(@34.944%) on – (1) conversion into a form not eligible for grant of registration under section 12AA or section 12AB or approval under section 10(23C) (iv) /(v)/ (vi)/ (via); or (2) merger with an entity not having similar objects and registered under section 12AA or section 12AB or approved under section 10(23C) (iv) /(v)/ (vi)/ (via); or (3) non-distribution of assets on dissolution to any other specified person within a period of 12 months from the end of the month in which the dissolution takes place. This levy of exit tax shall be in addition to income chargeable in the hands of the entity.
(ii)	115TD(3)	**<u>Deemed conversion into non-eligible form - Circumstances</u>**: A specified person shall be deemed to have been converted into any form not eligible for registration under section 12AA or section 12AB or approval under section 10(23C) (iv) /(v)/ (vi)/ (via) in a previous year, if,— (i) the registration granted to it under section 12AA or section 12AB or approval under section 10(23C) (iv) /(v)/ (vi)/ (via) has been cancelled; or

		(ii) it has adopted or undertaken modification of its objects which do not conform to the conditions of registration and,— (a) it has not applied for fresh registration under section 12AA or section 12AB or approval under section 10(23C)(iv) /(v)/ (vi)/ (via) in the said previous year; or (b) it has filed application for fresh registration u/s 12AA or 12AB or approval under section 10(23C) (iv)/(v)/(vi)/(via) but the said application has been rejected; or ***(iii) it has failed to make an application for –*** ***(a) reapproval/re-registration; or*** ***(b) renewal of approval/registration where the period of approval/registration is due to expire; or*** ***(c) final approval/registration within the period specified under clause (i)/(ii)/(iii) of the first proviso to section 10(23C) or clause (i)/(ii)/(iii) of section 12A(1)(ac), as the case may be, which expires in the said previous year.***
(iii)	115TD(2)	**Meaning of Accreted Income**: Aggregate FMV of total assets of the specified person as on the specified date ***Less*** Total liability of the specified person computed in accordance with the prescribed method of valuation *[See Method of Valuation prescribed by CBDT given in pages 10.77 to 10.81]*
		Notes – (1) Accreted income attributable to any asset which is established to have been directly acquired by the specified person out of its agricultural income exempt under section 10(1) would be ignored. Liability, in relation to such asset, also has to be ignored. (2) Accreted income attributable to any asset acquired by the specified person during the period beginning from the date of its creation or establishment and ending on the date from which the registration under section 12AA or section 12AB or approval under section 10(23C) (iv) /(v)/ (vi)/ (via) became effective[8], if the

[8]*Where the benefit under sections 11 and 12 or section 10(23C) (iv) /(v)/ (vi)/ (via) have been allowed to the trust or institution in respect of any previous year or years beginning prior to the date from which the registration or approval under section 12AA or 12AB or under section 10(23C) (iv) /(v)/ (vi)/ (via) became effective, then, the registration or approval shall be deemed to have become effective from the*

specified person has not been allowed any benefit of sections 11 and 12 or approval under section 10(23C) (iv) /(v)/ (vi)/ (via) during the said period, would be ignored. Liability, in relation to such asset, also has to be ignored.

(3) The asset and the liability of the charitable organisation which have been transferred on dissolution to another charitable trust or institution registered under section 12AA or section 12AB or a fund / institution / trust / university / educational institution / hospital / medical institution approved under section 10(23C) within specified time have to be ignored while calculating accreted income.

<u>Meaning of specified date [*Explanation* below section 115TD(7)]</u>:

	Case	Specified Date
(i)	conversion of the trust or institution registered u/s 12AA/12AB ***or approved under section 10(23C) (iv) /(v)/ (vi)/ (via) into a form not eligible for registration u/s 12AA/12AB or under section 10(23C) (iv) /(v)/ (vi)/ (via)***	The date of conversion
(ii)	merger with an entity not having similar objects or not registered u/s 12AA/12AB ***or not approved u/s 10(23C)(iv)/(v)/(vi)/ (via)***	The date of merger
(iii)	non-distribution of assets on dissolution to any charitable institution registered u/s 12AA/12AB or approved u/s 10(23C) within a period twelve months from dissolution.	The date of dissolution

<u>Date of conversion [*Explanation* below section 115TD(7)]</u>:

	Case	Specified Date
(i)	Where the registration u/s 12AA/12AB or approval granted ***under section 10(23C) (iv) /(v)/ (vi)/ (via) has been cancelled***	The date of the order cancelling registration u/s 12AA/12AB ***or approval under section 10(23C) (iv)/(v)/(vi)/ (via)***

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first day of the earliest previous year. Accordingly, accreted income attributable to asset acquired during the said period has to be considered. Liability in relation to such asset has to be reduced.

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<tr><td>(ii)</td><td>Where it has adopted or undertaken modification of its objects which do not conform to the conditions of registration/ approval and has not made an application for fresh registration/approval or the application made has been rejected.</td><td>The date of adoption or modification of any object.</td></tr>
<tr><td>(iii)</td><td>Where it has failed to make an application for –
(a) reapproval/re-registration,
(b) renewal of approval/ registration where the period of approval/ registration is due to expire, or
(c) final approval/registration within the period specified under clause (i)/(ii)/(iii) of the first proviso to section 10(23C) or clause (i)/(ii)/(iii) of section 12A(1)(ac), as the case may be, which expires in the said previous year.</td><td>The last date for making an application for registration or approval</td></tr>
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<td>(iv)</td>
<td>115TD(4)</td>
<td><u>Exit tax payable even if no income-tax is payable by the specified person</u>:

Even if no income-tax is payable by the specified person on its total income, tax on accreted income shall be payable by the trust or institution, like any other additional income-tax.</td>
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<td>(v)</td>
<td>115TD(5)</td>
<td>Period within which tax on accreted income has to be paid to the credit of the Central Government:

The principal officer or the trustee of the specified person, as the case may be, and the specified person shall also be liable to pay the tax on accreted income to the credit of the Central Government <u>within fourteen days from,—</u>
<table>
<tr><th></th><th>Circumstance</th><th>Relevant date</th></tr>
<tr><td>(1)</td><td>Where the registration or approval granted u/s 12AA/12AB or u/s 10(23C)(iv)/(v)/ (vi)/(via) has been cancelled</td><td>the date on which –
(a) the period for filing appeal under section 253 against the order cancelling the registration expires and no appeal has been filed by the specified person; (or)</td></tr>
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				(b) the order in any appeal, confirming the cancellation of the registration, is received by the specified person.
		(2)	(i) Where the trust has modified its objects and has not applied for fresh registration u/s 12AA/12AB or approval under section 10(23C)(iv)/ (v)/ (vi)/ (via) ***(ii) where the trust has failed to apply for –*** ***(a) re-registration/re-approval; or*** ***(b) renewal of registration/ approval, where the period of validity of registration or approval set to expire; or*** ***(c) final registration/ approval within the specified time period which expires in the relevant P.Y.***	the end of the previous year
		(3)	Where the trust has modified its objects and has filed application for fresh registration u/s 12AA/12AB or approval under section 10(23C)(iv)/ (v)/(vi)/(via) but the same was rejected	the date on which – (a) the period for filing appeal under section 253 against the order rejecting the application expires an no appeal has been filed by the specified person; (or) (b) the order in any appeal, confirming the cancellation of the application, is received by the specified person
		(4)	Where trust has merged with an entity not having	the date of merger

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<tr><td></td><td>similar objects or not registered u/s 12AA/12AB or not approved under section 10(23C) (iv) /(v)/ (vi)/ (via)</td><td></td></tr>
<tr><td>(5)</td><td>Where the trust fails to transfer upon dissolution all its assets to another registered trust or institution or approved fund or institution within 12 months from the end of the month in which the dissolution takes place</td><td>the date on which the period of 12 months expires.</td></tr>
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</td></tr>
<tr><td>(vi)</td><td>115TD(6)</td><td><u>No credit available for tax paid on accreted income:</u>
The tax on accreted income shall be treated as final payment of tax in respect of such income for which no credit can be taken by the specified person or any other person.</td></tr>
<tr><td>(vii)</td><td>115TD(7)</td><td><u>Non-availability of deduction under any other provision of the Act</u>:
No deduction is allowable under any other provision of the Act to the specified person or any other person in respect of the income which has been charged to tax or the tax thereon.</td></tr>
<tr><td>(viii)</td><td>115TE</td><td><u>Interest for non-payment of tax within prescribed time</u>:
In case of failure of payment of tax within the prescribed time, a simple interest@1% p.m. or part of it shall be applicable for the period of non-payment.
<u>Period of non-payment</u>:
<table>
<tr><th>Beginning from</th><th>Ending with</th></tr>
<tr><td>The date immediately after the last date on which such tax was payable</td><td>The date on which the tax is actually paid.</td></tr>
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</td></tr>
<tr><td>(ix)</td><td>115TF</td><td><u>Circumstance when specified person is deemed to be assessee-in-default</u>:
The principal officer or the trustee and specified person shall be deemed to be assessee-in-default for non-payment of tax and all provisions related to the recovery of taxes shall apply.
Further, in the case of transfer of assets upon dissolution of the trust or institution to a recipient, which is not a charitable organisation, the recipient of assets of the trust shall also be liable to be held as assessee-in-default in case of non-payment of tax and interest. However, in such a case, the recipient's liability shall be limited to the extent to which the assets received by him is capable of meeting the liability.</td></tr>
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Note - As per section 115TD(2), "Accreted Income" means the aggregate FMV of total assets of the specified person as on the specified date less total liability of such specified person computed in accordance with the prescribed method of valuation. Accordingly, Rule 17CB provide for method of valuation of assets and liabilities.

Method of valuation for the purposes of section 115TD(2)

<table>
<tr><th>Rule</th><th colspan="4">Provision</th></tr>
<tr><td>(1)</td><td colspan="4">The aggregate fair market value of the total assets of the specified person, shall be the aggregate of the fair market value of all the assets in the balance sheet as reduced by—
(i) any amount of income-tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of income-tax claimed as refund under the Act, and
(ii) any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset.</td></tr>
<tr><td rowspan="4">(2)</td><td colspan="4">The fair market value of the asset shall be determined in the following manner, namely –</td></tr>
<tr><td rowspan="3"></td><td colspan="3">(I) Shares and securities</td></tr>
<tr><td>(a)</td><td>Quoted shares and securities</td><td>(i) the <u>average of the lowest and highest price of such shares and securities</u> quoted on a recognised stock exchange as on the specified date; or
(ii) where on the specified date, there is <u>no trading</u> in such shares and securities on a recognised stock exchange, the <u>average of the lowest and highest price of such shares and securities on a recognised stock exchange on a date immediately preceding the specified date</u> when such shares and securities were traded on a recognised stock exchange,</td></tr>
<tr><td>(b)</td><td>Unquoted equity shares</td><td>$$\frac{(A+B-L)\times(PV)}{PE}$$
where,
A = book value of all the assets in the balance sheet (other than bullion, jewellery, precious stone, artistic work, shares,</td></tr>
</table>

				securities, and immovable property) as reduced by- (i) any amount of income-tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of income-tax claimed as refund under the Act; and (ii) any amount shown in the balance sheet as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset; B = fair market value of bullion, jewellery, precious stone, artistic work, shares, securities and immovable property as determined in the manner provided in this rule; L= book value of liabilities shown in the balance sheet, but not including the following amounts, namely: — (i) representing contingent liabilities other than arrears of dividends payable in respect of the paid-up capital in respect of equity shares; (ii) the amount set apart for payment of dividends on preference shares and equity shares; (iii) reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation; (iv) any amount representing provision for taxation, other than amount of income-tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of income-tax claimed as refund under the Act, to the extent of the excess over the tax payable with reference to the book profits in

			accordance with the law applicable thereto; (v) any amount representing provisions made for meeting liabilities, other than ascertained liabilities; (vi) any amount of cumulative preference shares; PE = total amount of paid up equity share capital as shown in the balance-sheet; PV = the paid up value of such equity share.
	(c)	**Shares and securities other than equity shares**	The fair market value of shares and securities other than equity shares shall be estimated to be price it would fetch if sold in the open market on the specified date on the basis of the valuation report from a merchant banker or an accountant in respect of such valuation.
	II.	**Immovable property**	
		The fair market value of an immovable property shall be higher of the following: (a) price that the property shall ordinarily fetch if sold in the open market on the specified date on the basis of the valuation report from a registered valuer; and (b) stamp duty value as on the specified date.	
	III.	**A business undertaking**	
		The fair market value of a business undertaking, held by a specified person, shall be its net assets determined in accordance with the following formula: Fair market value = (A + B - L), The value of A, B and L would be determined in the same manner as discussed above in the case of unquoted equity shares.	
	IV.	**Any other asset**	
		The fair market value of any asset, other than those referred to in (I), (II) and (III), shall be the price that the asset shall ordinarily fetch if sold in the open market on the specified date on the basis of valuation report from a registered valuer. However, in case no valuer is registered for valuation of such assets, the valuation report shall be obtained from a valuer who is a member of any one of the professional valuer bodies viz. Institution of Valuers, Institution of Surveyors (Valuation Branch), Institution of Government Approved	

Valuers, Practicing Valuers Association of India, the Indian Institution of Valuers, Centre for Valuation Studies, Research and Training, Royal institute of Chartered Surveyors; India Chapter, American Society of Appraisers, USA; Appraisal institute, USA or a valuer who is appointed by any public sector bank or public sector undertakings for valuation purposes.

(3) The total liability of the specified person shall be the book value of liabilities in the balance sheet on the specified date but not including the following amounts, namely -

(i) capital fund or accumulated funds or corpus, by whatever name called;

(ii) reserves or surpluses or excess of income over expenditure, by whatever name called;

(iii) any amount representing contingent liability;

(iv) any amount representing provisions made for meeting liabilities, other than ascertained liabilities;

(v) any amount representing provision for taxation, other than the amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of income-tax claimed as refund under the Act, to the extent of the excess over the income-tax payable with reference to the income in accordance with the law applicable thereto.

Explanation

Meaning of certain terms

Term	Meaning
Accountant	A fellow of the Institute of Chartered Accountants of India within the meaning of the Chartered Accountants Act, 1949 who is not appointed by the specified person as an auditor;
Balance sheet	The Balance Sheet of such specified person (including the notes annexed thereto and forming part of the accounts) as drawn up on the specified date which has been audited by an accountant.
Quoted share or security	A share or security quoted on any recognised stock exchange with regularity from time to time, where the quotations of such shares or securities are based on current transaction made in the ordinary course of business;
Specified date	The date referred to in *Explanation* to section 115TD of the Act.

Meaning of specified date [*Explanation* below section 115TD]:

	Case	Specified Date
(i)	Conversion into a form not eligible for registration u/s 12AA/12AB *or approved u/s 10(23C)(vi)/(v)/(vi)/(via)*	The date of conversion

<table>
<tr><td rowspan="3"></td><td colspan="3">Date of conversion
(a) date of order cancelling registration or approval
(b) date of adoption or modification of any object
(c) last date for making an application for renewal of registration/ approval or re-registration/re-approval where the period of validity set to expire or final registration/approval</td></tr>
<tr><td>(ii)</td><td>merger with an entity not having similar objects or not registered u/s 12AA/12AB or not approved u/s 10(23C)(vi)/(v)/(vi)/(via)</td><td>The date of merger</td></tr>
<tr><td>(iii)</td><td>non-distribution of assets on dissolution to any charitable institution registered u/s 12AA/12AB or approved u/s 10(23C) within a period twelve months from dissolution</td><td>The date of dissolution</td></tr>
<tr><td>Stamp duty value</td><td colspan="3">The value adopted or assessed or assessable by any authority of the Central Government or a State Government for the purpose of payment of stamp duty in respect of an immovable property.</td></tr>
<tr><td>Unquoted share and security</td><td colspan="3">Share or security which is not a quoted share or security.</td></tr>
</table>

10.3 TAXATION OF DISCRETIONARY TRUSTS [SECTION 164(1)]

Section 164 deals with taxation of trustees of discretionary trusts. This section applies in the case of a representative assessee referred to in section 160(1)(iii)/(iv) in a case where any income or part thereof is not specifically receivable on behalf of or for the benefit of any one person or where the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is receivable are indeterminate or unknown.

The representative assessees referred to in clauses (iii) and (iv) of section 160(1) are the Court of Wards, the Administrator General, the Official Trustee or any receiver or manager including any person whatever his designation who in fact manages the property on behalf of another, appointed by or under any order of a Court and a trustee appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise (including any Wakf Validating Act, 1913).

Such a discretionary trust will be liable to tax at the maximum marginal rate of income-tax on their entire income.

With a view to obviating hardship in genuine cases where the circumstances are such that tax evasion could not be considered to be main purpose of creating a trust, certain exceptions have been specified where the trust would not be taxed at the maximum marginal rate. The exceptions are as under:

(1) Where none of the beneficiaries has any other income chargeable to tax exceeding the maximum amount not chargeable to income-tax in the case of an AOP and none of the beneficiaries is a beneficiary under any other trust; or

(2) Where the relevant income or part of the relevant income is receivable under a trust declared by any person by a will and such trust is the only trust so declared under the will.

(3) the relevant income or part of relevant income is receivable under a trust created before 1.3.1970 by a non-testamentary instrument and the Assessing Officer is satisfied that the trust was so created bona fide exclusively for benefit of the dependent relatives of settlor or where the settlor is a HUF for the benefit of the members of such families in circumstances where such relatives or members are mainly dependent on the settlor for their support and maintenance.

(4) In cases where the relevant income is receivable by the trustee on behalf of provident fund, superannuation fund, gratuity fund, pension fund or any other fund created bona fide by a person carrying on a business or profession exclusively for the benefit of persons employed in such business or professions.

In the above four cases the income of the trustees will not be taxed at the maximum marginal rate. The relevant income or part of relevant income will be taxable as if it were the total income of an AOP.

Where any income in respect of which a trustee appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise, is liable as a representative assessee consists of, or includes, profits and gains of business, the above concessional treatment i.e. assessing the income at the rate applicable to an AOP will apply only if such profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is the only trust so declared by him.

For the purposes of these provisions, a trust under which a discretionary power is given to the trustees to decide the allocation of the income every year or a right is given to the beneficiary to exercise the option to receive the income or not each year will all be regarded as discretionary trusts and assessed accordingly. This is made clear in *Explanation 1* to section 164 which provides as under:

(a) Any income in respect of which the Court of Wards, the Administrator General, the Official Trustee, receiver, manager or trustee appointed under a trust declared by a duly executed instrument in writing (including Wakf deed) is liable as a representative assessee or any part thereof shall be regarded as not being specifically receivable on behalf or for the benefit of any person unless the person on whose behalf or for whose benefit such income or such part thereof is receivable during the previous year is expressly stated in the order of the Court or the instruments of trust or wakf deed, as the case may be, and is identifiable as such on the date of such order, instrument or deed.

(b) The individual shares of the person on whose behalf or for whose benefit such income or part thereof is receivable will be regarded as indeterminate or unknown unless the individual shares of such persons are expressly stated in the order of the court or the instrument of trust or wakf deed, as the case may be, and are ascertainable as such on the date of such order, instrument or deed.

This Explanation seeks to prevent trustees and beneficiaries from manipulating the arrangements in such a manner that a discretionary trust is converted into a specific trust whenever it suits them tax-wise.

(1) **Income from property held under trust wholly for charitable or religious purposes [Section 164(2)]:** In case the relevant income, (in respect of which the shares of the beneficiaries are indeterminate or unknown), is derived from property held under trust wholly for charitable or religious purpose or which is of the nature referred to in section 2(24)(iia) [voluntary contributions received by a trust] or which is of the nature referred to in sub-section (4A) of section 11 [business income received by a trust], the tax shall be charged on so much of the income as is not exempt under section 11 or section 12 as if the income not so exempt were the relevant income of an association of persons.

However, where the whole or any part of the relevant income is not exempt under section 11 or section 12 because any income thereof is for the benefit of prohibited persons or the rules with regard to investments in specified channels have not been followed, tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate.

(2) **Income from property held under trust partly for charitable or religious purposes and partly for other purposes [Section 164(3)]:** In case the relevant income is derived from property held under trust partly for charitable or religious purposes and partly for other purposes or which is of the nature referred to in section 2(24)(iia) (voluntary contributions received by a trust) or which is of the nature referred to in sub-section (4A) of section 11 (business income received by a trust) and the individual share of the beneficiaries in the income applicable to purposes other than charitable or religious purposes is not known, tax liability will be the aggregate of the following:

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

(b) the tax on that part of the relevant income which is applicable to purposes other than charitable or religious purposes, and which is either not specifically receivable on behalf of or for the benefit of any one person or in respect of which shares of beneficiaries are indeterminate or unknown, at the maximum marginal rate.

However, in the following cases, income will be charged to tax as if it were income of an association of persons:

(a) where none of the beneficiaries has any other income chargeable to tax exceeding the maximum amount not chargeable to income-tax in the case of an AOP and none of the beneficiaries is a beneficiary under any other trust; or

(b) where the relevant income is receivable under a trust created by will and such trust is the only trust so declared by him; and

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

Where the relevant income consists of or includes profits and gains of business, the preceding concessional method of taxation shall apply only if the income is receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is the only trust so declared by him.

Where the whole or any part of the relevant income is not exempt under section 11 or section 12 because any income thereof is for the benefit of prohibited persons or the rules with regard to investment in specified channels have not been followed, tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate.

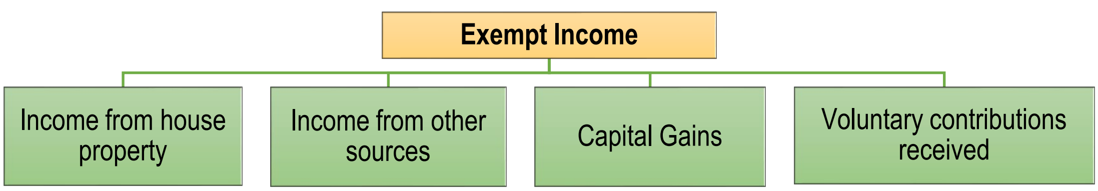
(3) **Taxation of Oral Trusts [Section 164A]:** Oral Trust is a trust which is not declared by a duly executed instrument in writing. As per section 164A, any income which a trustee receives or is entitled to receive on behalf of or for the benefit of any person under an oral trust will be chargeable to income tax at the maximum marginal rate.

However, such trust shall be deemed to be a trust declared by a duly executed instrument in writing if a statement in writing, signed by the trustee or trustees, setting out the purpose or purposes of the trust, particulars as to the trustee or trustees, the beneficiary or beneficiaries and the trust property, is forwarded to the Assessing Officer within three months from the date of declaration of the trust.

(4) **Case where part of trust income is chargeable [Section 165]:** In cases where only some portion of the trust's income to which the beneficiary or beneficiaries is/are entitled is taxable and the other portion is not taxable, the taxable portion of the income received by him from the trust as a beneficiary shall be only such portion thereof as bears to the whole income of the trust. In other words, where a part only of the trust income is chargeable to tax under this Act, the beneficiaries' share of the income should be taken to be that derived proportionately from the chargeable and non-chargeable portions of the trust income.

10.4 SPECIAL PROVISIONS RELATING TO INCOME OF POLITICAL PARTIES [SECTION 13A]

Section 13A of the Income-tax Act, 1961 grants exemption from tax to political parties in respect of their income specified below:



The aforesaid categories of income would qualify for exemption provided additional conditions for availing the benefit of the said section which are as under are met :

Conditions to be satisfied by political party

- Maintains such books of account and other documents to enable the A.O. to properly deduce its income therefrom
- Maintains a record of each such voluntary contribution (other than electoral bonds) in excess of ₹ 20,000 and the name and address of the contributor
- Audit of accounts of the political party by a chartered accountant
- No donation exceeding ₹ 2,000 to be received otherwise than by an A/c payee cheque/bank draft or use of ECS through a bank account or through such other prescribed electronic mode or electoral bond
- Submission of report u/s 29C(3) of the Representation of the People Act, 1951 for the financial year
- Furnishing of return of income for the P.Y. in accordance with section 139(4B)

Meaning of "Political Party" and "Electoral bond":

Political Party	A political party registered under section 29A of the Representation of the People Act, 1951
Electoral Bond	A bond issued by a scheduled bank (as authorised by the Central Government) under a scheme notified by the Central Government.

ILLUSTRATION 16

Explain in the context of provisions of the Act, whether the income derived during the year ended on 31.03.2024 in following case shall be subject to tax in the A.Y. 2024-25:

A political party, duly registered under section 29A of the Representation of the People Act, 1951, received rent of ₹ 1,25,000 per month of one of its building let out to a bank from 01.06.2023.

SOLUTION

Rent received by the political party from the bank is an income chargeable under the head "Income from house property". However, according to the provisions of section 13A, income from, *inter alia*, house property shall not be included in total income of a political party registered under section 29A of the Representation of the People Act, 1951, provided the political party fulfils the conditions as specified therein including furnishing a return of income for the previous year in accordance with the provisions of section 139(4B) on or before the due date under section 139. Therefore, if the stipulated conditions are fulfilled by the political party, rent of ₹ 1,25,000 per month received by the registered political party from letting out of its building to a bank would not be included in its total income.

ILLUSTRATION 17

The books of account maintained by a National Political Party registered with Election Commission for the year ended on 31.3.2024 discloses the following receipts:

		₹
(a)	Rent of property let out to a departmental store at Chennai	6,00,000
(b)	Interest on deposits other than banks	5,00,000
(c)	Contribution of ₹ 21,000 each from 100 persons (who have secreted their names)	21,00,000
(d)	Contribution from 10 persons by way of electoral bonds of ₹ 25,000 each	2,50,000
(e)	Cash contribution @ ₹ 2,100 each from 1,000 members (recorded in books of account)	21,00,000
(f)	Net profit of cafeteria run in the premises at Delhi	3,00,000

Compute the total income of the political party for the assessment year 2024-25, with reasons for inclusion or otherwise.

SOLUTION

The total income of a political party registered with the Election Commission is to be computed as per section 13A under which the income derived from house property, income from other sources and income by way of voluntary contributions received from any person, on fulfilling of the conditions as mentioned thereunder, are exempt from tax. However, in this case, since cash contribution in excess of ₹ 2,000 is received from 1000 persons, the political party has violated the condition of receipt of donation through account payee cheque/draft or prescribed electronic modes. Further, the political party has also violated the condition of maintenance of records in case of donations exceeding ₹ 20,000 received otherwise than by way of electoral bonds. Hence, its total income has to be computed as under without providing for exemption available under section 13A:

Computation of total income of National Political Party

	Particulars	₹
(a)	The rent of the property of ₹ 6 lacs located at Chennai [assuming the same to be the Gross Annual Value] less 30% of ₹ .6 lacs, being deduction u/s 24	4,20,000
(b)	Interest received on deposits	5,00,000
(c)	Contribution from 100 persons (who have secreted their names) of ₹ 21,000 each	21,00,000
(d)	Contribution from 10 persons by way of electoral bonds of ₹ 25,000 each	2,50,000

(e)	Cash contribution @ ₹ 2,100 each from 1,000 members (recorded in books of account)	21,00,000
(f)	Net profit of cafeteria at Delhi	3,00,000
Total Income		**56,70,000**

Note – Alternatively, the political party can contend that only ₹ 45 lakh is taxable on account of non-maintenance of records and receipt of cash donations, in which case the total income would be computed as under:

Computation of total income of National Political Party

	Particulars	₹
(a)	Rent of the property of ₹ 6 lacs located at Chennai	Exempt
(b)	Interest received on deposits	Exempt
(c)	Contribution from 100 persons (who have secreted their names) of ₹ 21,000 each	21,00,000
(d)	Contribution from 10 persons by way of electoral bonds of ₹ 25,000 each	Exempt
(e)	Cash contribution @ ₹ 2,100 each from 1,000 members (recorded in books of account)	21,00,000
(f)	Net profit of cafeteria at Delhi	3,00,000
	Total Income	**45,00,000**

Note: *It is presumed that the conditions regarding maintenance of books of account, audit, submission of report under section 29C of the Representation of the People Act, 1951 and filing of return of income under section 139(4B) are fulfilled by the political party, and hence it is eligible for exemption of income under section 13A.*

10.5 SPECIAL PROVISIONS RELATING TO VOLUNTARY CONTRIBUTIONS RECEIVED BY ELECTORAL TRUSTS [SECTION 13B]

(1) **Voluntary contribution treated as income:** Any voluntary contribution received by an electoral trust (as may be approved by the CBDT in accordance with the scheme to be made by the Central Government) shall be treated as its income under section 2(24).

(2) **Conditions for availing exemption under section 13B:** Any voluntary contributions received by an electoral trust would be exempt, if such electoral trust:

(I) distributes to a registered political party during the previous year, 95% of the aggregate donations received by it during the year along with the surplus if any, brought forward from any earlier previous year and

(II) function in accordance with the rules made by the Central Government.

(3) Functions of an electoral trust: Accordingly, the Central Government has notified Rule 17CA which provides that the following shall be the functions of an electoral trust referred to in section 13B –

(i) The electoral trust may receive voluntary contributions from

(a) an individual who is a citizen of India;

(b) a company which is registered in India; and

(c) a firm or Hindu undivided family or an Association of persons or a body of individuals, resident in India.

(ii) A receipt indicating the following shall be issued by the trust immediately on receipt of any contribution indicating the following:

(a) name and address of the contributor;

(b) Permanent account number of the contributor or passport number in the case of a citizen who is not a resident;

(c) amount and mode of contribution including name and branch of the Bank and date of receipt of such contribution;

(d) name of the electoral trust;

(e) Permanent account number of the electoral trust;

(f) date and number of approval by the prescribed authority; and

(g) Name and designation of the person issuing the receipt.

(iii) The electoral trust shall not accept contributions-

(a) from an individual who is not a citizen of India or from any foreign entity whether incorporated or not;

(b) from any other electoral trust which has been registered a company under section 25 of the Companies Act, 1956[9] and approved as an electoral trust under the Electoral Trusts Scheme, 2013;

(c) from a Government company as defined in section 2(45) of the Companies Act, 2013; and

(d) from a foreign source as defined in section 2(j) of the Foreign Contribution (Regulation) Act, 2010.

(iv) The electoral trust shall accept contributions only by way of an account payee cheque drawn on a bank or account payee bank draft or by electronic transfer to its bank account and shall not accept any contribution in cash.

(v) The electoral trust shall not accept any contribution without the PAN of the contributor, who is a resident and the passport number in the case of a citizen of India, who is not a resident.

(vi) A political party registered under section 29A of the Representation of the People Act, 1951 shall be an eligible political party and an electoral trust shall distribute funds only to the eligible political parties.

(vii) (a) The electoral trust may, for the purposes of managing its affairs, spend upto 5% of the total contributions received in a year subject to an aggregate limit of ₹ 5 lakh in the first year of incorporation and ₹ 3 lakh in subsequent years;

(b) the total contributions received in any financial year alongwith the surplus from any earlier financial year, if any, as reduced by the amount spent on managing its affairs, shall be the distributable contributions for the financial year;

(c) an electoral trust shall be required to distribute the distributable contributions received in a financial year, referred to in point (b) above, to the eligible political parties before 31st March of the said financial year, subject to the condition that at least 95% of the total contributions received during the financial year along with the surplus brought forward from earlier financial year, if any, are distributed.

(viii) The trust shall obtain a receipt from the eligible political party indicating the name of the political party, its permanent account number, registration number, amount of fund

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[9]Section 8 of the Companies Act, 2013

received from the trust, date of the receipt and name and designation of person signing such receipt.

(ix) The electoral trust shall not utilize any contributions for the direct or indirect benefit of the members or contributors, or for any of the following persons, namely:

(a) the members (including members of its Executive Committee, Governing Committee or Board of Directors) of the electoral trust;

(b) any relative of such Members;

(c) where such member or contributor is a Hindu undivided family, a member of that Hindu undivided family;

(d) any person who has made a contribution to the trust;

(e) any person referred in section 13(3); and

(f) any concern in which any of the persons referred to in clauses (a),(b),(c),(d) and (e) has a substantial interest.

(x) (a) An electoral trust shall keep and maintain such books of account and other documents in respect of its receipts, distributions and expenditure as may enable the computation of its total income in accordance with the provisions of the Act;

(b) The electoral trust shall also maintain a list of persons from whom contributions have been received and to whom the same have been distributed, containing the name, address and permanent account number (PAN) of each such person along with the details of the amount and mode of its payment including the name and branch of the bank.

(xi) Every electoral trust shall get its accounts audited by an accountant as defined in the *Explanation* below section 288(2) and furnish the audit report in Form No.10BC along with particulars forming part of its Annexure, to the Commissioner of Income-tax or the Director of Income-tax, as the case may be, having jurisdiction over the electoral trust, on or before the due date specified for furnishing the return of income by a company under section 139.

(xii) An electoral trust shall maintain a regular record of proceedings of all meetings and decisions taken therein.

(xiii) Every electoral trust shall furnish a certified copy of list of contributors and a list of political parties, to whom sums were distributed in the manner prescribed in (vii) above, to the Commissioner of Income-tax or the Director of Income-tax, as the case may be, every year along with the audit report;

(xiv) Any change in the shareholders, subsequent to the approval granted under the Electoral Trusts Scheme, 2013 shall be intimated to the Board within thirty days of such change.

Section 2(22AAA) defines 'Electoral Trust' to mean a trust so approved by the CBDT, in accordance with the scheme made in this regard by the Central Government.

In exercise of the powers conferred by section 2(22AAA), the Central Government, has through *Notification No.9/2013 dated 31.1.2013*, notified the Electoral Trusts Scheme, 2013 to lay down the procedure for grant of approval to an electoral trust which will receive voluntary contributions and distribute the same to political parties.

Eligibility

A company registered for the purposes of section 25 of the Companies Act, 1956 satisfying all of the following conditions shall be eligible to make an application for approval as an electoral trust, namely –

1. The company should be registered on or after 1.4.2012 for the purposes of section 25 of the Companies Act, 1956;
2. The name of the company registered for the purposes of section 25 of the Companies Act, 1956 has to include the phrase "electoral trust";
3. The sole object of the electoral trust should be to distribute the contributions received by it to the political party, registered under section 29A of the Representation of the People Act, 1951;
4. The electoral trust should have a permanent account number.

Criteria for Approval

An electoral trust shall be considered for approval if it fulfills all of the following conditions, namely –

1. The company registered for the purposes of section 25 of the Companies Act, 1956, which satisfies the above conditions;
2. The object of the electoral trust shall not be to earn any profit or pass any direct or indirect benefit to its members or contributors, or to any person referred to in section 13(3) or any person referred to in Rule 17CA(10) of the Rules;

3. It has made adequate arrangement for recording the receipts from the contributors in accordance with Rule 17CA;

4. The stipulations contained in Rule 17CA for functioning of the electoral trust are specifically included in the articles of association of the company registered for the purposes of section 25 of the Companies Act, 1956.

Renewal of approval

1. The approval shall be valid for the assessment year relevant to the financial year in which such application has been made and for a further period, not exceeding three assessment years, as may be specified in the approval.

2. The electoral trust may apply for renewal of approval at any time during the financial year immediately preceding the last assessment year, for which the approval has been originally granted, and such renewal of approval may be granted after examining the application in the same manner as laid out for approval in this scheme.

Withdrawal of approval

1. The CBDT may withdraw the approval granted under this Scheme if it is satisfied that the electoral trust has ceased its activities or its activities are not genuine or are not carried out in accordance with all or any of the conditions laid down under this Scheme or the provisions of Rule 17CA of the Rules, or any other condition imposed in the approval granted.

2. In order to ascertain whether an electoral trust, after its approval, is functioning in accordance with the provisions of Rule 17CA of the Rules, the CBDT may call for information or documents as it may deem fit from the electoral trust or may get an enquiry conducted in this regard by an income-tax authority or any other agency.

3. If the Commissioner of Income-tax or the Director of Income-tax is satisfied that an approved electoral trust is not fulfilling any of the conditions specified under this Scheme or the conditions subject to which approval was granted to it or does not function in accordance with Rule 17CA, he may, after making appropriate enquiries, furnish a report to the CBDT in this regard and the Board may take such action on the report as it may deem fit.

4. An order for withdrawal of the approval shall be passed after giving the electoral trust an opportunity of being heard, and shall record the reasons in writing for the withdrawal of approval.

5. A copy of the order withdrawing the approval shall be sent to the applicant, the Assessing Officer and the Commissioner of Income-tax or the Director of Income-tax, as the case may be.

10.6 TAXATION REGIME FOR SECURITIZATION TRUSTS AND ITS INVESTORS

(1) Meaning of Securitisation Trust [Clause (d) of *Explanation* below section 115TCA]:

"Securitisation trust" means a trust being a special purpose distinct entity or a special purpose vehicle (as per the guidelines on securitisation of standard assets issued by RBI) or a trust setup by a securitisation company or a reconstruction company, which fulfils such conditions, as may be prescribed.

(2) Exemption of income of securitisation trust from the activity of securitisation:

The income of securitisation trust from the activity of securitisation shall be exempt under section 10(23DA).

(3) Taxability of income from securitisation trust in the hands of the investor [Section 115TCA(1)]:

Section 115TCA(1) provides that any income accruing or arising to, or received by, a person, being an investor from the securitisation trust, out of investments made in the securitisation trust, shall be taxable in the hands of investor in the same manner as if the investor had made investment directly in the underlying assets and not through the trust.

(4) Nature of income paid or credited by securitisation trust in the hands of the investor [Section 115TCA(2)]:

The income paid or credited by the securitisation trust shall be deemed to be of the same nature and in the same proportion in the hands of the investor of the securitisation trust, as if it had been received by, or had accrued and arisen to, the securitisation trust during the previous year.

(5) Deemed credit to investor [Section 115TCA(3)]:

If the income accruing or arising to, or received by, the securitisation trust, during a previous year has not been paid or credited to the investor, the same shall be deemed to have been credited to the account of the said person on the last day of the previous year in the same proportion in which such person would have been entitled to receive the income had it been paid in the previous year.

(6) Statement specifying the details of nature of income to be furnished to investor and prescribed income-tax authority [Section 115TCA(4)]:

The securitisation trust shall provide breakup regarding nature and proportion of its income and such other relevant details to the investors and also to the prescribed income-tax authority in the prescribed form and verified in the prescribed manner, within the prescribed period.

(7) Income taxed in the year of accrual not taxable again in the year of payment [Section 115TCA(5)]:

Where income has been included in the total income of the investor in a previous year, on account of it having accrued or arisen in the said previous year, the same shall not be included in the total income of such person in the previous year in which such income is actually paid to him by the securitisation trust.

(8) Deduction of tax at source in respect of income payable to investor [Section 194LBC]:

Tax deduction at source under section 194LBC shall be effected by the securitisation trust at the time of payment or credit of income to the account of the investor, whichever is earlier.

S. No	Payee	Rate of TDS
(i)	Resident individuals and HUF	25%
(ii)	Resident payees, other than individuals and HUF	30%
(iii)	Non-corporate non-residents and foreign companies	Rates in force

Where any income as aforesaid is credited to any account in the books of account of the person liable to pay such income, such crediting is deemed to be credit of such income to the account of the payee and tax has to be deducted at source. The account to which such income is credited may be called “Suspense account” or by any other name.

(9) Application for low or nil deduction of tax at source:

The facility for the investors to obtain low or nil deduction of tax certificate would be available; the investor can make an application to the Assessing Officer, and he can, on an application made by the assessee in this behalf, issue a certificate under section 197 in this behalf for no deduction of income-tax or deduction of income-tax at a lower rate.

(10) Meaning of certain terms:

Explanation	Term	Meaning
(a)	Investor	A person who is holder of any securitised debt instrument or securities, or security receipt issued by the securitisation trust
(b)	Securities	Debt securities issued by a Special Purpose Vehicle as referred to in the guidelines on securitisation of standard assets issued by RBI

10.7 SCHEME FOR TAXATION OF REAL ESTATE INVESTMENT TRUST (REIT) AND INFRASTRUCTURE INVESTMENT TRUST (INVIT) [CHAPTER XII-FA – SECTION 115UA]

(1) The SEBI has notified the regulations relating to two categories of investment vehicles namely, the Real Estate Investment Trust (REIT) & Infrastructure Investment Trust (Invit).

(2) The SEBI (Real Estate Investment Trusts) Regulations, 2014 ("REIT Regulations") provide a framework for registration and regulation of Real Estate Investment Trusts ("REIT's").

Salient features of the REIT Regulations, as approved by the SEBI:

(a) REITs shall be set up as a trust and registered with SEBI. It shall have parties such as Trustee, Sponsor group, inducted sponsor and Manager.

(b) The trustee of a REIT means a person who holds the REIT assets in trust for the benefit of the unit holders, in accordance with these regulations. The trustee has to registered with the Board as Debenture Trustee and should not an associate of the sponsor(s) or manager.

(c) REIT shall invest in commercial real estate assets, on a freehold or leasehold basis, either directly or through a holdco and/or special purpose vehicles (SPVs). Real estate for the purpose of REIT Regulations means land and any permanently attached improvements to it, whether leasehold or freehold and includes buildings, sheds, garages, fences, fittings, fixtures, warehouses, car parks, etc. and any other assets incidental to the ownership of real estate but does not include mortgage.

(d) Once registered, the REIT shall raise funds through an initial offer. Subsequent raising of funds may be through follow-on offer, rights issue, qualified institutional placement, etc.

(e) Units of REITs shall be mandatorily listed on a recognized Stock Exchange and REIT shall make continuous disclosures in terms of the listing agreement.

(f) Not less than 80% of the value of the REIT assets shall be invested in completed and rent and/or income generating properties.

Upto 20% of the value of REIT assets shall be invested in following:

(1) developmental properties, whether directly or through a company or LLP;

(2) mortgage backed securities;

(3) listed/ unlisted debt of companies/body corporates in real estate sector;

(4) equity shares of companies which are listed on a recognized stock exchange in India which derive not less than 75% of their operating income from Real Estate activity;

(5) unlisted equity shares of companies which derive not less than 75% of their operating income from real estate activity

(6) government securities;

(7) unutilized FSI of a project where it has already made investment;

(8) TDR acquired for the purpose of utilization with respect to a project where it has already made investment;

(9) money market instruments or cash equivalents.

(g) REIT shall distribute not less than 90% of the net distributable cash flows, subject to applicable laws, to its unitholders, at-least on a half yearly basis.

(h) A REIT shall not invest in units of other REITs.

(3) Likewise, the SEBI (Infrastructure Investment Trusts) Regulations, 2014 ("InvIT Regulations") provide a framework for registration and regulation of Infrastructure Investment Trusts ("InvITs").

(4) The Finance (No.2) Act, 2014 had introduced a special taxation regime for providing the manner of taxability of –

(i) income in the hands of business trusts; and

(ii) income distributed by such business trusts in the hands of the unit holders.

Section 2(13A) of the Income-tax Act, 1961 defines a business trust to mean a trust registered as an Infrastructure Investment Trust (Invit) under SEBI (Infrastructure Investment Trusts) Regulations, 2014 or as a Real Estate Investment Trust (REIT) under SEBI (Real Estate Investment Trusts) Regulations, 2014.

Chapter XII-FA contains the special provisions relating to business trusts. Section 115UA(1) provides that any income distributed by a business trust to its unit holders shall be deemed to be of the same nature and in the same proportion in the hands of the unit holder, as it had been received by, or accrued to the business trust.

However, as per section 115UA(3A), any sum other than the following components of income –

(i) interest and dividend (received from SPV and distributed to unit holders)

(ii) rental income from directly owned real estate assets distributed to unitholders

(iii) income chargeable to tax in the hands of the business trust under section 115UA(2)

received by a unit holder from a business trust which is chargeable to tax under section 56(2)(xii) in the hands of unitholders under the head "Income from Other Sources" would not be deemed to be of same nature. Such sum chargeable to tax under section 56(2)(xii) would include repayment of debt or amount paid against redemption of units to the unit holders.

(5) Exemption of certain income to business trust [Section 10(23FC)]

Section 10(23FC) exempts any income of a business trust by way of-

- interest or dividend received or receivable from a Special Purpose Vehicle (SPV). Thus, the business trust enjoys a pass-through status in respect of interest or dividend received or receivable from a SPV.

"SPV" means any Indian company, -

(i) in which the REIT holds or proposes to hold not less than 50% of the equity share capital or interest;

(ii) which holds not less than 80% of its assets directly in properties and does not invest in other special purpose vehicles; and

(iii) which is not engaged in any activity other than holding and developing property and any other activity incidental to such holding or development;

(6) Exemption of Rental income of REIT from directly owned real estate asset [Section 10(23FCA)]

Any income of a business trust, being a REIT, by way of renting or leasing or letting out any real estate asset owned directly by such business trust is exempt in the hands of the business trust.

(7) Any distributed income referred to in section 115UA received by unit holders is exempt in their hands under section 10(23FD) to the extent it does not comprise of

- interest referred to in sub-clause (a) of section 10(23FC) (interest income from SPV distributed to unitholders) or
- dividend income referred to in section 10(23FC)(b) from a special purpose vehicle which has exercised option under section 115BAA and distributed to unit holders or
- rental income referred to in section 10(23FCA) (rental income from directly owned real estate assets).

(8) Section 115UA(2) provides that subject to the provisions of sections 111A and 112, the total income of a business trust shall be chargeable to tax at the maximum marginal rate.

(9) Section 56(2)(xii) provides that any specified sum received by a unit holder from a business trust during the previous year with respect to unit held by him at any time during the previous year would be chargeable to tax in the hands of unit holder under the head "Income from other sources.

Specified sum is to be computed in the following manner:

Specified sum = A (-) B (-) C (which shall be zero if sum of B and C is greater than A)	
A	***aggregate of sum distributed by the business trust with respect to such unit, during the previous year or during any earlier previous year or years, to such unit holder, who holds such unit on the date of distribution of sum or to any other unit holder who held such unit at any time prior to the date of such distribution, which is -*** ***(a) not in the nature of interest and dividend referred to in section 10(23FC) or rental income referred to in section 10(23FCA); and*** ***(b) not chargeable to tax in the hands of the business trust under section 115UA(2).***
B	***amount at which such unit was issued by the business trust; and***
C	***amount charged to tax under this clause in any earlier previous year;***

(10) **Section115UA(3) provides that distributed income or any part thereof, which is in the nature of**

- **interest income** received by the business trust from the SPV or
- **dividend income** received or receivable by the business trust from a SPV which has exercised the option under section 115BAA or
- **rental income** from real estate assets owned directly by the REIT [referred to in section 10(23FCA)]

is deemed to be the income of the unit holder in the previous year of distribution and subject to tax in the hands of the unit holder in that year.

(11) Any person responsible for making payment of income distributed on behalf of the business trust to a unit holder is required to furnish a statement to the unit holder and the prescribed authority within the prescribed time.

The statement should be in the prescribed form and manner. It should contain the particulars of the nature of income paid during the previous year as well as the other details as may be prescribed [Section 115UA(4)].

(12) Under section 139(4E), a business trust is mandatorily required to furnish a return of its income or loss in every previous year. All the provisions of the Income-tax Act, 1961 would apply as if it were a return required to be furnished under section 139(1).

(13) The scheme of taxability of income in the hands of the business trust, unit holders, sponsors etc. is briefed in the table given hereunder –

	Transaction	Section	Tax and TDS implications
(1)	**Transfer of listed units of the business trust by the unit holders**		Tax implications in the hands of unit holders: ➢ STT leviable on trading of listed units on a recognized stock exchange;
		2(42A)	➢ The period of holding of units of business trust to qualify as "long-term capital assets" is "more than 36 months";
		112A	➢ Long-term capital gains upto ₹ 1 lakh would be exempt in the hands of the unitholders; Long-term capital gain exceeding ₹ 1 lakh would be taxable @10% *plus* surcharge, if applicable, and health and education cess @4%.

		111A	➢ **Short-term capital gains** would be subject to concessional rate of tax@15% (*plus* surcharge, if applicable, and *cess@4%*).
(2)	**Exchange of shares in SPV by sponsor for units of Business Trust**	47(xvii)	<u>Tax implications in the hands of the sponsor</u>: ➢ Such exchange is not treated as a transfer. Hence, taxability of capital gains on such transfer **deferred** to the time of disposal of units by the sponsor;
		112A & 111A	➢ The sponsor would get the same tax treatment on offloading of units under an Initial offer on listing of units as it would have been available had he offloaded the underlying shareholding through an IPO. STT shall be levied on sale of such units of business trust which are acquired in lieu of shares of SPV, under an initial offer at the time of listing of units of business trust in the like manner as in the case of sale of unlisted equity shares under an IPO. The benefit of concessional tax regime of tax @15% on STCG and @10% on LTCG exceeding ₹ 1 lakh under section 112A shall be available to the sponsor on sale of units received in lieu of shares of SPV subject to levy of STT.
		49(2AC)	➢ For computing capital gains in the hands of the sponsor, cost of acquisition of units would be deemed to be the cost of acquisition of shares to the sponsor;
		2(42A)	➢ For computing capital gains in the hands of the sponsor, the period of holding of units to include the period of holding of shares for determining whether the capital gains are long-term or short-term.
(3)	**Interest income of business trust from SPV**		<u>Tax implications in the hands of the business trust & unit holders and TDS implications in the hands of the SPV & business trust</u>: ➢ Pass-through status for interest received by business trust from SPV:

		10(23FC)	➢ Interest income is not taxable in the hands of the business trust; and
		194A(3)(xi)	➢ SPV is not required to deduct tax at source on interest paid to business trust.
			Tax consequences on distribution of such income by the business trust to the unitholders:
		115UA(3)	The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of interest received or receivable from a SPV is deemed as income of unit holder.
		115A(1)(a)(iiac)	▪ Interest income taxable in the hands of the unit holders – ○ @5%, in case of unit holders, being non-corporate non-residents or foreign companies; and ○ at normal rates of tax, in case of resident unit holders.
		194LBA	▪ Business trust to deduct tax at source on interest component of income distributed to unit holders at the time of payment or credit of income to the account of the unit holder, whichever is earlier: ○ @5%, in case of unit holders, being non-corporate non-residents or foreign companies; and ○ @10%, in case of resident unit holders.
(4)	**Interest payments to non-resident lenders on ECBs by the business trust**	194LC	<u>**TDS implications in the hands of business trust**</u>: ➢ An Indian Company or a business trust paying interest income to a non-resident, not being a company, or to a foreign company is liable to deduct TDS@5% [Such interest would attract tax in the hands of the non-resident lenders @5% as per section 115A]. ▪ The above concessional rate of TDS@5% is applicable to interest in respect of money borrowed by the Indian Company or the business trust

			in foreign currency from a source outside India – (i) Under a loan agreement between 1st July 2012 and 30th June, 2023. (ii) By issuing long term infrastructure bonds between 1st July 2012 to 1st October 2014. (iii) By issuing long term bond including long term infrastructure bonds between 1st October 2014 and 30th June, 2023. (iv) By way of issue of rupee denominated bond on or before 30th June, 2023. ▪ However, tax is required to be deducted @4% in respect of monies borrowed by it from a source outside India by way of issue of any long-term bond or rupee denominated bond between 1st April, 2020 and 30th June, 2023, which is listed only on a recognised stock exchange located in any IFSC [Such interest would attract tax in the hands of the non-resident lenders @4% as per section 115A]. ▪ ***Further, tax is required to be deducted @9% in respect of monies borrowed by it from a source outside India by way of issue of any long-term bond or rupee denominated bond on or after 1st July, 2023, which is listed only on a recognised stock exchange located in any IFSC [Such interest would attract tax in the hands of the non-resident lenders @9% as per section 115A]***
(5)	**Dividend received by the business trust from SPV**		**Tax implications in the hands of the SPVs, business trust and unit holders and TDS implications in the hands of the SPV & business trust**:
		10(23FC)(b)	➢ Pass-through status for dividend received by business trust from SPV:

			- Dividend received or receivable from a special purpose vehicle, by the business trust would be exempt in its hands; - Consequently, SPV is not required to deduct tax at source on dividend paid to business trust.
		115UA(3)	➢ Tax consequences on distribution of such income by the business trust to the unitholders: The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of dividend received or receivable from a SPV, which has exercised option under section 115BAA, is deemed as income of unit holder.
		10(23FD) 115A(1)(a)(iiac)	▪ Dividend income taxable in the hands of the unit holders – ○ @10%, in case of unit holders, being non-corporate non-residents or foreign companies; and ○ at normal rates of tax, in case of resident unit holders. (However, in case where SPV has not exercised option under section 115BAA, dividend income distributed by the business trust would be exempt in the hands of the unit-holders)
		194LBA	▪ Business trust to deduct tax at source on dividend component of income distributed to unit holders at the time of payment or credit of income to the account of the unit holder, whichever is earlier, where SPV has exercised option under section 115BAA: ○ @ 10%, in case of unit holders, being non-corporate non-residents or foreign companies; and ○ @10%, in case of resident unit holders.

			(However, in a case where SPV has not exercised option under section 115BAA, no tax is required to be deducted at source by the business trust on dividend income distributed by it to the unitholders)
(6)	**Capital gains on disposal of assets by the Business Trust**	115UA(2)	<u>**Tax implications in the hands of the Business Trust and Unit holders**</u>: ➢ Capital gains is chargeable at the applicable rates in the hands of the Business Trust: ▪ In case of long-term capital gains, the provisions of section 112 would apply; ▪ In case of short-term capital gains on sale of listed shares, the provisions of section 111A would apply; ▪ Short-term capital gains, other than the gains subject to tax under section 111A, would be subject to maximum marginal rate.
		10(23FD)	➢ If such capital gains are further distributed to unitholders, the component attributable to capital gains would be exempt in the hands of the unit holders.
(7)	**Rental income arising to REIT from real estate property directly held by it**	10(23FCA)	➢ **Rental income of REIT from directly owned real estate asset** Any income of a business trust, being a REIT, by way of renting or leasing or letting out any real estate asset owned directly by such business trust is exempt in the hands of the business trust
		194-I	➢ **Rental income received or credited to a REIT** Where the income by way of rent is credited or paid to a business trust, being a REIT, in respect of any real estate asset, owned directly by such business trust, tax is <u>**not**</u> deductible at source.
		115UA(3)	➢ **Distributed income received by unit holder** The distributed income or any part thereof, received by a unit holder from the REIT,

			which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed as income of unit holder.
		194LBA	➢ **Distribution by REIT to unit holders of rental income from real estate assets directly owned by it** ► TDS@10% in case of distribution to a resident unit holder ► TDS at rates in force in case of distribution to a non-resident unit holder.
(8)	***Repayment of debt / Amount paid against redemption of units to unitholders***	***56(2)(xii)***	➢ ***Any sum other than the following components of income –*** ***(a) Interest and dividend received from SPV and distributed to unitholders*** ***(b) Rental income from real estate assets directly owned by it; and*** ***(c) Income chargeable to tax in the hands of the business trust u/s 115UA(2)*** ***received by a unitholder from a business trust is chargeable to tax in the hands of unit holder under the head "Income from other sources". It would be computed in the manner specified under section 56(2)(xii).***
(9)	**Income of business trust [Other than interest and dividend from SPV, rental income from real estate property]**	115UA(2)	**Tax implication in the hands of the Business Trust and Unit holders**: ➢ Long-term capital gains chargeable to tax u/s 112 – 20% ➢ Short-term capital gains chargeable to tax u/s 111A – 15% ➢ Any other income of the trust is chargeable to tax at the maximum marginal rate.
		10(23FD)	➢ The above income distributed to unit holders would be exempt in their hands.

ILLUSTRATION 18

A business trust, registered under SEBI (Real Estate Investment Trusts) Regulations, 2014, gives particulars of its income for the P.Y.2023-24:

(1) Interest income from Beta Ltd. – ₹ 4 crore;

(2) Dividend income from Beta Ltd. – ₹ 2 crore;

(3) Short-term capital gains on sale of listed shares of Beta Ltd. – ₹ 1.5 crore;

(4) Short-term capital gains on sale of developmental properties – ₹ 1 crore

(5) Interest received from investments in unlisted debentures of real estate companies – ₹ 10 lakh;

(6) Rental income from directly owned real estate assets – ₹ 2.50 crore

Beta Ltd. is an Indian company in which the business trust holds 70% of the shareholding.

Discuss the tax consequences of the above income earned by the business trust in the hands of the business trust and the unit holders, assuming that the business trust has distributed ₹ 10 crore to the unit holders in the P.Y.2023-24 (Assume that Beta Ltd. does not opt to pay tax under section 115BAA).

SOLUTION

Tax consequences in the hands of the business trust and its unit holders

(1) **Interest income of ₹ 4 crore from Beta Ltd.:** There would be no tax liability in the hands of business trust due to pass-through status enjoyed by it under sub-clause (a) of section 10(23FC) in respect of interest income from Beta Ltd., being the special purpose vehicle. Therefore, Beta Ltd. is not required to deduct tax at source on interest payment to the business trust.

The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of interest income received or receivable from a SPV is deemed income of the unit holder as per section 115UA(3).

The business trust has to deduct tax at source under section 194LBA –

- @ 10%, on interest component of income distributed to resident unit holders; and
- @ 5%, on interest component of income distributed to non-corporate non-resident and foreign companies' unit holders.

The interest component of income received from the business trust in the hands of each unitholder would be determined in the proportion of 4/11.1, by virtue of section 115UA(1).

(2) **Dividend income of ₹ 2 crore from Beta Ltd.:** The dividend distributed by the SPV to the business trust is exempt by virtue of section 10(23FC). Any distributed income referred to in section 115UA, which is in the nature of dividend income received or receivable from SPV, in a case where the SPV has exercised the option under section 115BAA, is taxable in the hands of unitholders by virtue of section 10(23FD). However, since Beta Ltd., being a SPV does not opt for section 115BAA, dividend component is exempt in the hands of the unitholders. Consequently, business trust is not required to deduct tax at source on the dividend component distributed to the unitholders.

(3) **Short-term capital gains of ₹ 1.50 crore on sale of listed shares of Beta Ltd.:** As per section 115UA(2), the business trust is liable to pay tax@15% under section 111A in respect of short-term capital gains on sale of listed shares of special purpose vehicle. There would, however, be no tax liability on the capital gain component of income distributed to unit holders, by virtue of the exemption contained in section 10(23FD).

(4) **Short-term capital gains of ₹ 1 crore on sale of developmental properties:** It is taxable at maximum marginal rate in the hands of the business trust as per section 115UA(2). There would be no tax liability in the hands of the unit holders on the capital gain component of income distributed to them, by virtue of the exemption contained in section 10(23FD).

(5) **Interest of ₹ 10 lakh received in respect of investment in unlisted debentures of real estate companies:** Such interest is taxable at maximum marginal rate, in the hands of the business trust, as per section 115UA(2)**.** However, there would be no tax liability in the hands of the unit holders on the interest component of income distributed to them, by virtue of section 10(23FD).

(6) **Rental income of ₹ 2.50 crore from directly owned real estate assets:** Any income of a business trust, being a REIT, by way of renting or leasing or letting out any real estate asset owned directly by such business trust is exempt in the hands of the trust as per section 10(23FCA).

Where the income by way of rent is credited or paid to a business trust, being a REIT, in respect of any real estate asset held directly by such REIT, no tax is deductible at source under section 194-I.

The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed income of the unit holder as per section 115UA(3). The business trust has to deduct tax at source@10% under section 194LBA in case of distribution to a resident unit holder and at rates in force in case of distribution to a non-resident unit holder.

The rental income component received from the business trust in the hands of each unitholder would be determined in the proportion of 2.5/11.1, by virtue of section 115UA(1).

10.8 SPECIAL TAXATION REGIME FOR INVESTMENT FUNDS AND INCOME RECEIVED FROM SUCH FUNDS [CHAPTER XII-FB] [SECTIONS 115UB, 10(23FBA) & 10(23FBB)]

(1) Tax liability of the unit holders:

Any income accruing or arising to, or received by, a person, being a unit holder of an investment fund, out of investments made in the investment fund shall be chargeable to income-tax in the same manner as if it were the income accruing or arising to, or received by, such person had the investments made by the investment fund, been made directly by him [Section 115UB(1)].

Note – Accordingly, income in the hands of the non-resident investor from offshore investments routed through Category I or Category II AIFs, being a deemed direct investment outside India by the non-resident investor, is not taxable in India under section 5(2) of the Act [Circular No. 14/2019, dated 3.7.2019].

(2) Exemption of income of investment fund other than income under the head profits and gains from business and profession [Section 10(23FBA)]

The Scheme provides for exemption of income, other than income chargeable under the head "Profits and gains of business or profession", in the hands of investment fund. The income in the nature of profits and gains of business or profession shall be taxable in the hands of the investment fund.

(3) Exemption to unit holder of income under the head "Profits and gains from business or profession" of investment fund [Section 10(23FBB)]

Income accruing or arising to, or received by, a unit holder of an investment fund, being that proportion of income which is of the same nature as income chargeable under the head "Profits and gains of business or profession" at investment fund level, shall be exempt under section 10(23FBB). This implies that all income from investment fund is taxable in the hands of unit holders except income under the head "PGBP".

(4) TDS in respect of income of units of investment fund to unit holders [Section 194LBB]

Investment fund to deduct tax at source on any income (other than the proportion of income which is of the same nature as income chargeable under the head "Profits and gains of business or profession" which is taxable at investment fund level) payable by the investment fund to a unit holder

- @10%, in case of payable to a resident unit holder
- at rates in force in case of payable to a non-corporate non-resident or foreign company unit holder

In case of income payable to a non-corporate non-resident or foreign company unit holder, no deduction is to be made in respect of any income that is not chargeable to tax under the Act.

Such tax has to be deducted at the time of credit of such income to the account of the payee or at the time of payment, whichever is earlier.

For this purpose, any such income credited to any account, whether called "suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be the credit of such income to the account of the payee, and the provisions of section 194LBB shall apply accordingly.

(5) Pass - through status for current year losses:

If in any year there is a loss under any head of income at the fund level and such loss cannot be or is not wholly set-off against income under any other head of income of the said previous year, then out of such losses,

(i) the loss arising to the Investment Fund under the head "Profits & Gains of Business or Profession" shall not be allowed to be passed through to the investors but has to be carried over at fund level to be set off against income of the next year in accordance with the provisions of Chapter VI

(ii) loss other than loss under the head "profits and gains from business or profession" would not be allowed be passed through to the investors if such loss has arisen in respect of a unit which has not been held by the unit holder for a period of at least 12 months [Section 115UB(2)].

Note – By implication, losses other than those referred to in (i) and (ii) above, which cannot be wholly set-off against current year income, would be passed on to the unit holders to be carry forward and set-off in their individual hands in accordance with the provisions of Chapter VI.

(6) Pass through status for losses accumulated as on 31.3.2019:

Losses, other than loss under the head "profits and gains from business or profession", if any, accumulated at the level of investment fund as on 31.3.2019, shall be

- deemed to be the loss of a unit holder who held the unit as on 31.3.2019 in respect of the investment made by him in the investment fund in the same manner as it were the loss incurred by him had he made such investments directly and
- shall be allowed to be passed through to the investors for the remaining period calculated from the year in which the loss has occurred for the first time taking that year as the first year and set off against their income in accordance with the provisions of Chapter VI.

Further, such accumulated losses shall not be available to the investment fund on or after 1.4.2019.

(7) Nature of income in the hands of unitholders:

The income paid or credited by the investment fund shall be deemed to be of the same nature and in the same proportion in the hands of the unit holder as if it had been received by, or had accrued or arisen to, the investment fund during the previous year. [Section 115UB(3)].

(8) Tax on total income:

As per section 115UB(4), the total income of the investment fund is chargeable to tax as follows:

Investment Fund	Rate of tax
A company or a firm	Rate or rates specified in the Finance Act of the relevant year (30%/25%, as the case may be, for a company and 30% for firm for A.Y.2024-25)
Other than a company or a firm	Maximum marginal rate

(9) Deemed credit on the last day of the previous year:

If the income accruing or arising to, or received by, an investment fund, during a previous year is not paid or credited to the unitholders, it shall be deemed to have been credited to the account of the unit-holder on the last day of the previous year in the same proportion in which such person would have been entitled to receive the income had it been paid in the previous year [Section 115UB(6)].

Income taxed in the year of accrual not taxable again in the year of payment [*Explanation 2* below section 115UB]:

It has been clarified that any income which has been included in the total income of the unit holder of an investment fund in a previous year, on account of it having accrued or arisen in the said previous year, would not be included in his total income in the previous year in which such income is actually paid to him by the investment fund.

(10) Summary:

The following table gives a summary of the above provisions:

	Particulars	Investment Fund	Unit holder
(i)	**Income under the head "Profits and gains of business or profession"** of the Investment Fund	Taxable	Exempt
(ii)	Income, **other than profits and gains of business or profession**	Exempt. Tax to be deducted on such income distributed to unitholders - @10%, in case of resident payee - at rates in force in case of non-resident payee	Taxable, as if he had directly made the investment.
(iii)	**Loss** under the head "**Profits and gains of business or profession"** incurred by the investment fund	To be carried forward for set-off as per Chapter VI at the Fund level	Not passed on to investors
(iv)	Loss (other than loss referred to in (iii) above) where such loss has arisen in respect of unit which has not been held by the **unit holder for a period of at-least 12 months**	The Act is silent relating to the permissibility or otherwise of carry forward of these losses in the hands of investment funds.	Not allowed to be carried forward by the unitholder. He cannot set-off such losses against his income.

(v)	Losses (other than losses referred to in (iii) and (iv) above) remaining after set-off against current year income.	Not allowed to be carried forward for set-off by the Investment Fund	Unit-holder can carry forward and set-off such losses against his income as per Chapter VI

Note – Losses, other than business losses, accumulated at the level of the investment fund as on 31.3.2019 would be deemed to be the loss of the unit holder who held the unit as on 31.3.2019 in respect of the investments made by him in the investment fund, in the same manner as it were the loss incurred by him had he made such investments directly. Such loss can be carried forward by the unitholder for the remaining period calculated from the year in which the loss had occurred for the first time taking that year as the first year. Accordingly, he can set-off such loss in accordance with the provisions of Chapter VI. The loss so deemed to be the loss of the unitholder shall not be available to the investment fund on or after 1.4.2019.

(11) Statement to be furnished:

The person responsible for crediting or making payment of the income on behalf of an investment fund and the investment fund are required to furnish, within the prescribed time, to the person who is liable to tax in respect of such income and to the prescribed income-tax authority, a statement in the prescribed form and verified in the prescribed manner. Such statement should give details of the nature of the income paid or credited during the previous year and such other relevant details as may be prescribed [Section 115UA(7)].

(12) Every investment fund has to compulsorily file its return of income or loss under section 139(4F), if it is not required to do so under any other provision of section 139. The provisions of the Act would apply as if such return of income or loss were a return required to be furnished under section 139(1).

(13) Meaning of certain terms:

	Term	Meaning
(a)	Investment fund	Any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category I or a Category II Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012, made under the Securities and Exchange Board of India Act, 1992 ***or regulated under the International Financial Services Centers Authority (Fund Management)***

		Regulations, 2022 made under the International Financial Services Center Authority Act, 2019;
(b)	Trust	A trust established under the Indian Trusts Act, 1882 or under any other law for the time being in force.
(c)	Unit	Beneficial interest of an investor in the investment fund or a scheme of the investment fund and shall include shares or partnership interests.

ILLUSTRATION 19

The following are the particulars of income of four investment funds for P.Y.2023-24:

Particulars	*A*	*B*	*C*	*D*
	₹ in lakh			
Business Income		*2*	*(2)*	*5*
Capital Gains	*16*	*14*	*(6)*	*20*
Income from other sources	*4*	*4*	*8*	*(2)*

Compute the total income of the investment funds and each unitholder for A.Y.2024-25, assuming that:

(1) each investment fund has 20 unitholders each having one unit held by them for a period exceeding 12 months; and

(2) income from investment in the investment fund is the only income of the unitholder.

If Investment Fund C has the following income components for A.Y.2025-26, what would be the total income of the fund and the unit holder for that year?

Business Income ₹ 2 lakh

Capital Gains ₹ 9 lakh

Income from Other Sources ₹ 8 lakh

SOLUTION

Computation of total income of the investment fund for A.Y. 2024-25

Particulars	A	B	C	D
	₹			
Business Income	Nil	2,00,000	Nil	3,00,000
Total Income	**Nil**	**2,00,000**	**Nil**	**3,00,000**

Computation of total income of a unit holder of the following Investment funds for A.Y. 2024-25

Particulars	A	B	C	D
	₹			
Capital Gains	80,000	70,000	-	1,00,000
Income from other sources	20,000	20,000	30,000	-
Total Income	**1,00,000**	**90,000**	**30,000**	**1,00,000**

Notes:

(i) The total income of Investment Fund B would be chargeable to tax @30% if the fund is a firm and @30%/25%, as the case may, if the fund is a company and at the maximum marginal rate, in any other case.

(ii) In case of Investment Fund D, the loss from other sources ₹ 2 lakh is set-off against business income of ₹ 5 lakh.

(iii) In case of Investment Fund C, the business loss of ₹ 2 lakh is set-off against income from other sources of ₹ 8 lakh. Loss of ₹ 6 lakh under the head "Capital gains" cannot be set-off against income under any other head. The same can be carried forward by the Unitholder for set-off in the subsequent years since, the units are held for a period of 12 months or more.

For A.Y. 2025-26, the brought forward capital loss of ₹ 30,000 [₹ 6 lakh/20] can be set-off against capital gains of ₹ 45,000 [₹ 9 lakh/20] by the unit-holder since, the period of holding of units is 12 months or more. Business income of ₹ 2 lakh would be taxable in the hands of the Investment Fund. Income from other sources of ₹ 40,000 (₹ 8 lakh/20) would be taxable in the hands of the unitholders.

SIGNIFICANT SELECT CASES

1	*New Noble Educational Society v. CCIT (2022) 448 ITR 594 (SC)*	
	Issue	**Analysis & Decision**
	Does the requirement under section 10(23)(vi) to solely engage itself in education mean that such institution cannot have objects not related to education? Also, is it necessary that the profits of business referred to in the seventh proviso to section 10(23C) be the profits of such business incidental to educational activity and not any other activity?	**Relevant provision of law**: Under section 10(23C)(vi), income of a university or educational institution existing solely for educational purposes and not for the purposes of profit, approved by the Principal Commissioner or Commissioner would be exempt. As per the second proviso to section 10(23C), the Principal Commissioner or Commissioner, on receipt of application from an institution under clause (ii) or clause (iii) of the first proviso thereof, shall call for documents or information from it or make such enquiries to satisfy himself about the genuineness of the activities of the institution and compliance of such requirements of any other law for the time being in force by it as are material for the purpose of achieving its objects. As per the seventh proviso to section 10(23C), the exemption provisions under section 10(23C)(vi) would not apply in relation to income of the educational institution, being profits and gains of business, unless the business is incidental to the attainment of its objectives and separate books of account are maintained by it in respect of such business. **Issue under consideration**: The issue under consideration is whether the requirement under section 10(23)(vi) to solely engage itself in education mean that such institution cannot have objects not related to education. Also, is it necessary that profits of business referred to in the seventh proviso to section 10(23C) be the profits of such business incidental to educational activity and not any other activity. **Analysis and Conclusion**: The Supreme Court, made the following observations and conclusions: (a) The requirement of the charitable institution, society or trust, etc., to "solely" engage itself in education or educational activities, and not

		engage in any activity of profit, means that such institutions cannot have objects which are unrelated to education. In other words, all objects of the society, trust, etc., must relate to imparting education or be in relation to educational activities. The term "solely" is not the same as "predominant/mainly". The term "solely" means to the exclusion of all others. (b) Where the objective of the institution appears to be profit-oriented, such institutions would not be entitled to approval under section 10(23C). At the same time, where surplus accrues in a given year or set of years *per se*, it is not a bar, provided such surplus is generated in the course of providing education or educational activities. (c) The seventh proviso to section 10(23C), as well as section 11(4A) refer to profits which may be "incidentally" generated or earned by the charitable institution. In the present case, the same is applicable only to those institutions which impart education or are engaged in activities connected to education. (d) The reference to "business" and "profits" in the seventh proviso to section 10(23C) and section 11(4A) merely means that the profits of business which is "incidental" to educational activity—i.e., relating to education such as sale of text books, providing school bus facilities, hostel facilities, etc. However, where institutions provide their premises or infrastructure to other entities, trusts, societies, etc., for the purposes of conducting workshops, seminars or even educational courses (which the concerned trust is not actually imparting) and outsiders are permitted to enrol in such seminars, workshops, courses, etc., then the income derived from such activity cannot be characterised as part of education or "incidental" to the imparting education. Additionally, the Supreme Court also held that wherever registration of trust or charities is obligatory under State

		or local laws, the concerned trust, society, other institution, etc., seeking approval under section 10(23C) should also comply with provisions of such State laws. This would enable the Commissioner or concerned authority to ascertain the genuineness of the trust, society, etc. This reasoning is reinforced by the recent insertion of another proviso of section 10(23C) with effect from April 1, 2021.
2.	***ACIT (Exemptions) v. Ahmedabad Urban Development Authority (and other appeals) (2022) 449 ITR 1 (SC)***	
	Issue	**Analysis & Decision**
	When can an activity be considered as trade, commerce or business for attracting the provisions of the proviso to section 2(15)?	**<u>Relevant provision of law</u>**: As per section 2(15), 'charitable purpose' includes relief of the poor, education, yoga, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. However, as per the proviso to section 2(15), "advancement of any other object of general public utility" shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity, unless,- (1) such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; and (2) the aggregate receipts from such activity or activities, during the previous year, does not exceed 20% of the total receipts, of the trust or institution undertaking such activity or activities, for the previous year. As per section 11(4A), for the purpose of availing the beneficial provisions of section 11(1)/(2)/(3) and (3A), the business must be incidental to the objectives of the trust and the trust has to maintain separate books of account in respect of such business. Likewise, the

		seventh proviso to section 10(23C) provides that for the purpose of availing exemption under section 10(23C)(iv)/(v)/(vi)/(via), the business should be incidental to the attainment of its objectives and separate books of accounts are maintained by the trust in respect of such business. **Issue under consideration**: The issue under consideration is when an activity can be considered as trade, commerce or business for attracting the provisions of the proviso to section 2(15). **Analysis**: The first consideration would be whether the activity concerned was or is in any manner covered by the objects clause. Thereafter, if the accounts disclose that the amounts paid are nominal mark-up over and above the cost incurred towards supplying the services, the activity may fall within the description of one advancing the general public utility. If on the other hand, there is a significant mark-up over the actual cost of service, the next step would be ascertain whether the quantitative limit in the proviso to section 2(15) is adhered to. **It is only in the event of the trust actually carrying on an activity in the course of achieving one of its objects, and earning income which should not exceed the quantitative limit prescribed at the relevant time, that it can be said to be driven by charitable purpose.** Section 11(4A) [and Seventh proviso to section 10(23C)] must be interpreted harmoniously with section 2(15), with which there is no conflict. **Carrying out activity in the nature of trade, commerce or business, or service in relation to such activities, should be conducted in the course of achieving the object of general public utility, and the income, profits or surplus or gains must, therefore, be incidental.** The requirement in section 11(4A) [and Seventh proviso to section 10(23C)] of maintaining separate books of account is also in line with the necessity of demonstrating that the quantitative limit prescribed in the proviso to section 2(15), has not been breached. **Conclusion**: The conclusions arrived at by way of this judgment, neither precludes any assessee (whether statutory or non-statutory) advancing objects of general

		public utility, from claiming exemption, nor the taxing authorities from denying exemption, in the future, if the receipts of the relevant year exceed the quantitative limit. The assessing authorities must on a yearly basis, scrutinize the record to discern whether the nature of the assessee's activities amount to "trade, commerce or business" based on its receipts and income (i. e., whether the amounts charged are on cost-basis, or significantly higher). If it is found that they are in the nature of "trade, commerce or business", then it must be examined whether the quantified limit (as amended from time to time) in proviso to section 2(15), has been breached, thus disentitling them to exemption.
3.	***CIT v. St. Peter's Educational Society (2016) 385 ITR 66 (SC)***	
	Issue	**Analysis & Decision**
	Would imparting education/training in specialized field like communication, advertising etc. and awarding diplomas/ certificates constitute an "educational purpose" for grant of exemption u/s 10(23C)(vi)?	Institutions engaged in providing specialized training in certain fields and awarding diplomas and certificates are also eligible for tax exemption in terms of section 10(23C)(vi). It is not mandatory for such institutions to impart education in formalized manner or conduct only recognized educational courses. Further, when corporates depute employees for gaining specialized knowledge, such imparting of knowledge by the institution would not mean that the institution is engaged in the activity of general public. Making of profit incidentally will not make the institution as existing for making profit.

TEST YOUR KNOWLEDGE

Questions

1. *A trust, unless created for "charitable purpose", does not qualify to claim exemption under Chapter III of the Act. In this context, explain the meaning of "charitable purpose" and examine whether the following objects constitute part of it:*

   (i) Rural reconstruction and upliftment of the masses through Cottage Industry.

   (ii) Welfare of industrial workers with a stipulation that the workers of settlor of trust have got preference over others.

2. *Ramji Charitable Trust has filed return of income for the Assessment Year 2024-25 within the stipulated time under section 139(4) and applied only 50% of its income for specified purposes. It intends to accumulate the balance 35% of income to be spent in future years. Accordingly, it filed its Statement in Form 10 in August, 2024 and deposited the money so accumulated in post office savings bank account. While completing the assessment, the Assessing Officer disallowed the accumulated income of 35% and taxed the same on the ground that the trust has filed its return of income only in December, 2024. Discuss the validity of the action of the Assessing Officer in this case.*

3. *An institution operating for promotion of education claiming exemption under section 11 since 1994 furnishes the following data for the assessment year 2024-25:*

S. No.	Particulars	₹ in crores
(i)	Fees collected from students	14
(ii)	Construction of a new computer science laboratory	0.50
(iii)	Land acquired to be used as a cricket field for the students	2
(iv)	Amount earmarked and set apart for construction of an arts block within the next 4 years.	4

   Compute the total income of the institution for the A.Y.2024-25.

4. *A public charitable trust registered under section 12AB, for the previous year ending 31.3.2024, derived gross income of ₹ 21 lakhs, which consists of the following:*

		(₹ in Lacs)
(a)	Income from properties held by trust (net)	10
(b)	Income (net) from business (incidental to main objects)	4
(c)	Voluntary contributions from public	7

The trust applied a sum of ₹ 11.60 lacs towards charitable purposes during the year which includes repayment of loan taken for construction of orphanage ₹ 3.60 lacs. The entire expenditure incurred on construction of orphanage was allowed as application of income in the P.Y. 2020-21.

Determine the taxable income of the trust for the assessment year 2024-25.

5. *Work out, from the following particulars, the amount of capital gain which shall be deemed to have been applied for charitable or religious purpose arising out of sale of a capital asset utilized for the purposes of trust to the extent of 60%:*

Particulars	₹
Cost of transferred asset	2,40,000
Sale consideration	3,60,000
Cost of new asset purchased	3,00,000

6. *An electoral trust approved by the CBDT is not liable to income-tax in respect of voluntary contribution received and other income - Examine the correctness of the statement.*

7. *Helpage is a charitable trust set up on 1.4.2010 with the object of providing relief to the poor. Later on, in April, 2012, it changed its object to medical relief. It applied for registration on the basis of its new object, i.e., medical relief, on 1.9.2012 and was granted registration under Section 12AA on 1.2.2013.*

On 1.4.2023, Helpage got merged with Poor Aid, is not eligible for registration under section 12AB or approval under section 10(23C). All the assets and liabilities of the erstwhile trust became the assets and liabilities of Poor Aid. The trust appointed a registered valuer for the valuation of its assets and liabilities. From the following particulars (including the valuation report), calculate the tax liability in the hands of the trust arising as a result of such merger:

(i) ***Land***

Location	Date of purchase	Stamp duty value on 1.4.2023	Value which the land would fetch, if sold in the open market on 1.4.2023	Book Value on 1.4.2023
		₹	₹	₹
Noida	1.9.2010	55 lakhs	58 lakhs	50 lakhs
Gurgaon	1.9.2013	100 lakhs	120 lakhs	110 lakhs

(ii) ***Shares***

Type of shares	Date of purchase	Face value of each share	Purchase price of each share	Price at which each share is quoted on BSE as on 1.4.2023		Open market value as on 1.4.2023 #
				Highest price	Lowest price	
		₹	₹	₹	₹	₹
5000 Quoted equity shares of A Ltd.	1.5.2014	100	110	320	300	
2000 Preference shares of B Ltd.	1.9.2015	100	100	-	-	180

 # on the basis of report of Merchant Banker

(iii) ***Liabilities***

Book value of liabilities on 1.4.2023 = ₹ 120 lakhs. This includes –

(a) Corpus fund ₹ 12 Lakhs.

(b) Provision for taxation ₹ 8 lakhs; and

(c) Reserves and Surplus ₹ 18 lakhs

8. *"Serving the poor", a charitable trust, is registered under section 12AB of the Act. On 1.4.2023, it got merged with another entity not eligible for registration under section 12AB or approval under section 10(23C).*

All the assets and liabilities of the erstwhile trust became the assets and liabilities of the merged entity.

The trust appointed a registered valuer for the valuation of its assets and liabilities. From the following particulars (including the valuation report), calculate the tax liability in the hands of the trust arising as a result of such merger:

(i) Stamp duty value of land held ₹ 15 lakhs. However, if this land is sold in the open market, it would ordinarily fetch ₹ 17 lakhs. The book value of the land is ₹ 20 lakhs.

(ii) 75,000 equity shares in Ink Ltd. traded in Delhi Stock Exchange. The lowest price per share on 1.4.2023 was ₹ 75 and the highest price on that day was ₹ 85. The book value was ₹ 67 lakhs.

(iii) 55,000 preference shares held in N Ltd. The shares will fetch ₹ 44 lakhs, if they are sold in the open market on 1.4.2023. Book value was ₹ 25 Lakhs.

(iv) Corpus fund as on 1.4.2023 ₹ 15 Lakhs.

(v) Outside liabilities ₹ 90 lakhs

(vi) Provision for taxation ₹ 5 lakhs.

(vii) Liabilities in respect of payment of various utility bills ₹ 6 lakhs.

Answers

1. Section 2(15) defines "charitable purpose" to include relief of the poor, education, medical relief, yoga, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. However, "advancement of any other object of general public utility" would not be a charitable purpose, if it involves carrying on of any activity in the nature of trade, commerce or business or, any activity of rendering of any service in relation to any trade, commerce or business, for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity or the retention of such income, by the concerned entity.

"Advancement of any other object of general public utility" would continue to be a "charitable purpose", if the total receipt from any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business does not exceed 20% of the total receipts of the trust in the previous year, and such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(i) The Supreme Court has, in *Thiagarajar Charities vs. Addl. CIT (1997) 225 ITR 1010,* observed that "cottage industry" is associated with the idea of a small, simple enterprise or industry in which employees work in their own houses or in a small place, gathered together for the purpose, using their own equipments and is usually found in rural areas or so carried on, by the poorer section of the society. In substance, the activity of rural reconstruction and upliftment of masses through cottage industry is to afford relief to the poor and consequently, it is for charitable purpose.

(ii) The welfare of industrial workers with a stipulation that the workers of settlor of trust have preference over others would also constitute "charitable purpose" within the meaning of section 2(15). The Patna High Court has, *in CIT v. Tata Steel Charitable Trust (1993) 203 ITR 764*, observed that exemption under section 11(1) can be availed only if the following conditions are satisfied –

(1) the trust is created for a charitable purpose; and

(2) no part of the income of such trust enures or has been used or applied directly or indirectly for the benefit of any person referred to in section 13(3).

The list of persons contained in section 13(3) does not include employees of the settlor of the trust. Section 13(3)(d), which includes any relative of the author, can have no application because "relative" means a person connected by birth or marriage with another person. A person having relationship pursuant to a contract like that of an employer and an employee cannot be said to be a relative. The High Court concluded that it was immaterial that any employee of the settler of the trust had acquired any benefit out of the income of the trust as an ordinary member of the community. Therefore, the application of part of the income of the trust for the benefit of the employees of the settler cannot disentitle the trust from claiming exemption under section 11.

2. Section 11(2) provides that a charitable trust has to apply 85% of its income to charitable purposes and where 85% of its income is not applied for such purposes, the trust may accumulate or set apart either the whole or part of its income for future application for such purposes in India. The requirement of the Act is that the trust has to make an application/intimation in the prescribed form, for accumulation of income, specifying the purpose and the period (not exceeding 5 years). The application should be filed or furnished before the assessing authority two months prior to the due date specified under section 139(1). Further, the money so set apart or accumulated should be invested/deposited in any one or more of these modes or forms specified under section 11(5).

In case the statement in Form 10 is submitted in August, 2024 and the amount accumulated was deposited in post office savings bank account, which is a mode specified in section 11(5). However, the benefit of accumulation would not be available if the return of income is not furnished on or before the due date of filing of return of income under section 139(1). In this case, trust has not filed its return on or before the due date under section 139(1). The return of income was filed only in December, 2024. Therefore, the action of the Assessing Officer, in this case, is valid.

3. Computation of total income of the institution for the A.Y. 2024-25

Particulars	₹ (in crores)
Fees received	14.00
Less : 15% (exempt even if not spent for the objects of the institution)	2.10
	11.90
Less: Amount applied for charitable purposes	
Actual amount spent on construction of computer science lab **(See Note 1)**	0.50
Actual amount spent on purchase of land for cricket field **(See Note 1)**	2.00
	2.50
	9.40
Less : Accumulated for specified purpose **(See Note 2)**	4.00
Total Income	**5.40**

Notes:

(1) The institution must utilise 85% of its income within the previous year for the objects of the institution. The institution can apply its income either for revenue expenditure or for capital expenditure provided the expenditure is incurred for promoting the objects of the institution. Land acquired and meant for use as cricket field for students is a capital expenditure incurred for promoting the objects of the institution and hence, eligible for deduction. Likewise, the amount spent on construction of computer science laboratory is also eligible for deduction.

(2) Section 11(2) provides that a trust/institution can accumulate or set apart its income for a specified purpose by furnishing statement in prescribed format to the concerned Assessing Officer. However, the period for which the funds can be accumulated cannot exceed 5 years. The amount so accumulated should be invested in the forms and modes specified in section 11(5). In this case, the institution has to furnish statement in Form 10 two months prior to the due date of filing return of income to the Assessing Officer, stating the purpose for which the income is being accumulated or set apart and the period for which the income is being accumulated or set apart, which shall, in no case, exceed five years. Further, the institution has to invest ₹ 4 crore in the specified forms and modes.

Note – *Section 11(2) stipulates the conditions for accumulation, on fulfillment of which the income so accumulated or set apart would not be included in the total income of the previous year of the trust. The condition stipulated in clause (c) of Section 11(2) is that the statement in Form 10 has to be furnished at least 2 months prior to the due date of filing of return of income u/s 139(1). However, as per section 13(9), the income accumulated would not be excluded from total income if Form 10 is not submitted on or before the due date under section 139(1). Section 13(9) permits exclusion of accumulated income from total income of the previous year, if Form 10 is filed on or before the due date under section 139(1). CBDT Circular No.6/2023 dated 24.5.2023 clarifies that the statement of accumulation in Form No. 10 is required to be furnished at least two months prior to the due date of furnishing return of income so that it may be taken into account while auditing the books of account. However, the accumulation/deemed application shall not be denied to a trust as long as the statement of accumulation/deemed application is furnished on or before the due date of furnishing the return as provided in section 139(1).*

4. **Computation of taxable income of public charitable trust**

	Particulars	₹
(i)	Income from property held under trust (net)	10,00,000
(ii)	Income (net) from business (incidental to main objects)	4,00,000
(iii)	Voluntary contributions from public	7,00,000
	Voluntary contribution made with a specific direction towards corpus are alone to be excluded under section 11(1)(d). In this case, there is no such direction and hence, included.	
		21,00,000

	Less: 15% of the income eligible for retention / accumulation without any conditions	3,15,000
		17,85,000
	Less: Amount applied for the objects of the trust	
	(i) Amount spent for charitable purposes (₹ 11,60,000 - ₹ 3,60,000)	8,00,000
	(ii) Repayment of loan for construction of orphan home (See Note below)	-
	Taxable Income	**9,85,000**

Note - As per *Explanation 4(ii)* to section 11(1), any application for charitable or religious purposes, from any loan or borrowing in the concerned year, shall not be treated as application of income for charitable or religious purposes. However, the amount not so treated as application, shall be treated as application in the year in which the loan is repaid. The Fourth proviso to *Explanation 4(ii)* to section 11(1) clarifies that this provision will, however, not apply where application is from loan or borrowing made on or before 31.3.2021.

Since the amount spent on construction of orphanage was allowed as deduction in the P.Y. 2020-21, repayment of loan taken for such purposes will not be allowed as application as it would tantamount to double deduction.

5. In this case, since the asset which is transferred is utilized for the purposes of the trust only to the extent of 60%, only the proportionate amount (i.e., 60%) of the capital gain would be regarded as having been applied for charitable or religious purposes.

As per section 11(1A), where a capital asset held under trust is transferred, and only a part of the net consideration is utilized for acquiring a new capital asset, only so much of the capital gain as is equal to the amount, if any, by which the amount so utilized exceeds the cost of the transferred asset shall be considered to have been applied for the objects of the trust.

In this case, only a part of the net consideration of ₹ 3,60,000 is utilized for acquiring the new capital asset costing ₹ 3,00,000. The amount utilized in acquiring the new asset (i.e., ₹ 3,00,000) exceeds the cost of the transferred asset (i.e., ₹ 2,40,000) by ₹ 60,000.

Therefore, only 60% of (₹ 3,00,000 – ₹ 2,40,000) = 60% of ₹ 60,000 = ₹ 36,000 is deemed to be applied for the objects of the trust.

6. Section 13B provides exemption in respect of voluntary contribution received by an electoral trust approved by the CBDT in accordance with the scheme to be made by the Central Government.

Voluntary contribution received by an electoral trust would be treated as its income under section 2(24), but shall be exempt under section 13B if the trust distributes to a registered political party during the year, 95% of the aggregate donations received by it during the year along with surplus brought forward from any earlier years. Another condition for availing the benefit under this section is that the electoral trust should function in accordance with the rules framed by the Central Government.

It may be noted that the exemption under section 13B will be available only in respect of voluntary contribution received by an electoral trust. The exemption cannot be claimed in respect of any other income of the electoral trust.

Therefore, the given statement is not correct.

7. As per section 115TD, the accreted income of "Helpage", a charitable trust, registered under section 12AA which is merged with Poor Aid, an entity not entitled for registration under section 12AB or approval under section 10(23C), would be chargeable to tax at the rate of 34.944% [30% plus surcharge @12% plus cess@4%].

Computation of accreted income and tax liability in the hands of the Helpage trust arising as a result of merger with Poor Aid

Particulars	Amount (₹)
Aggregate FMV of total assets as on 1.4.2023, being the specified date (date of merger) **[See Working Note 1]**	1,39,10,000
Less: Total liability computed in accordance with the prescribed method of valuation **[See Working Note 2]**	82,00,000
Accreted Income	**57,10,000**
Tax Liability @ 34.944% of ₹ 57,10,000 (rounded off)	**19,95,300**
Working Notes:	
(1) Aggregate fair market value of total assets on the date of merger	
- **Land at Noida, being immovable property, purchased on 1.9.2010**	-
Since the trust was registered only on 1.2.2013 and benefit of section 11 and 12 was available to the trust only from A.Y.2013-	

	14, relevant to P.Y.2012-13, being the previous year in which the application for registration is made, the value of land purchased in P.Y.2010-11, in respect of which benefit under sections 11 and 12 was not availed, has to be ignored for computing accreted income.	
-	**Land at Gurgaon, being an immovable property, purchased on 1.9.2013**	1,20,00,000
	[The fair market value of land would be higher of ₹ 120 lakhs i.e., price that the land would ordinarily fetch if sold in the open market and ₹ 100 lakhs, being stamp duty value as on the specified date, i.e., 1.4.2023]	
-	**Quoted equity shares of A Ltd. [5,000 x ₹ 310 per share]**	15,50,000
	[₹ 310 per share, being the average of the lowest (₹ 300) and highest price (₹ 320) of such shares on the specified date]	
-	**Preference shares of B Ltd. [2,000 x ₹ 180 per share]**	
	[The fair market value which it would fetch if sold in the open market on the specified date i.e., FMV on 1.4.2023]	3,60,000
		1,39,10,000
(2)	**Total liability**	
-	Reserves and Surplus ₹ 18 lakhs [not includible]	-
-	Corpus Fund of ₹ 12 lakhs [not includible]	-
-	Provision for taxation ₹ 8 lakhs [not includible]	-
-	Other Liabilities	
	[₹ 120 lakhs - ₹ 18 lakhs - ₹ 12 lakhs - ₹ 8 lakhs]	82,00,000
		82,00,000

8. As per section 115TD, the accreted income of "Serving the poor", a charitable trust, registered under section 12AA which merged with an entity not entitled for registration under section 12AB or approval under section 10(23C), would be chargeable to tax at maximum marginal rate @ 34.944% [30% plus surcharge @12% plus cess@4%].

Computation of accreted income and tax liability in the hands of the trust arising as a result of merger with the "not eligible" entity for A.Y. 2024-25

Particulars	Amount (₹)
Aggregate FMV of total assets as on 1.4.2023, being the specified date (date of merger) **[See Working Note 1]**	1,21,00,000

Less: Total liability computed in accordance with the prescribed method of valuation **[See Working Note 2]**	96,00,000
Accreted Income	**25,00,000**
Tax Liability @ 34.944% of ₹ 25,00,000	**8,73,600**
Working Notes:	
(1) Aggregate fair market value of total assets on the date of merger	
- **Land, being an immovable property**	17,00,000
[The fair market value of land would be higher of ₹ 17 lakhs i.e., price that the land would ordinarily fetch if sold in the open market and ₹ 15 lakhs, being stamp duty value as on the specified date]	
- **Quoted equity shares in Ink Ltd. [75,000 x ₹ 80 per share]**	60,00,000
[₹ 80 per share, being the average of the lowest (₹ 75) and highest price (₹ 85) of such shares on the date of merger]	
- **55,000 preference shares of N Ltd.**	
[The fair market value which it would fetch if sold in the open market on the date of merger i.e., FMV on 1.4.2023]	44,00,000
	1,21,00,000
(2) Total liability	
- Outside liabilities	90,00,000
- Corpus Fund of ₹ 15 lakhs [not includible]	-
- Provision for taxation ₹ 5 lakhs [not includible]	-
- Liabilities in respect of payment of various utility bills [since this liability is an ascertained liability]	6,00,000
	96,00,000

CHAPTER 11

TAX PLANNING, TAX AVOIDANCE AND TAX EVASION

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **distinguish** between tax planning, tax avoidance and tax evasion;
- **analyse** whether a specified activity resulting in reduction of tax liability would be considered as tax planning, tax avoidance or tax evasion;
- **examine** the doctrine of form and substance in the context of tax planning;
- **analyse** the provisions of General Anti-avoidance Rules (GAAR)
- **examine** the applicability of General Anti-avoidance Rules (GAAR) *vis-a-vis* Specific Anti-avoidance Rules (SAAR)

CHAPTER OVERVIEW

Tax Planning, Tax Avoidance and Tax Evasion

General Anti-Avoidance Rules (GAAR)

11.1 TAX PLANNING, TAX AVOIDANCE AND TAX EVASION – AN OVERVIEW

Tax planning involves an intelligent application of the various provisions of the direct tax laws to practical situations in such a manner as to reduce the tax impact on the assessee to the minimum. A thorough understanding of the principles, practices and procedures of tax laws and the ability to apply such knowledge to various practical situations is expected at the final level.

A thorough up-to-date knowledge of tax laws is a pre-requisite for a successful study of tax planning techniques. Not only an up-to-date knowledge of the statute is necessary, but one must also be aware of the contents of the various circulars issued by the CBDT and also of case laws in the form of various decisions of the Courts. One of the best methods to study tax planning in action is to analyze the case laws. In view of this position, students should realise the importance and usefulness of keeping track of the judgments of the Supreme Court and of various High Courts reported in tax law journals from time to time. Students should make it a point to go through the relevant cases and understand the issues involved and the rationale of the judgments. Of course, tax planning in any particular case would depend on the facts and circumstances of that particular case.

Apart from the above, students are advised to go through the articles on tax laws published in tax journals and financial papers. With this brief introduction, let us go into the basic concepts of tax planning.

(1) **Concept of tax planning**: Before entering into a transaction or before starting a business, one normally considers its profitability and other aspects. Amongst other aspects, the tax implications of the transactions of the business have to be thought out before actually embarking on the deal. Otherwise, one may be caught unwittingly in huge tax liability. Planning from the point of view of taxation helps in generating greater savings of investible surplus.

Tax planning may be defined as an arrangement of one's financial affairs in such a way that, without violating in any way the legal provisions, full advantage is taken of all tax exemptions, deductions, concessions, rebates, allowances and other reliefs or benefits permitted under the Act so that the burden of taxation on the assessee is reduced to the minimum.

It involves arranging one's financial affairs by intelligently anticipating the effects which the tax laws will have on the arrangements now being adopted. As such it is a very stimulating intellectual exercise.

Any tax planning scheme should be a natural one and should not give an appearance of an artificial arrangement on the face of it. The tax planner or the tax adviser should exercise great care and caution in designing any tax planning scheme as its failure will result in great difficulties and heavy burden of tax on the assessee for whom the scheme is evolved.

In relation to income-tax, the following may be noted as illustrative instances of tax-planning measures:

(a) Varying the residential status taking into consideration the number of days of stay in India to be a resident, in case of an individual.

(b) Choosing the suitable form of assessable entity (Individual, HUF, Firm, Co-operative society, Association of persons, Company, Trust, etc. to obtain optimal tax concessions).

(c) Exercising the option to shift out of default regime under section 115BAC and paying tax as per the normal provisions of Income-tax law in case of Individual, HUF, AOPs or BOI.

(d) Exercising the option to pay tax as per concessional tax regimes under section 115BAA or 115BAB in case of corporate assessee subject to satisfaction of certain conditions and non-allowability of certain exemptions or deductions.

(c) Choosing suitable forms of investment (share capital, loan capital, lease, mortgages, tax exempt investments, priority sector, etc.), considering deductions available in respect of interest or dividend etc.

(d) Programmed replacement of assets to take advantage of the provisions governing depreciation.

(e) Programmed sale of capital assets depending upon the period of holding and deductions specifically available for assets held for long term.

(f) Diversification of the business activities (hotel industry, agro-based industry etc.) considering the various profit-linked and investment-linked benefits available under the provisions of the Act.

(g) The use of the concept of commercial expediency to claim deduction in respect of expenditure, in computing business income.

(2) Tax planning, tax evasion and tax avoidance: Three methods of reducing taxes have been developed in most countries of the world over a period of time.

Methods of reducing taxes

- Tax planning
- Tax evasion
- Tax avoidance

The dividing line between tax evasion and tax avoidance is very thin. The Direct Taxes Enquiry Committee (Wanchoo Committee) has tried to draw a distinction between the two items in the following words.

"The distinction between 'evasion' and 'avoidance', therefore, is largely dependent on the difference in methods of escape resorted to.

Tax Planning

- Availing tax exemptions or tax privileges offered by the Government, strictly in accordance with law.

Tax evasion

- Manoeuvre involving an element of deceit, misrepresentation of facts, falsification of accounting calculations or downright fraud. In simple terms, tax evasion refers to any attempt to avoid payment of taxes by using illegal means.

Tax avoidance

- Between two extremes i.e., tax planning and tax evasion, a vast domain for selecting a variety of methods which, though technically satisfying the requirements of law, in fact, circumvent it with a view to eliminate or reduce tax burden.

Common forms of tax evasion

- Misrepresentation or suppression of facts;
- Failure to record investments in books of account;
- Claim of expenditure not substantiated by any evidence;
- Recording of any false entry in books of account;
- Failure to record any receipt in books of account having a bearing on total income; and
- Failure to report any international transaction or deemed international transaction or specified domestic transaction under Chapter X.

These constitute misreporting of income attracting penalty@200% under section 270A.

(3) **Judicial thinking—A brief study:** The judicial attitude towards tax avoidance schemes is very strict and the landmark judgment of the Supreme Court in *M/s. Mc Dowell and Co. Ltd. vs. Commercial Tax Officer (1985) 154 ITR.148 (SC)* is proof of the same. Though this decision was rendered in the context of A.P. General Sales Tax Act, the principles emerging out of this decision will have relevance to direct taxes also.

Before discussing the relevant observations of the Supreme Court in relation to tax avoidance scheme it will be instructive to have an idea of the development in judicial thinking in England since our own judicial thinking on the subject has been largely derived from English thinking.

English Scene: In *Inland Revenue Commissioner vs. Duke of Westminster 1936 AC 1* it was held "Every man is entitled if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax."

After the World War II and the consequent huge profiteering and racketeering the attitude of the courts towards the avoidance of tax perceptibly changed and hardened. Commenting on a tax avoidance scheme, the court observed that it scarcely lies in the mouth of the taxpayer who plays with fire to complain of burnt fingers.

It was felt that there must be some limit to the devices which courts can put up with in order to defeat the fiscal intentions of the legislature. A very significant departure from the Westminster Principle was made in *Ramsay vs. Inland Revenue Commissioners (1982) AC 300*. It was felt in that case that even though the doctrine that courts could not go behind a given genuine document or transaction to some supposed underlying substance was a cardinal principle, it must not be overstated or over-extended. While obliging the courts to accept documents or transactions, found to be genuine, as such, the doctrine did not compel the court to look at the document or transaction in blinkers isolated from any context to which it properly belonged. If it could be seen that a document or transaction was intended to have effect as a part of a nexus or series of transactions or as an ingredient of a wider transaction intended as a whole, there was nothing in the doctrine to prevent it being so regarded. To do so was not to prefer form to substance or substance to form. It was the task of the court to ascertain the legal nature of any transaction to which it was sought to attach a tax consequence and if that emerged from a series or combination of transactions, intended, apart as such, as was that series or combination which might be regarded.

Thus, two points were established. The first was a significant change in the approach adopted by the court with regard to its judicial role towards tax avoidance scheme. The second was that it was crucial when considering any such scheme to take the analysis far enough to determine where the profit, gain or loss was really to be found. It was also stated that the fact that the court accepted that each step in a transaction was a genuine step producing its intended legal results did not confine the court to consider each step in isolation for the purpose of assessing the fiscal results. Thus, we can say that the true principle of the decision in Ramsey was that the fiscal consequence of a preordained series of transactions intended to operate as such, are generally to be ascertained by considering the result of the series as a whole and not by dissecting the scheme and considering each transaction separately.

In *I.R.C. vs. Burmah Shell Co. Ltd. (1982) STC 30 (Burmah)* and *Furniss (Inspector of Taxes) vs. Dawson (1984) 1 All E.R.530*, it was held that where tax avoidance was targeted through a series of transactions with no commercial or substantial value but with the only aim of avoiding tax, the Courts have to ignore the transactions and the tax liability has to be determined as if these transactions never took place.

Indian Scenario: In *CIT vs. A. Raman & Co. 1 SCR 10,* the Supreme Court followed the dictum of the Westminster's case. It observed that avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. The taxpayer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon consideration of morality but on the operation of the Income-tax Act, 1961. Legislative injunction in taxing statutes may not, except on pain of penalty, be violated but it may lawfully be circumvented. The same view was expressed in *CIT vs. Kharwar (1969) 72 ITR 603 (SC)* as follows:

"The taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction, if the parties have chosen to conceal by a device the legal relation, it is open for the taxing authorities to unravel the device and to determine the true character of relationship. The legal effect of a transaction, however, cannot be displaced by probing into the substance of the transaction."

However, the Supreme Court in *Mc Dowell's* case clearly departed from the above views and expressly disassociated itself with the earlier observations of the Supreme Court echoing the sentiments of Westminster principle. The court enumerated the evil consequences of tax avoidance as follows:

(1) Substantial loss of much needed public revenue.

(2) Serious disturbance caused to the economy of the country by the piling up mountains of black money, directly causing inflation.

(3) Large hidden loss to the community by some of the best brains of the country involved in perpetual litigation.

(4) Sense of injustice and inequality which tax avoidance arouses in the minds of those who are unwilling or unable to profit from it.

(5) The unethical practice of transferring the burden of tax liability to the shoulders of the guileless, good citizens from those of the 'artful dodgers'.

The court felt that there was as much moral sanction behind taxation laws as behind any other welfare legislation and avoidance of taxation was not ethical.

In the view of the Court, the proper way to construe a taxing statute while considering a device to avoid tax was not to ask whether the provisions should be construed literally or liberally, nor whether the transaction was not unreal and not prohibited by the statute, but whether the transaction was as device to avoid tax and whether the transaction was such that the judicial process might record its approval to it.

The court felt that it was neither fair nor desirable to expect the legislature to intervene and take care of every device to avoid taxation. It was up to the court to take stock to determine the nature of the new and sophisticated legal devices to avoid tax and consider whether the situation created by the devices could be related to the existing legislation with the aid of emerging techniques of interpretation as was done in Ramsey's case to expose the devices for what they are really worth and to refuse to give judicial benediction.

The Supreme Court emphasised that tax planning may be legitimate provided it is within the framework of law and colorable devices cannot be part of tax planning. It is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. The Supreme Court also recommended that it is the obligation of every citizen to pay the taxes honestly without resorting to subterfuge.

Tax planning may be legitimate provided it is within the framework of law

Another significant case decided by the Supreme Court, though involving a dispute relating to payment of bonus, is worthy of reference at this stage as it also reflects the same thinking as in *Mc Dowell's* case. In *Associated Rubber Industries case (1986) 157 ITR 77(SC)*, a new wholly owned subsidiary company was created with no asset of its own except investments transferred by the holding company with no business income, except receiving dividend from the transferred investments. The Supreme Court held that on facts, the purpose of such a transfer of investments was nothing but to reduce the gross profits of the holding company and thereby to reduce the payment of bonus. There was no direct evidence that the subsidiary was formed as a device to reduce the gross profits of the principal company for whatever purpose. But Justice Chinnappa Reddy in passing his judgment was following the principles earlier laid down by him in *Mc Dowell's* case and was of the opinion that the transfer of shares was nothing but a device like tax evasion to avoid a welfare legislation like the Payment of Bonus Act. It was observed that it is the duty of the Court in every case where ingenuity is expended to avoid liability to taxation and welfare legislation, to get behind the smoke screen and discover the true state of affairs.

The above decision seems to have introduced a new doctrine that it is upto the court to take stock, weigh out sophisticated legal devices and expose the devices for what they really are. The fact that this new doctrine has started gaining ground very fast is seen from a quick succession of decisions, after *Mc Dowell* in *Kartikeya vs. Sarabhai* and in *Associated Rubber's* case. The above change in the trend of judicial thinking clearly shows that the line of demarcation between Tax Planning and Tax avoidance.

In order to curb tax avoidance, provisions such as

- applicability of transfer pricing provisions in respect of specified domestic transactions,
- treating any transaction with the person located in the notified jurisdiction areas to be treated as international transaction,
- General Anti-avoidance Rules,
- provisions relating to furnishing of Tax Residency Certificate for claiming benefit of double tax avoidance agreements

have been introduced.

The decision in *Mc Dowell's* case and the subsequent developments have evoked lot of debate in all legal and tax circles.

The Gujarat High Court in *CIT vs. Smt. Minal Rameshchandra (1987) 61 CTR (Guj) 80* had occasion to consider the impact of *Mc Dowell's* case. The following propositions appear to emerge from the same.

(i) *Mc Dowell's* case and observations therein cannot be ignored and these are binding on all courts.

(ii) *Mc Dowell's* case and observation therein should be understood in the context of questioning the legitimacy of the use of artificial and transparent device and sham practices to circumvent the law.

(iii) Where the arrangement cannot be dismissed as an artificial tax device (and not as a legitimate transaction), the subject can be taxed only having "regard to strict letter of the law and not merely to the spirit of the statute or the substance of the law" and had been consistently laid down earlier. In this sense there is no radical departure from law, prior to Mc Dowell case.

In *CWT. vs. Arvind Narottam [1988] 173 ITR 479 (SC)* Judge Sabyasachi Mukharji J. made the following significant observations:

(i) Where the language of the deed of settlement is plain and admits no ambiguity there is no scope for considerations of tax avoidance.

(ii) One would wish as noted by Chinnappa Reddy in Mc Dowell's case that one could get the enthusiasm of Justice Holmes that taxes are the price of civilization and one would like to pay that price to buy civilization. But the question which many ordinary taxpayers very often in a country of shortages (with ostentatious consumption and deprivation for the large masses) ask is does he with taxes buy civilization or does he facilitate the waste and ostentation of the few. Unless waste and ostentation in government spending are avoided or eschewed no amount of moral sermons would change people's attitude to tax avoidance.

(iii) Where the true effect on the construction of the deeds is clear, appeal to discourage tax avoidance is not a relevant consideration".

In the light of the above development, we have to ascribe a proper meaning to the concept of tax-planning. We can take a cue from the structure of our tax laws.

Our tax laws tend to serve a dual purpose of collecting revenue and of achieving certain social objectives. There are in-built tax incentives which promote savings and investments in new enterprises and facilitate the development of backward areas. A lot of exemptions and incentives are provided in all the direct taxes. If an assessee takes maximum advantage of these incentives, exemptions etc. and enlarges the scope of his disposable resources, there can be no objection because the legislature wants the optimum utilisation of these incentives to promote economic activity in the country. The complexity of our tax-laws makes it impossible for even an intelligent assessee to comprehend them properly and avail all the reliefs which may be genuinely provided by such laws. Moreover, the interaction of other laws such as MRTP Act, FERA, Companies Act etc. make the exercise much more complicated. It requires, therefore, meticulous planning to bring down the tax commitments keeping in view not only the statutes but also the judge-made law. We may say that the above area properly belongs to tax-planning. In this sense there is nothing unethical about tax-planning.

Due to constant changes in the law and new court decisions, it is always necessary to have a continuous review in relation to all matters of tax planning so that appropriate changes are introduced without delay.

(4) **Doctrine of form and substance:** One of the reasons which prompts a taxpayer to resort to tax planning is the existence of the doctrine of form and substance. The principle involved in this doctrine is simple. How far Court may stretch the wording of a Statute to cover a particular set of facts, where those facts have clearly been created by a tax payer in order to avoid or minimise his tax and the literal interpretation of the Statute is not, at first sight apt to cover them? Is it possible to ignore the form of a transaction and determine the substance thereof?

Landmark Judgments wherein the doctrine of form and substance played a major role in decision making:

(i) In *Commissioner of Income tax vs. Motor and General Stores (P) Ltd. (1967) 66 ITR 692,* the Supreme Court had observed that in the absence of any suggestion of bad faith or fraud the true principle is that the taxing statute has to be applied in accordance with the legal rights of the parties to the transaction. According to the court, when the transaction is embodied in a document the liability to tax depends upon the meaning and content of the language used in accordance with the ordinary rules of construction. The House of Lords in *Duke of Westminster vs. ICR (1936) 19 ATC 498* held that in considering the substance of the transaction, the legal form cannot be disregarded.

(ii) It was held in *CIT vs. B.M. Kharwar (1969) 72 ITR 603 (SC)* that the taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction. If the parties have chosen to conceal by device the legal relation, it is open to the taxing authority to unravel the device and to determine the true character of the relationship. However, the legal effect of a transaction cannot be displaced by probing into 'the substance of the transaction'. This principle applies alike to cases in which the legal relation is recorded in a formal document and to cases where it has to be gathered from the evidence - oral and documentary - and the conduct of the parties to the transaction. However, this view of the Supreme Court has now been expressly disapproved by the Supreme Court in *Mc Dowell & Co. Ltd.'s case.*

(iii) Justice Shah, in *Ram Laxman Sugar Mills vs. CIT (1967) 66 ITR 613, 617 (SC),* has stated that to ascertain the legal effect of a transaction, the court seeks, in the first instance, to determine the intention of the parties and if ambiguous expressions are used, the court may normally adopt such interpretation consistent with the parties thereto having acted on the assumption of its validity. Thus, any claim made by a taxpayer will be scrutinized from the point of view of his intention and if there was any intention to defraud the revenue, the court will consider the transaction or the claim as fraud.

Thus, we can say that unless there is clear evidence of *malafide* intention resulting in a form which is a "colorable device" or "mere legal facade" or "non-genuine" form the tax authorities are not justified in disregarding the legal form and probing into the substance of the transaction.

Principles governing the form and substance: Theory of interpretation of a taxing statute:

(i) It is well settled that when a transaction is arranged in one form known to law, it will attract tax liability while, if it is entered into in another form which is equally lawful, it may not. In considering, whether a transaction attracts tax or not, the form of the transaction put through by the assessee is to be considered and not the substance thereof.

(ii) The above rule cannot naturally apply where the transaction, as put through by the assessee, is not genuine but colourable or is a mere device. For here, the question is not one between 'form' and 'substance' but between appearance and truth.

(iii) In deciding whether the transaction is a genuine or colourable one, it will be open to the authorities to pierce the corporate veil and look behind the legal facade at the reality of the transaction.

(iv) Where the authorities are charged under the Act with the duty of determining the nature or purpose of and payment or receipt on the facts of a case, it is open to them to work at the substance of the matter and the formal aspect may be ignored.

(v) Where the terms of a transaction are embodied in a document, it should not be construed only in its formal or technical aspect. While the words used should be looked at, too much importance should not be attached to the name or label given by the parties and the document should be interpreted so as to accord with the real intention of the parties as appearing from the instrument.

As noted earlier, the decisions of the Supreme Court in the cases of *Mc Dowell, Karthikeya Sarabhai and Associated Rubber Industries,* clearly show a preference for the 'substance' over the 'form', if the circumstances of the case warrant such a preference. Where the transactions are genuine, perfectly authentic and not sham, the mere fact that the transaction results in less liability or no liability to tax should not put the transaction to a legal scrutiny questioning the substance of the transaction, attributing a motive behind it. It is up to the Court to take stock of the situation, weigh out sophisticated legal devices and expose the devices for what they really are.

(5) Doctrine of Precedence: Doctrine of Precedence would be applicable in case of tax laws. The following principles which govern the rule of precedence may be noted.

- **Supreme Court:**
  - (i) The Supreme Court judgments are *absolutely binding* on all the courts, Tribunals and authorities.
  - (ii) Not only the *ratio decidendi*[1], but also *obiter dicta*[2] of the Supreme Court are binding on all the Courts.
  - (iii) When there are two irreconcilable decisions of the Supreme Court on some point of law, the decision of a larger Bench shall prevail.
  - (iv) When there are two irreconcilable decisions of two Benches of similar strength, the decision later in time will have to be followed by the lower courts.
  - (v) The Supreme Court judgments cannot be ignored by the lower courts though such judgments are *per incuriam.*
  - (vi) The Supreme Court, though expected to follow its own judgments, is not bound to follow them and in appropriate cases it can review its earlier judgment.
- **High Courts:**
  - (i) A Division Bench of a High Court is generally bound by its earlier decision, but it may refuse to follow the same if the earlier judgment is *per incuriam*[3].

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[1] *the rationale for deciding a case*
[2] *things said by the way (additional observations, remarks, and opinions given while deciding a case)*
[3] *Without referring to the statutory provision*

(ii) If the Division Bench of a High Court does not agree with its earlier judgment it will have to either follow the same or refer the issue to a Full Bench.

(iii) A Division Bench of High Court is bound to follow a decision of the Full Bench of the same High Court.

(iv) A single judge of a High Court is bound by a decision of a Division Bench or of the Full Bench of the same High Court.

(v) A single judge of a High Court is not bound to follow the decision of another single judge, though he is expected to follow the same.

(vi) All the lower authorities, Commissioner (Appeals) and Tribunals are absolutely bound to follow the decision of a High Court within whose jurisdiction they function. Here, the High Court decisions include decision of a single judge.

(vii) The lower authorities and courts can ignore a decision of a High Court only if it is overruled by a larger Bench of the same High Court, or by the Supreme Court or by a later enactment.

♦ **Others:**

(i) The Assessing Officer and the Commissioner, while acting under section 263, cannot refuse to follow the decision of the High Court. They cannot pass orders which are inconsistent with the decisions of the High Court within whose jurisdiction they function, even for the purpose of keeping the issue alive.

(ii) In all Indian Acts like the Income-tax Act, 1961, to keep the uniformity of law, a High Court should normally follow the decision of another High Court, unless it finds an overriding reason not to follow the same.

(iii) The lower appellate authorities are bound to follow the decision of another High Court, though they do not function within the jurisdiction of the said High Court, if there is no contrary decision of any other High Court.

(iv) The Assessing Officer or the Commissioner need not follow the decision of another High Court if the department has not accepted the said decision and has taken the matter to Supreme Court.

(v) The Bench of the Appellate Tribunal, should generally follow the orders of other Benches of the Tribunal, unless those orders of the Tribunal are *per incuriam.*

(vi) An order of a Full Bench of a Tribunal is binding on the ordinary Bench of the Tribunal.

(vii) If an ordinary bench of a Tribunal does not agree with an order of another Bench of the Tribunal, and that order of another Bench of the Tribunal is not *per incuriam*, the Bench cannot differ from the view taken by the other Bench. It can only get the matter referred to a larger Bench. But this is subject to the general rule that as far as possible, the Bench should try to follow the orders of the Benches.

(viii) The Tribunal orders are binding on the Commissioner (Appeals) falling within the territorial jurisdiction of the Tribunal passing the order in question.

(ix) The Assessing Officer and the Commissioner are bound by the order of the Tribunal (falling within the jurisdiction of the Tribunal unless the Department has not accepted the decision of the Tribunal.)

Summary for Quick Reference of Doctrine of Precedence:

Decision of	Will precede over the decision of
Supreme Court	
Supreme Court	All the Courts, Tribunals and authorities
Larger Bench of Supreme Court	Smaller Bench of Supreme Court
Supreme Court at a later point in time (if same strength)	Supreme Court at an earlier point in time
High Court	
High Court (even if single judge decision)	All the lower authorities, Commissioner (Appeals), Joint Commissioner (Appeals) and Tribunals functioning within the jurisdiction of the High Court
Full Bench of High Court	Division Bench of same High Court and single judge of same High Court
Division Bench of High Court	Single Judge of same High Court
Appellate Tribunal	
Full Bench of a Tribunal	Ordinary Bench of the Tribunal
Tribunal	Assessing Officer, Commissioner and Commissioner (Appeals)

11.2 GENERAL ANTI-AVOIDANCE RULES

There is a growing concern amongst the revenue in many countries that taxpayers structure transactions to reduce the tax costs. The Base Erosion and Profits Shifting (BEPS) project of the

Organization for Economic Cooperation and Development ("OECD") along with G-20 countries sort to tackle this issue. The BEPS Action plans have come out with various recommendations on the issue, both to address it within the international treaty framework (for example, introducing the principle purpose test, limitation of benefits clause, amending the permanent establishment clause, etc.) and in the domestic tax law context (for example, controlled foreign corporation rules, equalization levy, etc.).

Tax avoidance is not defined in taxing statutes. Tax avoidance is, nevertheless, the outcome of actions taken by the assessee, none of which or no combination of which is illegal or forbidden by the law as such. International literature on the subject tends to describe it in the following ways:

- Tax avoidance involves the legal exploitation of tax laws to one's own advantage.
- Every attempt by legal means to prevent or reduce tax liability which would otherwise be incurred, by taking advantage of some provisions or lack of provisions in the law.
- An arrangement entered into solely or primarily for the purpose of obtaining a tax advantage.

Taxpayers consider it their legitimate right to arrange their affairs in a manner as to pay the least tax possible. However, tax authorities internationally consider aggressive tax planning schemes by taxpayers to erode the tax base unnaturally, particularly when effective rates of tax diminish significantly. Several countries have, therefore, legislated to prevent tax avoidance in various ways

The General Anti-Avoidance Rules (GAAR) provisions aim at combating 'impermissible tax avoidance'. Many countries, like the United Kingdom, China, South Africa, Australia, Canada and Brazil have incorporated General Anti-Avoidance Rules in their domestic tax laws to deal with aggressive tax planning.

The Indian GAAR

In India, the GAAR concept was initially introduced in the Direct Taxes Code Bill, 2009 [DTC Bill, 2009]. Later, a Revised Discussion Paper was released. The Direct Taxes Code Bill, 2010 [DTC Bill, 2010] proposed to introduce GAAR from 1st April 2012 onwards. The GAAR provisions were introduced in the Income-tax Act, 1961 vide the Finance Act, 2012 by insertion of new Chapter X-A. Chapter X-A was substituted by the Finance Act, 2013.

The Government subsequently set up a panel under Parthasarathy Shome to review the proposals. The Committee suggested that the rules be deferred by three years to 2016-17, arguing that more time is needed to create administrative machinery for its implementation and called for intensive training of officials.

The Shome Committee Report explains the need for and rationale of GAAR as under:

(i) GAAR has been enacted as a codification of the proposition that, while interpreting the tax legislation, substance should be selected over a legal form.

(ii) Transactions have to be real and are not to be looked at in isolation.

(iii) The fact that the transactions are legal, does not imply that they are acceptable with reference to the underlying meaning embedded in the fiscal statute.

(iv) Thus, where there is no business purpose except to obtain a tax benefit, the GAAR provisions would not allow such a tax benefit to be availed through the tax statute. These propositions have comprised part of jurisprudence in direct tax laws as reflected in various judicial decisions.

The GAAR provisions codify this 'substance over form' basis of the tax law.

The CBDT, vide Press Release dated January 27, 2017, clarified that the GAAR provisions shall be effective from A.Y.2018-19 onwards, i.e., financial year 2017-18 onwards. The provisions of GAAR are contained in Chapter X-A of the Income-tax Act, 1961. The necessary procedures for application of GAAR and conditions under which it shall not apply, have been enumerated in Rules 10U to 10UC of the Income-tax Rules, 1962.

Prior to A.Y. 2018-19, the Act contained only Specific Anti-Avoidance Rules (SAARs) to prevent tax avoidance. SAAR targets known tax planning schemes which are commonly used by taxpayers but are not acceptable owing to misuse or abuse of tax laws, or they result in a consequence unintended in the law. In the Act, the following may, *inter alia*, be considered specific examples of SAAR -

(i) Section 40A(2) on excessive or unreasonable payments to related parties not deductible

(ii) Section 80-IA(8) on transactions with tax exempt entities to be valued at market value.

(iii) Sections 92 to 92F on transfer pricing regulations applicable to international transactions. These provisions are also made applicable to specified domestic transactions by the Finance Act, 2012.

(iv) Section 93 on avoidance of tax by transfer of income to non-residents through transfer of assets, rights or interest.

(v) Section 94 on avoidance of tax by certain transactions in securities.

(vi) Section 94A on transactions with persons located in notified jurisdictions.

(vii) Section 2(22)(e) on deemed dividend.

(viii) Section 40(a)(i) and (ia) on the disallowance of expenses for non-deduction of tax at source.

(ix) Section 9 on scope of 'income deemed to accrue or arise in India'. The Finance Act, 2012 had widened its scope to overcome the Supreme Court's ruling in Vodafone and some other cases.

(x) *Explanations 1 to 13* to section 43(1) on determination of actual cost of assets ignoring agreements, etc., in certain cases.

Tax treaties also provide certain anti-avoidance rules for instance, the Limitation of Benefit (LOB) Clause and concept of Beneficial Ownership.

The above list of provisions relating to SAAR other than section 94 are discussed in the respective chapters of the Study Material. Before moving to the discussion on provisions of GAAR, let's understand section 94.

Special provisions for avoidance of tax by certain transactions in securities [Section 94]

Section 94 aims at preventing avoidance of tax by an assessee by sale or purchase of securities under different circumstances.

Dividend and Income Stripping transactions [Section 94(7)]

(a) If any person buys or acquires any securities or unit within a period of three months prior to the record date and

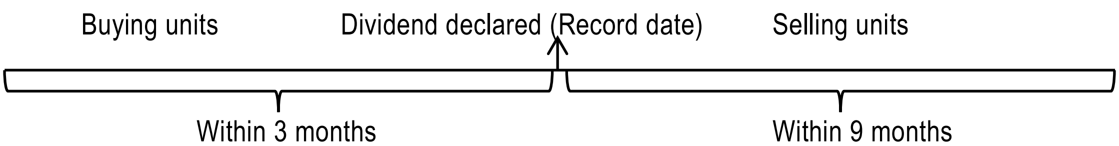
(b) such person sells or transfers –

  (i) such securities **within a period of three months** after such date, or

  (ii) such unit within a period **of nine months after such date** and

(c) the dividend or income on such securities or unit received or receivable by such person is exempted,

then, the loss, if any, arising therefrom shall be ignored for the purposes of computing his income chargeable to tax. Such loss would be ignored to the extent of the amount of dividend or income received or receivable on such securities or unit.



***Note** – Since dividend and income from units of mutual fund specified under section 10(23D) and UTI is taxable in the hands of shareholders/unitholders, the provisions of section 94(7) are currently not relevant in relation to such income.*

In case of dividend from units of business trust, the same would be taxable in the hands of unitholders, if the Special Purpose Vehicle (SPV) exercises the option under section 115BAA, in which case the provisions of section 94(7) would not be attracted. However, if the SPV does not exercise option under section 115BAA, dividend component of income distributed to unit-holders would be exempt in the hands of unit-holders, in which case the provisions of section 94(7) would be attracted if the person buys and sells or transfers units within the specified period mentioned above.

Bonus Stripping Transactions [Section 94(8)]

According to section 94(8), where

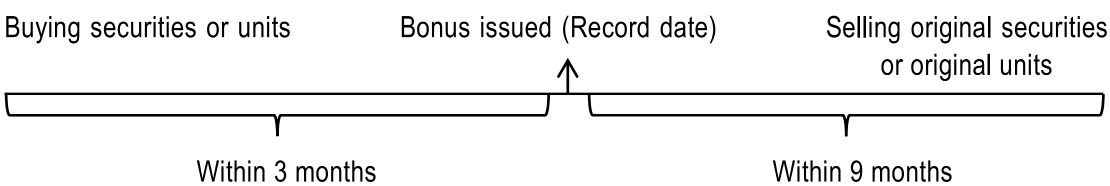
(a) any person buys or acquires any securities or units within a period of **three months** prior to the record date;

(b) such person is allotted additional securities or units without any payment on the basis of holding such securities or units on such date;

(c) such person sells or transfers all or any of the securities or units referred to in (a) above within a period of **nine months** after such date, while continuing to hold all or any of the additional securities or units referred to in (b), then –

(i) the loss on sale of original securities or units sold within a period of 9 months after the record date will be ignored for the purpose of computing his income chargeable to tax and

(ii) the amount of such loss so ignored will be deemed to be the cost of purchase or acquisition of the bonus securities or units referred to in (b) above, held by him on the date of such sale or transfer.



Meaning of certain terms

	Term	Meaning
(i)	Record date	Such date as may be fixed by - (i) a company; or

		(ii) a mutual fund or the Administrator of the specified undertaking or the specified company as referred to in the Explanation to section 10(35); (iii) A business trust (iv) An Alternative Investment Fund defined under regulation 2(1)(b) of the SEBI (AIF) Regulations, 2012 made under the SEBI Act, 1992 for the purposes of entitlement of the holder of the securities or units, as the case may be, to receive dividend, income, or additional securities or unit without any consideration, as the case may be.
(iii)	Securities	The term includes stocks and shares.
(iv)	Unit	It means (i) unit of a business trust (ii) unit of a mutual fund specified in section 10(23D) or unit of the Unit Trust of India. (iii) beneficial interest of an investor in an Alternative Investment Fund, and shall include shares or partnership interests.

Applicability of General Anti-Avoidance Rule [Section 95]

(i) Section 95 of the Act with regard to the applicability of GAAR provides that an arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement and the consequence in relation to tax arising there from may be determined subject to the provisions of this Chapter.

(ii) The section further clarifies that the provisions of this Chapter may be applied to any step in, or a part of, the arrangement as they are applicable to the arrangement.

(iii) The section starts with a non-obstante clause which means, if there is a conflict with provisions in other sections, then this section shall prevail over other conflicting provisions.

(iv) The term arrangement referred to in section 95 of the Act, has been defined in section 102 under clause (1) and means any step in, or a part or whole of, any transaction, operation, scheme, agreement or understanding, whether enforceable or not, and includes the alienation of any property in such transaction, operation, scheme, agreement or understanding;

The term ‘Step’ has been defined in section 102 under clause (9) to include a measure or an action, particularly one of a series taken in order to deal with or achieve a particular thing or object in the arrangement.

Example 1

Facts:

M/s India Chem Ltd. is a company incorporated in India. It sets up a unit in a Special Economic Zone (SEZ) in F.Y. 2019-20 for manufacturing of chemicals. It claims 100% deduction of profits earned from that unit in F.Y. 2023-24 and subsequent years as per section 10AA of the Act. Is GAAR applicable in such a case?

Interpretation:

There is an arrangement of setting up of a unit in SEZ which results in a tax benefit. However, this is a case of tax mitigation where the tax payer is taking advantage of a fiscal incentive offered to him by complying with the conditions imposed and economic consequences of the provisions in the legislation e.g., setting up the business unit in SEZ area. Hence, the Revenue would not invoke GAAR as regards this arrangement.

Example 1A

Facts:

In the above example 1, let us presume M/s India Chem Ltd. has another unit for manufacturing chemicals in a non-SEZ area. It then diverts its production from such manufacturing unit and shows the same as manufactured in the tax exempt SEZ unit, while doing only the process of packaging there. Is GAAR applicable in such a case?

Interpretation:

This is a case of misrepresentation of facts by showing production of non-SEZ unit as production of SEZ unit. Hence, this is an arrangement of tax evasion and not tax avoidance.

Tax evasion, being unlawful, can be dealt with directly by establishing correct facts. GAAR provisions will not be invoked in such a case.

Example 1B

Facts:

In the above example 1A, let us presume that M/s India Chem Ltd. does not show production of non-SEZ unit as a production of SEZ unit but transfers the product of non-SEZ unit at a price lower than the fair market value to SEZ unit and does only some insignificant activity in SEZ unit. Thus, it is able to show higher profits in SEZ unit than in non-SEZ unit, and consequently claims higher deduction in computation of income. Can GAAR be invoked to deny the tax benefit?

Interpretation:

As there is no misrepresentation of facts or false submissions, it is not a case of tax evasion. The company has tried to take advantage of tax provisions by diverting profits from non-SEZ unit to SEZ unit. This is not the intention of the SEZ legislation. However, such tax avoidance is specifically dealt with through the provisions contained in section 10AA(9), as per which provisions of section 80-IA(8) would get attracted in such a case. Further, if the aggregate of such transactions entered into in the relevant previous year exceed the threshold of ₹ 20 crore, domestic transfer pricing regulations under section 92BA would be attracted. Hence, the Revenue need not invoke GAAR in such a case, though GAAR and SAAR can co-exist as per clarification given in the CBDT Circular.

Example 1C

Facts:

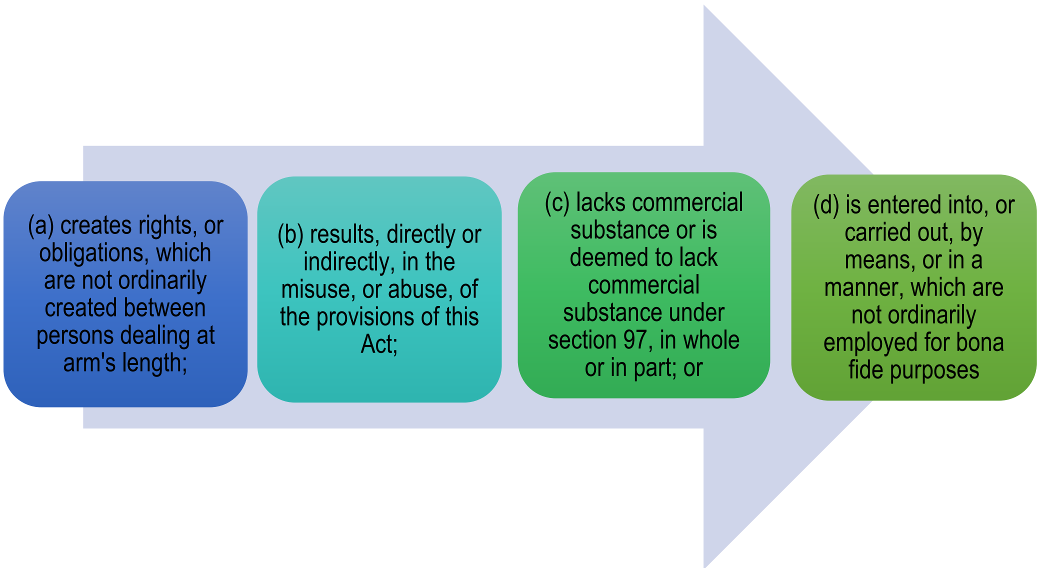
In the above example 1B, let us presume, that both units in SEZ area (say A) and non-SEZ area (say B) work independently. M/s India Chem Ltd. started taking new export orders from existing as well as new clients for unit A and gradually, the export from unit B declined. The company offered lower profits from unit B in computation of income. Can GAAR be invoked on the ground that there has been shifting or reconstruction of business from unit B to unit A for the main purpose of obtaining tax benefit?

Interpretation:

The issue of tax avoidance through shifting/reconstruction of existing business from one unit to another has been specifically dealt with in section 10AA of the Act. Hence, the Revenue need not invoke GAAR in such a case, though GAAR and SAAR can co-exist as per clarification given in the CBDT Circular.

Impermissible Avoidance Agreement [Section 96]

(1) An impermissible avoidance arrangement (IAA) means an arrangement, the main purpose or one of the main purposes of which is to obtain a tax benefit and also any of the following tests is satisfied:



(2) **The purpose test of obtaining tax benefit and tainted element test as under clauses (a) to (d)** above are **twin conditions** that satisfy an impermissible avoidance arrangement. The purpose test requires that the main purpose or one of the main purposes is to obtain tax benefit. The term "tax benefit" has been defined in section 102 clause (10) as under -

(a) a reduction or avoidance or deferral of tax or other amount payable under this Act; or

(b) an increase in a refund of tax or other amount under this Act; or

(c) a reduction or avoidance or deferral of tax or other amount that would be payable under this Act, as a result of a tax treaty; or

(d) an increase in a refund of tax or other amount under this Act as a result of a tax treaty; or

(e) a reduction in total income or

(f) an increase in loss,

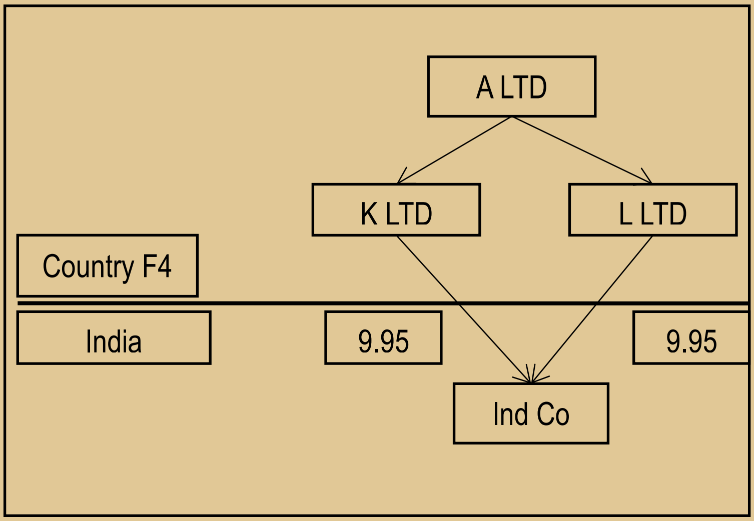
in the relevant previous year or any other previous year.

(3) **The first tainted element** refers to non-arm's length dealings where an arrangement creates rights and obligations, which are not normally created between parties dealing at arm's length. As there are specific transfer pricing regulations (SAAR) applicable to international transactions and certain specified domestic transactions, this tainted element is to be examined only in those transactions which are not covered by Transfer Pricing regulations and where the main purpose of the arrangement is to obtain tax benefit.

(4) **The second tainted** element refers to an arrangement which results in misuse or abuse of the provisions of the Act. It implies cases where the law is followed in letter or form but not in spirit or substance, or where the arrangement results in consequences which are not intended by the legislation, revealing an intent to misuse or abuse the law.

Example 2

Facts:



Under the provisions of a tax treaty between India and country F4, any capital gains arising from the sale of shares of Indco, an Indian company, would be taxable only in F4 if the transferor is a resident of F4 except where the transferor holds more than 10% interest in the capital stock of Indco. A company, A Ltd., being resident in F4, makes an investment in Indco through two wholly owned subsidiaries (K Ltd. and L Ltd.) located in F4. Each subsidiary holds 9.95% shareholding in the Indian Company, the total adding to 19.9% of equity of Indco. The subsidiaries sell the shares of Indco and claim exemption as each is holding less than 10% equity shares in the Indian company. Can GAAR be invoked to deny treaty benefit?

Interpretation:

The above arrangement of splitting the investment through two subsidiaries appears to be with the intention of obtaining tax benefit under the treaty. Further, there appears to be no commercial substance in creating two subsidiaries as they do not change the economic condition of investor A Ltd. in any manner (i.e. on business risks or cash flow), and reveals a tainted element of abuse of tax laws. Hence, the arrangement can be treated as an impermissible avoidance arrangement by invoking GAAR. Consequently, treaty benefit *would be denied by ignoring K and L, the two subsidiaries, or by treating K and L as one and the same company for tax computation purposes.*

(5) **The third tainted** element refers to an arrangement which lacks commercial substance or is deemed to lack commercial substance**.**

(6) **The fourth element** refers to an arrangement which is entered into, or carried out, by means of, or in a manner which is normally not employed for a bona fide purpose. In other words, it means an arrangement that possesses abnormal features. This is not a purpose test but a manner test.

Arrangement to lack commercial substance [Section 97]

Another alternate condition of an impermissible avoidance arrangement is that the arrangement lacks commercial substance or is deemed to lack commercial substance in whole or in part.

(1) Under section 97, certain arrangements have been deemed to lack commercial substance as under –

(a) the substance or effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part; or

(b) it involves or includes—

(i) round trip financing;

(ii) an accommodating party;

(iii) elements that have effect of offsetting or cancelling each other; or

(iv) a transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of funds which is the subject matter of such transaction; or

(c) it involves the location of an asset or of a transaction or of the place of residence of any party which is without any substantial commercial purpose other than obtaining a tax benefit (but for the provisions of this Chapter) for a party.

(d) it does not have a significant effect upon the business risks or net cash flows of any party to the arrangement apart from any effect attributable to the tax benefit that would be obtained (but for the provisions of this Chapter)

(2) Clause (a) is the codification of **substance v. form doctrine**. It implies that where the substance of an arrangement is different from what is intended to be shown by the form of

the arrangement, then the tax consequence of a particular arrangement should be assessed based on the ―substance of what took place. In other words, it reflects the inherent ability of the law to **remove the corporate veil and look beyond form**.

(3) Sub-clause (i) of clause (b) deems an arrangement, which includes round tripping of funds, to lack commercial substance. For this purpose, the phrase round trip financing has been further defined. Round trip financing includes any arrangement in which, through a series of transactions—

(a) funds are transferred among the parties to the arrangement; and

(b) such transactions do not have any substantial commercial purpose other than obtaining the tax benefit (but for the provisions of this Chapter),

without having any regard to—

(A) whether or not the funds involved in the round trip financing can be traced to any funds transferred to, or received by, any party in connection with the arrangement;

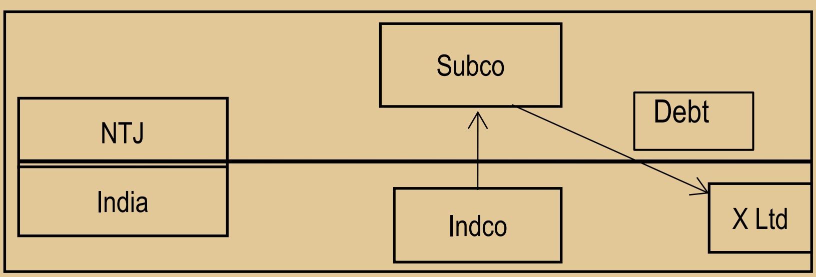
(B) the time, or sequence, in which the funds involved in the round trip financing are transferred or received; or

(C) the means by, or manner in, or mode through, which funds involved in the round trip financing are transferred or received.

Example 3

<u>Facts:</u>

Indco incorporates a Subco in a LTJ (Low Tax Jurisdiction) with equity of US $100. Subco gives a loan of US $ 100 to another Indian company (X Ltd.) at the rate of 10% p.a. X Ltd. claims deduction of interest payable to Subco from the profit of business. There is no other activity in Subco. Can GAAR be invoked in such a case?



Interpretation:

The arrangement appears to avoid payment of tax on interest income by Indco in case loan is directly provided by Indco to X Ltd. The arrangement involves round tripping of funds even though the funds emanating from Indco are not traced back to Indco in this case. Hence, the arrangement may be deemed to lack commercial substance.

Consequently, in the case of Indco, Subco may be disregarded and the interest income may be taxed in the hands of Indco.

(4) Sub-clause (ii) of clause (b) deems an arrangement which includes an accommodating party to lack commercial substance. For this, the phrase "accommodating party" has been further defined. A party to an arrangement shall be an accommodating party, if the main purpose of the direct or indirect participation of that party in the arrangement, in whole or in part, is to obtain, directly or indirectly, a tax benefit (but for the provisions of this Chapter) for the assessee whether or not the party is a connected person in relation to any party to the arrangement.

It means that where a party is included in an arrangement mainly for obtaining tax benefit to the taxpayer, then such party may be treated as an accommodating party and consequently the arrangement shall be deemed to lack commercial substance. Also, it is not necessary that such party should be connected to the taxpayer.

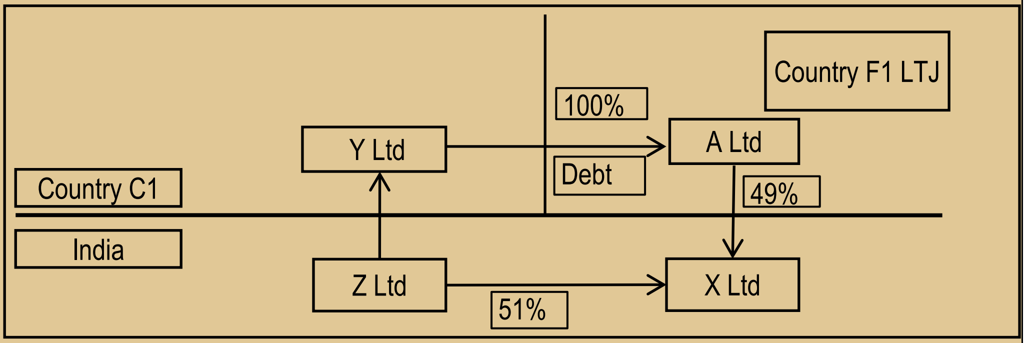
(5) Sub-clause (iii) of clause (b) deems an arrangement, which includes elements that have effect of offsetting or cancelling each other to lack commercial substance.

(6) Sub-clause (iv) of clause (b) deems an arrangement, which disguises value, source or location etc. of funds, to lack commercial substance. In other words, such arrangements have an element of deceit as regards funds.

(7) Clause (c) deems an arrangement to lack commercial substance where it involves the location of an asset or of a transaction or of the place of residence of any party and such location is without any substantial commercial purpose. It means if a particular location is selected for an asset or transaction or residence, and such selection has no substantial commercial purpose, then such arrangement shall be deemed to lack commercial substance.

Example 4

Facts:



(i) Y Ltd. is a company incorporated in country C1. It is a non-resident in India.

(ii) Z Ltd. is a company resident in India.

(iii) A Ltd. is a company incorporated in country F1 and it is a 100% subsidiary of Y Ltd.

(iv) A Ltd. and Z Ltd. form a joint venture company X Ltd. in India after the date of commencement of GAAR provisions. There is no other activity in A Ltd.

(v) The India-F1 tax treaty provides for non-taxation of capital gains in the source country and country F1 charges no capital gains tax in its domestic law.

(vi) A Ltd. is also designated as a permitted transferee of Y Ltd. Permitted transferee means that though shares are held by A Ltd, all rights of voting, management, right to sell etc., are vested in Y Ltd.

(vii) As per the joint venture agreement, 49% of X Ltd's equity is allotted to A Ltd. and 51% is allotted to Z Ltd.

(viii) Thereafter, the shares of X Ltd. held by A Ltd. are sold to C Ltd., a company connected to the Z Ltd. group.

As per the tax treaty with country F1, capital gains arising to A Ltd. are not taxable in India. ***As per the India – Country C1 tax treaty, capital gains is chargeable to tax in the source country.*** *Can GAAR be invoked to deny the treaty benefit?*

Interpretation:

The arrangement of routing investment through country F1 results in a tax benefit. Since there is no business purpose in incorporating company A Ltd. in country F1 which is an LTJ, it can be said that the main purpose of the arrangement is to obtain a tax benefit. The alternate course available in this case is direct investment in X Ltd. joint venture by Y Ltd.

The tax benefit would be the difference in tax liabilities between the two available courses.

The next question is, does the arrangement have any tainted element? It is evident that there is no commercial substance in incorporating A Ltd. as it does not have any effect on the business risk of Y Ltd. or cash flow of Y Ltd. As the twin conditions of main purpose being tax benefit and the existence of a tainted element are satisfied, GAAR may be invoked.

Additionally, as all rights of shareholders of X Ltd. are being exercised by Y Ltd instead of A Ltd, it again shows that A Ltd lacks commercial substance.

Hence, it is possible to invoke GAAR in this case.

(8) In section 97(4), the following factors are considered relevant but not sufficient for determining whether an arrangement lacks commercial substance or not, namely—

(i) the period or time for which the arrangement (including operations therein) exists;

(ii) the fact of payment of taxes, directly or indirectly, under the arrangement;

(iii) the fact that an exit route (including transfer of any activity or business or operations) is provided by the arrangement.

Consequence of impermissible avoidance arrangement [Section 98]

(1) If an arrangement is declared to be an impermissible avoidance arrangement, then the consequences may include denial of tax benefit or a benefit under a tax treaty. The consequence may be determined in such manner as is deemed appropriate in the circumstances of the case. Certain illustrations of the manner have been provided, namely:—

(a) disregarding, combining or re-characterizing any step in, or a part or whole of, the impermissible avoidance arrangement;

(b) treating the impermissible avoidance arrangement as if it had not been entered into or carried out;

(c) disregarding any accommodating party or treating any accommodating party and any other party as one and the same person;

(d) deeming persons who are connected persons in relation to each other to be one and the same person for the purposes of determining tax treatment of any amount;

(e) reallocating amongst the parties to the arrangement—

(i) any accrual, or receipt, of a capital or revenue nature; or

(ii) any expenditure, deduction, relief or rebate;

(f) treating—

(i) the place of residence of any party to the arrangement; or

(ii) the situs of an asset or of a transaction,

at a place other than the place of residence, location of the asset or location of the transaction as provided under the arrangement; or

(g) considering or looking through any arrangement by disregarding any corporate structure.

(2) It has also been provided that –

(i) any equity may be treated as debt or *vice versa*;

(ii) any accrual, or receipt, of a capital nature may be treated as of revenue nature or vice versa; or

(iii) any expenditure, deduction, relief or rebate may be recharacterised.

Treatment of connected persons and accommodating party [Section 99]

(1) As per section 99, for the purposes of Chapter X-A, in determining whether a tax benefit exists—

(i) the parties who are connected persons in relation to each other may be treated as one and the same person;

(ii) any accommodating party may be disregarded;

(iii) such accommodating party and any other party may be treated as one and the same person;

(iv) the arrangement may be considered or looked through by disregarding any corporate structure.

(2) The term 'connected person' is defined in section 102 clause (4). Connected person means any person who is connected directly or indirectly to another person and includes –

Treatment of connected persons and accommodating party [Section 99]

(1) As per section 99, for the purposes of Chapter X-A, in determining whether a tax benefit exists—

(i) the parties who are connected persons in relation to each other may be treated as one and the same person;

(ii) any accommodating party may be disregarded;

(iii) such accommodating party and any other party may be treated as one and the same person;

(iv) the arrangement may be considered or looked through by disregarding any corporate structure.

(2) The term 'connected person' is defined in section 102(4). Connected person means any person who is connected directly or indirectly to another person and includes –

If Connected Person is an				A Company/Firm /AOP/BOI/HUF having substantial interest in the business of the person or any director/partner/member or any relative of such director/partner/member	A Company/Firm/ AOP/BOI/HUF whose director/partner/ member has substantial interest in the business of the person or family or any relative of such director/partner/ member	Any person who carries on business – being an individual or any relative of such person has substantial interest in the business of that other person – being a company/ Firm/AOP/BOI/HUF or any director /partner/member or any relative of such director/partner/member has substantial interest in the business of that other person
Individual: any relative or who has substantial interest in the business of the person or any relative of such individual	**Company:** any director or relative of such director	**Firm/ AOP/ BOI:** any partner/ member or relative of such partner/member	**HUF:** Any member or relative of such member			

Framing of guidelines under Income-tax Rules [Section 101]

The provisions of Chapter XA have to be applied in accordance with such guidelines and subject to such conditions as may be prescribed. These guidelines are contained in Rules 10U to 10UC.

(1) As per Rule 10U, the provisions of General Anti Avoidance Rule are not applicable to

(a) an arrangement where the tax benefit in the relevant assessment year arising, in aggregate, to all the parties to the arrangement does not exceed a sum of rupees three crores.

(b) a Foreign Institutional Investor -

(i) who is an assessee under the Act;

(ii) who has not taken benefit of an agreement referred to in section 90 or section 90A as the case may be; and

(iii) who has invested in listed securities, or unlisted securities, with the prior permission of the competent authority, in accordance with the Securities and Exchange Board of India (Foreign Institutional Investor) Regulations, 1995 and such other regulations as may be applicable, in relation to such investments.

(c) a person, being a non-resident, in relation to investment made by him by way of offshore derivative instruments or otherwise, directly or indirectly, in a Foreign Institutional Investor.

(d) any income accruing or arising to, or deemed to accrue or arise to, or received or deemed to be received by, any person from transfer of investments made before the 1st day of April, 2017 by such person.

However, the provisions of GAAR shall apply to any arrangement [other than specified in (d) above], irrespective of the date on which it has been entered into, in respect of the tax benefit obtained from the arrangement on or after the 1st day of April, 2017.

(2) Where a part of an arrangement is declared to be an impermissible avoidance arrangement, the consequences in relation to tax shall be determined with reference to such part only [Rule 10UA].

(3) The Assessing Officer shall, before making a reference to the Commissioner under section 144BA(1), issue a notice in writing to the assessee seeking objections, if any, to the applicability of provisions of GAAR in his case [Rule 10UB(1)].

Implementation of GAAR Provisions under the Income-tax Act, 1961

Clarifications on certain queries about implementation of GAAR [Circular No.7 of 2017 dated 27-1-2017]

The provisions of Chapter X-A of the Income-tax Act, 1961 relating to General Anti-Avoidance Rule came into force from 1st April, 2017. Certain queries were received by the Board about *implementation of GAAR provisions. The Board constituted a Working Group in June, 2016 for this purpose. The Board has considered the comments of the Working Group and the following clarifications were issued:*

Question no. 1: *Will GAAR be invoked if SAAR applies?*

Answer: *It is internationally accepted that specific anti avoidance provisions may not address all situations of abuse and there is need for general anti-abuse provisions in the domestic legislation. The provisions of GAAR and SAAR can coexist and are applicable, as may be necessary, in the facts and circumstances of the case.*

Question no. 2: *Will GAAR be applied to deny treaty eligibility in a case where there is compliance with LOB test of the treaty?*

Answer: *Adoption of anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies and the same are required to be tackled through domestic anti-avoidance rules. If a case of avoidance is sufficiently addressed by LOB in the treaty, there shall not be an occasion to invoke GAAR.*

Question no. 3: *Will GAAR interplay with the right of the taxpayer to select or choose method of implementing a transaction?*

Answer: *GAAR will not interplay with the right of the taxpayer to select or choose method of implementing a transaction.*

Question no. 4: *Will GAAR provisions apply where the jurisdiction of the FPI is finalised based on non-tax commercial considerations and such FPI has issued P-notes referencing Indian securities? Further, will GAAR be invoked with a view to denying treaty eligibility to a Special Purpose Vehicle (SPV), either on the ground that it is located in a tax friendly jurisdiction or on the ground that it does not have its own premises or skilled professional on its own roll as employees.*

Answer: *For GAAR application, the issue, as may be arising regarding the choice of entity, location etc., has to be resolved on the basis of the main purpose and other conditions provided under section 96 of the Act. GAAR shall not be invoked merely on the ground that the entity is located in a tax efficient jurisdiction. If the jurisdiction of FPI is finalized based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit, GAAR will not apply.*

Question no. 5: *Will GAAR provisions apply to (i) any securities issued by way of bonus issuances so long as the original securities are acquired prior to 01 April, 2017 (ii) shares issued post 31 March, 2017, on conversion of Compulsorily Convertible Debentures, Compulsorily Convertible Preference*

Shares (CCPS), Foreign Currency Convertible Bonds (FCCBs), Global Depository Receipts (GDRs), acquired prior to 01 April, 2017; (iii) shares which are issued consequent to split up or consolidation of such grandfathered shareholding?

Answer: *Grandfathering under Rule 10U(1)(d) will be available to investments made before 1st April 2017 in respect of instruments compulsorily convertible from one form to another, at terms finalized at the time of issue of such instruments. Shares brought into existence by way of split or consolidation of holdings, or by bonus issuances in respect of shares acquired prior to 1st April 2017 in the hands of the same investor would also be eligible for grandfathering under Rule 10U(1)(d) of the Income-tax Rules, 1962.*

Question no. 6: *The expression "investments" can cover investment in all forms of instrument - whether in an Indian Company or in a foreign company, so long as the disposal thereof may give rise to income chargeable to tax. Grandfathering should extend to all forms of investments including lease contracts (say, aircraft leases) and loan arrangements, etc.*

Answer: *Grandfathering is available in respect of income from transfer of investments made before 1st April, 2017. As per Accounting Standards, 'investments' are assets held by an enterprise for earning income by way of dividends, interest, rentals and for capital appreciation. Lease contracts and loan arrangements are, by themselves, not 'investments' and hence grandfathering is not available.*

Question no. 7: *Will GAAR be invoked if arrangement is sanctioned by an authority such as the Court, National Company Law Tribunal or is in accordance with judicial precedents etc.?*

Answer: *Where the Court has explicitly and adequately considered the tax implication while sanctioning an arrangement, GAAR will not apply to such arrangement.*

Question no. 8: *Will a Fund claiming tax treaty benefits in one year and opting to be governed by the provisions of the Act in another year attract GAAR provisions? An example would be where a Fund claims treaty benefits in respect of gains from derivatives in one year and in another year sets-off losses from derivatives transactions against gains from shares under the Act.*

Answer: *GAAR provisions are applicable to impermissible avoidance arrangements as under section 96. In so far as the admissibility of claim under treaty or domestic law in different years is concerned, it is not a matter to be decided through GAAR provisions.*

Question no. 9: *How will it be ensured that GAAR will be invoked in rare cases to deal with highly aggressive and artificially pre-ordained schemes and based on cogent evidence and not on the basis of interpretation difference?*

Answer: *The proposal to declare an arrangement as an impermissible avoidance arrangement under GAAR will be vetted first by the Principal Commissioner / Commissioner and at the second stage by an Approving Panel, headed by judge of a High Court. Thus, adequate safeguards are in place to ensure that GAAR is invoked only in deserving cases.*

Question no. 10: *Can GAAR lead to assessment of notional income or disallowance of real expenditure? Will GAAR provisions expand the scope of charging provisions or scope of taxable base and/or disallow the expenditure which is actually incurred and which otherwise is admissible having regard to diverse provisions of the Act?*

Answer: *If the arrangement is covered under section 96, then the arrangement will be disregarded by application of GAAR and necessary consequences will follow.*

Question no. 11: *A definite timeline may be provided such as 5 to 10 years of existence of the arrangement where GAAR provisions will not apply in terms of the provisions in this regard in section 97(4).*

Answer: *Period of time for which an arrangement exists is only a relevant factor and not a sufficient factor under section 97(4) to determine whether an arrangement lacks commercial substance.*

Question no. 12: *It may be ensured that in practice, the consequences of a transaction being treated as an 'impermissible avoidance arrangement' are determined in a uniform, fair and rational basis. Compensating adjustments under section 98 of the Act should be done in a consistent and fair manner. It should be clarified that if a particular consequence is applied in the hands of one of the participants, there would be corresponding adjustment in the hands of another participant.*

Answer: *Adequate procedural safeguards are in place to ensure that GAAR is invoked in a uniform, fair and rational manner. In the event of a particular consequence being applied in the hands of one of the participants as a result of GAAR, corresponding adjustment in the hands of another participant will not be made. GAAR is an anti-avoidance provision with deterrent consequences and corresponding tax adjustments across different taxpayers could militate against deterrence.*

Question no. 13: *Tax benefit of INR 3 crores as defined in section 102(10) may be calculated in respect of each arrangement and each taxpayer and for each relevant assessment year separately. For evaluating the main purpose to be obtaining of tax benefit, the review should extend to tax consequences across territories. The tax impact of INR 3 crores should be considered after taking into account impact to all the parties to the arrangement i.e. on a net basis and not on a gross basis (i.e. impact in the hands of one or few parties selectively).*

Answer: *The application of the tax laws is jurisdiction specific and hence what can be seen and examined is the Tax Benefit' enjoyed in Indian jurisdiction due to the 'arrangement or part of the* *arrangement'. Further, such benefit is assessment year specific. Further, GAAR is with respect to an arrangement or part of the arrangement and therefore limit of INR 3 crores cannot be read in respect of a single taxpayer only.*

Question no. 14: *Will a contrary view be taken in subsequent years if arrangement held to be permissible in an earlier year?*

Answer: *If the PCIT/Approving Panel has held the arrangement to be permissible in one year and facts and circumstances remain the same, as per the principle of consistency, GAAR will not be invoked for that arrangement in a subsequent year.*

Question no. 15: *No penalty proceedings should be initiated pursuant to additions made under GAAR at least for the initial 5 years.*

Answer: *Levy of penalty depends on facts and circumstances of the case and is not automatic. No blanket exemption for a period of five years from penalty provisions is available under law. The assessee, may at his option, apply for benefit u/s 273A if he satisfies conditions prescribed therein.*

TEST YOUR KNOWLEDGE

Questions

1. *Distinguish between Tax planning and Tax Evasion.*

2. *Specify with reason, whether the following acts can be considered as (i) Tax planning; or (ii) Tax management; or (iii) Tax evasion.*

   (i) *Mr. P deposits ₹ 1,00,000 in PPF account so as to reduce his total income from ₹ 5,90,000 to ₹ 4,90,000.*

   (ii) *SQL Ltd. maintains a register of tax deduction at source effected by it to enable timely compliance.*

   (iii) *An individual tax payer making tax saver deposit of ₹ 1,00,000 in a nationalised bank.*

   (iv) *A partnership firm obtaining declaration from lenders/depositors in Form No. 15G/15H and forwarding the same to income-tax authorities.*

   (v) *A company installed an air-conditioner costing ₹ 75,000 at the residence of a director as per terms of his appointment but treats it as fitted in quality control section in the factory. This is with the objective to treat it as plant for the purpose of computing depreciation.*

   (vi) *RR Ltd. issued a credit note for ₹ 80,000 as brokerage payable to Mr. Ramana who is the son of the managing director of the company. The purpose is to increase the total income of Mr. Ramana from ₹ 6,20,000 to ₹ 7,00,000 and reduce the income of RR Ltd. correspondingly.*

   (vii) *A company remitted provident fund contribution of both its own contribution and employees' contribution on monthly basis before due date.*

3. *Examine the doctrine of form and substance in the context of tax planning.*

4. *The merger of a loss making company with a profit making one results in losses setting off profits, a lower net profit and lower tax liability for the merged company. Would the losses be disallowed by applying GAAR?*

5. *A choice is made by a company by acquiring an asset on lease over outright purchase. The company claims deduction for lease rentals in case of acquisition through lease rather than depreciation as in the case of purchase of the asset. Would the lease rent payment, being higher than the depreciation, be disallowed as expense under GAAR?*

6. *M/s Global Architects Inc is a company incorporated in country F1. It is engaged in the business of providing architectural design services all over the world. It receives an offer from Lovely Resorts Pvt Ltd, an Indian company, for design and development of resorts all over India.*

India-F1 tax treaty provides that architectural services are technical services and payment for the same to a company may be taxed in India. However, if such professional services are provided by a firm or individual, then payment for such services are taxable only if the firm has a fixed base in India or stay of partners/ employees in India exceed 180 days. Limitation of benefit clause does not exist in tax treaty between India-F1.

M/s Global Architects Inc forms a partnership firm with a third party (director of the company) having only a nominal share in the F1. The firm enters into an agreement to carry out the services in India. The company seconded its trained manpower to the firm.

Thus, the partnership firm claimed the treaty benefit and no tax was paid in India. Can such an arrangement be examined under GAAR?

Answers

1. Tax planning is carried out within the framework of law by availing the deductions and exemptions permitted by law and thereby minimizing tax liability. Tax planning is an arrangement by which full advantage is taken of the concessions and benefits conferred by the statute, without violation of legal provisions. Tax evasion on the other hand is an attempt to reduce tax liability by dubious or artificial methods or downright fraud. It is illegal and denies the State its legitimate share of tax.

2. **Tax Planning / Tax Management / Tax Evasion**

	Answer	Reason
1.	**Tax planning**	Depositing money in PPF and claiming deduction under section 80C is as per the provisions of law.
2.	**Tax management**	Maintaining a register of payments subject to TDS helps in complying with the obligations under the Income-tax Act, 1961.
3.	**Tax planning**	Making a tax saver deposit of ₹ 1,00,000 in a nationalized bank for claiming deduction under section 80C by an individual is a permitted tax planning measure under the provisions of income-tax law.
4.	**Tax management**	Obtaining declaration from lenders/depositors in Form No. 15G/15H by a partnership firm and forwarding the same to

		Income-tax authorities is in the nature of compliance with statutory obligation under the Income-tax Act, 1961.
5.	**Tax evasion**	An air conditioner fitted at the residence of a director as per the terms of his appointment would be a furniture qualifying for depreciation @10%, whereas an air conditioner fitted in a factory would be a plant qualifying for a higher depreciation @15%. The wrong treatment unjustifiably increases the amount of depreciation and consequently, reduces profit and consequent tax liability. Treatment of air-conditioner fitted at the residence of a director as a plant fitted at the factory would tantamount to furnishing of false particulars in an attempt to evade tax.
6.	**Tax evasion**	Issuance of a credit note for ₹ 80,000 by RR Ltd. as brokerage payable to Mr. Ramana, the son of the Managing Director, to increase his total income from ₹ 6.2 lakh to ₹ 7.00 lakh and to correspondingly reduce the company's total income is a method of reducing the tax liability of the company by recording a fictitious transaction. The company is liable to tax at a flat rate of 30%/25%/22%, as the case may be, whereas Mr. Ramana would not be liable to pay any tax as per the default regime under section 115BAC, since his total income does not exceed ₹ 7,00,000, consequent to which he would be eligible for tax rebate of ₹ 25,000 under section 87A. Reducing tax liability by recording a fictitious transaction would tantamount to tax evasion.
7.	**Tax management**	Remitting of own contribution to provident fund and employees contribution to provident fund on a monthly basis before the due date is proper compliance with the statutory obligations.

3. The following are certain principles enunciated by the Courts on the question as to whether it is the form or substance of a transaction, which will prevail in income-tax matters:

(i) **Form of transaction is to be considered in case of genuine transactions -** It is well settled that when a transaction is arranged in one form known to law, it will attract tax liability whereas, if it is entered into in another form which is equally lawful, it may not. Therefore, in considering whether a transaction attracts tax or not, the form of the transaction put through is to be considered and not the substance. **However, this rule applies only to genuine transactions.** [*CIT v. Motor and General Stores (P) Ltd. v. CIT (1967) 66 ITR 692(SC)*.

(ii) **True legal relation is the crucial element for taxability -** It is open for the authorities to pierce the corporate veil and look behind the legal facade at the reality of the transaction. The taxing authority is entitled as well as bound to determine the true legal relation resulting from a transaction. The true legal relation arising from a transaction alone determines the taxability of a receipt arising from the transaction *[CIT v. B.M. Kharwar (1969) 72 ITR 603 (SC)]*

(iii) **Substance (i.e. actual nature of expense) is relevant and not the form –** Under section 97, an arrangement shall be deemed to lack commercial substance if the substance or effect of the arrangement as a whole, is inconsistent with or differs significantly from, the form of its individual steps or a part. Accordingly, such arrangement would be impermissible avoidance arrangement and be subject to GAAR. However, GAAR provisions will be applicable only to an arrangement where the tax benefit in the relevant A.Y. arising, in aggregate to all parties to the arrangement exceeds ₹ 3 crores. The Income-tax Act, 1961 also contains Specific Anti-avoidance provisions to address the concern of tax avoidance.

Some examples where Supreme Court has upheld substance over form are -

(a) In case of an expenditure, the mere fact that the payment is made under an agreement does not preclude the department from enquiring into the actual nature of the payment [*Swadeshi Cotton Mills Co. Ltd. v. CIT (1967) 63 ITR 57(SC)*].

(b) In order to determine whether a particular item of expenditure is of revenue or capital nature, the substance and not merely the form should be looked into. [*Assam Bengal Cement Co. Ltd. v. CIT (1955) 27 ITR 34 (SC)*].

4. As regards setting off of losses, the provisions relating to merger and amalgamation already contain specific anti-avoidance safeguards. Therefore, GAAR need not be invoked when SAAR is applicable, though as per *CBDT Circular No. 7/2017 dated 27.01.2017,* GAAR and SAAR can co-exist. Further, since merger and amalgamation would be carried out under the order of the National Company Law Tribunal (NCLT), GAAR need not be invoked if the NCLT has explicitly and adequately considered the tax implication while sanctioning the merger scheme.

5. GAAR provisions would not apply in this case as the taxpayer merely makes a selection out of the options available to him under the provisions of the Act for which he is eligible and satisfies the stipulated conditions, if any. Even if choice of such option results in lower tax liability, the same is a result of tax planning.

6. It is obvious that there was no commercial necessity to create a separate firm except to obtain the tax benefit. The firm was only on paper as the manpower was drawn from the company. The firm did not have any commercial substance. Moreover, it is a case of treaty abuse. Hence, GAAR may be invoked to disregard the firm and tax payment for architectural services as fee for technical services. However, the rate of tax on such payment shall be as applicable under the treaty, if more beneficial.

CHAPTER 12

TAXATION OF DIGITAL TRANSACTIONS

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **appreciate** the meaning of e-commerce and how business is transacted through E-commerce;
- **identify** the issues and problems in taxing e-commerce transactions;
- **comprehend** the OECD recommendations for taxing e-commerce transactions under Action Plan 1 of Base Erosion and Profit Shifting (BEPS) project;
- **appreciate** the need for equalization levy;
- **comprehend and apply** the provisions of equalisation levy contained in Chapter VIII of the Finance Act, 2016 and the relevant Rules in problem solving and addressing related issues;
- **determine** the income arising on transfer of virtual digital asset and taxability thereof;
- **examine** the applicability of the provisions of tax deducted at source on transfer of virtual digital asset by a resident assessee.

CHAPTER OVERVIEW

E-commerce
- Meaning
- How e-commerce transactions takes place

Equalisation Levy

Taxation of Virtual Digital Assets

12.1 INTRODUCTION

The rapid growth of information and communication technology has resulted in substantial expansion of the supply and procurement of digital goods and services globally, including India. The digital economy is growing at a faster pace than the global economy as a whole.

At present, in the digital domain, business may be conducted without regard to national boundaries and may dissolve the link between an income-producing activity and a specific location. Hence, business in digital domain doesn't actually occur in any physical location but instead takes place in "cyberspace." Persons carrying business in digital domain could be located anywhere in the world. Entrepreneurs across the world have been quick to evolve their business to take advantage of these changes. It has also made it possible for the businesses to conduct themselves in ways that did not exist earlier, and given rise to new business models that rely more on digital and telecommunication network, do not require physical presence, and derives substantial value from data collected and transmitted from such networks.

The growth of e-commerce economy has revolutionised the concept of *brick and mortar* to *click and order.* The need for physical presence in a jurisdiction is consequently getting diminished. Therefore, due to transformed business models, communication with suppliers and customers take place virtually and digitally. Emergence of new age technologies such as 3D printing, sharing economy, internet of things etc. has revolutionised new business models in line with the digital epoch making it difficult to identify the location of source or origin point of a business transaction.

The expansion of business in digital form, give rise to certain tax challenges in relation to nexus, data and characterization of digital transactions. Over the years, to address these tax challenges certain developments are taking place to tax digital transactions which are carried out either by a non-resident non-corporate/ a foreign company or by a resident assessee. This chapter encompasses these developments introduced in the form of equalisation levy, taxability based on significant economic presence, applicability of tax deduction at source on e-commerce transactions and taxation of gains arising on transfer of virtual digital assets by a resident assessee.

12.2 WHAT IS E-COMMERCE?

Clause (a) of *Explanation* to Section 194O defines "electronic commerce" to mean the supply of goods or services or both, including digital products over digital or electronic network.

E-commerce or electronic commerce is one of the main components of the Digital Economy. In its widest sense, it encompasses consumer and business transactions conducted over a network, with the help of computers and telecommunications. In other words, e-commerce refers to the exchange of goods or services for value on the internet. E-commerce, *inter-alia,* includes, online shopping, online trading of goods and services, electronic fund transfers, electronic data exchanges and online trading of financial instruments.

[1]OECD defines e-commerce as the sale or purchase of goods or services, conducted over computer networks by methods specifically designed for the purpose of receiving or placing orders. Accordingly, whether a commercial transaction qualifies as e-commerce is determined by the ordering method rather than the characteristics of the product purchased, the parties involved, the mode of payment or the delivery channel. The ordering process is considered as a crucial determinant of an e-commerce transaction in the OECD definition.

E-commerce facilitates trade across borders, increases convenience for consumers, and enables firms to reach new markets. E-commerce reforms have rapidly evolved through the development of new business models, which often integrate new and emerging digital technologies as well as new online payment mechanisms. Many e-commerce business models use online platforms, facilitating purchases between often unknown and dispersed buyers and sellers. Another emerging trend is the growth of subscription e-commerce business models, whereby users access goods and services in a continuous, recurring stream. E-commerce business models integrate digital ordering mechanisms alongside physical infrastructures, including within brick-and-mortar stores.

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[1] OECD (2019), Unpacking E-commerce: Business Models, Trends and Policies, OECD Publishing, Paris, https://doi.org/10.1787/23561431-en.

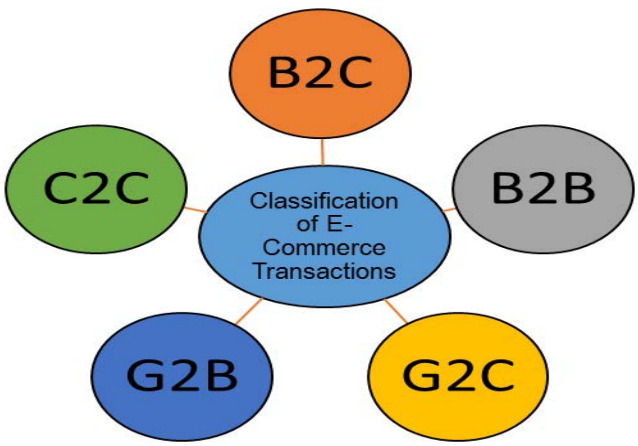
12.3 CONDUCT OF BUSINESS IN DIGITAL ECONOMY

E-commerce is a method of conducting business transactions and not a business transaction by itself. Therefore, the contents of a business transaction done through e-commerce means is no different from that of a business transaction carried out through traditional means.

New business models expand the e-commerce frontier in two ways. First, new business models can enable more transactions to move online in a given market or for a given set of participants. Second, new business models can enable whole new markets to emerge for goods and services that previously could not have been bought or sold online, or allow new participants to enter the market.

Digital technologies enable e-commerce innovations and often serve as the backbone of business model developments. Some of these technologies, like smart assistants enabled by artificial intelligence (AI), constitute new channels for selling or purchasing products over electronic networks. Similarly, online payment innovations can help to unlock e-commerce potential by promoting trusted online transactions between unknown parties.

Classification of E-commerce based on parties involved in transactions. Major types are mentioned below:



(i) **Business to Customers (B2C):** In this type of e-commerce, transactions take place between businesses and consumers. In B2C e-commerce, products or services are sold to end-users (i.e. consumers).

__Examples:__ Amazon.in, Flipkart.com, Myntra.com, Snapdeal.com etc. are the examples of B2C e-commerce businesses, where consumers can find almost anything be it books, electronic products like washing machines, USB storage devices, clothes, shoes or personal care etc.

(ii) **Business to Business (B2B):** In B2B e-commerce, transactions take place between two businesses.

Example: *IndiaMART, TradeIndia, Alibaba, go4WorldBusiness.com (an online B2B marketplace for global exporters and importers), Amazon, the US-based ecommerce giant etc are the example of B2B online platforms.*

(iii) **Government to Customers (G2C):** The online platform between a government and its citizens or consumers for paying taxes, registering vehicles, and providing information and services such as filing of income-tax return etc.

(iv) **Government to Business (G2B)/ Business to Government (B2G):** In G2B/ B2G e-commerce, an electronic exchange of any information between businesses and the government, usually using internet so the cooperation or communication takes place on the internet. In G2B, government agencies and business use websites, procurement marketplaces, applications, web services.

Example: *Government e-Marketplace (GeM), a one stop portal to facilitate online procurement of common use Goods & Services required by various Government Departments /Organizations / PSUs.*

INAM-Pro is a web based application, designed by National Highways and Infrastructure Development Corporation Ltd (NHIDCL) and launched by the Ministry as a common platform to bring cement buyers and sellers together.

(v) **Customer to Customer (C2C):** When goods or services are bought and sold between two consumers, C2C e-commerce business takes place.

Example: Olx, a C2C e-commerce online platform where customer sells his used goods to other customer; eBay, an online marketplace in which an individual sells a product or service to another.

E-Commerce Business Models

With the advancement of digitalization and emergence of new technologies, new forms of e-commerce business models have evolved. Some of such ways of transacting e-commerce business are discussed here below:

Online platform e-commerce business model:

In the context of e-commerce, online platforms act as intermediaries between buyers and sellers to facilitate the exchange of goods and services over the Internet. Buyers benefit due to the presence of variety of products available with diverse sellers. Likewise, sellers discover many buyers to whom they can sell their products. As compared to the physical stores, digital marketplace deliver variety of goods and service.

Meaning of Marketplace based model and Inventory based model of e-commerce[2]:

Marketplace based model *of e-commerce means providing an information technology platform by an e-commerce entity on a digital & electronic network to act as a facilitator between buyer and seller.*

Inventory based model of e-commerce *means an e-commerce activity where inventory of goods and services is owned by e-commerce entity and is sold to the consumers directly.*

Subscription e-commerce business model: Subscription business model is characterised by regular and recurring payments for the repeated provision of a good or a service. The subscription business model can relate to recurring purchases of digital goods and services, or a combination of both digital and tangible products (such as a newspaper subscription that includes access to digital content). Some current e-commerce subscription business models, such as Spotify or Netflix etc.

Digital identity and its potential for e-commerce: Digital identity refers to the set of information used by a computer to authenticate an identity. For example, India's Aadhaar programme issues a unique number to every Indian citizen which is a valid means of identification *vis-à-vis* the government as well as private Internet sites including Airbnb, Uber and digital wallet services.

Subscription access to tangible and bundled goods and services: A recent e-commerce trend has been the growth of subscription business models for tangible goods, including in categories like beauty supplies (Birchbox), minerals (Celestial Minerals), groceries (Blue Apron, Hello Fresh), snack foods (Nature Box), cosmetics and self-care products (Dollar Shave Club, Harry's), and many more.

Online-offline e-commerce business models: These business models serve as extensions of e-commerce, pushing the edges of online purchases into physical stores. Some business models combine online ordering with offline distribution, which may be useful to enable the online purchase of products whose quality may not be assessed from a distance, such as perishable goods like groceries. Many businesses have taken advantage of the ubiquity of digital technologies to grow business models based on a combination of both online and offline features. Other online businesses are moving offline by adding brick-and-mortar elements to enable the online sale of other goods, like clothing, where fit may be difficult to assess from a distance.

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[2] *Consolidated FDI Policy Circular of 2017, dated 28.8.2017 read with Press Note dated 26.12.2018*

Mobile technologies - Helping e-commerce to flourish in brick-and-mortar stores: Mobile technologies empower consumers to perform a range of digital activities, including online shopping. Consumers use digital technologies throughout the commercial process, but smartphones enable buyers to compare prices, to do research and finally make transactions from any networked location.

Online groceries – e-commerce frontier: Many businesses are successfully selling perishable food and groceries online. Some online business models offer direct shipping of purchased groceries alongside guarantees related to quality and customer satisfaction to give consumers confidence in the purchase of perishable goods and services.

Innovative payment mechanisms: Safely and remotely exchanging money online, including across borders, is fundamental to e-commerce. Safe and effective online payment mechanisms facilitate trusted online transactions, boosting the growth of e-commerce between unknown buyers and sellers. Many online payment mechanisms are closely associated with the rise of e-commerce. In fact, one of the earliest online payment models is "Paypal", which is emerged in combination with the pioneering online auction house and e-commerce platform eBay, to enable safe online payments between the parties involved.

Digital wallets: An online payment can be broadly considered to be a "purchase order placed using devices connected to the Internet", a definition that is relevant to many forms of e-commerce. One mechanism of enabling online payments includes the use of digital wallets, also known as "e-wallets" or "electronic wallets".

Digital wallets allow e-commerce by enabling trusted transactions online, without which most e-commerce purchases would not be possible. Consumers may be more willing to do a transaction online using a digital wallet as opposed to directly sharing financial information with online retailers.

Mobile money - Extending e-commerce to the unbanked: Another form of payment innovation that enables e-commerce is the rise of a specific form of mobile payment, also known as "mobile money", particularly for unbanked people (i.e. those without access to financial services). Mobile money differs from digital wallets insofar that the mechanism for payment is conducted via mobile communication networks, and does not necessarily require an existing relationship with a financial services provider.

Mobile money is facilitated by mobile network operators who use a system of agents to accept regular currency in the form of cash and store an equivalent value in a digital wallet, which can then be transferred to other users or can be withdrawn later. Mobile money is connected with a mobile phone number and often uses two-factor authentication through a personal identification number issued at the point of registration. Mobile money can be transferred to others who are also registered with the same mobile money system, exchanged with merchants for goods and services, or can be withdrawn as cash from a mobile money agent. Mobile money can therefore act as a means of storing and transferring value in a secure and convenient way for unbanked people.

Resources: *The discussion on E-commerce Business Models in this chapter is essentially based on the text published in "Unpacking E-commerce: Business Models, Trends and Policies, OECD Publishing, Paris" available at https://doi.org/10.1787/23561431-en.*

12.4 TAXATION ISSUES RELATING TO DIGITAL ECONOMY

These new business models have created new tax challenges. The typical taxation issues relating to digital economy are:

(i) the difficulty in characterizing the nature of payment and establishing a nexus or link between taxable transaction, activity and a taxing jurisdiction,

(ii) the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

The digital business, thus, challenges physical presence-based permanent establishment rules. If permanent establishment principles are to remain effective in the new economy, the fundamental PE components developed for the old economy i.e. place of business, location, and permanency must be reconciled with the new digital reality. Further, characterizing the income as technical services becomes difficult since the technical services rendered digitally does not involve human intervention, as the digital platforms operate on sophisticated artificial intelligence mechanism. Hence the new digital business models gives rise to 'stateless income' and thereby going completely tax free.

12.5 OECD RECOMMENDATIONS UNDER ACTION PLAN 1 OF THE BEPS PROJECT

Due to the tax challenges arising from digitalization, the G20-OECD BEPS Action Plan Committee as part of its 2015 Action 1 Report identified a number of broader tax challenges raised by digitalisation, notably in relation to nexus, data and characterisation.

The Action Report 1 analysed the following three options, namely -

(i) a new nexus rule in the form of a "***significant economic presence***" test,

(ii) ***a withholding tax*** which could be applied to certain types of digital transactions, and

(iii) ***an equalisation levy***, intended to address a disparity in tax treatment between foreign and domestic businesses where the foreign business had a sufficient economic presence in the jurisdiction

The OECD has recommended several options to tackle the direct tax challenges which include:

(1) Modifying the existing definition of permanent establishment to provide for whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country's economy.

(2) Introducing the concept of a virtual fixed place of business in the concept of permanent establishments i.e., creation of a permanent establishments when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website.

(3) Imposition of a final withholding tax on gross basis in case of certain payments made for digital goods or services provided by a foreign e-commerce provider or imposition of a equalisation levy on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having permanent establishment in other contracting state.

It was concluded that countries could introduce any of these options in their domestic laws as additional safeguards against BEPS, provided they respect existing treaty obligations, or in their bilateral tax treaties. The above options can be resorted to as an interim measure until a clear solution emerges on taxing digital economy.

Taking into consideration the potential of new digital economy and the rapidly evolving nature of business operations, it becomes necessary to address the challenges in terms of taxation of such digital transactions. In order to arrive at a long term solution, the OECD along with the BEPS Inclusive Framework is working on arriving at a consensus based solution to tackle the tax challenges arising out of the digital economy as part of a 'Unified Approach' under Pillar One.

12.6 EQUALISATION LEVY - CHAPTER VIII IN THE FINANCE ACT, 2016

Consequent to the BEPS Action Report 1, a committee was constituted by the CBDT to evaluate the alternatives suggested in the BEPS Action Report 1 for addressing the challenges arising on taxing the digital economy. Pursuant to the recommendations of the Committee, Chapter VIII of the Finance Act, 2016, titled "Equalisation Levy" was introduced. It provides for an equalisation levy @6% of the amount of consideration for specified services received or receivable by a non-resident not having PE in India, from a resident in India who carries out business or profession, or from a non-resident having PE in India. The Finance Minister, in his Speech while introducing the Finance Bill, 2016 stated as follows:

"151. In order to tap tax on income accruing to foreign e-commerce companies from India, it is proposed that a person making payment to a non-resident, who does not have a permanent establishment, exceeding in aggregate ₹ 1 lakh in a year, as consideration for online advertisement, will withhold tax at 6 of gross amount paid, as EL. The levy will only apply to B2B transactions."

One of the primary reasons for introducing the Equalisation Levy through the Finance Act is to deny tax treaty benefits, as otherwise it may defeat the entire purpose of introducing the Equalisation Levy. The CBDT constituted Committee specifically addresses this aspect in their report and clarifies that tax credit under the relevant tax treaties would not be available, since Equalisation Levy is not in the nature of income tax.

The CBDT issued a notification dated 27^{th} May, 2016, stating that the provisions of Chapter VIII relating to the equalisation levy would come into effect from 1st June 2016. This Chapter extends to the whole of India except Jammu and Kashmir. It applies in respect of consideration received or receivable for specified services provided on or after 1.6.2016.

In order to widen and deepen the equalisation levy net beyond online advertisement, its scope had been extended by the Finance Act, 2020 to consideration received or receivable for e-commerce supply or services made or provided or facilitated on or after 1.4.2020.

However, the consideration received or receivable for specified services and for e-commerce supply or services would not include the consideration, which are taxable as royalty or fees for technical services in India under the Income-tax Act, read with the DTAA notified by the Central Government under section 90 or section 90A.

Equalisation Levy

- ***Specified Services@6%***
- ***E-Commerce Supply or Services @ 2%***

The key aspects related to Equalisation Levy have been discussed below.

(1) Meaning of "Equalisation Levy" [Section 164(d) of the Finance Act, 2016]:

Equalisation levy means the tax leviable on consideration received or receivable for any specified service or e-commerce supply or services.

(2) Charge of Equalisation Levy on *'Specified Services'* [Section 165 of Finance Act, 2016]:

(i) Equalisation levy @6% is leviable on the amount of consideration for specified service received or receivable by a person, being a non-resident from -

(a) a person resident in India and carrying on business or profession; or

(b) a non-resident having a PE in India.

(ii) Equalisation levy is not chargeable, where –

(a) the non-resident providing the specified service has a PE in India and the specified service is effectively connected with such PE;

(b) the aggregate amount of consideration for specified service received or receivable in a previous year by the non-resident from a person resident in India and carrying on business or profession, or from a non-resident having a PE in India, does not exceed ₹ 1 lakh; or

(c) where the payment for the specified service by the person resident in India, or the PE in India is not for the purposes of carrying out business or profession.

(3) Charge of Equalization levy on E-commerce supply or services [Section 165A of the Finance Act, 2016]

(i) Chargeability of Equalization levy on E-commerce supply or services: Equalization levy@2% would be chargeable on the amount of consideration received or receivable by an e-commerce operator from e-commerce supply or services made or provided or facilitated by it—

(1) to a person resident in India; or

(2) to a non-resident in the specified circumstances as provided below; or

IP address

(3) to a person who buys such goods or services or both using internet protocol address located in India.

An IP (Internet Protocol) address is a unique identifier assigned to devices connected to a network, such as the internet. IP addresses can be associated with specific geographical locations, including different countries.

(ii) Non-chargeability of equalization levy: The equalization levy shall not be charged—

(1) where the e-commerce operator making or providing or facilitating e-commerce supply or services **has a permanent establishment in India** and such e-commerce supply or services is effectively connected with such PE;

(2) where the equalization levy **is leviable under section 165**; or

(3) **sales, turnover or gross receipts**, as the case may be, of the e-commerce operator from the e-commerce supply or services made or provided or facilitated as referred in point (i) above **is less than ₹ 2 crore** during the previous year.

(iii) Meaning of "specified circumstances":

(1) sale of advertisement, which targets a customer, who is resident in India or a customer who accesses the advertisement through internet protocol address located in India; **and**

(2) sale of data, collected from a person who is resident in India or from a person who uses internet protocol address located in India.

(iv) "Consideration received or receivable from e-commerce supply or services" would include:

(1) consideration for sale of goods irrespective of whether the e-commerce operator owns the goods. However, it shall **not** include consideration for sale of such goods which are owned by a person resident in India or by a permanent establishment in India of a person non-resident in India, if sale of such goods is effectively connected with such permanent establishment;

(2) consideration for provision of services irrespective of whether service is provided or facilitated by the e-commerce operator. However, it shall **not** include consideration for provision of services which are provided by a person resident in India or by permanent establishment in India of a person non-resident in India, if provision of such services is effectively connected with such permanent establishment.

(4) Definition of "Specified Service", "E-Commerce Operator" and "E-Commerce Supply or Services" [Section 164 of the Finance Act, 2016]:

	Term	Meaning
(i)	Specified Services	(i) Online advertisement; (ii) Any provision for digital advertising space or any other facility or service for the purpose of online advertisement; (iii) Any other service as may be notified by the Central Government. **Note –** 'Online' means a facility or service or right or benefit or access that is obtained through the internet or any other form of digital or telecommunication network.
(ii)	E-Commerce Operator	A non-resident who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both
(iii)	E-Commerce Supply or Services	(i) online sale of goods owned by the e-commerce operator; or (ii) online provision of services provided by the e-commerce operator; or (iii) online sale of goods or provision of services or both, facilitated by the e-commerce operator; or (iv) any combination of activities listed in (i), (ii) or (iii) above. "Online sale of goods" and "online provision of services" would include one or more of the following online activities (a) acceptance of offer for sale; or (b) placing of purchase order; or (c) acceptance of the purchase order; or (d) payment of consideration; or (e) supply of goods or provision of services, partly or wholly.

(5) Provisions of Chapter on Equalisation Levy:

Section	Subject	Provisions
166	**Collection & Recovery of Equalisation Levy on Specified Services**	
	Person responsible for deduction of equalisation levy	Every person, being a resident and carrying on business or profession or a non-resident having a permanent establishment in India shall deduct equalisation levy referred to in section 165(1) from the amount paid or payable to a non-resident in respect of the specified service.
	Rate of equalisation levy	***6%*** of the amount of consideration for specified service paid or payable to a non-resident in respect of specified service by a person resident in India and carrying on business or profession or a non-resident having a PE in India. The amount of consideration, the amount of equalisation levy, interest and penalty payable and refund shall be **rounded off to the nearest multiple of ten rupees**. For this purpose, any part of a rupee consisting of paise shall be ignored and, thereafter, if such amount is not a multiple of ten, then, if the last figure in that amount is five or more, the amount shall be increased to the next higher amount which is a multiple of ten and if the last figure is less than five, the amount shall be reduced to the next lower amount which is a multiple of ten [Rule 3 of Equalisation Levy Rules, 2016].
	Threshold limit	Equalisation levy is deductible if the aggregate amount of consideration for specified service in a previous year exceeds **one lakh rupees**.
	Time period for remittance of equalisation levy	The equalisation levy so deducted during any calendar month shall be paid by every assessee to the credit of the Central Government **by the 7th of the month immediately following the said calendar month**. The assessee who is required to deduct and pay equalisation levy, shall pay the amount of such levy, by remitting it into the Reserve Bank of India or in any branch of the State Bank of India or of any authorised

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<tr><td></td><td></td><td>Bank accompanied by an equalisation levy challan. [Rule 4 of Equalisation Levy Rules, 2016]</td></tr>
<tr><td></td><td>Consequence of failure to deduct equalisation levy</td><td>Any assessee who fails to deduct equalisation levy shall, notwithstanding such failure, be liable to pay the levy to the credit of the Central Government by the 7th of the month immediately following the said calendar month.

Thus, if the assessee responsible for deducting equalisation levy, fails to so deduct, he has, in any case, to pay such levy to the credit of the Central Government by the 7th of the month immediately following the said calendar month.</td></tr>
<tr><td>166A</td><td>Collection and recovery of equalisation levy on e-commerce supply or services</td><td></td></tr>
<tr><td></td><td></td><td>The equalisation levy referred to in section 165A(1), has to be paid by every e-commerce operator to the credit of the Central Government for the quarter of the financial year ending with the date specified in column (2) of the Table below by the due date specified in the corresponding entry in column (3) of the said Table:
<table><tr><th>S. No.</th><th>Date of ending of the quarter of the F.Y.</th><th>Due date of the F.Y.</th></tr><tr><td>(1)</td><td>30th June</td><td>7th July</td></tr><tr><td>(2)</td><td>30th September</td><td>7th October</td></tr><tr><td>(3)</td><td>31st December</td><td>7th January</td></tr><tr><td>(4)</td><td>31st March</td><td>31st March</td></tr></table>
The amount of consideration, the amount of equalisation levy, interest and penalty payable and refund shall be rounded off to the nearest multiple of ten rupees. For this purpose, any part of a rupee consisting of paise shall be ignored and, thereafter, if such amount is not a multiple of ten, then, if the last figure in that amount is five or more, the amount shall be increased to the next higher amount which is a multiple of ten and if the last figure is less than five, the amount shall be reduced to the next lower amount which is a multiple of ten [Rule 3 of Equalisation Levy Rules, 2016 as amended by the Equalisation Levy (Amendment) Rules, 2020].</td></tr>
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<tr><td></td><td></td><td>The e-commerce operator who is required to pay equalisation levy, shall pay the amount of such levy, by remitting it into the Reserve Bank of India or in any branch of the State Bank of India or of any authorised Bank accompanied by an equalisation levy challan [Rule 4 of Equalisation Levy Rules, 2016, as amended by the Equalisation Levy (Amendment) Rules, 2020].</td></tr>
<tr><td></td><td colspan="2"><u>Points of difference between Section 166 and 166A</u>
• As per section 166 – <u>Equalisation Levy on Specified Services -</u> The person responsible for collecting the levy is the service recipient availing the specified service(s), who has to deduct Equalisation Levy from the amount paid or payable to a non-resident in respect of such service(s). The service recipient responsible for deduction and remittance, is a resident carrying on business or profession or a non-resident having PE in India
• As per section 166A – <u>Equalisation Levy on e-commerce supply or services</u> - The person responsible for paying the levy is the recipient of the amount i.e., an e-commerce operator effecting e-commerce supply or services. There is no deduction obligation on the part of the service recipient/ buyer, in this case. Therefore, in this case, the responsibility for payment of equalisation levy is vested on the non-resident e-commerce operator who does not have a PE in India or even in case the non-resident e-commerce operator has a PE in India but such transaction is not effectively connected with such PE in India.</td></tr>
<tr><td>167</td><td>Furnishing of statement</td><td></td></tr>
<tr><td></td><td>Statement in prescribed form within time</td><td>Every assessee or e-commerce operator shall, within the prescribed time after the end of each financial year, prepare and deliver or cause to be delivered to the Assessing Officer or to any other authority or agency authorised by the Board in this behalf, a statement in the prescribed form, verified in the prescribed manner and setting forth the prescribed particulars in respect of all specified services or e-commerce supply or services, as the case may be, during such financial year.
The statement in respect of all specified services/ e-commerce supply or services, as the case may be, chargeable to equalisation levy during any financial year is required to be furnished electronically under digital signature or electronically through electronic verification code in Form No. 1, duly verified, on or before 30th June immediately following that financial year [Rule 5 of Equalisation Levy Rules, 2016 as amended by the Equalisation Levy (Amendment) Rules, 2020]</td></tr>
</table>

	Time limit for filing a revised statement	An assessee or e-commerce operator who has not furnished the statement on or before 30th June immediately following the financial year or having furnished a statement within that time, notices any omission or wrong particulars therein, may furnish a statement or a revised statement, as the case may be. Such statement or revised statement has to be filed at any time **before the expiry of two years from the end of the financial year** in which the specified service was provided, or e-commerce supply or services was made or provided or facilitated.
	Time limit for filing a statement in response to notice issued by the Assessing Officer	Where any assessee or e-commerce operator fails to furnish the statement within the prescribed time, the Assessing Officer may serve a notice upon such assessee or e-commerce operator requiring him to furnish the statement in the prescribed form, verified in the prescribed manner and setting forth the prescribed particulars, within such time, as may be prescribed. The Assessing Officer has been empowered to issue notice for furnishing such statement, which then has to be furnished, within 30 days from date of serving of such notice [Rule 6 of Equalisation Levy Rules, 2016]
168	**Processing of statement**	
	Manner of processing of statement	Where a statement has been made under section 167 by the assessee or e-commerce operator, such statement shall be processed in the following manner, namely:— (a) the equalisation levy shall be computed after making the adjustment for **any arithmetical error in the statement**; (b) the **interest**, if any shall be computed on the basis of **sum deductible or payable, as the case may be**, as computed in the statement; (c) the sum payable by, or the amount of refund due to, the assessee or e-commerce operator, shall be determined after adjustment of interest computed against the equalisation levy paid under section 166(2) or section 166A or interest paid section 170 and any amount paid otherwise by way of tax or interest; (d) an intimation shall be prepared or generated and sent to the assessee or e-commerce operator,

		specifying the sum determined to be payable by, or the amount of refund due to him; and (e) the amount of refund due to the assessee or e-commerce operator in pursuance of such determination shall be granted to him. However, no such intimation shall be sent after the expiry of **one year from the end of the financial year** in which the **statement or revised statement** is furnished.
	Prescribed form for service of notice of demand on the assessee /e-commerce operator	Where any levy, interest or penalty is payable under the equalisation levy provisions, a notice of demand in Form No. 2 specifying the sum so payable shall be served upon the assessee or e-commerce operator, as the case may be. Further, intimation issued upon processing of the **statement or revised statement** shall also be deemed to be a notice of demand [Rule 7 of Equalisation Levy Rules, 2016]
	Scheme for centralised processing of statements	For the purposes of processing of statements, the CBDT may make a scheme for centralised processing of such statements to expeditiously determine the tax payable by, or the refund due to, the assessee or e-commerce operator as required thereunder.
169	**Rectification of mistake**	
	Time limit for amending an intimation	With a view to rectifying any mistake apparent from the record, the Assessing Officer may amend any intimation issued under section 168. Such intimation can be amended within **one year from the end of the financial year** in which the intimation sought to be amended was issued.
	Amendment can be made *suo motu* or brought to notice by the assessee/e-commerce operator	The Assessing Officer may make an amendment to any intimation, either *suo motu* or on any mistake brought to his notice by the assessee or e-commerce operator.
	Opportunity of being heard to be given by the Assessing Officer before amending an intimation	An amendment to any intimation, which has the effect of increasing the liability of the assessee or e-commerce operator or reducing a refund, shall not be made unless the Assessing Officer has given notice to the assessee or e-commerce operator of his intention so to do and has given the assessee or e-commerce operator a reasonable opportunity of being heard.

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<tr><td></td><td></td><td>Where any such amendment to any intimation has the effect of enhancing the sum payable or reducing the refund already made, the Assessing Officer shall make an order specifying the sum payable by the assessee or e-commerce operator and the provisions of this Chapter shall apply accordingly.</td></tr>
<tr><td>170</td><td>Interest on delayed payment of equalisation levy</td><td>An assessee or e-commerce operator who fails to credit the equalisation levy or any part thereof within the period specified u/s 166 or 166A, to the account of the Central Government, has to pay simple interest at the rate of 1% of such levy for every month or part of a month by which such crediting of the tax or any part thereof is delayed.</td></tr>
<tr><td>171</td><td>Penalty for failure to deduct or pay equalisation levy.</td><td>
<table>
<tr><th>Nature of default</th><th>Penalty</th></tr>
<tr><td>Failure to deduct whole or part of equalisation levy u/s 166</td><td>In addition to payment of equalisation levy u/s 166(3) and interest u/s 170, penalty equal to the amount of equalisation levy that he failed to deduct would be leviable</td></tr>
<tr><td>Failure to pay whole or part of Equalisation levy as required u/s 166A</td><td>In addition to equalisation levy u/s 166A and interest u/s 170, penalty equal to the amount of equalisation levy that he failed to pay is leviable.</td></tr>
<tr><td>Failure to remit equalisation levy to the Central Government on or before 7th of the following month, after deduction of the same u/s 165(1)</td><td>In addition to paying the equalisation levy on specified services u/s 166(2) and interest u/s 170, a penalty of ₹ 1,000 for every day during which the failure continues is leviable.
However, such penalty shall not exceed the amount of equalisation levy that he failed to pay.</td></tr>
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</td></tr>
<tr><td>172</td><td>Penalty for failure to furnish statement</td><td>For failure to furnish the statement within 30th June of the immediately following year or within 30 days from the date of service of notice by the Assessing Officer, penalty of ₹ 100 for each day during which the failure continues is leviable.</td></tr>
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173	**Circumstances when penalty cannot be imposed under section 171 and 172**	No penalty for failure to deduct or pay equalisation levy or failure to furnish statement shall be imposable, if the assessee or e-commerce operator proves to the satisfaction of the Assessing Officer that there was reasonable cause for the said failure. Further, no order imposing a penalty under this Chapter shall be made unless the assessee or e-commerce operator has been given a reasonable opportunity of being heard.
174	**Appeal to Commissioner of Income-tax (Appeals).**	
	Time limit for filing of appeal against an order imposing penalty	An assessee or e-commerce operator aggrieved by an order imposing penalty under this Chapter, may appeal to the Commissioner of Income-tax (Appeals) within a period of **30 days from the date of receipt of the order** of the Assessing Officer
	Fee for filing appeal	An appeal shall be in the prescribed form [Form 3] and verified in the prescribed manner. It shall be accompanied by a **fee of ₹ 1,000**. It may be filed electronically under digital signature or electronically through EVC. Any document accompanying Form No.3 has to be furnished in the manner in which Form No.3 is furnished [Rule 8 of Equalisation Levy Rules, 2016]
	Provisions of the Income-tax Act, 1961 applicable in case of such appeals	Where an appeal has been filed, the provisions of sections 249 to 251 of the Income-tax Act, 1961 would, as far as may be, apply to such appeal. Section 250 specifies the procedure in appeal and section 251 enlists the powers of the Commissioner (Appeals).
175	**Appeal to Appellate Tribunal**	
	Assessee/ e-commerce operator/ CIT may file appeal to Appellate Tribunal against an order passed by Commissioner (Appeals) u/s 174	An assessee or e-commerce operator aggrieved by an order made by the Commissioner of Income-tax (Appeals) under section 174 may appeal to the Appellate Tribunal against such order. The Commissioner of Income-tax may, if he objects to any order passed by the Commissioner of Income-tax (Appeals) under section 174, direct the Assessing Officer to appeal to the Appellate Tribunal against such order.
	Time limit for filing appeal	An appeal shall be filed within **60 days** from the date on which the order sought to be appealed against is received

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<tr><td></td><td></td><td>by the assessee or e-commerce operator or by the Commissioner of Income-tax, as the case may be.</td></tr>
<tr><td></td><td>Fee for filing appeal</td><td>The appeal shall be in the prescribed form [Form No.4] and verified in the prescribed manner.
In the case of an appeal filed by an assessee or e-commerce operator, it shall be accompanied by a fee of ₹1,000. Also, the form of appeal, the grounds of appeal and the form of verification appended thereto shall be signed by the person specified in Form No.4, as applicable to the assessee or e-commerce operator, as the case may be [Rule 9 of Equalisation Levy Rules, 2016]</td></tr>
<tr><td></td><td>Provisions of the Income-tax Act, 1961 applicable in case of such appeals</td><td>Where an appeal has been filed before the Appellate Tribunal under sub-section (1) or sub-section (2), the provisions of sections 253 to 255 of the Income-tax Act, 1961 would, as far as may be, apply to such appeal.</td></tr>
<tr><td>176</td><td>Punishment for false statement</td><td>If a person -
(a) makes a false statement in any verification under this Chapter or any rule made thereunder; or
(b) delivers an account or statement, which is false, and which he either knows or believes to be false, or does not believe to be true,
he shall be punishable with imprisonment for a term which may extend to three years and with fine.</td></tr>
<tr><td></td><td></td><td>An offence so punishable shall be deemed to be non-cognizable within the meaning of the Code of Criminal Procedure. This is irrespective of anything contained in the Code of Criminal Procedure, 1973.</td></tr>
<tr><td>177.</td><td>Institution of prosecution</td><td>Prior sanction of the Chief Commissioner of Income-tax is required for instituting prosecution against any person for any offence under section 176.</td></tr>
<tr><td>178.</td><td>Application of certain provisions of Income-tax Act, 1961</td><td>The following provisions of the Income-tax Act, 1961 shall so far as may be, apply in relation to equalisation levy, as they apply in relation to income-tax.
<table>
<tr><th>Section</th><th>Content</th></tr>
<tr><td>119</td><td>Instruction to subordinate authorities</td></tr>
<tr><td>120</td><td>Jurisdiction of income-tax authorities</td></tr>
<tr><td>131</td><td>Power regarding discovery, production of evidence, etc.</td></tr>
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		133A	Power of survey
		138	Disclosure of information respecting assesses
		156	Notice of demand
		Chapter XV	Liability in special cases
		220-227	- When tax payable and when assessee deemed in default, - Penalty payable when tax in default, - Certificate to Tax Recovery Officer, - Tax Recovery Officer by whom recovery is to be effected, - Validity of certificate and cancellation or amendment thereof, - Stay of proceedings in pursuance of certificate and amendment or cancellation thereof, - Other modes of recovery, - Recovery through State Government.
		229	Recovery of penalties, fine, interest and other sums
		232	Recovery by suit or under other law not affected.
		260A	Appeal to High Court
		261	Appeal to Supreme Court
		262	Hearing before Supreme Court
		265 to 269	- Tax to be paid notwithstanding reference etc., - Execution for costs awarded by Supreme Court, - Amendment of assessment on appeal - Exclusion of time taken for copy, - Filing of appeal or application for reference by income-tax authority, - Definition of "High Court"

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<tr><td>278B</td><td>Offences by companies</td></tr>
<tr><td>280A</td><td>Special Courts</td></tr>
<tr><td>280B</td><td>Offences triable by Special Court</td></tr>
<tr><td>280C</td><td>Trial of offences as summons case</td></tr>
<tr><td>280D</td><td>Application of Code of Criminal Procedure, 1973 to proceedings before Special Court</td></tr>
<tr><td>282</td><td>Service of notice generally</td></tr>
<tr><td>288 to 293</td><td>- Appearance by authroised representative,
- Rounding off of income,
- Rounding off of amount payable and refund due,
- Receipt to be given,
- Indemnity,
- Power to tender immunity from prosecution,
- Cognizance of offences,
- Section 360 of the Code of Criminal Procedure, 1973 and the Probation of Offenders Act, 1958, not to apply,
- Return of income, etc., not to be invalid on certain grounds,
- Notice deemed to be valid in certain circumstances,
- Presumption as to assets, books of account etc.,
- Authorisation and assessment in case of search or requisition,
- Bar of suits in civil courts</td></tr>
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<td>179</td>
<td>Power to make rules</td>
<td>The Central Government is empowered to make rules for the purposes of carrying out the provisions of this Chapter.</td>
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<td>In particular, such rules may also provide for all or any of the following matters, namely:—
(a) the time within which and the form and the manner in which the statement shall be delivered or caused to be delivered or furnished under section 167;</td>
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		(b) the form in which an appeal may be filed and the manner in which it may be verified under sections 174 and 175; (c) any other matter which is to be, or may be, prescribed.
		Every rule made under this Chapter shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of **30 days**. This period of 30 days may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree: (i) in making any modification in the rule, then, the rule shall thereafter have effect only in such modified form; (ii) that the rule should not be made, then, the rule would be of no effect. However, any such modification or annulment would be without prejudice to the validity of anything previously done under that rule.
180	**Power to remove difficulties**	The Central Government is empowered to remove any difficulty which arises in giving effect to the provisions of this Chapter. It may, by order published in the Official Gazette, not inconsistent with the provisions of this Chapter, remove the difficulty. However, no such order shall be made after **31.3.2022**. Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

(6) Relevant provisions in the Income-tax Act, 1961:

	Section	Provision
(i)	9(1)(i)	As per section 9(1)(i), all income accruing or arising, whether directly or indirectly, through or from any business connection in India is deemed to accrue or arise in India. *Explanation 2A* provides that "significant economic presence of a non-resident in India" would also constitute "business connection" in India. **Significant economic presence** means

	Nature of transaction	Condition
(a)	in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India	Aggregate of payments arising from such transaction or transactions during the previous year should exceed ₹ 2 crores.
(b)	systematic and continuous soliciting of business activities or engaging in interaction with users in India	The number of users should be atleast 3 lakhs.

Further, the above transactions or activities shall constitute significant economic presence in India, whether or not,—

(i) the agreement for such transactions or activities is entered in India;

(ii) the non-resident has a residence or place of business in India; or

(iii) the non-resident renders services in India:

However, where a business connection is established by reason of significant economic presence in India, only so much of income as is attributable to the transactions or activities referred to in (a) or (b) above shall be deemed to accrue or arise in India.

Clause (a) of *Explanation 1* to section 9(1)(i) provides that in case of a business, other than the business having business connection in India on account of significant economic presence, of which all the operations are not carried out in India, the income deemed to accrue or arise in India would only be such part of the income as is reasonably attributable to the operations carried out in India.

Explanation 3A provides that income attributable to the operations carried out in India would include income from –

(i) such advertisement which targets a customer who resides in India or who accesses the advertisement through internet protocol address (IPA) located in India;

(ii) sale of data collected from a person who resides in India or from a person who uses IPA located in India; and

(iii) sale of goods or services using data collected from a person who resides in India or from a person who uses IPA located in India.

Accordingly, such income would be deemed to accrue or arise in India in the hands of a non-resident and be subject to income-tax in his hands.

		The above provisions contained in this Explanation shall also apply to the income attributable to the transactions or activities referred to in Explanation 2A which constitute "Significant economic presence". **Note:** The above provision broadens the scope of 'income attributable to the operations carried out in India" and brings within the tax net, the above specified incomes. This impact will also enable taxation of "non-resident to non-resident" transactions pertaining to above mentioned activities.Section 295 empowers CBDT to make rules for carrying out the purposes of the Act. Also, section 295(2) enlists the specific matters in respect of which the CBDT may make rules. Through amendment made in section 295(2)(b), it is expected that the CBDT will issue rules to determine the profits taxable in India by virtue of *Explanation 3A*. Section 9(1)(i) requires existence of business connection for deeming business income to accrue or arise in India. DTAAs, however, provide that business income is taxable only if there is a permanent establishment in India. As per section 90(2), the provisions of the Income-tax Act, 1961 or the DTAA, whichever is beneficial, shall apply. The PE concept is narrower than the business connection concept. Therefore, in a case where the Indian Government has entered into DTAA with a country, unless and until the PE test is satisfied, significant economic presence provisions would not be applicable. However, in cases not covered by DTAAs, business income attributable to business connection (significant economic presence) is taxable.
(ii)	**10(50)**	In order to avoid double taxation on account of Equalisation Levy and income-tax liability under the provisions of the Income-tax Act, 1961, section 10(50) exempts any income arising from providing any specified service on or after the date on which the provisions of Chapter VIII of the Finance Act, 2016 comes into force, or arising from any e-commerce supply or services made or provided or facilitated **on or after 1.4.2020** and chargeable to equalisation levy under that Chapter. However, the income arising from providing specified services and the income arising from any e-commerce supply or services would not include any income which is taxable as royalty or fees for technical services in India under the Income-tax Act, read with the DTAA notified by the Central Government under section 90 or section 90A. Exemption under section 10(50) is available in respect of amounts which have been subjected to Equalisation Levy. However, in case of transactions in respect of which equalisation levy is not attracted, the provisions of the Income-tax Act, 1961, as applicable, will apply.
(iii)	**40(a)(ib)**	In order to ensure compliance with the provisions this Chapter, section 40(a)(ib) provides that if any consideration is paid or payable to a non-resident for a specified service on which equalisation levy is deductible,

		and such levy has not been deducted or after deduction, has not been paid on or before the due date under section 139(1), then, such expenses incurred by the assessee towards consideration for specified service shall not be allowed as deduction. However, where in respect of such consideration, if the equalisation levy has been deducted in any subsequent year or has been deducted during the previous year but paid after the due date specified under section 139(1), such sum shall be allowed as deduction in computing the income of the previous year in which such levy has been paid. **Note:** The disallowance would be attracted only in the case of equalization levy **on specified services**, where the onus is on the service recipient to deduct the equalization levy.
(iv)	**194-O**	Section 194-O provides that where sale of goods or provision of services of an e-commerce participant is facilitated by an e-commerce operator through its digital or electronic facility or platform, such e-commerce operator is liable to deduct tax at source **@1%** of the gross amount of such sales or services or both, at the time of credit of amount of such sale or services or both to the account an e-commerce participant or at the time of payment thereof to such e-commerce participant by any mode, whichever is earlier. However, no tax is required to be deducted under section 194-O in case of any sum credited or paid to an e-commerce participant, being an individual or HUF, where the gross amount of such sale or services or both during the previous year does not exceed ₹ 5 lakh and such e-commerce participant has furnished his PAN/ Aadhaar number to e-commerce operator. [Discussed in detail in Chapter 13: Deduction, Collection and Recovery of tax of Module 3 of the Study Material].

Summary of provisions relating to Equalisation Levy and TDS on E-commerce Transactions

	Section 165 of the Finance Act, 2016	Section 165A of the Finance Act, 2016	Section 194-O of the Income-tax Act, 1961
Nature of levy/ deduction	Equalisation Levy	Equalisation Levy	TDS under the Income-tax Act, 1961
Chargeability of EL/ Deductibility of income-tax	On consideration received or receivable by an **assessee, being a non-resident**	On consideration received or receivable by an **E-commerce Operator**, being a non-resident owning, operating or managing	Where **sale of goods or provision of services of an e-commerce participant** (being

	(NR), for specified services	digital or electronic facility or platform for online sale of goods or online provision of services or both, **for e-commerce supply or services made or provided or facilitated.** **Consideration received or receivable from e-commerce supply or services" would include -** (1) consideration for sale of goods irrespective of whether the e-commerce operator owns the goods. However, it shall not include consideration for sale of such goods which are owned by a person resident in India or by a PE in India of a person non-resident in India, if sale of such goods is effectively connected with such PE; (2) consideration for provision of services irrespective of whether service is provided or facilitated by the e-commerce operator. However, it shall not include consideration for provision of services provided by a person resident in India or by PE in India of a person non-resident	a person **resident in India** selling goods or providing services or both, including digital products) **is facilitated by an e-commerce operator through its digital or electronic facility or platform**, such e-commerce operator is liable to deduct tax at source at the time of credit or payment, whichever is earlier.

		in India, if provision of such services is effectively connected with such PE.	
	***Note -** The consideration received or receivable for specified services and for e-commerce supply or services would, however, not include the consideration, which are taxable as royalty or fees for technical services in India under the Income-tax Act, read with the DTAA notified by the Central Government under section 90 or section 90A.*		
Rate	**6%**	**2%**	**1%**
Person responsible for paying/ deducting	Every person, being a resident and carrying on business or profession or a non-resident having a PE in India	An e-commerce operator, being a non-resident who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both	An e-commerce operator shall be deemed to be the person responsible for paying to the resident e-commerce participant. Further, wherever the purchaser of goods or service recipient (e.g., end customer) directly makes any payment to the e-commerce participant, then, in such cases, such payments shall be deemed to have been made by the e-commerce operator to the resident e-commerce participant and accordingly, deduction has to be made by the e-commerce operator.

Consideration on which EL is chargeable / income-tax is deductible	The amount of consideration for specified service received or receivable by a person, being a NR from - (a) a person resident in India and carrying on business or profession; or (b) a NR having a PE in India.	The amount of consideration received or receivable by an e-commerce operator from e-commerce supply or services made or provided or facilitated by it— (1) to a person resident in India; or (2) to a NR in the specified circum-stances, namely – (i) sale of advertise-ment (advt), which targets a customer, who is resident in India or a customer who accesses the advt through internet protocol address (IPA) located in India; **and** (ii) sale of data, collected from a person who is resident in India or from a person who uses IPA located in India; or (3) to a person who buys such goods or services or both using IPA located in India.	Gross amount of sale or services or both.

Meaning of certain terms	"**Specified Services**" means- (i) Online advt; (ii) Any provision for digital advertising space or any other facility or service for the purpose of online advt; (iii) Any other service as may be notified by the Central Government. **Note** – 'Online' means a facility or service or right or benefit or access that is obtained through the internet or any other form of digital or tele-communication network.	"**E-Commerce Supply or Services**" mean – (i) online sale of goods owned by the e-commerce operator; or (ii) online provision of services provided by the e-commerce operator; or (iii) online sale of goods or provision of services or both, facilitated by the e-commerce operator; or (iv) any combination of activities listed in clause (i), (ii) or clause (iii). **Note** - "Online sale of goods" and "online provision of services" would include one or more of the following online activities (a) acceptance of offer for sale; or (b) placing of purchase order; or (c) acceptance of the purchase order; or (d) payment of consideration; or (e) supply of goods or provision of services, partly or wholly.	"**Services**" include fees for technical and fees for professional services as defined u/s 194J of the Income-tax Act, 1961.
Non-chargeability of EL / Non-	EL is **not** chargeable, where – a. the **NR** providing the specified	EL is **not** chargeable where – (a) where the **e-commerce**	No tax is required to be deducted u/s 194-O in case of any sum credited or

deduction of tax at source	service **has a PE in India** and the specified service is effectively connected with such PE; b. the aggregate amount of consideration for specified service received or receivable in a PY by the NR from a person resident in India and carrying on business or profession, or from a NR having a PE in India, **does not exceed ₹ 1 lakh;** or (c) where the payment for the specified service by the person resident in India, or the PE in India is <u>**not**</u> **for the purposes of carrying out business or profession**.	**operator** making or providing or facilitating e-commerce supply or services **has a PE in India** and such e-commerce supply or services is effectively connected with such PE; (b) where the **EL is leviable u/s 165**; or (c) **sales, turnover or gross receipts**, as the case may be, of the e-commerce operator from the e-commerce supply or services made or provided or facilitated **is less than ₹ 2 crore during the PY**.	paid **to an e-commerce participant, being an individual or HUF**, where the **gross amount of such sale or services or both during the previous year does not exceed ₹ 5 lakh** and such e-commerce participant has furnished his **PAN/ Aadhaar number to e-commerce operator**.

Equalisation Levy (EL) on Specified Services

6% of amount of consideration received or receivable

For Specified Services

Meaning of Specified Services:

(i) **Online advertisement**

(ii) Prov. for **digital advertisement space** or any other facility or service for online **advertisement**

(iii) Any other service notified by the Government

By a NR not having PE in India or providing services not effectively connected with his PE in India

From a resident in India carrying on business or profession **(or)** **From** a NR having PE in India

Does the **aggregate amount of such consideration** received or receivable for specified services by a NR **exceed ₹ 1 lakh** in the relevant PY?

Yes → EL is attracted

No → EL is not attracted

Deduction of EL

EL@6% is deductible from consideration paid or payable for specified services by a –

- resident carrying on business or profession; or
- NR having PE in India

Remittance of EL

EL deducted during any month to be paid to the credit of the Central Government by the **7th of the next month**

Consequences of failure to deduct EL

The person liable to deduct EL has to, in any case, pay the EL to the credit of the Central Government by the 7th of the next month.

\+

Simple interest@**1% p.m.** or part of a month is attracted for the period of delay in remittance.

\+

Penalty = the amount of EL deductible.

For delayed remittance, penalty@ **₹ 1,000 per day** of failure attracted, not exceeding the amount of EL not paid.

\+

Disallowance of entire consideration attracted u/s 40(a)(ib)

Equalisation Levy (EL) on e-commerce supply or services

2% of amount of consideration received or receivable

By an E-Commerce Operator i.e., a non-resident who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both

From E-Commerce Supply or Services made or provided or facilitated by it

Meaning of E-Commerce Supply or Services:

(i) **Online sale of goods** owned by the e-commerce operator

(ii) **Online provision of services** provided by the E-Commerce Operator

(iii) **Online sale of goods or provision of services or both facilitated** by the E-Commerce Operator

(iv) Any combination of activities listed in (i), (ii) or (iii) above

To a NR in the foll specified circumstances:

(i) **sale of advt.** targeting a customer resident in India or who accesses the advt. thro IPA located in India; and

(ii) **sale of data** collected from a person resident in India or who uses IPA located in India.

(or)

To a person resident in India

(or)

To a person who buys such goods or services or both using IPA located in India

Does the E-commerce operator have a PE in India?

Yes

Is the E-Commerce supply or services effectively connected with such PE?

Yes → EL is **not** attracted

No

No

EL is attracted if sales, turnover or gross receipts of the E-Commerce Operator from the e-commerce supply or services made/provided/facilitated **is Rs.2 crore or more** during the PY

Payment of EL : EL to be paid by every e-commerce operator to the credit of Central Govt for the quarter of F.Y. ending 30th June, 30th Sep, 31st Dec and 31st March by 7th July, 7th Oct, 7th Jan and 31st March, respectively.

Consequences of failure to pay EL

Equalisation Levy u/s 166A

(+)

Simple interest@1% p.m. or part of a month is attracted for the period of delay in remittance u/s 170

(+)

Penalty = the amount of EL that he has failed to pay

12.7 TAXATION OF VIRTUAL DIGITAL ASSETS

There has been a phenomenal increase in transactions in virtual digital assets. Further, a market is emerging where payment for the transfer of a virtual digital asset can be made through another such asset. Accordingly, for the taxation of virtual digital assets, a scheme has been introduced by the Finance Act, 2022.

Meaning of virtual digital asset [Section 2(47A)]

It means -

(a) any information or code or number or token (not being Indian currency or foreign currency),

- generated through cryptographic means or otherwise, by whatever name called,
- providing a digital representation of value exchanged with or without consideration,
- with the promise or representation of having inherent value, or
- functions as a store of value or a unit of account including its use in any financial transaction or investment, but not limited to investment scheme; and
- can be transferred, stored or traded electronically;

(b) a non-fungible token or any other token of similar nature, by whatever name called;

The non-fungible token means such digital asset as may be notified by the Central Government.

Accordingly, the Central Government has, vide notification no. 75/2022 dated 30.6.2022, specified a token which qualifies to be a virtual digital asset as non-fungible token. However, it shall not include a non-fungible token whose transfer results in transfer of ownership of underlying tangible asset and the transfer of ownership of such underlying tangible asset is legally enforceable.

(c) any other digital asset, as may be notified by the Central Government.

However, the Central Government may, by notification, exclude any digital asset from the definition of virtual digital asset subject to specified conditions.

Accordingly, the Central Government has, vide notification no. 74/2022 dated 30.6.2022, notified that the following virtual digital assets would be excluded from the definition of virtual digital asset–

(i) Gift card or vouchers, being a record that may be used to obtain goods or services or a discount on goods or services;

(ii) Mileage points, reward points or loyalty card, being a record given without direct monetary consideration under an award, reward, benefit, loyalty, incentive, rebate or promotional program that may be used or redeemed only to obtain goods or services or a discount on goods or services;

(iii) Subscription to websites or platforms or application

Taxability of income from transfer of virtual digital assets [Section 115BBH]

(1) **Tax rate on transfer of virtual digital asset –** Where the total income of an assessee includes any income from the transfer of any virtual digital asset, such income would be taxed @30% under section 115BBH.

(2) **No deduction allowed –** In computing the income from transfer of virtual digital asset, no deduction would be allowed under any provisions of the Act in respect of any expenditure or allowance except cost of acquisition, if any. Further, no set off of any loss is allowed to the assessee from such income.

(3) **Set off or carry forward of loss from transfer of virtual digital asset not allowed –** Loss from transfer of virtual digital asset would **not** be allowed to be set off against income computed under any provision of this Act to the assessee and such loss would not be allowed to be carried forward to succeeding assessment years.

(4) **Virtual digital asset need not to be a capital asset -** The definition of "transfer" under section 2(47) would apply to any virtual digital asset, whether it is a capital asset or not.

Taxability of receipt of virtual digital asset as gift or for inadequate consideration [Section 56(2)(x)]

In order to tax gift of virtual digital asset in the hands of the recipient, section 56 has been amended to include virtual digital asset within the definition of "property".

Accordingly, if virtual digital asset is received by any person from any person

(i) **Without consideration:** The aggregate fair market value of such virtual digital asset on the date of receipt would be taxed as the income of the recipient, if it exceeds ₹ 50,000.

(ii) **For inadequate consideration:** If the difference between the aggregate fair market value and such consideration exceeds ₹ 50,000, such difference would be taxed as the income of the recipient.

However, the exclusions from the applicability of section 56(2)(x) will apply to gift virtual digital asset also. For example, if virtual digital asset is received as a gift by an individual from his relative, the value of the same would not be treated as income.

TDS on payment on transfer of virtual digital asset [Section 194S]

(1) **Applicability and rate of TDS –** Section 194S requires any person who is responsible for paying to any resident any sum by way of consideration for transfer of a virtual digital asset to deduct tax @1% of such sum.

(2) **Time of deduction –** The deduction is to be made at the time of credit of consideration to the account of the resident or at the time of payment of such sum by any mode, whichever is earlier.

Where consideration is credited to any account in the books of account of the person liable to pay such sum, such credit of the sum is deemed to be the credit of such sum to the account of the payee and tax has to be deducted at source. The account to which such sum is credited may be called "Suspense Account" or by any other name.

(3) **Cases where the consideration for transfer of virtual digital asset is wholly in kind or partly in kind and partly in cash** – In a case where the consideration for transfer of virtual digital asset is

- wholly in kind or in exchange of another virtual digital asset, where there is no part in cash; or
- partly in cash and partly in kind but the part in cash is not sufficient to meet the liability of deduction of tax in respect of whole of such transfer,

the person responsible for paying such consideration has to, before releasing the consideration, ensure that tax required to be deducted has been paid in respect of such consideration for the transfer of virtual digital asset.

(4) **Non applicability of TDS under section 194S –** No tax is required to be deducted under section 194S, where the consideration is payable by the person referred to in column (2) of the table below and aggregate value of such consideration during the financial year does not exceed the threshold limit in the corresponding row of column (3) of the table below:

(1)	Consideration is payable by (2)	Threshold limit (3)
(i)	Specified person, being an individual or a Hindu undivided family	≤ ₹ 50,000

	- whose total sales, gross receipts or turnover from his business or profession does not exceed ₹ 1 crore in case of business or ₹ 50 lakhs in case of profession, during the financial year immediately preceding the financial year in which such virtual digital asset is transferred; or - not having any income under the head "Profits and gains of business or profession".	
(ii)	Other than specified person mentioned in (i) above	≤ ₹ 10,000

(5) Due date of remittance to Government Account [Rule 30] and Furnishing statement and certificate of TDS u/s 194S [Rules 31A and 31]

<table>
<tr><th rowspan="2">Sl. No.</th><th>(1)</th><th>(2)</th><th>(3)</th><th>(4)</th></tr>
<tr><th>Particulars</th><th>Specified Person</th><th>Exchange</th><th>Any other person</th></tr>
<tr><td>(i)</td><td>Rule 30 – Time of payment to Government Account</td><td>30 days from the end of the month of deduction</td><td colspan="2">In case of tax deducted in March, on or before 30th April.
In any other case, on or before 7 days from the end of the month of deduction.</td></tr>
<tr><td rowspan="3">(ii)</td><td>Rule 31A – Furnishing of Statement of TDS u/s 200(3)</td><td></td><td colspan="2"></td></tr>
<tr><td>Form</td><td>Form 26QE</td><td>Form 26QF</td><td>Form 26Q</td></tr>
<tr><td>Time</td><td>Within 30 days from the end of the month of deduction</td><td colspan="2">Common for Exchange and any other person
<table><tr><th>Qtr ending</th><th>Due date</th></tr><tr><td>30th June</td><td>31st July</td></tr><tr><td>30th Sep</td><td>31st Oct</td></tr><tr><td>31st Dec</td><td>31st Jan</td></tr><tr><td>31st March</td><td>31st May</td></tr></table></td></tr>
<tr><td>(iii)</td><td>Rule 31 – TDS Certificate</td><td>Form 16E to be furnished within 15 days from the due date of furnishing TDS statement in Form 26QE.</td><td colspan="2">Form 16A to be furnished within 15 days from the due date of furnishing TDS statement in Form 26QF/Form 26Q.</td></tr>
</table>

ILLUSTRATION 1

Compute the income-tax payable by Mr. Abhinav, aged 32 years, who has the following income for the A.Y.2024-25:

(i)	*Interest on fixed deposits with SBI (Gross)*	*₹ 1,10,000*
(ii)	*Interest on savings bank account with SBI*	*₹ 15,000*
(iii)	*Consideration received for transfer of VDA*	*₹ 62,000*
(iv)	*Cost of acquisition*	*₹ 21,000*
(v)	*Expenses on transfer of VDA*	*₹ 1,000*

SOLUTION

Total income (excluding Income from transfer of VDA) is below the basic exemption limit of ₹ 2,50,000. Therefore, tax on income, other than income from VDA, is Nil. Income of ₹ 41,000 (₹ 62,000 – ₹ 21,000) from transfer of VDA would be taxable@30% (plus cess of 4%), even if the total income including income from transfer of VDA is less than the basic exemption limit. The tax on income from transfer of VDA would be ₹ 12,792, being 31.2% of ₹ 41,000. The expenses on transfer of VDA is not allowable as deduction.

Section 194S provides for deduction of tax on payment on transfer of virtual digital asset to a resident at the rate of 1% of consideration. Hence, the transferor would have deducted tax of ₹ 620, being 1% of ₹ 62,000.

Tax@10% under section 194A would have been deducted by SBI from ₹ 1,10,000. TDS u/s 194A = ₹ 11,000

Net tax payable by Mr. Abhinav would be ₹ 1,172 (₹ 12,792 – ₹ 11,000 (TDS u/s 194A) – ₹ 620 (TDS u/s 194S).

ILLUSTRATION 2

Compute the income-tax payable by Mr. Siddhanth, aged 24 years, who has the following income for the A.Y.2024-25

(i)	*Income from Salaries (computed)*	*₹ 8,40,000*
(ii)	*Interest on savings bank account with Axis Bank*	*₹ 12,000*
(iii)	*Consideration received on transfer of VDA to Mr. Harsh*	*₹ 50,000*
(iv)	*Cost of acquisition of VDA transferred*	*₹ 5,000*

Mr. Harsh is employed with ABC Ltd. on a monthly salary of ₹ 50,000. In addition, he has interest on savings bank account with Bank of India.

Mr. Siddhanth has not exercised option to shift out of section 115BAC. Ignore TDS on income other than VDA.

SOLUTION

Tax payable by Mr. Siddhanth for A.Y. 2024-25

Particulars		Amount in ₹
Total income (excluding income from transfer of VDA) [₹ 8,40,000 + ₹ 12,000]		8,52,000
Income from VDA (₹ 50,000 – ₹ 5,000)		45,000
Total Income		**8,97,000**
Tax on income other than VDA		
Upto ₹ 3,00,000	Nil	
₹ 3,00,001 to ₹ 6,00,000 @5%	₹ 15,000	
₹ 6,00,001 to ₹ 8,52,000 @10%	₹ 25,200	40,200
Tax on income from VDA @30%		13,500
		53,700
Add: Health and education cess @ 4%		2,148
		55,848
Less: TDS under section 194S [Mr. Harsh is a specified person since he does not have income under the head "Profits and gains of business and profession" and the consideration payable by him does not exceed ₹ 50,000. Accordingly, Mr. Harsh need not deduct tax u/s 194S on consideration payable to Siddhanth]		Nil
Net tax payable		**55,848**
Net tax payable (rounded off)		**55,850**

ILLUSTRATION 3

Compute the income-tax payable by Mr. Raj, aged 32 years, who has the following income for the A.Y.2024-25

(i) *Business loss* *(₹ 3,18,000)*

(ii)	*Interest on fixed deposits with HDFC Bank*	*₹ 18,000*
(iii)	*Consideration received on transfer of VDA*	*₹ 4,20,000*
(iv)	*Cost of acquisition of VDA transferred*	*₹ 20,000*

SOLUTION

As per section 71, business loss of the current year can be set off against income from other sources of that year. Therefore, business loss of ₹ 3,18,000 can be set off against interest of ₹ 18,000 from fixed deposits.

As per section 115BBH, business loss cannot be set off against income from transfer of VDA. Therefore, balance business loss of ₹ 3,00,000 cannot be set off against Income from VDA of ₹ 4,00,000 (₹ 4,20,000 – ₹ 20,000). The same has to be carried forward to A.Y.2025-26 for set-off against business income of that year.

Tax on Income from VDA would be ₹ 1,24,800 (i.e., 31.2% of ₹ 4 lakh).

Section 194S provides for deduction of tax on payment on transfer of virtual digital asset to a resident at the rate of 1% of consideration. Hence, the transferor would have deducted tax of ₹ 4,200, being 1% of ₹ 4,20,000.

Net tax payable by Mr. Raj = ₹ 1,24,800 – ₹ 4,200 = ₹ 1,20,600.

(6) **Non-applicability of section 203A and 206AB on specified person -** The provisions of section 203A containing the requirement of obtaining TAN and section 206AB requiring higher rate of TDS for non-filers of income-tax return would **not** be applicable in case of specified person referred in 4(1).

(7) **Cross application of section 194-O and section 194S -** In case of a transaction where tax is deductible under section 194-O along with the section 194S, then, the tax shall be deducted under section 194S and not section 194-O.

(8) **Power of the CBDT to issue guidelines –** In case any difficulty arises in giving effect to the provisions of this section, the CBDT is empowered to issue guidelines, with the prior approval of the Central Government, for the purposes of removing the difficulty.

Every guideline issued by the CBDT shall be laid before each House of Parliament, and shall be binding on the income-tax authorities and on the person responsible for paying the consideration on transfer of such virtual digital asset.

Accordingly, the CBDT has, with the prior approval of the Central Government, vide Circular no. 13/2022 dated 22.6.2022, issued the following guidelines. These guidelines would apply only in cases where transfer of virtual digital asset is taking place on or through an Exchange. In other cases (like peer to peer and others) provisions of section 194S would apply and so far as these guidelines are concerned clarifications provided only in Question 6 shall apply.

Question 1: Who is required to deduct tax when the transfer of virtual digital asset is taking place on or through an Exchange and payment is made by the purchaser to the Exchange (directly or through broker) and then from the Exchange it goes to seller directly or through the broker?

Answer: According to section 194S, any person who is responsible for paying to any resident any sum by way of consideration for transfer of virtual digital asset is required to deduct tax.

Thus, in a peer to peer (i.e., direct buyer to seller) transaction, the buyer (i.e., person paying the consideration) is required to deduct tax under section 194S. The tax so deducted is required to be deposited with Government in accordance with the time and procedure prescribed in the Act read with the relevant provisions of the Income-tax Rules, 1962.

After deduction, the deductor is required to furnish a quarterly statement (in Form No. 26Q) for all such transactions of the quarter on or before the due date prescribed in the Income-tax Rules, 1962. For specified person Form 26QE has been introduced.

It may be clarified that the TDS shall be on consideration for transfer of virtual digital asset less GST. **[Clarified by the CBDT vide circular no. 14/2022 dated 28.6.2022 for all other transactions not conducted on or through Exchange]**

However, if the transaction is taking place on or through an Exchange, there is a possibility of tax deduction requirement under section 194S at multiple stages. Hence, in order to remove difficulties for transactions taking place on or through an Exchange, the following clarifications have been issued by CBDT :-

(i) **In a case where the transfer of virtual digital asset takes place on or through an Exchange and the virtual digital asset being transferred is owned by a person other than the Exchange:** In this case, buyer would be crediting or making payment to the Exchange (directly or through a broker). The Exchange, then, would be required to credit or make payment to the owner of virtual digital asset being transferred, either directly or through a broker. Since there are multiple players, to remove difficulty it has been clarified that:

1. Tax may be deducted under section 194S only by the Exchange which is crediting or making payment to the seller (owner of the virtual digital asset being transferred). In a case where broker owns the virtual digital asset, it is the

broker who is the seller. Hence, the amount of consideration being credited or paid to the broker by the Exchange is also subject to tax deduction under section 194S.

2. In a case where the credit/ payment between Exchange and the seller is through a broker (and the broker is not seller), the responsibility to deduct tax under section 194S shall be on both the Exchange and the broker. However, if there is a written agreement between the Exchange and the broker that broker shall be deducting tax on such credit/ payment, then broker alone may deduct the tax under section 194S. The Exchange would be required to furnish a quarterly statement (in Form 26QF) for all such transactions of the quarter on or before the due date prescribed in the Income-tax Rules, 1962.

(ii) **In a case where the transfer of virtual digital asset takes place on or through an Exchange and the virtual digital asset being transferred is owned by such Exchange:** In this case, there are no multiple players. The buyer is required to deduct tax under section 194S. However, there may be a practical issue as the buyer may not know whether the virtual digital asset being transferred is owned by the Exchange or not. Hence, there may be genuine doubt in the mind of buyer with regard to its responsibility to deduct tax under section 194S. This difficulty would also be there if the buyer is buying virtual digital asset from an Exchange through a broker.

To remove this difficulty, it has been clarified that while the primary responsibility to deduct tax under section 194S, in this case, remains with the buyer or his broker, as an alternative the Exchange may enter into a written agreement with the buyer or his broker that in regard to all such transactions, the Exchange would be paying the tax on or before the due date for that quarter. The Exchange would be required to furnish a quarterly statement (in Form 26QF) for all such transactions of the quarter on or before the due date prescribed in the Income-tax Rules, 1962. The Exchange would also be required to furnish its income tax return and all these transactions must be included in such return. If these conditions are complied with, the buyer or his broker would not be held as assessee in default under section 201 for these transactions.

Meaning of certain terms:

(i) The term "Exchange" means any person that operates an application or platform for transferring of virtual digital assets, which matches buy and sell trades and executes the same on its application or platform.

(ii) The term "Broker" means any person that operates an application or platform for transferring of virtual digital assets and holds brokerage account/accounts with an Exchange for execution of such trades.

Question 2: Question no 1 was with respect to transactions where the consideration for transfer of virtual digital asset is not in kind. How will this operate in a situation where it is in kind or in exchange of another virtual digital asset?

Answer: In the above situation, the buyer will release the consideration in kind after seller provides proof of payment of such tax (e.g., Challan details etc.). In a situation where virtual digital asset "A" is being exchanged with another virtual digital asset "B", both the persons are buyer as well as seller. One is buyer for "A" and seller for "B" and another is buyer for "B" and seller for "A". Thus, both need to pay tax with respect to transfer of virtual digital asset and show the evidence to other so that virtual digital assets can then be exchanged. This would then be required to be reported in TDS statement along with challan number. Form 26Q has included provisions for reporting such transactions. For specified persons, Form 26QE has been introduced. **[Also clarified by the CBDT vide circular no. 14/2022 dated 28.6.2022 for all other transactions not conducted on or through Exchange]**

However, if the transaction is through an Exchange there is practical issue in implementing this provision. In order to address this practical issue and to remove difficulty, it is clarified that in such a situation, as an alternative, tax may be deducted by the Exchange. Such an alternative mechanism can be exercised by the Exchange based on written contractual agreement with the buyers/sellers.

If such an alternative mechanism is exercised,

(i) the Exchange would be required to deduct tax for both legs of the transactions and pay to the Government. In the Form 26Q it will need to report it as tax deducted on both legs of the transaction.

(ii) the buyer and seller would not be independently required to follow the procedure prescribed under proviso to section 194S(1) i.e., to ensure that the tax required to be deducted has been paid by the other person, before releasing the consideration.

(iii) The tax withheld in kind under section 194S and converted into INR shall be deposited in the Government Account as per the time line and process given in the Income-tax Rules 1962.

It has been clarified that there would not be any further TDS for converting the tax withheld in kind in the form of virtual digital asset into INR or from one virtual digital asset to another virtual digital asset and then into INR.

Question 3: Whether the provision of section 194Q is also applicable on transfer of virtual digital asset?

Answer: Without going into the merit whether virtual digital asset is goods or not, it is clarified that once tax is deducted under section 194S, tax would not be required to be deducted under section 194Q. **[Also clarified by the CBDT vide circular no. 14/2022 dated 28.6.2022 for all other transactions also not conducted on or through Exchange]**

Question 4: Whether the consideration for transfer of virtual digital asset shall be on Gross basis after including GST/commission or it shall be on "net basis" after exclusion of these items.

Answer: In order to remove difficulty, it is clarified that the tax required to be withheld under section 194S shall be on the "net" consideration after excluding GST/charges levied by the deductor for rendering service.

Question 5: In transactions where payment is being carried out through payment gateways, there may be tax deduction twice. To illustrate that a person "XYZ" is required to make payment to the seller for transfer of virtual digital asset. He makes payment of ₹ 1,00,000 through digital platform of "ABC". On these facts liability to deduct tax under section 194S may fall on both "XYZ" and "ABC". Is tax required to be deducted by both?

Answer: In order to remove this difficulty, it is provided that in the above example, the payment gateway will not be required to deduct tax under section 194S on a transaction, if the tax has been deducted by the person ("XYZ") required to make deduction under section 194S. Hence, in the above example, if "XYZ" has deducted tax under section 194S on ₹ 1,00,000, "ABC" will not be required to deduct tax under section 194S on the same transaction. To facilitate proper implementation, "ABC" may take an undertaking from "XYZ" regarding deduction of tax.

TEST YOUR KNOWLEDGE

Questions

1. *Explain the core reasons for difference between the e-commerce transactions and the traditional business transactions causing difficulty to tax the income of e-commerce transactions.*

2. *E-commerce transactions have replaced concepts generally associated with international transactions traditionally. Discuss briefly the taxation issues involving such transactions.*

3. *ABC Ltd., an Indian company, is carrying on the business of manufacture and sale of teakwood furniture under the brand name "PUREWOOD". In order to expand its overseas sales/exports, it launched a massive advertisement campaign of its products. For the purpose of online advertisement, it utilized the services of PQR Inc., a London based company. During the previous year 2023-24, ABC Ltd. paid ₹ 5 lakhs to PQR Inc. for such services. Discuss the tax implications/TDS implications of such payment and receipt in the hands of ABC Ltd. and PQR Inc., respectively, if –*

   (i) PQR Inc. has no permanent establishment in India

   (ii) PQR Inc. has a permanent establishment in India, and the service is effectively connected to the permanent establishment in India

4. *MNO Inc., a Country A based company, is carrying on the business of manufacture and sale of furniture under the brand name "PUREWOOD". In order to increase its share in Indian market, it launched a massive advertisement campaign of its products. For the purpose of online advertisement, it utilized the services of PQR Inc., a Country Y based company which also owns and operates a digital platform. The gross receipt of PQR Inc from provision of such services during the P.Y.2023-24 is ₹ 3 crores. During the previous year 2023-24, MNO Inc. paid ₹ 5 lakhs to PQR Inc. for such services. Discuss the tax implications of such payment and receipt in the hands of MNO Inc. and PQR Inc., respectively, if –*

   (i) both MNO Inc. and PQR Inc. have no permanent establishment in India

   (ii) MNO Inc. has a permanent establishment in India but PQR Inc. has no permanent establishment in India

   (iii) PQR Inc. has a permanent establishment in India and the advertisement services are effectively connected with such PE.

5. *XYZ & Co., a non-resident entity based in Singapore, owns and operates an electronic facility through which it effects online sale of goods manufactured by it. The following are its receipts from the P.Y.2023-24 –*

	Particulars	**Amount in ₹**
(a)	Receipts from sale of goods to persons resident in India	158 lakhs
(b)	Receipts from sale of goods to persons not resident in India but resident in other parts of South-East Asia	96 lakhs
	Out of the said sum, ₹ 57 lakhs relates to receipts from persons using internet protocol address located in India.	

Discuss the equalisation levy implications of such receipt in the hands of XYZ & Co., if –

(i) *XYZ & Co. has no permanent establishment in India*

(ii) *XYZ & Co. has a permanent establishment in India, and the sale of goods is effectively connected to the permanent establishment in India*

Would your answer change if out of the receipts in (b) above, only ₹ 40 lakhs relates to receipts from persons using internet protocol address located in India?

6. *PQR Ltd., an Indian headquartered multinational company, has entered into a fixed fee agreement for ₹ 3 crores with X-Accounting Ltd., UK for the Financial Year 2023-24, which was approved by the Central Government. As part of the agreement, X-Accounting Ltd., UK maintains an online web-platform through which it provides IFRS advisory and consultancy services, which also includes providing response to queries raised by PQR Ltd. The technical staff of X-Accounting Ltd., UK provide their expert views virtually over the platform within 24-72 hours. Further, X- Accounting Ltd. also provides customised training through the embedded online video platform exclusively for the personnel working with PQR Ltd.*

X-Accounting Ltd. does not have any offices outside the UK. Examine the tax implications/TDS implications of such payment and receipt in the hands of X-Accounting Ltd., UK and PQR Ltd., India under Chapter VIII of the Finance Act, 2016 (as amended by the Finance Act, 2021) and the Income-tax Act, 1961.

Extract of Article 13 of India-UK DTAA

1. *Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.*

2. *However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the law of that State; but if the*

beneficial owner of the royalties or fees for technical services is a resident of the other Contracting State, the tax so charged shall not exceed :

(a) in the case of royalties within paragraph 3(a) of this Articles, and fees for technical services within paragraphs 4(a) and (c) of this Article,—

(i) during the first five years for which this Convention has effect ;

(aa) 15 per cent of the gross amount of such royalties or fees for technical services when the payer of the royalties or fees for technical services is the Government of the first-mentioned Contracting State or a political sub-division of that State, and

(bb) 20 per cent of the gross amount of such royalties or fees for technical services in all other cases; and

(ii) during subsequent years, 15 per cent of the gross amount of such royalties or fees for technical services; and

(b) in the case of royalties within paragraph 3(b) of this Article and fees for technical services defined in paragraph 4(b) of this Article, 10 per cent of the gross amount of such royalties and fees for technical services.

3. For the purposes of paragraph 2 of this Article, and subject to paragraph 5, of this Article, the term "fees for technical services" means payments of any kind of any person in consideration for the rendering of any technical or consultancy services (including the provision of services of a technical or other personnel) which :

(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3(a) of this article is received ; or

(b) are ancillary and subsidiary to the enjoyment of the property for which a payment described in paragraph 3(b) of this Article is received ; or

(c) make available technical knowledge, experience, skill know-how or processes, or consist of the development and transfer of a technical plan or technical design.

4. The definition of fees for technical services in paragraph 4 of this Article shall not include amounts paid:

(a) for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property, other than property described in paragraph 3(a) of this Article;

(b) for services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with the operation of ships, or aircraft in international traffic

(c) for teaching in or by educational institutions;

(d) for services for the private use of the individual or individuals making the payment ; or

(e) to an employee of the person making the payments or to any individual or partnership for professional services as defined in Article 15 (Independent personal services) of this Convention.

Answers

1. The core reasons for difference between e-commerce transactions and traditional business transactions causing difficulty to tax the income from e-commerce transactions under the Income-tax Act, 1961 are absence of national boundaries, no requirement of physical presence of goods and no requirement of physical delivery (in certain cases). Since e-commerce transactions are completed in cyberspace, it is often not clear as to the place where the transaction is effected, thereby causing difficulty in implementing source rule taxation.

2. The typical taxation issues relating to e-commerce are:

(1) the difficulty in characterizing the nature of payment and establishing a nexus or link between taxable transaction, activity and a taxing jurisdiction,

(2) the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

3. Chapter VIII of the Finance Act, 2016, "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

“Specified Service” means -

(1) online advertisement;

(2) any provision for digital advertising space or any other facility or service for the purpose of online advertisement; and

(3) any other service as may be notified by the Central Government.

However, equalisation levy shall not be levied-

- where the non-resident providing the specified services has a permanent establishment in India and the specified service is effectively connected with such permanent establishment.
- the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed ₹ 1 lakh.
- where the payment for specified service is not for the purposes of carrying out business or profession

(i) Where PQR Inc. has no permanent establishment in India

In the present case, equalisation levy @6% is chargeable on the amount of ₹ 5,00,000 received by PQR Inc., a non-resident not having a PE in India from ABC Ltd., an Indian company. Accordingly, ABC Ltd. is required to deduct equalisation levy of ₹ 30,000 i.e., @6% of ₹ 5 lakhs, being the amount paid towards online advertisement services provided by PQR Inc., a non-resident having no permanent establishment in India. Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of 100% of the amount paid while computing business income.

Since equalisation levy is attracted on the amount of ₹ 5 lakhs, the said amount is exempt from income-tax by virtue of section 10(50) of the Income-tax Act, 1961.

(ii) Where PQR Inc. has permanent establishment in India and the service is effectively connected to the permanent establishment in India

Equalisation levy would not be attracted where the non-resident service provider (PQR Inc., in this case) has a permanent establishment in India and the service is effectively connected to the permanent establishment in India. Therefore, the ABC Ltd. is not required to deduct equalisation levy on ₹ 5 lakhs, being the amount paid towards online advertisement services to PQR Inc, in this case.

Since equalisation levy is not attracted in this case, exemption under section 10(50) of the Income-tax Act, 1961 would not be available. Therefore, tax has to be deducted by ABC Ltd. at the rates in force under section 195 in respect of such payment to PQR Inc. Non-deduction of tax at source under section 195 would attract disallowance under section 40(a)(i) of 100% of the amount paid while computing business income.

4. Chapter VIII of the Finance Act, 2016, "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

"Specified Service" means

(1) online advertisement;

(2) any provision for digital advertising space or any other facility or service for the purpose of online advertisement and

(3) any other service as may be notified by the Central Government.

However, equalisation levy shall not be levied-

- where the non-resident providing the specified services has a permanent establishment in India and the specified service is effectively connected with such permanent establishment.
- the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed ₹ 1 lakh.
- where the payment for specified service is not for the purposes of carrying out business or profession.

Equalization levy@2% would be chargeable on the amount of consideration received or receivable by an e-commerce operator from e-commerce supply or services made or provided or facilitated by it—

(1) to a person resident in India; or

(2) to a non-resident in the specified circumstances as provided below; or

(3) to a person who buys such goods or services or both using internet protocol address located in India.

The equalization levy shall not be charged—

(1) where the e-commerce operator making or providing or facilitating e-commerce supply or services has a permanent establishment in India and such e-commerce supply or services is effectively connected with such PE;;

(2) where the equalization levy is leviable under section 165; or

(3) sales, turnover or gross receipts, as the case may be, of the e-commerce operator

from the e-commerce supply or services made or provided or facilitated is less than ₹ 2 crore during the previous year.

Meaning of "specified circumstances":

(1) sale of advertisement, which targets a customer, who is resident in India or a customer who accesses the advertisement though internet protocol address located in India; and

(2) sale of data, collected from a person who is resident in India or from a person who uses internet protocol address located in India.

(i) Where MNO Inc. and PQR Inc. have no permanent establishment in India

Equalisation levy would not be attracted in the present case since MNO Inc., a non-resident service recipient, does not have a permanent establishment in India. Therefore, the MNO Inc. is not required to deduct equalisation levy @ 6% on ₹ 5 lakhs, being the amount paid towards online advertisement services to PQR Inc.

However, equalisation levy @2% under section 165A is attracted on ₹ 5 lakhs, being the amount of consideration received by PQR Inc, an e-commerce operator from e-commerce services provided by it to MNO Inc., a non-resident in the specified circumstance, namely, sale of advertisement, which targets a customer, who is resident in India, since the gross receipts of PQR Inc. in the P.Y. 2023-24 exceeds ₹ 2 crores.

(ii) Where MNO Inc. has a permanent establishment in India but PQR Inc. does not have a permanent establishment in India

In the present case, equalisation levy @6% is chargeable on the amount of ₹ 5,00,000 received by PQR Inc., a non-resident not having a PE in India from MNO Inc., a non-resident having a PE in India. Accordingly, MNO Inc. is required to deduct equalisation levy of ₹ 30,000 i.e., @6% of ₹ 5 lakhs, being the amount paid towards online advertisement services provided by PQR Inc., a non-resident having no permanent establishment in India. Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of 100% of the amount paid while computing business income.

Since equalisation levy is attracted on the amount of ₹ 5 lakhs, the said amount is exempt from income-tax by virtue of section 10(50) of the Income-tax Act, 1961.

(iii) Where PQR Inc. has a permanent establishment in India and the advertisement services are effectively connected with such PE

Equalisation levy would not be attracted where the non-resident service provider (PQR Inc., in this case) has a permanent establishment in India and the service is effectively connected to the permanent establishment in India. Therefore, MNO Inc. is not required to deduct equalisation levy on ₹ 5 lakhs, being the amount paid towards online advertisement services to PQR Inc, in this case.

Since equalisation levy is not attracted in this case, exemption under section 10(50) of the Income-tax Act, 1961 would not be available.

However, since PQR Inc. has a PE in India and advertisement services are effectively connected with the PE in India, such advertisement income would be deemed to accrue or arise in India in the hands of PQR Inc. under section 9(1)(i) and would be taxable in the hands of PQR Inc. under the Income-tax Act, 1961.

5. Section 165A in the Finance Act, 2016 provides for equalisation levy@2% on the amount of consideration received or receivable by an e-commerce operator from e-commerce supply or services made or provided or facilitated by it, *inter alia*, to a person resident in India and a person who buys such goods or services or both using internet protocol address located in India.

In the present case, XYZ & Co. is an e-commerce operator since it is a non-resident owning and operating an electronic facility for online sale of goods and provision of services.

(i) XYZ & Co. has no permanent establishment in India

In this case, the gross receipts of the e-commerce operator from the e-commerce supply and services facilitated is ₹ 2.15 crore.

	Particulars	Amount in ₹
(a)	Receipts from sale of goods to persons resident in India	158 lakhs
(b)	Receipts from sale of goods to persons not resident in India (using internet protocol address located in India)	57 lakhs
Total receipts		**215 lakhs**

Since total receipts which are chargeable to equalisation levy exceed ₹ 2 crore, equalisation levy@2% is attracted on the above sum of ₹ 215 lakhs, which would amount to ₹ 4.30 lakhs.

Note – If the receipts in (b) above were only ₹ 40 lakhs, then equalisation levy would not be attracted since the gross receipts would be only ₹ 198 lakhs, which is less than ₹ 2 crores.

(ii) XYZ & Co. has a permanent establishment in India, and the sale of goods is effectively connected to the permanent establishment in India

Equalisation levy would not be attracted where the non-resident E-Commerce Operator (XYZ & Co., in this case) has a permanent establishment in India and the sale of goods is effectively connected to the permanent establishment in India.

This is irrespective of the quantum of receipts in (b) above i.e., whether ₹ 57 lakhs or ₹ 40 lakhs.

6. Section 165A of the Finance Act, 2016 provides for equalisation levy@2% on the amount of consideration received or receivable by an e-commerce operator from e-commerce supply or services made or provided or facilitated by it, *inter alia*, to a person resident in India and a person who buys such goods or services or both using internet protocol address located in India.

We need to determine whether X-Accounting Ltd., UK is an e-commerce operator

E-Commerce Operator means a non-resident who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both.

In the given situation, X-Accounting Ltd., UK, a non-resident, maintains a digital platform for online provision of services. Therefore, X-Accounting Ltd. is an e-commerce operator defined in section 165A.

However, the consideration received or receivable for specified services and for e-commerce supply or services would not include the consideration, which are taxable as, *inter alia,* fees for technical services in India under the Income-tax Act, read with the DTAA notified by the Central Government under section 90 or section 90A.

As per the Income-tax Act, 1961 and India-UK DTAA, fee for advisory services and training services by X-Accounting Ltd., UK comes within the scope of "fees for technical services" defined thereunder.

Hence, the consideration received for such services, being in the nature of fee for technical services, would not be subject to equalization levy.

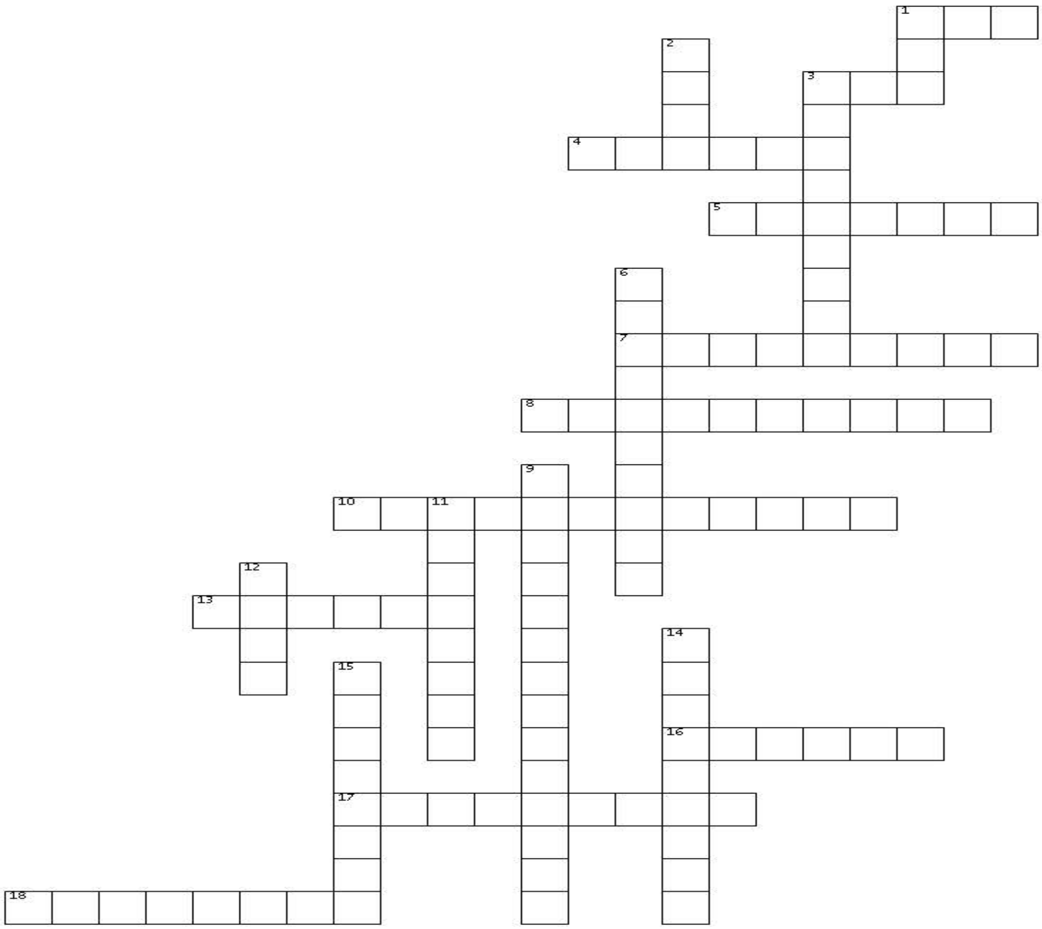
Now, we will consider the income-tax implications.

Any fees for technical services will be deemed to accrue or arise in India if they are payable by, *inter alia,* a person who is resident in India except where the fees is payable in respect of technical services utilised in a business or profession carried on by such person outside India or for the purpose of making or earning any income from any source outside India.

Hence, ₹ 3 crores would be deemed to accrue or arise in India in the hands of X-Accounting Ltd., UK and would be chargeable to tax in India as per Income-tax Act, 1961.

Withholding tax provisions under section 195 would be attracted and PQR Ltd, India has to withhold taxes on the payment made to X-Accounting Ltd., UK at the rate of 20%, which is the rate as per India-UK DTAA. The rate as per section 115A is also 20% but will be further increased by surcharge @2% and HEC @4%. Hence, the effective rate of tax as per Income-tax Act, 1961 would be 21.216%. Therefore, the rate as per DTAA i.e., 20% is more beneficial.

CROSSWORD PUZZLE



ACROSS

1. In order to constitute an ….. (acronym), members thereof must join for any common purpose or common action with the object of producing income.

3. ….. (acronym) @15% of book profit is leviable, where book profit is deemed to be the total income of the company.

4. Section 115BBF contains the concessional tax regime for royalty income in respect of ….. developed and registered in India.

5. Section 119A empowers the CBDT to adopt and declare a Taxpayer's ……..

7. ….. donation received by charitable trusts would be subject to tax@30% under section 115BBC.

8. A ………………. existing solely for educational purposes and not for profit and whose aggregate annual receipts do not exceed Rs.5 crore is eligible for exemption u/s 10(23C)(iiiad)

10. Where a charitable trust claims the cost of asset as application of income, then, it cannot claim deduction for …………….. in respect of such asset.

13. Section 115BBG levies tax on income from transfer of ……… credits.

16. …….. donations received by a charitable trust would be exempt only if invested in forms and modes specified u/s 11(5).

17. Section 13B contains special provisions relating to voluntary contributions received by ….. trusts.

18. …… received by a business trust from a SPV, which does not exercise option u/s 115BAA, and distributed to unitholders is exempt both in the hands of the business trust and the unit holders.

DOWN

1. ….. (acronym)@9% of adjusted total income is leviable in case the person is a unit located in an IFSC deriving its income solely in convertible foreign exchange.

2. ……. (acronym) enjoys pass through status in respect of rental income from real estate property directly held by it.

3. The principle of ….. is that no person can trade with himself or make income out of himself.

6. The tonnage income for a previous year is the aggregate of tonnage income of each ……… ship.

9. Section 115TCA contains the taxation regime for …………trusts.

11. Deposit in PPF by an individual to avail the benefit of deduction of section 80C is an example of tax …….

12. Chapter X-A of the Income-tax Act, 1961 contains the provisions relating to ….. (acronym)

14. ……is leviable at a flat rate of 10% in case of companies opting for section 115BAA or section 115BAB.

15. Section 115TD provides for levy of exit tax on …… income of a charitable trust.

CROSSWORD PUZZLE