ASSESSMENT OF VARIOUS ENTITIES

After studying this chapter, you would be able to:

- **compute** the book profit of a company and Minimum Alternate Tax (MAT) payable.
- **determine** the MAT credit to be carried forward.
- **examine** the applicability of MAT provisions in the case of a foreign company.
- **compute** the tax payable by a company and mutual fund on dividend/income distributed.
- **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.
- **examine** whether alternate minimum tax (AMT) would be applied in the case of persons other than companies.
- **compute** AMT and determine AMT credit to be carried forward.
- **compute** the total income of a firm, AOP/BoI and its partners/members applying the general and special provisions under the Act.
- **identify and address** the issues arising in respect of transactions relating to determination of total income of a HUF, firm, AOP and company.
- **determine** the liability of partners of a firm and LLP on dissolution.
- **examine** the incidence of taxation on mutual concerns.
12.1 ASSESSMENT 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) anybody 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 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 for such assessment years as may be specified in the CBDT’s order.

(2) Classes of Companies

- Domestic and Foreign Company: Companies can be classified into two groups, viz. (i) Domestic company and (ii) Foreign company.

  (i) **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;
  (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:

---

1 The Companies Act, 2013
(i) a company formed and registered under any law relating to companies which was or is in force in any part of India;

(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 Board to be a company under section 2(17)(iv);

(iv) in the case of any of the Union territories of Dadra and Nagar Haveli, Goa, Daman and Diu, and Pondicherry, a company formed and registered under any law for the time being in force in that Union territory.

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 made payable only within India to all the shareholders.

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.

(ii) Foreign Company: A company that 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 and
2. companies in which public are not substantially interested.

The former types of companies are also referred to as ‘widely-held companies’ while the latter are also referred to as ‘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 (formed for promoting commerce, arts, science, religion, charity or any other useful object and which prohibits payment of dividends to its members).

(iii) A company having no share capital which is declared by the Board 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 Government under section 620A of the Companies Act 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 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 recognised stock exchange in India; or
- its equity shares carrying at least 50% (40% in case of industrial companies) 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

---

2 Section 8 of Companies Act, 2013
3 Section 2(68) of Companies Act, 2013
(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, it should be noted that all public limited companies must automatically be treated as companies in which public are substantially interested, whereas 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 for the purpose of rates of tax prescribed.

Domestic companies are taxed at 30% but where the total turnover or gross receipt in the previous year 2015-16 does not exceed ₹ 50 crore it shall be taxed at 25% of the total income. However, a foreign company will be taxed at 50% or 40%, depending upon the composition of its total income. A surcharge @7% of the tax payable is to be charged 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 to be charged in the case of domestic companies and 5% of tax payable in the case of foreign companies, if the total income exceeds ₹ 10 crore.

(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. The list of such special provisions is as follow:

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Section</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2(22)(e)</td>
<td>Advance or loan by a closely held company - deemed dividend</td>
</tr>
<tr>
<td>2</td>
<td>56(2)(viib)</td>
<td>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</td>
</tr>
<tr>
<td>3</td>
<td>68</td>
<td>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</td>
</tr>
<tr>
<td>4</td>
<td>79</td>
<td>Carry forward and set-off of losses in case of closely held companies</td>
</tr>
<tr>
<td>5</td>
<td>179</td>
<td>Liability of directors of private company in liquidation</td>
</tr>
</tbody>
</table>
(3) Concessional rate of tax on dividends received by Indian companies from specified foreign companies [Section 115BBD]

(i) **Concessional rate** - Dividends received by Indian companies from specified foreign companies to be subject to a concessional rate of 15% (as against the general rate of 30% applicable to Indian companies).

(ii) **No expenditure is allowed** - This rate of 15% would be applied on gross dividend, in the sense, that no expenditure would be allowable in respect of such dividend.

(iii) **Meaning of specified foreign company** - Specified foreign company means a foreign company in which the Indian company holds 26% or more in nominal value of the equity share capital of the company. Therefore, this concessional rate would not be applicable in respect of dividend received from a foreign company in which the holding of the Indian company is less than 26% of the nominal value of the equity share capital.

(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 18.5% 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 18.5% (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, education cess @2% and secondary and higher education cess@1% 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 clause (b) of section 115JB(2) shall for the purpose of this section prepare its statement of profit and loss account for the relevant previous year in accordance with the provisions of Schedule III to the Companies Act, 2013 [clause (a) of section 115JB(2)].

(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 account for the relevant previous year in accordance with the provisions of the Act governing such company [clause (b) of section 115JB(2)].

(c) The section also specifies that the statement of profit and loss account for the relevant previous year has to be computed 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 account
(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 account 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 account 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 account:

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

[It may be noted that income-tax includes –
(1) dividend distribution tax under section 115-O/tax on distributed income under section 115R;
(2) interest;
(3) surcharge;
(4) education cess; and
(5) secondary and higher education cess (Explanation 2 to section 115JB)].

(b) Amount carried to Reserves: Amount carried to any reserves, by whatever name called, other than any amount transferred to Special Reserve under section 33AC;

(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;

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4 As per section 2(41) of the Companies Act, 2013, the financial year of a company shall be the period ending 31st March of every year. If a company is incorporated on or after 1st January of a year, then the financial year shall be the period ending 31st March of the following year.
(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 [other than long-term capital gains exempt under section 10(38)] 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 AOP or BOI, 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, 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 18.5%;

(fc) The amount representing-

- notional loss on transfer of a capital asset, being share or 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 therefor;

(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 have been deducted to compute book profit.

**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 account:** The carrying amount of shares at the time of
exchange would be taken into consideration for computing the amount of gain. The
amount of gain on such transfer, if any, credited to profit and loss account will be reduced.

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 account*.

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 [other than long-term capital gain
exempt under section 10(38)] or sections 11 or 12 apply, if such amount is credited to the
*statement of profit and loss account*;

(iia) **Depreciation:** The amount of depreciation debited to the *statement of profit and loss
account* (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 account*, 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 AOP or BOI:** The amount of income, being
the share of the assessee in the income of an AOP or BOI, 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 account*;

(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, 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 account* and the income-tax
payable thereon in accordance with the provisions of the Income-tax Act, 1961, other than
the provisions of Chapter XII-B, is at a rate less than 18.5%;
(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 account;

(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 account, 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;

(iii) **Brought forward loss or unabsorbed depreciation**: Amount of brought forward loss or unabsorbed depreciation, whichever is less 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 account.

(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) has been inserted in section 115JB to provide the framework for computation of book profit for Ind AS compliant companies in the year of adoption and thereafter.
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—
### Table of Items and Point of Time

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

(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 profit and loss account.

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. **Sub-section (2B)** states that in demerger, 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.

For example, companies which adopt Ind AS with effect from 1 April 2016 are required to prepare their financial statements for the year 2016-17 as per the requirements of Ind AS. Such companies are also required to prepare an opening balance sheet as on 1st April 2015 and restate the financial statements for the comparative period 2015-16.

In such a case, the first time adoption adjustments as of 31 March 2016 shall be considered for computation of MAT liability for previous year 2016-17 (Assessment year 2017-18) and thereafter.

Further, in this case, the five years period shall be previous years 2016-17, 2017-18, 2018-19, 2019-20 and 2020-21.

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 of 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 of 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)]

<table>
<thead>
<tr>
<th>Clause</th>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Year of convergence</td>
<td>the previous year within which the convergence date falls.</td>
</tr>
<tr>
<td>(ii)</td>
<td>Convergence date</td>
<td>the first day of the first Indian Accounting Standards reporting period as defined in the Ind AS 101.</td>
</tr>
</tbody>
</table>
(iii) Transition amount

<table>
<thead>
<tr>
<th>Transition amount</th>
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</thead>
<tbody>
<tr>
<td>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:</td>
</tr>
<tr>
<td>(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;</td>
</tr>
<tr>
<td>(B) Revaluation surplus for assets in accordance with the Indian Accounting Standards 16 and Indian Accounting Standards 38 adjusted on the convergence date;</td>
</tr>
<tr>
<td>(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;</td>
</tr>
<tr>
<td>(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;</td>
</tr>
<tr>
<td>(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</td>
</tr>
<tr>
<td>(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.</td>
</tr>
</tbody>
</table>

[clause (iii)]

# Translational 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 has 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:

<table>
<thead>
<tr>
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</thead>
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<tr>
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<td>To be included in book profits at the time of realisation/ disposal/ retirement or otherwise transferred</td>
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<td>2</td>
<td>Gains and losses from investments in equity instruments designated at fair value through other comprehensive income (Ind AS 109)</td>
<td>To be included in book profits at the time of realisation/ disposal/ retirement or otherwise transferred</td>
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<td>3</td>
<td>Remeasurements of defined benefit plans (Ind AS 19)</td>
<td>To be included in book profits every year as the re-measurements gains and losses arise</td>
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<td>Any other item</td>
<td>To be included in book profits every year as the gains and losses arise</td>
</tr>
</tbody>
</table>

(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 realisation/ 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

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?

**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 2016 are required to prepare their financial statements for the year 2016-17 as per requirements of Ind AS. Such companies are also required to prepare an opening balance sheet as of 1st day of April 2015 and restate the financial statements for the comparative period 2015-16. In such a case, the first time adoption adjustments as of 31st day of March 2016 should be considered [i.e. the start of business on 1st day of April 2016 (or, equivalently, close of business on 31st day of March 2016)] for computation of MAT liability for previous year 2016-17 (Assessment year 2017-18) 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 (including dividend distribution taxes) 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 2015-16 which was recognized in profit and loss account in FY 2015-16 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 (including dividend distribution taxes) 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:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Erstwhile Indian GAAP</th>
<th>Ind-AS (considering fair value/revaluation adjustment on PPE)</th>
<th>Fair Value/Revaluation Adjustments and corresponding depreciation</th>
</tr>
</thead>
<tbody>
<tr>
<td>WDV/Deemed Cost as on 1 April 2015</td>
<td>100</td>
<td>1000</td>
<td>900</td>
</tr>
<tr>
<td>Depreciation @10% for F.Y. 2015-16</td>
<td>10</td>
<td>100</td>
<td>90</td>
</tr>
<tr>
<td>WDV as on 1 April 2016</td>
<td>90</td>
<td>900</td>
<td>810</td>
</tr>
<tr>
<td>Depreciation @10% for F.Y. 2016-17</td>
<td>9</td>
<td>90</td>
<td>81</td>
</tr>
<tr>
<td>WDV as on 1 April 2017</td>
<td>81</td>
<td>810</td>
<td>729*</td>
</tr>
<tr>
<td>Sale value as on 1 April 2017</td>
<td>900</td>
<td>900</td>
<td></td>
</tr>
<tr>
<td>Profit on sale credited to P &amp; L</td>
<td>819</td>
<td>90</td>
<td></td>
</tr>
<tr>
<td>Adjustment for MAT - revaluation amount after adjustment of the depreciation</td>
<td>0</td>
<td>729*</td>
<td></td>
</tr>
<tr>
<td>Profit on sale to be considered for MAT</td>
<td>819</td>
<td>819</td>
<td></td>
</tr>
</tbody>
</table>

**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 2017-2018 onwards?
**Answer:** For assessment year 2017-2018, the deduction of lower of depreciation or losses shall be allowed based on the position as on 31 March 2016. 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, 2017 ending for Companies Act purposes and are required to transition to Ind AS will have to prepare financial statements for MAT purposes for FY 2016-17 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 2016 and under Ind AS for 3 months thereafter. The transition amount will be calculated with reference to 1st January, 2017.

(vi) **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, along with the return of income filed under section 139(1) or in response to a notice under section 142(1)(i), a report from a chartered accountant certifying that the book profit has been computed in accordance with the provisions of this section [Section 115JB(3)].

(vii) **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(4)].

(viii) **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)].
(ix) **Non-applicability of MAT on income arising from life insurance business**

Also, it has been provided that any 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)].

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

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

<table>
<thead>
<tr>
<th>Existence of DTAA with the country of residence of the foreign company</th>
<th>Additional condition to be satisfied for non-applicability of MAT</th>
</tr>
</thead>
<tbody>
<tr>
<td>(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)</td>
<td>It should not have a permanent establishment in India in accordance with the provisions of such Agreement</td>
</tr>
<tr>
<td>(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</td>
<td>It is not required to seek registration under any law for the time being in force relating to companies.</td>
</tr>
</tbody>
</table>

(xi) **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 18.5%. [Section 115JB(7)]

**Illustration 1**

A domestic company, ABC Ltd., furnishes the following particulars in respect of Assessment Year 2018-19 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 account as per the Companies Act, 2013**  
   * ₹ 215 Lacs*
2. **Statement of Profit and Loss A/c includes:**
   - **Credits:**
     - Dividend income from Indian companies  
       * ₹ 20 Lacs*
     - Excess realized on sale of land held as investment  
       * ₹ 30 Lacs*
   - **Debits:**
     - Depreciation on straight line method basis  
       * ₹ 100 Lacs*
     - Provision for loss of subsidiary company  
       * ₹ 60 Lacs*
3. **Depreciation allowable as per the Income-tax Rules, 1962**  
   * ₹ 150 Lacs*
(4) Short term Capital gains on sale of land mentioned above as computed under Income-tax Act, 1961 ₹ 40 Lacs

(5) Losses brought forward as per books of account and as per Income-tax Act, 1961:
   Business loss ₹ 50 Lacs
   Unabsorbed depreciation ₹ 60 Lacs

The company has represented to you that the excess realized on sale of land cannot form part of the book profit for purposes of section 115JB. You will have to deal with this issue assuming that ABC Ltd. is not required to comply with the Indian Accounting Standards.

Note - The turnover of ABC Ltd. for the P.Y.2015-16 was ₹ 40 crore.

Solution

In the case of a company, it has been provided that where tax on 18.50% 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 Income-tax Act, 1961

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹ (in Lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per statement of profit and loss account</td>
<td>215</td>
</tr>
<tr>
<td>Add: Depreciation debited to profit and loss account</td>
<td>100</td>
</tr>
<tr>
<td>Provision for losses of subsidiary company</td>
<td>60</td>
</tr>
<tr>
<td></td>
<td>160</td>
</tr>
<tr>
<td>Less: Dividend income – exempt under section 10(34)</td>
<td>20</td>
</tr>
<tr>
<td>Excess realized on sale of land (considered separately)</td>
<td>30</td>
</tr>
<tr>
<td>Depreciation allowable as per Income-tax Rules, 1962</td>
<td>150</td>
</tr>
<tr>
<td></td>
<td>200</td>
</tr>
<tr>
<td>Business Income</td>
<td>175</td>
</tr>
<tr>
<td>Less: Set-off of brought forward business loss</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td>125</td>
</tr>
<tr>
<td>Capital gains</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>165</td>
</tr>
<tr>
<td>Less: Set-off of unabsorbed depreciation</td>
<td>60</td>
</tr>
<tr>
<td>Total Income as per Income-tax Act, 1961</td>
<td>105</td>
</tr>
</tbody>
</table>
II. Computation of book profit under section 115JB

<table>
<thead>
<tr>
<th>Particulars</th>
<th>(₹ in Lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per profit and loss account</td>
<td>215</td>
</tr>
<tr>
<td>Add: Provision for loss of subsidiary</td>
<td>60</td>
</tr>
<tr>
<td>Depreciation</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>375</td>
</tr>
<tr>
<td>Less: Dividend income exempt under section 10(34)</td>
<td>20</td>
</tr>
<tr>
<td>Depreciation</td>
<td>100</td>
</tr>
<tr>
<td>Business loss which is less than unabsorbed depreciation</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td>170</td>
</tr>
<tr>
<td>“Book Profit”</td>
<td>205</td>
</tr>
</tbody>
</table>

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 ₹ 105 Lacs,

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax payable ₹ 105 Lacs @ 25%, since the turnover of the company for the previous year 2015-16 does not exceed ₹ 50 crore.</td>
<td>26,25,000</td>
</tr>
<tr>
<td>Add: Surcharge @ 7%</td>
<td>1,83,750</td>
</tr>
<tr>
<td></td>
<td>28,08,750</td>
</tr>
<tr>
<td>Add: Education cess &amp; SHEC@ 3%</td>
<td>84,263</td>
</tr>
<tr>
<td>Total Tax payable</td>
<td>28,93,013</td>
</tr>
<tr>
<td></td>
<td>28,93,010</td>
</tr>
</tbody>
</table>

IV. Computation of Minimum Alternate Tax

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax @18.50% of book profit of ₹ 205 lacs</td>
<td>37,92,500</td>
</tr>
<tr>
<td>Add: Surcharge @ 7%</td>
<td>2,65,475</td>
</tr>
<tr>
<td></td>
<td>40,57,975</td>
</tr>
<tr>
<td>Add: Education cess &amp; SHEC@ 3%</td>
<td>1,21,739</td>
</tr>
<tr>
<td>Minimum Alternate Tax payable</td>
<td>41,79,714</td>
</tr>
<tr>
<td></td>
<td>41,79,710</td>
</tr>
</tbody>
</table>
Since 18.50% of book profit exceeds the tax payable as per the Income-tax Act, 1961, the book profit of ₹ 205 lacs would be deemed to be the total income and the tax payable on such total income shall be 18.5% thereof i.e. 37,92,500 plus surcharge @7% being ₹ 2,65,475 plus education cess and SHEC @3% (of tax and surcharge) being ₹ 1,21,739. Total tax liability would be ₹ 41,79,710.

**Note:** With regard to the company’s representation, in respect of capital gain whether liable for book profit tax under section 115JB, it may be noted that since the excess realized on sale of land has been included in net profit computed under Schedule III of the Companies Act, 2013, it will form part of book profit [Bombay High Court judgment in CIT v. Veekay Lal Investment Co. Pvt. Ltd. (2001) 249 ITR 597].

**Illustration 2**

*Maitri Jeans (P) Ltd. is in the business of manufacturing jeans. For the assessment year 2018-19, it paid tax @18.50% on its book profit computed under section 115JB. The Assessing Officer though satisfied that it is liable to pay book profit tax U/s. 115JB, wants to charge interest under sections 234B and 234C as no advance tax was paid during the financial year 2017-18. The company seeks your opinion on the proposed levy of interest. Advice.*

**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 18.5% 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 18.5%.

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.2018-19, it is liable to pay advance tax. Since Maitri Jeans (P) Ltd. has not paid any advance tax during the financial year 2017-18, 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 31/03/2018.

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

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

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

<table>
<thead>
<tr>
<th>No.</th>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Profit from unit established in special economic zone</td>
<td>5,00,000</td>
</tr>
<tr>
<td>2.</td>
<td>Share in income of an AOP as a member</td>
<td>1,00,000</td>
</tr>
<tr>
<td>3.</td>
<td>Income from units of UTI</td>
<td>75,000</td>
</tr>
<tr>
<td>4.</td>
<td>Long term capital gains</td>
<td>3,00,000</td>
</tr>
</tbody>
</table>

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) Balance of Statement of Profit and Loss shown in Balance Sheet at the asset side as at 31/03/2018 was ₹ 10 lakhs which includes unabsorbed depreciation of ₹ 4 lakhs.

(iv) The capital gain has been invested in specified assets under section 54EC.

(v) The AOP, of which the company is a member, has paid tax at maximum marginal rate.

(vi) 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. 2018-19, assuming that Sona Ltd. is not required to comply with the Indian Accounting Standards.

**Solution**

**Computation of “Book Profit” for levy of MAT under section 115JB for A.Y.2018-19**

<table>
<thead>
<tr>
<th>Particulars</th>
<th><code> </code></th>
<th><code> </code></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Profit as per Statement of Profit and Loss</td>
<td>15,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Add:</strong> Net profit to be increased by the following amounts as per <em>Explanation 1</em> to section 115JB:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Provision for the loss of subsidiary</td>
<td>70,000</td>
<td></td>
</tr>
<tr>
<td>- Provision for doubtful debts, being the amount set aside as provision for diminution in the value of any asset</td>
<td>75,000</td>
<td></td>
</tr>
<tr>
<td>- Provision for income-tax</td>
<td>1,05,000</td>
<td></td>
</tr>
<tr>
<td><em>Further, as per <em>Explanation 2</em> 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]</em></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Depreciation</td>
<td>3,60,000</td>
<td>6,10,000</td>
</tr>
<tr>
<td><strong>Less:</strong> Net profit to be decreased by the following amounts as per <em>Explanation 1</em> to section 115JB:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Share in income of an AOP as a member</td>
<td>1,00,000</td>
<td></td>
</tr>
<tr>
<td><em>In a case, where AOP has paid tax on its total income at maximum marginal rate, no income-tax is payable 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 profit and loss account]</em></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Income from units in UTI</td>
<td>75,000</td>
<td></td>
</tr>
<tr>
<td><em>Income from units in UTI shall be reduced while computing the book profits, since the same is exempt under section 10(35)]</em></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Depreciation other than depreciation on revaluation of assets (<code>3,60,000 – </code>1,50,000)</td>
<td>2,10,000</td>
<td></td>
</tr>
</tbody>
</table>
- Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>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</td>
<td></td>
</tr>
</tbody>
</table>

| Book Profit                                                | ₹ 13,25,000 |

**Computation of MAT liability under section 115JB**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>18.50% of book profit</td>
<td>2,45,125</td>
</tr>
<tr>
<td><strong>Add:</strong> Education cess@2%</td>
<td>4,903</td>
</tr>
<tr>
<td>Secondary and higher education cess@1%</td>
<td>2,451</td>
</tr>
<tr>
<td>Minimum Alternate Tax liability</td>
<td>2,52,479</td>
</tr>
<tr>
<td><strong>MAT liability (rounded off)</strong></td>
<td>2,52,480</td>
</tr>
</tbody>
</table>

**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.

4. Long-term capital gains cannot be deducted while computing book profit even if such amount of capital gains is invested in specified assets under section 54EC, since book profit has to be computed by adding/deducting the items mentioned under *Explanation 1* to section 115JB alone. Capital Gains reflected in the statement of profit and loss shall be part of book profit under section 115JB. Capital gains exempted under section 54EC cannot also be excluded for computing book profit. *CIT v. Veekaylal Investment Co. P. Ltd.* (2001) 249 ITR 597 (Bom.) & *N J Jose and Co. (P) Ltd.* v. *ACIT* (2010) 321 ITR 132 (Ker.)
(xii) 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.

(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) The tax credit shall be allowed to be set off in a year in which tax becomes payable on the total income computed in accordance with provisions of the Act other than section 115JB.

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

(5) 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.

(6) 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.

(7) 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.

(8) 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 sub-section (1) of section 115JB 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

<table>
<thead>
<tr>
<th>A.Y.</th>
<th>Normal tax liability including foreign tax credit</th>
<th>Tax liability u/s. 115JB</th>
<th>Tax payable by the assessee [Higher of (2) and (3)]</th>
<th>Additional tax liability (4) - (2)</th>
<th>Credit u/s. 115JAA utilised</th>
<th>Credit available for carry forward</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td>(5)</td>
<td>(6)</td>
<td>(7)</td>
</tr>
<tr>
<td>2008-09</td>
<td>100</td>
<td>300</td>
<td>300</td>
<td>200</td>
<td>-</td>
<td>200</td>
</tr>
<tr>
<td>2009-10</td>
<td>120</td>
<td>90</td>
<td>120</td>
<td>NIL</td>
<td>30#</td>
<td>170</td>
</tr>
<tr>
<td>2010-11</td>
<td>150</td>
<td>110</td>
<td>150</td>
<td>NIL</td>
<td>40</td>
<td>130</td>
</tr>
<tr>
<td>2011-12</td>
<td>180</td>
<td>200</td>
<td>200</td>
<td>20</td>
<td>-</td>
<td>150</td>
</tr>
<tr>
<td>2012-13</td>
<td>200</td>
<td>190</td>
<td>200</td>
<td>NIL</td>
<td>10</td>
<td>140</td>
</tr>
<tr>
<td>2013-14</td>
<td>300</td>
<td>280</td>
<td>300</td>
<td>NIL</td>
<td>20</td>
<td>120</td>
</tr>
<tr>
<td>2014-15</td>
<td>250</td>
<td>230</td>
<td>250</td>
<td>NIL</td>
<td>20</td>
<td>100</td>
</tr>
<tr>
<td>2015-16</td>
<td>225</td>
<td>175</td>
<td>225</td>
<td>NIL</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>2016-17</td>
<td>250</td>
<td>240</td>
<td>250</td>
<td>NIL</td>
<td>10</td>
<td>40</td>
</tr>
<tr>
<td>2017-18</td>
<td>275</td>
<td>270</td>
<td>275</td>
<td>NIL</td>
<td>5</td>
<td>35</td>
</tr>
<tr>
<td>2018-19</td>
<td>300</td>
<td>295</td>
<td>300</td>
<td>NIL</td>
<td>5</td>
<td>30*</td>
</tr>
</tbody>
</table>

# Even though credit of 200 is available, only 30 can be utilised so that the tax payable by the assessee does not go below the amount computed under section 115JB.

* out of the credit of 30, 10 relates to A.Y. 2008-09 and 20 relates to A.Y. 2011-12. In view of provisions of sub-section (3A) of section 115JAA, the credit of 10 will now be allowable after A.Y. 2018-19 and would accordingly lapse after five years AY. 2023-24. However, credit of 20 pertaining to A.Y. 2011-12 would be allowed to be carried forward till A.Y. 2026-27.

(5) **Tax on distributed profit of domestic companies: Chapter XII D [Section 115-O]**

The amounts declared, distributed or paid on or after 1.4.2003 by a domestic company by way of dividends are charged to additional income-tax at the flat rate of 15%, in addition to normal income-tax chargeable on the income of the company. Dividend received from domestic companies on or after 1.4.03 are exempt in the hands of shareholders subject to the amount of dividend chargeable to tax under section 115BBDA [Section 115-O(1)]

For the purpose of this section, dividend includes dividend under section 2(22) but shall not include 2(22)(e).
(i) **Removal of cascading effect of dividend distribution effect:**

(a) Section 115-O(1A) seeks to provide relief from double taxation of dividends by removing the cascading effect of dividend distribution tax in a multi-tier corporate structure. A holding company receiving dividend from its subsidiary company can reduce the same from dividends declared, distributed or paid by it.

However, there are certain conditions to be fulfilled to avail this benefit. They are –

<table>
<thead>
<tr>
<th>Status of subsidiary company</th>
<th>Conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Where subsidiary is a domestic company</td>
<td>the subsidiary should have paid the dividend distribution tax, as payable on such dividend</td>
</tr>
<tr>
<td>Where subsidiary is a foreign company</td>
<td>the tax is payable by the domestic company under section 115BBD on such dividend</td>
</tr>
</tbody>
</table>

**Meaning of holding company** - For this purpose, a holding company is one which holds more than 50% of the nominal value of equity shares of the subsidiary.

(b) The NPS [Non Pension System] Trust is exempted from the applicability of dividend distribution tax in respect of dividend paid to any person for, or on behalf of, the NPS Trust. Hence, the dividend paid to any person for, or on behalf of, the NPS Trust would not be subject to dividend distribution tax. Therefore, for the purpose of calculating dividend distribution tax, a company can reduce such dividend from the dividends declared, distributed or paid by it. [Section 115-O(1A)]

(ii) **Grossing up of dividend distributed:**

Section 115-O(1B) provides that for the purposes of determining the tax on distributed profits payable in accordance with the section 115-O, any amount by way of dividends referred to in section 115-O(1), as reduced by the amount referred to in section 115-O(1A) [referred to as net distributed profits], shall be increased to such amount as would, after reduction of the tax on such increased amount at the rate specified in section 115-O(1), be equal to the net distributed profits.

**Illustration 4**

_X Ltd., a domestic company, has distributed on 1/11/2017, dividend of `230 lakh to its shareholders. On 1/10/2017, X Ltd. has received dividend of `60 lakh from its domestic subsidiary company Y Ltd., on which Y Ltd. has paid dividend distribution tax under section 115-O. Compute the additional income-tax payable by X Ltd. under section 115-O._

**Solution**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹ in lakh</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend distributed by X Ltd.</td>
<td>230</td>
</tr>
</tbody>
</table>
Illustration 5

Yaman Limited is a company in which 60% of the shares are held by Piloo Limited. Yaman Limited declared a dividend amounting to ₹35 lacs to its shareholders for the financial year 2016-17 in its Annual General Meeting held on 10th July, 2017. Dividend distribution tax was paid by Yaman Limited on 21st July, 2017. Piloo Limited declared an interim dividend amounting to ₹50 lacs on 15th October, 2017.

Compute the amount of tax on dividend payable by Piloo Limited.

What would be your answer, if 58% shares of Piloo Limited are held by Kafi Limited, an Indian company?

Solution

As per section 115-O, dividend distribution tax at the rate of 17.304% (i.e., 15% plus surcharge@12%, education cess@2% and secondary and higher education cess@1%) is leviable on dividend declared, distributed or paid by a domestic company. As per section 115-O(1A), a holding company receiving dividend from its domestic subsidiary company can reduce the same from dividend declared, distributed or paid by it. The dividend from its domestic subsidiary company should be received in the same financial year in which the holding company declares, distributes or pays the dividend. Further, the dividend shall not be considered for reduction more than once.

---

5 As per sub-section (1B) of section 115-O, for the purpose of grossing up, the rate specified in sub-section (1) has to be considered. The rate specified in sub-section (1) is 15%. Further, in the example given in the Explanatory Memorandum to the Finance (No.2) Bill, 2014, grossing up has been done at the rate of 15%.

However, it is also possible to take a view that grossing up should be done at the rate of 17.304% (that is, 15% plus surcharge@12% plus education cess and SHEC@3%), which is the effective rate of dividend distribution tax.
The conditions to be fulfilled for this purpose are as follows:

1. The domestic subsidiary company should have paid the dividend distribution tax which is payable on such dividend;

2. The recipient holding company should be a domestic company;

   For this purpose, a holding company is a company which holds more than 50% of the nominal value of equity shares of another company.

Section 115-O (1B) provides that for the purposes of determining the tax on distributed profits payable in accordance with section 115-O, any amount by way of dividends referred to in section 115-O(1), as reduced by the amount referred to in section 115-O(1A) [referred to as net distributed profits], shall be increased to such amount as would, after reduction of the tax on such increased amount at the rate specified in section 115-O(1), be equal to the net distributed profits.

On the basis of the aforesaid provision, dividend distribution tax payable by Piloo Limited shall be computed as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹ in lakh</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend distributed by Piloo Ltd.</td>
<td>50.00</td>
</tr>
<tr>
<td>Less: Dividend received from subsidiary Yaman Ltd. (60% of ₹ 35 lacs)</td>
<td>21.00</td>
</tr>
<tr>
<td>Net distributed profits</td>
<td>29.00</td>
</tr>
<tr>
<td>Add: Increase for the purpose of grossing up of dividend</td>
<td></td>
</tr>
<tr>
<td>₹ 29 x 100 /85 = ₹ 34.12 minus ₹ 29.00</td>
<td>5.12</td>
</tr>
<tr>
<td>Gross dividend</td>
<td>34.12</td>
</tr>
<tr>
<td>Additional income-tax payable by Piloo Ltd. u/s 115-O [15% of ₹ 34.12 lakh]</td>
<td>5.12</td>
</tr>
<tr>
<td>Add: Surcharge@12%</td>
<td>0.61</td>
</tr>
<tr>
<td></td>
<td>5.73</td>
</tr>
<tr>
<td>Add: Education cess@2% and SHEC@1%</td>
<td>0.17</td>
</tr>
<tr>
<td></td>
<td>5.90</td>
</tr>
</tbody>
</table>

In order to remove the cascading effect of DDT in a multi-tier corporate structure, section 115-O provides that, in case any domestic company (Piloo Ltd., in this case) receives any dividend during the year from any subsidiary company (Yaman Ltd., in this case) and such subsidiary company (Yaman Ltd.) has paid the DDT as payable on such dividend, then, dividend distributed by the holding company (Piloo Ltd.,) in the same year to the extent of dividend received from the subsidiary (Yaman Ltd.), shall not be subject to DDT under section 115-O, irrespective of whether the holding company (Piloo Ltd.) is a subsidiary of any other company (Kafi Ltd., in this case).

Therefore, in spite of the fact that Piloo Ltd. is a subsidiary of Kafi Ltd., it can reduce the amount
of dividend received from Yaman Ltd. for computation of dividend distribution tax. Therefore, dividend distribution tax payable by Piloo Ltd. shall be 17.304% of ₹ 34.12 lacs (grossed up amount) i.e. ₹ 5.90 lacs.

(iii) **Payment of DDT even if no income-tax is payable by the company**

Even if no income-tax is payable by a domestic company on its total income computed in accordance with the provisions of Income-tax Act, 1961, the tax on distributed profits shall be payable by such company [Section 115-O(2)].

(iv) **Prescribed period for payment of DDT**

Additional income-tax must be paid to the credit of the Central Government within fourteen days from the date of

(a) declaration of any dividend or

(b) distribution of any dividend or

(c) payment of any dividend,

whichever is earliest [Section 115-O(3)].

(v) **No credit of DDT paid**

The tax on distributed profits so paid by the company shall be treated as the final payment of tax in respect of the amount declared, distributed or paid as dividends and no further credit therefore shall be claimed by the company or by any other person in respect of the amount of tax so paid [Section 115-O(4)].

(vi) **No deduction under any other provisions**

No deduction under any of the provisions of the Income-tax Act, 1961 shall be allowed to the company or shareholder in respect of the dividend income or DDT [Section 115-O(5)].

(vii) **Exemption from levy of DDT on distributions by a SPV to a business trust**

Non-levy of DDT on distributed profits in respect of any amount declared, distributed or paid by way of dividends (whether interim or otherwise) out of its current income –

(a) By a specified domestic company i.e., by a domestic company in which a business trust has become a holder of the whole of the nominal value of equity share capital of the company (excluding the equity share capital required to be held mandatorily by any other person in accordance with any law for the time being in force or any directions of Government or any regulatory authority or equity share capital held by any Government or Government body).

(b) On or after the specified date i.e., on or after the date of acquisition of such holding referred to in (a) above by the business trust. [Section 115-O(7)].

However, this exemption would not be applicable in respect of any amount declared, distributed
or paid at any time by the specified domestic company out of its accumulated profits or current profits upto the date of acquisition by the business trust of the specified holding [as per (a) above] in the SPV.

(viii) **Exemption from levy of DDT on distributions by unit located in International Financial Services Centre**

Sub-section (8) has been inserted in section 115-O to provide that no tax on distributed profits shall be chargeable in respect of the total income of a company being a unit located in International Financial Services Centre, deriving income solely inconvertible foreign exchange, for any assessment year on any amount declared, distributed or paid by such company, by way of dividends (whether interim or otherwise) on or after 1st April, 2017 out of its current income, either in the hands of the company or the person receiving such dividend.

(ix) **Interest on non-payment or delayed payment of additional income-tax by the company**

Section 115P provides that non-payment of dividend distribution tax within the time allowed under section 115-O(3) attracts simple interest @1% for every month or part thereof on the amount of such tax for the period beginning from the date following the date on which the tax was payable and ending with the date on which the tax is actually paid. The Principal Officer of a domestic company and the company is liable to pay interest on such non-payment or delayed payment.

(x) **Deemed assessee-in-default**

Section 115Q provides that the Principal Officer and the company would be deemed to be an assessee-in-default if they fail to pay the tax in accordance with the provisions of section 115-O.

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

(i) Under section 115-O, dividend distribution tax (DDT) is levied on a company at the time when it distributes, declares or pays any dividend to its shareholders. Consequently, the amount of dividend received by the shareholders is not included in the total income of the shareholder, by virtue of exemption provided under section 10(34) subject to the amount of dividend chargeable to tax under section 115BBDA.

(ii) So far, the consideration received by a shareholder on buy-back of shares by a company is not treated as dividend but is taxable as capital gains under section 46A.

(iii) While payment of dividend is one option available to a company to distribute its reserves to its shareholders, another option available is to buy-back its own shares at a consideration determined by it. If the company exercises the former option, the payment of dividend would be subject to DDT under section 115-O and income in the hands of shareholders would be exempt as per section 10(34) subject to section 115BBDA. However, if the company prefers
the second option, the income would be taxed in the hands of shareholder under section 46A as capital gains.

(iv) In order to discourage the practice of domestic companies resorting to buy back of unlisted shares instead of payment of dividends in order to avoid payment of tax by way of DDT, especially if the capital gains arising to the shareholders are either not chargeable to tax or are taxable at a lower rate, Chapter XII-DA, comprising of sections 115QA, 115QB and 115QC, levies additional income-tax on buy back of such shares by domestic companies. The income arising to the shareholders in respect of such buy back of unlisted shares by the domestic company would be exempt under section 10(34A), where the company is liable to pay the additional income-tax on the buy-back of shares.

(v) **Levy of additional income-tax@20% on buyback of unlisted shares [Section 115QA]**

Section 115QA provides that in addition to the income-tax chargeable in respect of the total income of a domestic company for any assessment year, any amount of distributed income by the company on buy-back of shares (not being shares listed on a recognised stock exchange) from a shareholder shall be charged to tax @20% (plus surcharge@12% and education cess@2% and secondary and higher education cess@1%)

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.

<table>
<thead>
<tr>
<th>Meaning of buyback and distributed income</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Buyback</strong></td>
</tr>
<tr>
<td><strong>Distributed income</strong></td>
</tr>
</tbody>
</table>

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:
<table>
<thead>
<tr>
<th>Sub Rule No.</th>
<th>Circumstance</th>
<th>Manner of determination of amount received by the company in respect of issue of shares being bought back</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>Where shares have been issued by a company to any person way of subscription</td>
<td>Amount actually received by the company in respect of such share including any amount actually received by way of premium.</td>
</tr>
<tr>
<td>3</td>
<td>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</td>
<td>The amount actually received in respect of such shares as reduced by the sum so returned. However, if the sum or any part of it so returned was chargeable to additional income-tax under section 115-O and the company has paid such additional income tax, then, such sum or part thereof, as the case may be, shall not be reduced.</td>
</tr>
<tr>
<td>4</td>
<td>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</td>
<td>The fair market value of the share as 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)].</td>
</tr>
<tr>
<td>5</td>
<td>Where the share has been issued by a company being an amalgamated company, under a scheme of amalgamation, in lieu</td>
<td>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.</td>
</tr>
</tbody>
</table>
### 6. Where the Shares are issued by resulting company under a scheme of demerger:

<table>
<thead>
<tr>
<th>Amount received by the resulting company in respect of shares issued by it under a scheme of demerger:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net book value of assets transferred in a demerger ( \times ) ( \frac{\text{Net worth of the demerged co. immediately before demerger}}{\text{Net book value of assets transferred in a demerger}} )</td>
</tr>
</tbody>
</table>

### 7. Amount received in respect of the original shares issued by the demerged company post demerger:

<table>
<thead>
<tr>
<th>Amount received by the demerged company in respect of the original shares</th>
<th>(-) the amount as so arrived under sub-rule (6).</th>
</tr>
</thead>
</table>

### 8. 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

<table>
<thead>
<tr>
<th>The amount received by the company for issue of such share shall be determined in accordance with the following formula: Amount received = ( \frac{A}{B} )</th>
</tr>
</thead>
<tbody>
<tr>
<td>Where, ( A = ) an amount being lower of the following amounts:</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(a) FMV of the asset or liability (as determined by a Merchant Banker) ( \times ) The part of consideration being paid by issue of shares The total consideration</th>
</tr>
</thead>
<tbody>
<tr>
<td>(b) 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>
<tr>
<td>9</td>
</tr>
<tr>
<td>-------------------------------</td>
</tr>
<tr>
<td><strong>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</strong></td>
</tr>
</tbody>
</table>

| **B** = the number of shares issued by the company as part of consideration: |
| The amount received by the company for issue of shares shall be determined in accordance with the following formula: |

\[
\text{Amount received} = \frac{(A - B)}{C}
\]

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,

\[ C = \text{number of shares issued on conversion or succession.} \]

| Rule | Description | Consideration
|------|-------------|-------------------|
| 10   | 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”
| 11   | 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.
| 12   | 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.
| 13   | 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.

(vi) 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.
(vii) 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.

(viii) 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 6

XYZ Ltd., a domestic company, purchases its own unlisted shares on 4th July, 2017. 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, 2017.

Solution

XYZ Ltd is liable to pay ₹1,84,576 as additional income-tax, which is the amount calculated @23.072% (20% plus surcharge@12% plus cess@3%) on ₹8 lakh, being its distributed income (i.e., ₹21 lakh – ₹13 lakh).

The additional income-tax was payable on or before 18th July, 2017. However, the same was paid only on 29th September 2017.

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

<table>
<thead>
<tr>
<th>Period</th>
<th>No. of months/part of month</th>
</tr>
</thead>
<tbody>
<tr>
<td>19th July – 18th August, 2017 (whole of first month)</td>
<td>1</td>
</tr>
<tr>
<td>19th August – 18th September, 2017 (whole of second month)</td>
<td>1</td>
</tr>
<tr>
<td>19th September – 29th September, 2017 (part of third month)</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total number of months</strong></td>
<td><strong>3</strong></td>
</tr>
</tbody>
</table>
Interest under section 115QB is payable @1% per month for 3 months on the amount of additional tax payable i.e., ₹ 1,84,500 (rounded off as per Rule 119A). Therefore, interest payable under section 115QB is ₹ 5,535.

(7) 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 licence 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 –

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

(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 tonnagae 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.

**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 on-shore 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.
Similarly, if both Houses agree that the notification should not be issued, then such notification will be of no effect.

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

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.

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,

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.

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.

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.

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]**

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.

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.

(8) 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 misutilisation / 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.

\[
\text{Taxable amount} = \text{Relevant shipping income} \times \frac{\text{Extent of reserves unutilized or misutilised}}{\text{Total reserve created during the year}}
\]

(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.

**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, along with the return of income for that previous year, the report of an accountant, in the prescribed form duly signed and verified by such accountant.

**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 metres, 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 metres 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 licence 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.

For 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 would 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 does 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.

(8) **Conversion of an Indian branch of foreign company into an Indian subsidiary company [Chapter XII-BB] [Section 115JG]**

(i) The provisions of this section apply to a foreign company engaged in banking business in India through its branch situated in India, which is converted into an Indian subsidiary company in accordance with the scheme framed by RBI.

(ii) If the conditions notified by the Central Government in this behalf are satisfied, then capital gains arising from such conversion would not be chargeable to tax in the assessment year relevant to the previous year in which such conversion takes place.

(iii) Also, the provisions of the Act relating to computation of income of foreign company and Indian subsidiary company would apply with such exceptions, modifications and adaptations as specified in the notification.

(iv) Further, the benefit of set-off of unabsorbed depreciation, set-off and carry forward of losses, tax credit in respect of tax paid on deemed income relating to certain companies available under the Act shall apply with such exceptions, modifications and adaptations as specified in the notification.

(v) If the conditions specified in the scheme of RBI or notification issued by the Central Government are not complied with, then, all the provisions of the Act would apply to the foreign company and Indian subsidiary company without any benefit, exemption or relief under this section.

(vi) If the benefit, exemption or relief has been granted to the foreign company or Indian subsidiary company in any previous year and thereafter, there is a failure to comply with any of the conditions specified in the scheme or notification, then, such benefit, exemption or relief shall be deemed to have been wrongly allowed.

(vii) In such a case, the Assessing Officer is empowered to re-compute the total income of the assessee for the said previous year and make the necessary amendment. This power is notwithstanding anything contained in the Income-tax Act, 1961.

(viii) The provisions of rectification under section 154, would, accordingly, apply and the four year period within which such rectification should be made has to be reckoned from the end of the previous year in which the failure to comply with such conditions has taken place.
(ix) Every notification under issued under this section shall be laid before each House of Parliament.

12.2 TAX ON INCOME DISTRIBUTED BY SPECIFIED COMPANY OR A MUTUAL FUND [CHAPTER XII-E: SECTIONS 115R, 115S AND 115T]

(1) Tax on income distributed [Section 115R(2)]

Any amount of income distributed by the specified company as defined in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 or a Mutual Fund to its unit holders on or after 1.4.03 shall be chargeable to tax and the specified company or the Mutual Fund shall be liable to pay additional income-tax at the rate specified in the table below. Thus, the income from units received by a unit holder on or after 1.4.03 is exempt from income-tax under section 10(35).

<table>
<thead>
<tr>
<th>Type of Fund</th>
<th>Person to whom income is distributed</th>
<th>Rate of tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Money market mutual fund (MMMF) or liquid fund</td>
<td>Individual or HUF</td>
<td>25%</td>
</tr>
<tr>
<td></td>
<td>Any other person</td>
<td>30%</td>
</tr>
<tr>
<td>Fund other than MMMF or liquid fund</td>
<td>Individual or HUF</td>
<td>25%</td>
</tr>
<tr>
<td></td>
<td>Any other person</td>
<td>30%</td>
</tr>
<tr>
<td>Infrastructure Debt Fund set up as a Mutual Fund</td>
<td>Non-corporate non-resident or a foreign company</td>
<td>5%</td>
</tr>
</tbody>
</table>

However, this does not apply in respect of any income distributed
(a) by the Administrator of the specified undertaking to the unit holders or

(b) to a unit holder of equity oriented funds in respect of any distribution made from such funds.

(2) Grossing up of income distributed [Section 115R(2A)]

For the purposes of determining the additional income-tax payable in accordance with section 115R(2), the amount of distributed income shall be increased to such amount as would, after reduction of the additional income-tax on such increased amount at the rate specified in section 115R(2), be equal to the amount of income distributed by the Mutual Fund.

(3) Time limit to deposit the tax [Section 115R(3)]

The person responsible for making the payment of income distributed by the UTI or a Mutual Fund and the UTI or the Mutual Fund itself, as the case may be, shall be liable to pay the tax
under this provision to the credit of the Central Government within fourteen days from the date of distribution or payment of such income, whichever is earlier.

(4) **No deduction under any other provision [Section 115R(4)]**

No deduction under any provision of the Income-tax Act, 1961 shall be allowed to the UTI or to a Mutual Fund in respect of income, which has been subject to tax under section 115R(2).

---

**Clarification regarding scope of additional income-tax on distributed income under section 115R [Circular No. 6/2014, dated 11.2.2014]**

Section 115R provides for levy of additional tax on distributed income to unit holders. Some Assessing Officers have taken a view that mutual funds/specified companies are required to pay additional income-tax under section 115R not only on income distributed by way of dividend but also on payments made at the time of redemption/repurchase of units as well as at the time of allotment of bonus units to existing investors.

On these issues, the CBDT has clarified the following –

(i) Section 115R(2) requires payment of additional income-tax at the rates prescribed thereunder in respect of any amount distributed by a specified company or a mutual fund to its unit holders. The income so distributed by such entities constitutes dividend paid to the unit holders and is liable to tax thereunder. However, redemption of units or repurchase of units would not attract levy of tax under section 115R(2) as such income is not in the nature of income “distributed” to the unit holders and hence, lies outside the purview of this section.

(ii) Further, the income so distributed by the mutual fund or the specified company is specifically exempt from tax under section 10(35) in the hands of the recipient unit holders. As per the proviso to section 10(35), exemption of income thereunder is not applicable to those cases where transfer of units take place. The recipient of income is, therefore, liable to pay capital gains tax, if applicable, as per the relevant provisions of the Act, on transfer of such units.

(iii) Also, since issue of bonus units is not akin to distribution of income by way of dividend, the same would not be subject to additional income tax under section 115R. This inference can be drawn from the provisions of section 55, prescribing “cost of acquisition” of bonus shares as Nil for the purposes of computation of capital gains tax.

Thus, in view of the above position, the CBDT has, in exercise of its powers under section 119, clarified that additional income-tax under section 115R(2) is to be levied on income distributed by way of dividend to unit-holders of mutual fund or specified companies. Further, it is specifically clarified that receipts from redemption/repurchase of units or allotment of additional units by way of bonus units would not be subject to levy of additional income-tax thereunder.

---

(5) **Interest on non-payment of tax [Section 115-S]**

If the person responsible for making payment of the income distributed by the specified company or a Mutual Fund and the specified company or the Mutual Fund, as the case may
be, fails to pay the additional income-tax to the credit of the Central Government within the time allowed under section 115-R, he or it shall be liable to pay simple interest at the rate of 1% for every month or part thereof on such amount of tax which has not been paid or was not paid in time 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.

(6) **Deemed assessee-in-default [Section 115-T]**

If the person responsible for making payment of the income distributed by the specified company or a Mutual Fund and the specified company or the Mutual Fund, as the case may be, fails to pay the additional income-tax to the credit of the Central Government, he or it shall be deemed to be an assessee in default in respect of the amount of tax payable and all the provisions of this Act for the collection and recovery of income-tax shall apply.

(7) **Meaning of certain terms**

<table>
<thead>
<tr>
<th>Explanation</th>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>Mutual Fund</td>
<td>A Mutual Fund specified under section 10(23D).</td>
</tr>
<tr>
<td>(b)</td>
<td>Equity oriented fund</td>
<td>(i) the Unit Scheme, 1964 made by the Unit Trust of India; and (ii) such fund where the investible funds are invested by way of equity shares in domestic companies to the extent of more than 65% of the total proceeds of such funds, provided that the percentage of equity share holding of the fund shall be computed with reference to the annual average of the monthly averages of the opening and closing figures;</td>
</tr>
<tr>
<td>(c)</td>
<td>Unit Trust of India</td>
<td>The Unit Trust of India established under the Unit Trust of India Act, 1963.</td>
</tr>
<tr>
<td>(d)</td>
<td>Money market mutual fund</td>
<td>A money market mutual fund as defined in clause 2(p) of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 i.e. it means a scheme of a mutual fund which has been set up with the objective of investing exclusively in money market instruments.</td>
</tr>
<tr>
<td>(e)</td>
<td>Liquid fund</td>
<td>A scheme or plan of a mutual fund which is classified by the Securities and Exchange Board of India as a liquid fund in accordance with the guidelines issued by it in this behalf under the Securities and Exchange Board of India Act, 1992 or regulations made thereunder.</td>
</tr>
</tbody>
</table>
12.3 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 -

<table>
<thead>
<tr>
<th></th>
<th>Form</th>
<th>Regulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>A special purpose distinct entity</td>
<td>SEBI (Public Offer and Listing of Securitised Debt Instrument) Regulations, 2008</td>
</tr>
<tr>
<td>(ii)</td>
<td>A special purpose vehicle</td>
<td>The guidelines on securitisation of standard assets issued by RBI</td>
</tr>
<tr>
<td>(iii)</td>
<td>A trust setup by a securitisation company or a reconstruction company</td>
<td>Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) (or) the RBI directions/guidelines.</td>
</tr>
</tbody>
</table>

(2) **Exemption of income of securitisation trust from the activity of securitisation:**

The income of securitisation trust from the activity of securitisation shall continue to 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 the 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 and to the same extent 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

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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.

**Rule 12CC inserted to prescribe the period for furnishing the statement containing the details of nature of income paid or credited to the investor by the securitisation trust and to the prescribed income-tax authority under section 115TCA(4) [Notification No. 107/2016, dated 28-11-2016]**

CBDT has, vide notification no. 107/2016 dated 28-11-2016, inserted new Rule 12CC to provide that the statement of income distributed by a securitisation trust to its investor has to be furnished to the Principal Commissioner or the Commissioner of Income-tax within whose jurisdiction the principal office of the securitisation trust is situated, **by 30th November of the financial year** following the previous year during which such income is distributed.

Further, the statement of income distributed also has to be furnished to the investor by **30th June of the financial year** following the previous year during which the income is distributed.

(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 [New Section 194LBC effective from 1.6.2016]:**

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.

<table>
<thead>
<tr>
<th>Payee</th>
<th>Rate of TDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Resident individuals and HUFs</td>
<td>25%</td>
</tr>
<tr>
<td>(ii) Resident payees, other than individuals and HUFs</td>
<td>30%</td>
</tr>
<tr>
<td>(iii) Non-corporate non-residents and foreign companies</td>
<td>Rates in force</td>
</tr>
</tbody>
</table>
(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:**

<table>
<thead>
<tr>
<th>Explanation</th>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>Investor</td>
<td>Means a person who is holder of any securitised debt instrument or securities or security receipt issued by the securitisation trust</td>
</tr>
<tr>
<td>(b)</td>
<td>Securities</td>
<td>Means debt securities issued by a Special Purpose Vehicle as referred to in the guidelines on securitisation of standard assets issued by RBI</td>
</tr>
</tbody>
</table>

**12.4 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 includes sponsor and Manager.

(b) The trustee of a REIT shall be a SEBI registered debenture trustee who is not an associate of the Sponsor/manager.

(c) REIT shall invest in commercial real estate assets, either directly or through a holdco and/or special purpose vehicles (SPVs). In such SPVs, a REIT shall hold or propose to hold controlling interest and not less than 51% of the equity share capital or interest. Further, such SPVs shall hold not less than 80% of its assets directly in properties and shall not invest in other SPVs and which is not engaged in any activity other than holding and developing property and any other activity incidental to such holding or development.
(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. The minimum subscription size for units of REIT shall be ₹ 2 lakhs.

(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. Trading lot for such units shall be ₹ 1 lakh.

(f) For coming out with an initial offer, the value of the assets owned/proposed to be owned by REIT shall be of value not less than ₹ 500 crore. Further, minimum issue size for initial offer shall be ₹ 250 crore. Further, the minimum number of unitholders should not be less than 200.

(g) The Trustee shall generally have an overseeing role in the activity of the REIT. The manager shall assume operational responsibilities pertaining to the REIT.

(h) A REIT may have multiple sponsors, subject to each holding at least 5% of the units of the REIT. Such sponsors shall collectively hold not less than 25% of the units of the REIT for a period of not less than 3 years from the date of listing. After 3 years, the sponsors, collectively, shall hold minimum 15% of the units of REIT, throughout the life of the REIT.

(i) Not less than 80% of the value of the REIT assets shall be in completed and rent generating properties.

Upto 20% of the value of REIT assets shall be invested in following:

1. developmental properties;
2. mortgage backed securities;
3. listed/unlisted debt of companies/body corporates in real estate sector;
4. equity shares of companies listed on a recognized stock exchange in India which derive not less than 75% of their operating income from Real Estate activity;
5. government securities;
6. money market instruments or cash equivalents.

(j) A REIT shall invest in at least 2 projects with not more than 60% of value of assets invested in one project.

(k) REIT shall distribute not less than 90% of the net distributable cash flows, subject to applicable laws, to its investors, at least on a half yearly basis.

(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 has 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) defines a business trust to mean a trust –

- registered as an Infrastructure Investment Trust (Invit) under SEBI (Infrastructure Investment Trusts) Regulations, 2014 or a Real Estate Investment Trust (REIT) under SEBI (Real Estate Investment Trusts) Regulations, 2014;
- the units of which are required to be listed on a recognized stock exchange in accordance with the aforesaid regulations.

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.

(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 received or receivable from a Special Purpose Vehicle (SPV). Thus, the business trust enjoys a pass-through status in respect of interest received or receivable from a SPV; or

- dividend referred to in section 115-O(7) i.e., any income of a business trust by way of dividend received from SPV, being a specified domestic company in which a business trust has become the holder of the whole of the nominal value of equity share capital of the company. Such dividend income is also exempt in the hands of the unit-holder.

"SPV" means any Indian company, -

(i) in which the REIT holds or proposes to hold controlling interest and not less than 51% 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.
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.

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) or
- rental income referred to in section 10(23FCA).

Section 115UA(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 [referred to in sub-clause (a) of section 10(23FC)] 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.

Any person responsible for making payment of distributed income 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)].

Rule 12CA provides that the statement of income distributed by a business trust to its unit holder has to be furnished to the Principal Commissioner or the Commissioner of Income-tax within whose jurisdiction the principal office of the securitisation trust is situated, by 30th November of the financial year following the previous year during which such income is distributed.

Further, the statement of income distributed also has to be furnished to the investor by 30th June of the financial year following the previous year during which the income is distributed.

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).

The scheme of taxability of income in the hands of the business trust, unit holders, sponsors etc. is briefed in the table given hereunder –

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Section</th>
<th>Tax and TDS implications</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Transfer of listed units of the business trust by the unit holders</td>
<td></td>
<td>Tax implications in the hands of unit holders: STT leviable on trading of listed units on a recognized stock exchange;</td>
</tr>
</tbody>
</table>
### ASSESSMENT OF VARIOUS ENTITIES

| 2(42A) | 10(38) | 111A | **Tax implications in the hands of the sponsor:**
| --- | --- | --- | ---
| **The period of holding of units of business trust to qualify as “long-term capital assets” is “more than 36 months”;** | **Long-term capital gains** would be **exempt** in the hands of the unit-holders; | **Short-term capital gains** would be subject to concessional rate of tax@15% (plus surcharge, if applicable, and cess@3%). |

### Exchange of shares in SPV by sponsor for units of Business Trust

| 2(42A) | 47(xvii) | 10(38) & 111A | **Tax implications in the hands of the sponsor:**
| --- | --- | --- | ---
| **Tax implications in the hands of the business trust & unit holders and TDS implications in the hands of the SPV & business trust:**
| 49(2AC) | **Pass-through status for interest received by business trust from SPV:**
| 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 is long-term or short-term.**

---

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<table>
<thead>
<tr>
<th>10(23FC)</th>
<th>194A(3)(xi)</th>
<th>115A(1) (iac)</th>
<th>194LBA</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Interest income is not taxable in the hands of the business trust; and</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>▪ SPV is not required to deduct tax at source on interest paid to business trust.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Tax consequences on distribution of such income by the business trust to the unit-holders:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>▪ Interest income taxable in the hands of the unit holders –</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>o @5%, in case of unit holders, being non-corporate non-residents or foreign companies; and</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>o at normal rates of tax, in case of resident unit holders.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>▪ Business trust to deduct tax at source on interest component of income distributed to unit holders:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>o @5%, in case of unit holders, being non-corporate non-residents or foreign companies; and</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>o @10%, in case of resident unit holders.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**TDS implications in the hands of business trust:**

- **TDS@5%** on interest payments to non-resident lenders on ECBs by the business trust [Such interest would attract tax in the hands of the non-resident lenders@5% as per section 115A].
- The above concessional rate of TDS is applicable to -
  - moneys borrowed by the business trust in foreign currency from a source outside India –
    - (a) under a loan agreement at any time on or after 1.7.2012 but before 1.7.2020; |
    - (b) by way of issue of long-term bonds at any time on or after 1.10.2014 but before 1.7.2020 with the approval of the Central Government 
  - and
### ASSESSMENT OF VARIOUS ENTITIES

| (5) | Dividend received by the business trust from SPV | 115-O(7), 10(23FC)(b), 10(23FD) | **Tax implications in the hands of the SPVs, business trust and unit holders:**
|     |                                                |                              | ➢ Dividend distributed by the SPV to the business trust is exempt by virtue of section 115-O(7), if the SPV is a specified domestic company in which the business trust has become the holder of whole of the nominal value of equity share capital of the company
|     |                                                |                              | ➢ Dividend referred to in section 115-O(7), received by the business trust would be exempt in its hands;
|     |                                                |                              | ➢ The dividend component referred to in section 10(23FC)(b), of income distributed by the trust to unit holders will be exempt from tax in the hands of unit holders. |

| (6) | Capital gains on disposal of assets by the Business Trust | 115UA(2), 10(23FD) | **Tax implications in the hands of the Business Trust and Unit holders:**
|     |                                                       |                              | ➢ 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.
|     |                                                       |                              | ➢ If such capital gains are further distributed to unit-holders, 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 | 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
<table>
<thead>
<tr>
<th>Property directly held by it</th>
<th>Business trust is exempt in the hands of the business trust</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>115UA(3)</td>
<td><strong>Distributed income received by unit holder</strong>&lt;br&gt;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.</td>
<td></td>
</tr>
<tr>
<td>194LBA (from 1.6.2015)</td>
<td><strong>Distribution by REIT to unit holders of rental income from real estate assets directly owned by it</strong>&lt;br&gt;► TDS@10% in case of distribution to a resident unit holder.&lt;br&gt;► TDS at rates in force in case of distribution to a non-resident unit holder.</td>
<td></td>
</tr>
<tr>
<td>194-I (from 1.6.2016)</td>
<td><strong>Rental income received or credited to a REIT</strong>&lt;br&gt;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 <strong>not</strong> deductible at source.</td>
<td></td>
</tr>
<tr>
<td>(8)</td>
<td><strong>Tax implication in the hands of the Business Trust and Unit holders:</strong>&lt;br&gt;► Any other income of the trust is chargeable to tax at the maximum marginal rate (i.e., @35.535%).&lt;br&gt;► Such income distributed to unit holders would be exempt in their hands.</td>
<td></td>
</tr>
</tbody>
</table>

**Illustration 7**

A business trust, registered under SEBI (Real Estate Investment Trusts) Regulations, 2014, gives particulars of its income for the P.Y.2017-18:

(1) **Interest income from Beta Ltd. – ₹ 4 crore**;

(2) **Dividend income from Beta Ltd. – ₹ 2 crore**;
Beta Ltd. is an Indian company in which the business trust holds controlling interest. The business trust holds 100% of the shareholding of Beta Ltd.

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.2017-18.

**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 the 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.
   - However, 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 unit holders and foreign companies.

   Interest component of income distributed to unit holders is 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.

   The interest component of income received from the business trust in the hands of each unit holder 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 115-O(7), since the SPV is a specified domestic company in which the business trust has become the holder of whole of the nominal value of equity share capital of the company. Further, there would be no tax liability in the hands of the business trust, due to specific exemption provided under sub-clause (b) of section 10(23FC).

   Any distributed income referred to in section 115UA, to the extent it does not comprise of interest [referred to in sub-clause (a) of section 10(23FC)] and rental income from real estate assets owned directly by the business trust [referred to in section 10(23FCA)] received by unit holders, is exempt in their hands under section 10(23FD). Therefore, by virtue of section 10(23FD), there...
would be no tax liability on the dividend component [referred to in sub-clause (b) of section 10(23FC)] of income distributed to unit holders in their hands.

(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 of 35.535% 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@35.535%, being the 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 unit holder would be determined in the proportion of 2.5/11.1, by virtue of section 115UA(1).

**Notes:**

(1) 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.
(2) Sub-clause (a) of section 10(23FC) exempts any income of a business trust by way of interest received or receivable from a Special Purpose Vehicle (SPV). Thus, the business trust enjoys a pass-through status in respect of interest received or receivable from a SPV.

(3) Sub-clause (b) of section 10(23FC) exempts any income of a business trust by way of dividend received from SPV, being a specified domestic company in which a business trust has become the holder of the whole of the nominal value of equity share capital of the company. Such dividend income is also exempt in the hands of the unit-holder.

(4) SPV means an Indian company in which the business trust holds controlling interest and any specific percentage of shareholding, as may be required by the regulations under which such trust is granted registration [not less than 51% as per the current SEBI (Real Estate Investment Trusts) Regulations, 2014].

Such company should hold not less than 80% of its assets directly in properties and should not invest in other SPVs and should not be engaged in any activity other than holding and developing property and any other activity incidental to such holding or development.

Since Beta Ltd. is an Indian company in which the business trust holds controlling interest and 100% of shareholding, it is a special purpose vehicle. It is presumed that Beta Ltd. fulfills the other conditions specified in the regulations to qualify as an SPV.

(5) The distributed income of the business trust, to the extent it comprises of interest referred to in sub-clause (a) of section 10(23FC) and rental income 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. Accordingly, the business trust is required to deduct tax at source on the interest component and rental component of income distributed to its unit holders.

(6) Any distributed income referred to in section 115UA, to the extent it does not comprise of interest referred to in sub-clause (a) of section 10(23FC) and rental income referred to in section 10(23FCA), received by unit holders is exempt in their hands under section 10(23FD).

(7) 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.

12.5 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)].

(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 from profits and gains of business, 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 and 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 and profession” at investment fund level, shall be exempt under section 10(23FBB).

(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-resident non-corporate or non-corporate unit holder

In case of income payable to a non-resident non-corporate or non-corporate 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) **No pass through for losses:**

If in any year there is a loss at the fund level, either current loss or the loss which remained to be set off, such loss 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 [Section 115UB(2)].
(6) **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 [Section 115UB(3)].

(7) **Tax on total income:**

As per section 115UB(4), the total income of the investment fund is chargeable to tax as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Investment Fund</th>
<th>Rate of tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>A company or a firm</td>
<td>Rate or rates specified in the Finance Act of the relevant year (30% for A.Y.2018-19)</td>
<td></td>
</tr>
<tr>
<td>Other than a company or a firm</td>
<td>Maximum marginal rate</td>
<td></td>
</tr>
</tbody>
</table>

(8) **Non-applicability of DDT:**

Income paid by an investment fund to its unit holders would not be subject to dividend distribution tax under Chapter XII-D or tax on distributed income under Chapter XII-E [Section 115UB(5)].

(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 unit-holders, 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)].

(10) **Summary:**

The following table gives a summary of the above provisions:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Investment Fund</th>
<th>Unit holder</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Income under the head “Profits and gains of business or profession” of the Investment Fund</td>
<td>Taxable</td>
<td>Exempt</td>
</tr>
<tr>
<td>(ii) Income, other than profits and gains of business or profession</td>
<td>Exempt. Tax to be deducted on such income distributed to unit-holders - @10% in case of resident payee</td>
<td>Taxable, as if he had directly made the investment.</td>
</tr>
</tbody>
</table>
(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)].

Rule 12CB provides that the statement of income paid or credited by an investment trust to its unit holder has to be furnished to the Principal Commissioner or the Commissioner of Income-tax within whose jurisdiction the principal office of the investment trust is situated, by **30th November of the financial year** following the previous year during which such income is paid or credited.

Further, the statement of income paid or credited also has to be furnished to the unit holder by **30th June of the financial year** following the previous year during which the income is paid or credited.

(12) TDS provisions would not be attracted in respect of the income received by the investment fund. This would be provided by issue of appropriate notification under section 197A(1F) subsequently.

(13) 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).

(14) 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.
(15) **Meaning of certain terms:**

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Investment fund</td>
<td>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;</td>
</tr>
<tr>
<td>(b) Trust</td>
<td>A trust established under the Indian Trusts Act, 1882 or under any other law for the time being in force.</td>
</tr>
<tr>
<td>(c) Unit</td>
<td>Beneficial interest of an investor in the investment fund or a scheme of the investment fund and shall include shares or partnership interests.</td>
</tr>
</tbody>
</table>

**Illustration 8**

The following are the particulars of income of three investment funds for P.Y.2017-18:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>A</th>
<th>B</th>
<th>C</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business Income</strong></td>
<td></td>
<td>2</td>
<td>(2)</td>
</tr>
<tr>
<td><strong>Capital Gains</strong></td>
<td>16</td>
<td>14</td>
<td>(6)</td>
</tr>
<tr>
<td><strong>Income from other sources</strong></td>
<td>4</td>
<td>4</td>
<td>8</td>
</tr>
</tbody>
</table>

Compute the total income of the investment funds and unit-holders for A.Y.2018-19, assuming that:

(i) each investment fund has 20 unit holders each having one unit; and  
(ii) income from investment in the investment fund is the only income of the unit-holder.

If Investment Fund C has the following income components for A.Y.2019-20, 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 source** ₹8 lakh
Solution

Computation of total income of the investment fund for A.Y.2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>A</th>
<th>B</th>
<th>C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Income</td>
<td>Nil</td>
<td>2,00,000</td>
<td>Nil</td>
</tr>
<tr>
<td>Total Income</td>
<td>Nil</td>
<td>2,00,000</td>
<td>Nil</td>
</tr>
</tbody>
</table>

Computation of total income of a unit holder of the following Investment funds for A.Y. 2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>A</th>
<th>B</th>
<th>C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Gains</td>
<td>80,000</td>
<td>70,000</td>
<td>-</td>
</tr>
<tr>
<td>Income from other sources</td>
<td>20,000</td>
<td>20,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Total Income</td>
<td>1,00,000</td>
<td>90,000</td>
<td>30,000</td>
</tr>
</tbody>
</table>

Notes:

(i) The total income of Investment Fund B would be chargeable to tax@30% if the fund is a company or firm and at the maximum marginal rate, in any other case.

(ii) 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. The same has to be carried forward by the Investment Fund for set-off in the subsequent years.

(iii) For A.Y.2019-20, the brought forward capital loss of ₹ 6 lakh can be set-off against capital gains of ₹ 9 lakh. Business income of ₹ 2 lakh would be taxable in the hands of the Investment Fund. Capital gains of ₹ 3 lakh (₹ 9 lakh – ₹ 6 lakh) and Income from other sources of ₹ 8 lakh would be taxable in the hands of the unit-holders. The total income of each unit holder for A.Y.2019-20 would be ₹ 55,000, comprising of –

  Capital gains = ₹ 15,000 [i.e., ₹ 3 lakh/20]

  Income from other sources = ₹ 40,000 [i.e., ₹ 8 lakh / 20]

12.6 ASSESSMENT OF OTHER ENTITIES

(1) Levy of Alternate Minimum Tax (AMT) on all persons claiming profit-linked deductions, other than companies [Chapter XII-BA–Sections 115JC to 115JF]

(i) The Finance Act, 2011 had introduced the concept of AMT in relation to LLPs and accordingly the LLPs were subject to AMT @ 18.5% of adjusted total income.
(ii) Though the concept of Alternate Minimum Tax (AMT) was similar to MAT in case of corporates, however, the tax base in the case of LLPs was the adjusted total income computed as per the Income-tax Act, 1961 and not the book profit computed after making the specified adjustments to the profit as per the profit and loss account prepared in accordance with Schedule VI to the Companies Act, 1956.

(iii) The Finance Act, 2012 extended the levy of AMT to certain persons other than companies, in order to widen the tax base vis-à-vis profit-linked deductions. Accordingly, 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 would be subject to AMT with effect from A.Y.2013-14 [Section 115JEE(1)]. The provisions of AMT would, however, not be applicable to an individual, HUF, AOP, BOI, whether incorporated or not, or artificial juridical person, if the adjusted total income of such person does not exceed ₹ 20 lakh [Section 115JEE(2)].

Investment-linked tax deduction claimed under section 35AD also falls within the scope of alternate minimum tax.

(iv) 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].

(v) “Adjusted total income” would mean the total income before giving effect to Chapter XII-BA 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”;
2. section 10AA; 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.

(vi) 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 due date of filing of return under section 139(1).

(vii) 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.
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.

Also a proviso is inserted by the Finance Act, 2017 so as to provide that 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 up to 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.

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 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 9

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. 2018-19. 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. 2017-18.

Solution

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits and gains of business or profession</td>
<td>45,00,000</td>
</tr>
<tr>
<td>Less: Deduction under section 80-IB</td>
<td>20,00,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>25,00,000</td>
</tr>
<tr>
<td><strong>Tax payable</strong></td>
<td></td>
</tr>
<tr>
<td>Up to ₹ 2,50,000</td>
<td>Nil</td>
</tr>
<tr>
<td>5% on next ₹ 2,50,000</td>
<td>12,500</td>
</tr>
<tr>
<td>20% on next ₹ 5,00,000</td>
<td>1,00,000</td>
</tr>
<tr>
<td>30% on balance ₹ 15,00,000</td>
<td>4,50,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>5,62,500</td>
</tr>
</tbody>
</table>

**Computation of Alternate Minimum Tax (AMT)**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Income as per the Income-tax Act, 1961</td>
<td>25,00,000</td>
</tr>
<tr>
<td>Add: Deduction under section 80-IB</td>
<td>20,00,000</td>
</tr>
<tr>
<td><strong>Adjusted Total Income</strong></td>
<td>45,00,000</td>
</tr>
<tr>
<td><strong>AMT</strong> = 18.5% × 45,00,000 =</td>
<td>8,32,500</td>
</tr>
</tbody>
</table>

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.2018-19 would, therefore, be ₹ 8,32,500 plus education cess@2% and secondary and higher education cess@1%, totaling ₹ 8,57,475.

Mr. Rajesh would be eligible for credit to the extent of ₹ 2,78,100 [₹ 8,57,475 – ₹ 5,79,375 (i.e., ₹ 5,62,500 + 3% cess)] 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.

(2) Assessment 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. In the case of an individual who is a minor or a lunatic, the assessment of his income will be made on his guardian or the trustee. However, if the incapacitated person has no trustee or guardian or trustee or guardian is a non-resident and cannot be traced, the assessment can be made directly on the minor or lunatic. The rights and duties of all representative assesses are the same as those of the persons they are representing.

(i) Total income of an individual: The Total Income of an individual is arrived at after making deductions under Chapter VI-A from the Gross Total Income. As we have learnt earlier, Gross Total Income is the aggregate of the net income computed under the 5 heads of income, after giving effect to the provisions for clubbing of income and set-off and carry forward and setoff of losses.

(ii) Assessment of a non-resident individual

The manner for computation of total income explained above is also applicable to an individual who is a non-resident during the previous year. The scope of deemed income taxable in the hands of a non-resident as laid down in section 5 has already been 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 2 -“Residence and Scope of Total Income” and for other related provisions of non-residents, refer Part II: International Taxation, Chapter 1 – “Non-resident taxation” in Module 4.

(iii) Flat rate of tax on winnings from lotteries, crossword puzzles etc. [Section 115BB]

Under section 115BB, gross winnings from lotteries, crossword puzzles, races including horse
races (other than income from the activity of owning and maintaining race horses), card games and other games of any sort or from gambling or betting of any nature whatsoever shall be chargeable to income-tax at a flat rate of 30% on the gross winnings.

(iv) 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 3 - ‘Incomes which do not form part of total income’.

(v) Exemptions and reliefs 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.

(c) Relief in tax when salary is paid in arrears [Section 89].

(vi) 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].

In any other case, the share of member shall form part of his total income.

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.

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 certain individuals: Section 87A provides a rebate from the tax payable by an assessee, being an individual resident in India, whose total income
does not exceed ₹ 3,50,000. Such assessee shall get a tax relief of ₹ 2,500. In effect, the rebate would be the tax payable or ₹ 2,500, whichever is less.

- **Relief when salary etc. is paid in arrears or in advance [Section 89]:** It has already been explained in the Chapter relating to salaries that arrears or advances of salaries are assessable in the hands of the recipients in the year in which these are received. Consequently, in a financial year, an employee may become chargeable to tax in respect of salary for more than 12 months. Likewise, any payment in the nature of profit in lieu of salary (within the meaning of section 17(3)) is also chargeable in the year of receipt in addition to the normal salary received by the employee. In consequence, the aggregate salary income may become liable to tax at a rate higher than that at which it would otherwise have been assessed. To obviate such a hardship, the Assessing Officer has been empowered to grant relief in appropriate cases, on the employee making an application, in accordance with Rule 21A of the Income-tax Rules, 1962.

In appropriate cases coming under section 192(2A), where the employer is the Government or a public sector undertaking, co-operative society, local authority, university, institution or body, such employer himself is entitled to take into account the relief under section 89(1).

(3) **Assessment 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. (Concept of HUF is already discussed in detail in Chapter 1: Basic Concepts).

(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:** However, 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 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 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.

(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) Income from an impartible estate is included in the hands of the holder of the estate and not in the hands of the HUF. Even if the impartible estate is owned by the HUF, income from such estate is includible in the hands of the holder of the estate who is the eldest member of the HUF.

(c) Section 10(2) exempts any receipt by an individual as a member of a HUF out of the family income.

(d) 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) Conversion of separate property into property of HUF: However, to the above exemption there is an exception provided by section 64(2). Even though we have discussed this in the appropriate place it will be better to recapitulate.

Before this, let us understand the concept of conversion. 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, 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.

(vi) 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. Charan dass 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 given example 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:

(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 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.
It is earned with the aid of joint family funds.

There is real and sufficient connection between the investment of the joint family funds and the income by way of remuneration earned.

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.

Members of HUF and 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 joint Hindu family enters into a partnership with strangers, the member of the family do 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.

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.

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.

Gifts by HUF: A HUF as such is incapable of making a gift to any of its member. However, the Karta of a HUF has power to gift out of joint family property for certain approved purposes. The gift should be reasonable. For example, a father may make a gift of the ancestral moveable properties of the joint family, of which he is the Karta, for the purpose of discharging duties.
prescribed by Hindu Law. The income of the joint family will stand reduced to the extent to the income arising out of the assets thus gifted out.

(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 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 8 on “Income from other sources”.

Illustration 10

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 2010-11 onwards. The business income of HUF for the year ended 31.3.2018 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 1-10-2017. 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) **Assessment of Local Authority**

(i) **General meaning**: The expression “local authority” has not been defined by the Income-tax Act, 1961 but by section 2(31) of the General Clauses Act. 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 on the whole of its income at 30%. Surcharge @12% is applicable where total income exceeds ₹ 1 crore. Education cess @2% and Secondary and higher education cess @1% have to be added to the income-tax and surcharge.

### (5) Assessment 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) **General:** Meaning of terms ‘firm’, ‘partner’ and ‘partnership’ has already discussed in Chapter 1: Basic Concepts. 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 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.

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 outside India.
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 education cess@2% plus secondary and higher education cess@ 1%.

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 condition. 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 education cess @2% and secondary and higher education cess @1% will be levied on income-tax plus surcharge, if applicable.

(ii) Assessment: For the purpose of our discussion, we can divide the partnership firms assessable under this Act, into two types:

(A) Partnership Firm Assessed As Such (PFAS) [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 the firm shall be assessed as a firm and not as an AOP. However, 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 clause (v) of section 28.

- **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.

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 a partner other than an individual (example a company) cannot be working partner. 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.

It should be authorised by the Partnership Deed:

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 time 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. 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 an 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.

**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.

**Example:** A and B entered into partnership agreement on April 1, 2017. As per the deed, each of them will be entitled to salary of ₹ 2,000 per month apart from profit. On August 1, 2017, they executed a supplementary deed by which they increased the remuneration to ₹ 3,000 each effective from 1st April 2017. Discuss the validity of the supplementary deed.

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, 2017 onwards. The supplementary deed is executed on August 1, 2017 increasing the limit of remuneration. Such increase in the limit of remuneration will be allowable only from 1st August 2017, being the date of supplementary deed. Hence, for the period from 1st April 2017 to 31st July 2017, the partners will be allowed remuneration only at the rate of ₹ 2,000 per month.

**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:

<table>
<thead>
<tr>
<th>Book Profit</th>
<th>Quantum of Deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>On the first ₹ 3 lakh of book profit or in case of loss</td>
<td>₹ 1,50,000 or 90% of book profit, whichever is higher</td>
</tr>
<tr>
<td>on the balance of book profit</td>
<td>60% of book profit</td>
</tr>
</tbody>
</table>
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 above 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.

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 firms 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 authorised by and in accordance with the partnership deed.
(2) The interest payable by a firm to its partners should not be for a period falling prior to the date of such partnership deed authorizing the payment of such interest.

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

Apart from the above conditions the conditions prescribed by section 36(1)(iii) and section 40(a)(i) should also be satisfied. Section 36(1)(iii) provides that the amount of interest paid in respect of capital borrowed must be for the purposes of the business or profession. Section 40(a)(i) provides that any interest which is payable outside India or in India to a non-corporate non-resident or to foreign company will not be allowed as a deduction unless tax has been deducted therefrom.

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 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). 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. However, interest received from one partner cannot be set-off against interest paid to another partner under this proviso.

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.

**Illustration 11**

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 1.4.2010. 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 1.10.2017 which, apart from providing for payment of salary to the two working partners as mentioned in the deed of partnership executed on 1.4.2010, 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 1.4.2017.

The firm was dissolved on 31.3.2018 and the capital assets of the firm were distributed among the partners on 20.4.2018. The net profit of the firm for the year ended 31.3.2018 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 1.4.2017 to 31.3.2018.

(ii) Interest amounting to ₹50,000 paid to the partners on the balances standing to the credit of their Current accounts from 1.4.2017 to 31.3.2018

(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 1.11.2017.

(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 on motor car bought and used exclusively for business purposes, but registered in the name of partner ‘H’.

(i) Depreciation under section 32(1)(ii) amounting to ₹ 37,500 of new machinery bought and installed for manufacture of pens on 1.11.2017 at a cost of ₹ 5,00,000.

(ii) 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 2017-18 was ₹ 50,000.

(c) The fair market value of the capital assets as on 31.3.2018 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 2018-19.

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. 2018-19**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per profit &amp; loss account</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Add: Interest to partners on capital accounts for the period from 1.4.2017 to 30.9.2017 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)]</td>
<td>50,000</td>
</tr>
<tr>
<td>Interest to partners on current accounts from 1.4.2017 to 31.3.2018–not authorized by the deed, hence disallowed [Note (ii)].</td>
<td>50,000</td>
</tr>
<tr>
<td>100% of ₹ 25,000 paid towards purchase of television sets otherwise than by way of account payee cheque (being stock in trade, hence disallowed) [Note (iv)].</td>
<td>25,000</td>
</tr>
<tr>
<td>Description</td>
<td>Amount</td>
</tr>
<tr>
<td>----------------------------------------------------------------------------</td>
<td>--------</td>
</tr>
<tr>
<td>Difference on account of valuation of closing stock-in-trade at market value (₹ 65,000 less ₹ 60,000) [Note (ix)]</td>
<td>5,000</td>
</tr>
<tr>
<td>Salary paid to working partners considered separately.</td>
<td>2,50,000</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Additional depreciation on new machinery (₹ 5,00,000 x 20%) = ₹ 1,00,000. Only 50% is allowable as deduction. [Note (vii)]</td>
<td>50,000</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Interest received from bank on fixed deposits considered separately</td>
<td>25,000</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Salary to working partners -</td>
<td></td>
</tr>
<tr>
<td>(i) As per limit in section 40(b)</td>
<td></td>
</tr>
<tr>
<td>On first ₹ 3,00,000 @ 90%</td>
<td>2,70,000</td>
</tr>
<tr>
<td>On the balance of ₹ 1,55,000 @ 60%</td>
<td>93,000</td>
</tr>
<tr>
<td>(ii) Salary actually paid</td>
<td>2,50,000</td>
</tr>
<tr>
<td>Deduction allowed being (i) or (ii) whichever is less</td>
<td>2,50,000</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Business loss relating to assessment year 2017-18 set off</td>
<td>50,000</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from business</td>
<td>1,55,000</td>
</tr>
<tr>
<td>Income from other sources</td>
<td></td>
</tr>
<tr>
<td>Interest received from bank on fixed deposits</td>
<td>25,000</td>
</tr>
<tr>
<td>Total Income</td>
<td>1,80,000</td>
</tr>
</tbody>
</table>

**Explanation for the treatment of various items**

(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 1.10.2017 alone is eligible for deduction, since...
the partnership deed was executed only on 1.10.2017. Interest for the period prior to 1.10.2017 is not allowed.

(ii) The partnership deed of 1.10.2017 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).

(iv) Section 40A(3) provides for disallowances @100% of the expenditure incurred otherwise than by an account payee cheque / account payee bank draft or use of ECS through bank account. 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.

(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.

(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 2017-18 is not considered for calculation of book-profit.
Section 45(4) is not applicable to the firm for the assessment year 2018-19, though the dissolution of the firm took place on 31.3.2018, as there was no transfer by way of distribution of capital assets during the relevant previous year. The distribution of the capital assets took place on 20.4.2018. The capital gains will, therefore, be assessable in the assessment year 2019-20.

- **Partner in a representatively capacity:** If an individual is a partner in a firm in a representatively 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 representatively partner will not be subject to the conditions and ceiling as prescribed for disallowance. But interest paid by the firm to such individual as representatively partner or person represented shall be subject to the conditions and ceiling as prescribed *(Explanation 1).*

**Example:** X is a partner in a firm in a representatively 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 and 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.

**Example:** X is a partner of a firm in his individual capacity and is not a representatively 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.

- **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 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 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.

Rates of tax: A PFAS will be chargeable in respect of its total income at the rate of 30% plus surcharge @12% if its total income exceeds ₹1 crore, plus education cess@2% plus secondary and higher education cess@1% thereon.

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. It does not matter whether it is a PFAS firm or PFAOP firm. 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.
- **Tax rate of firm [Section 167A]:** In the case of a firm which is assessable as a firm, tax shall be charged at the rate as specified in the Finance Act of the relevant year.

- **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 one or more of the persons who were partners of the firm before the change continue as partner or partners after the change.

  (b) All the partners of firm continue to be the partner of the firm but there is a change in their profit sharing ratio 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.

  **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.

  **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 as if no discontinuance or dissolution has taken place and all the provisions of the Act shall be applicable accordingly.
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.

Illustration 12

Vijay Agencies, a partnership firm constituted by three partners with equal shares was dissolved on 1-04-2017 after a search. The tax liability of the firm outstanding to be paid was determined at ₹15 Lacs. Out of three partners, one was declared insolvent on 18-03-2018 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 Lacs from the Account of one such partner. You are asked by the partners of the dissolved firm the following questions:

(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

(i) 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, 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 Lacs. 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 Lacs recovered by attachment of the bank account of one of the partners is also in order.

Conversion of company into a 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.
ASSESSMENT OF VARIOUS ENTITIES

(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. However, under the Income-tax Act, no exemption is available on conversion of a company into an LLP. As a result, transfer of assets on conversion would attract capital gains tax. Further, there is no specific provision enabling the LLP to carry forward the unabsorbed losses and unabsorbed depreciation of the predecessor company.

(iii) Therefore, section 47(xiiiib) provides that -

1. any transfer of a capital asset or intangible asset by a private company or unlisted public company to a LLP; or
2. any transfer of a share or shares held in a company by a shareholder on conversion of a company into a 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 lakh 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 crore;
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.

(iv) 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)].

(v) 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)].

(vi) However, if the entity fails to fulfill any of the conditions mentioned in (iii) 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.

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

(viii) 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)].

(ix) 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)].

(x) 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)].

(xi) 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)]
(xii) 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(xiib), then, the LLP would be eligible for such deduction from the year in which the transfer took place.

(xiii) 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)].

**Illustration 13**

A Pvt. Ltd. has converted into a LLP on 1.4.2017. The following are the particulars of A Pvt. Ltd. as on 31.3.2017 –

1. Unabsorbed depreciation ₹ 13.32 lakh
   Business loss ₹ 27.05 lakh
2. Unadjusted MAT credit under section 115JAA ₹ 8 lakh
3. WDV of assets
   - Plant & Machinery (15%) ₹ 60 lakh
   - Building (10%) ₹ 90 lakh
   - Furniture (10%) ₹ 10 lakh
4. Cost of land (acquired in the year 2000) ₹ 50 lakh
5. VRS expenditure incurred by the company during the previous year 2015-16 is ₹ 50 lakh. The company has been allowed deduction of ₹ 10 lakh each for the P.Y.2015-16 and P.Y.2016-17 under section 35DDA.

Assuming that the conversion fulfills all the conditions specified in section 47(xiib), explain the tax treatment of the above in the hands of the LLP.

**Solution**

1. As per section 72A(6A), the LLP would be able to carry forward and set-off the unabsorbed depreciation and business loss of A Pvt. Ltd. as on 31.3.2017. However, if in any subsequent year, say previous year 2018-19, the LLP fails to fulfill any of the conditions mentioned in section 47(xiib), the set-off of loss or depreciation so made in the previous year 2018-19 would be deemed to be the income chargeable to tax of P.Y.2019-20.

2. As per section 115JAA(7), the credit for MAT paid by A Pvt. Ltd. cannot be availed by the successor LLP.
The aggregate depreciation for the P.Y.2017-18 would be –

Plant & Machinery  ₹ 9 lakh (15% of ₹ 60 lakh)
Building           ₹ 9 lakh (10% of ₹ 90 lakh)
Furniture          ₹ 1 lakh (10% of ₹ 10 lakh)

In this case, since the conversion took place on 1.4.2017, the entire depreciation is allowable in the hands of the LLP. Had the conversion taken place on any other date, say 1.7.2017, the depreciation shall be apportioned between the company and the LLP in proportion to the number of days the assets were used by them. In such a case, the depreciation allowable in the hands of A Pvt. Ltd. and the LLP would be calculated as given below -

In the hands of A Ltd. (for 91 days)

<table>
<thead>
<tr>
<th>Asset</th>
<th>Days</th>
<th>Cost</th>
<th>Calculation</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant and machinery</td>
<td>91</td>
<td>₹ 900000</td>
<td>$\frac{91}{365} \times 900000$</td>
<td>₹ 2,24,384</td>
</tr>
<tr>
<td>Building</td>
<td>91</td>
<td>₹ 900000</td>
<td>$\frac{91}{365} \times 900000$</td>
<td>₹ 2,24,384</td>
</tr>
<tr>
<td>Furniture</td>
<td>91</td>
<td>₹ 100000</td>
<td>$\frac{91}{365} \times 100000$</td>
<td>₹ 24,932</td>
</tr>
</tbody>
</table>

In the hands of the LLP (274 days)

<table>
<thead>
<tr>
<th>Asset</th>
<th>Days</th>
<th>Cost</th>
<th>Calculation</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant and machinery</td>
<td>274</td>
<td>₹ 900000</td>
<td>$\frac{274}{365} \times 900000$</td>
<td>₹ 6,75,616</td>
</tr>
<tr>
<td>Building</td>
<td>274</td>
<td>₹ 900000</td>
<td>$\frac{274}{365} \times 900000$</td>
<td>₹ 6,75,616</td>
</tr>
<tr>
<td>Furniture</td>
<td>274</td>
<td>₹ 100000</td>
<td>$\frac{274}{365} \times 100000$</td>
<td>₹ 75,068</td>
</tr>
</tbody>
</table>

(4) The cost of acquisition of land in the hands of the LLP would be the cost for which A Pvt. Ltd. acquired it, i.e., ₹ 50 lakh.

(5) The LLP would be eligible for deduction of ₹ 10 lakh each for the P.Y.2017-18, P.Y.2018-19, P.Y.2019-20 and under section 35DDA.

(B) Association of persons (AOP) including partnership firms assessed as AOP (PFAOP)

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 provided they did not
in law constitute a partnership. 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. For this reason
appointing of a common agent, manager or lessee will not make the owners assessable
as an association of persons. Thus, where the income does not arise to the group of
members from any joint venture or joint activities the group of persons cannot be assessed
as an association of persons. The most important features of an association of persons
are that -

(i) the number of members is not restricted and
(ii) the shares of each member or group of members is not definite and ascertainable.

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. Thus, in all cases where the share of each member in group of
members is definite and precisely ascertainable, the assessment cannot be made as an
association of persons.

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.
Section 185 provides that where a firm does not comply with the provisions of section 184 for any assessment year, the firm shall be assessed as a firm and not as an AOP, which was the case earlier. However, 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 total income of AOP/BOI and PFAOP**

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 assesseee.

2. In computing the total income, salary, bonus, commission, remuneration or interest paid to partners/members will not be allowed.

However in the case of payment of interest the following provisions will apply:

**Explanation 1:** If interest is paid by an AOP/BOI to any member who was also paid interest to the AOP/BOI then only that amount of interest paid by the AOP/BOI will be disallowed in its assessment which is in excess of the interest paid by the member to the AOP/BOI.

**Explanation 2:** If an individual is a member of an AOP/BOI in a representative capacity, on behalf of or for the benefit of another person, then interest paid by the AOP/BOI to such individual in his personal capacity will not be taken into account for the purpose of disallowance. But interest paid by the AOP/BOI to such individual or vice-versa or representative member or interest paid by the AOP/BOI directly to the beneficiary will be taken into account for the purpose of disallowance.

**Explanation 3:** 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 AOP/BOI are unknown**

[Section 167B]: Tax on the total income would be computed as follows:

<table>
<thead>
<tr>
<th>Circumstances</th>
<th>Taxability</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. If individual share of any partner is not known</td>
<td>tax will be levied at the maximum marginal rate, or at a higher rate. But if total income of any member of AOP/BOI is taxable at a rate higher than maximum marginal rate then total income of AOP/BOI shall be chargeable to tax at such higher rate of tax.</td>
</tr>
</tbody>
</table>
| 2. | If individual share of a partner is known and | then the AOP/BOI will pay tax at the maximum marginal rate. But if total income of any member of AOP/BOI is taxable at a rate higher than maximum marginal rate then total income of AOP/BOI shall be chargeable to tax at such higher rate of tax as follows:  
- Portion of income attributable to such member shall be taxable at such high rate as applicable to that member.  
- Balance portion of income shall be taxable at the maximum marginal rate of tax. |
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>total income of any member/partner (excluding his share from AOP/BOI) exceeds the basic exemption limit</td>
<td></td>
</tr>
<tr>
<td>(b)</td>
<td>no member/partner has total income (excluding his share from AOP/BOI) exceeding the basic exemption limit</td>
<td>the AOP/BOI will pay tax at the rates applicable to an individual.</td>
</tr>
</tbody>
</table>

- **Computation of member's/partner's share in the total income of association of persons/AOP [Section 67A]:** A member’s share in the income of an association of persons/AOP (wherein the shares of members are determinate/known) will be computed as follows:

(a) Any interest, salary, bonus, commission, remuneration, etc. paid to a member/partner during the previous year will be deducted from the total income of the association, and the balance will be apportioned among the members in proportion to their respective shares.

(b) If the amount apportioned to a member/partner as per (a) is a profit, any interest, salary, etc. paid to him by the association or AOP firm during the previous year will be added to that amount and the aggregate sum will be such member's/partner's share in the income of the AOP/AOP firm.

(c) If the amount apportioned to a member/partner as per (a) is a loss, any interest, salary, etc., paid to him by the association or AOP firm will be deducted from the amount of loss and the balance sum will be such member's/partner's share in the income of the AOP/AOP firm.

The share of a member in the income/loss of the AOP/AOP firm 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 AOP/AOP firm will be allowed as deduction from share while computing his income under “Profits and gains of business or profession.”

♦ Assessment of share in the hands of member/partner [Section 86]:
- A member’s/partner’s share in the total income of an association of persons/AOP firm will be treated as follows:
  
  If an AOP/AOP firm has paid tax at the maximum marginal rate, or a higher rate, the partner’s share in the total income of the firm will not be included in his total income and will be exempt.

  If the AOP/AOP firm has paid tax at regular rates applicable to an individual, the member’s/partner’s share in the income of the association/AOP firm will be included in his total income for rate purposes only. In other words, the member/partner will be allowed rebate at the average rate in respect of such share.

  - If the AOP/AOP firm has not paid tax on its total income, the member’s/partner’s share in the total income of the association/AOP firm will be included in his total income and taxed at regular rates.

♦ Share of member of an AOP/BOI in the income of the AOP/BOI 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 18.5% 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 18.5% of its book profit.

  (ii) *Explanation 1* below sub-section (2) of section 115JB 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 AOP/BOI in the income of the AOP/BOI in certain circumstances. A company which is a member of an AOP is also not required to pay tax in respect of its share in the income of the AOP in such cases. However, under section 115JB, a company which is a member of an AOP is liable to MAT on such share also,
since such income is not excluded from the book profit while computing the MAT liability of the member. It may be noted that in a similar situation, in the case of a partner of 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 [other than section 10(38)] applies, has to be reduced for computing book profit.

(iv) In order to ensure equity, clause (iic) has been inserted in Explanation 1 to section 115JB to provide that the share of a member of an AOP or BOI, in the income of the AOP or BOI, 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 been inserted in Explanation 1 to add back the expenditures, if any, debited to the profit and loss account, corresponding to such income, while computing book profit for levy of MAT.

Illustration 14

JK Associates is an Association of Persons (AOP) consisting of two members, J and K. Shares of the members are: 60%(J) and 40%(K). Income of the AOP for the previous year 2017-18 is ₹6 lacs. Compute tax liability of the AOP and the members in the following situations:

(i) J and K have their income, other than income from AOP, amounting to ₹1 lac and ₹2.7 lacs, respectively.

(ii) J and K's income, other than income from AOP, amount to ₹1 lac and ₹1.20 lacs, respectively.

Solution

Computation of tax of AOP is governed by section 167B of the Income-tax Act, 1961. 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.
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**

(i) As K’s income, other than that from the AOP, exceeds the basic exemption limit, the AOP shall pay tax at maximum marginal rate of 35.535% (i.e. 30% plus 15% surcharge plus education cess@2% plus secondary and higher education cess@1%). Thus the tax payable by AOP = ₹ 6,00,000 x 35.535% = ₹ 2,13,210.

(ii) 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 = ₹ 32,500 + ₹ 975 = ₹ 33,475.

**Tax Liability of J and K**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>J ₹</th>
<th>K ₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Share of profit from AOP</td>
<td>Exempt</td>
<td>Exempt</td>
</tr>
<tr>
<td>Income from other sources</td>
<td>1,00,000</td>
<td>2,70,000</td>
</tr>
<tr>
<td>Total Income</td>
<td>1,00,000</td>
<td>2,70,000</td>
</tr>
<tr>
<td>Tax liability</td>
<td>NIL</td>
<td>1,000</td>
</tr>
<tr>
<td>Less: Rebate under section 87A</td>
<td>-</td>
<td>1,000</td>
</tr>
<tr>
<td>Total tax payable</td>
<td>NIL</td>
<td>NIL</td>
</tr>
</tbody>
</table>

(ii) Share of profit from AOP 3,60,000 2,40,000

Income from other sources 1,00,000 1,20,000

(A) 4,60,000 3,60,000

Tax liability 10,500 5,500

Add: Education cess@2% + SHEC@1% 315 165

Total tax payable (B) 10,815 5,665

Average rate of tax [B/A x 100] 2.351% 1.573%

Total tax liability 10,815 5,665

Less: Rebate under section 86 read with section 110
### Assessment 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 purposes of 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) Exemptions:
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 11 “Deductions from Gross Total Income”.

It may also be noted that the provisions of section 194A which require deduction of income-tax at source from interest other than interest on securities, credited or paid, do not apply to such income credited or paid—

(i) by a co-operative society (other than a co-operative bank) to a member thereof or to any other co-operative society;

(ii) in respect of deposits with a primary agricultural credit society or a primary credit society or a co-operative land mortgage bank or a co-operative land development bank;

(iii) in respect of deposits (other than time deposits) with a co-operative society, other than a co-operative society or bank engaged in carrying on the business of banking.
Illustration 15

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 bye-laws 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.

(7) Assessment 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 one self 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 can be carried forward to the next year and set-off against income of the relevant assessment year. 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.

12.7 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 disallowed 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

- 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** - 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** - Where the total income includes the following income namely –

  (a) income by way of dividends (other than dividends referred to in section 115-O) in respect of Global Depository Receipts of an Indian company engaged in specified knowledge based industry or service, purchased by him 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%. [Section 115ACA(1)]

(iii) **No deduction is allowed** - 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 the income from the Global Depository Receipts. [Section 115ACA(2)]

(iv) **No benefit of first and second proviso of section 48** - 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. [Section 115ACA(3)].

(v) **Meaning of certain terms:**

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
</table>
| 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 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; |
| 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.    | 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 has 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.

(v) Concessional rate of tax - Section 115BBF has been inserted to provide 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 eligible assesssee:**

   Eligible assesssee 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 assesssee 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.

(xi) **Meaning of 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—
   - transfer of all or any rights (including the granting of a licence) in respect of a patent; or
   - imparting of any information concerning the working of, or the use of, a patent; or
   - use of any patent; or
   - rendering of any services in connection with the activities referred to in (1) to (3) above.

(xii) **Meaning of lumpsum:**

   “Lump sum” includes an advance payment on account of such royalties which is not returnable.

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(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, a new section 115BBG has been inserted to provide 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.

## (4) Tax incentives to International Financial Services Centres [Sections 10(38), 111A, 115JB & 115-O]

In order to encourage the growth of International Financial Services Centres (IFSCs) into a world class financial services hub, it is necessary to ensure a competitive tax regime to International Financial Services Centre. Accordingly, the following incentives have been provided to units set up in the IFSC under the Income-tax Act, 1961:

<table>
<thead>
<tr>
<th>Section</th>
<th>Exemption/Levy</th>
<th>Incentive to IFSCs</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Levy of STT and CTT</td>
<td>Exemption from levy of STT and CTT: Provisions of Chapter VII of the Finance (No.2) Act, 2004 providing for levy of STT, not to apply to taxable securities transactions entered into by any person on a recognised stock exchange located in IFSC where the consideration for such transaction is paid or payable in foreign currency, thereby exempting such transactions from STT with effect from 1st June, 2016. The provisions of Chapter VII of the Finance Act, 2013 providing for levy of CTT, not to apply to taxable commodities transactions entered into by any person on a recognised association located in unit of IFSC where the consideration for such transaction is paid or payable in foreign currency, thereby exempting such transaction from CTT with effect from 1st June, 2016.</td>
</tr>
<tr>
<td>10(38)</td>
<td>Exemption of LTCG only if STT is paid: Exemption of income by way of long term capital gains arising from transfer of listed equity shares or listed units of an equity oriented fund or business trust provided</td>
<td>Exemption of LTCG even if STT not paid: Second proviso has been inserted in section 10(38) to exempt tax on long-term capital gains in respect of income arising from transaction undertaken in foreign currency on a recognised stock exchange located in an International Financial Services Centre even if STT not paid.</td>
</tr>
<tr>
<td>(iii) 111A</td>
<td><strong>Levy of STCG@15% if STT is paid</strong></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Short term capital gains arising from transfer of listed equity shares or listed units of an equity oriented fund or business trust is taxable at a concessional rate of 15% provided securities transaction tax is paid.</td>
<td></td>
</tr>
<tr>
<td>(iv) 115JB</td>
<td><strong>MAT levy @18.5%:</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>In case of a company, if the tax payable on the total income as computed under the Income-tax Act, is less than 18.5% of its book profit, such book profit shall be deemed to be the total income of the company and the Minimum Alternate Tax (MAT) payable by the company for the relevant previous year shall be <strong>18.5% of such book profit.</strong></td>
<td></td>
</tr>
<tr>
<td>(v) 115-O</td>
<td><strong>Levy of DDT@15%:</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Additional income-tax@15% is attracted on any amount declared, distributed or paid by a domestic company by way of dividends.</td>
<td></td>
</tr>
</tbody>
</table>

When securities transaction tax is **not paid** in respect of such transaction.

Levy of STCG@15% even if STT is not paid

Second proviso has been inserted in section 111A(1) to provide that short term capital gains arising from **transaction undertaken in foreign currency** on a recognised stock exchange located in an International Financial Services Centre would be taxable at a concessional rate of 15% even when securities transaction tax is **not paid** in respect of such transaction.

Concessional rate of MAT@9%:

Sub-section (7) has been inserted in section 115JB to provide that 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 18.5%.

Exemption from levy of DDT:

Sub-section (8) has been inserted in section 115-O to provide that no tax on distributed profits shall be chargeable in respect of the total income of a company being a unit located in International Financial Services Centre, deriving income solely in convertible foreign exchange, for any assessment year on any amount declared, distributed or paid by such company, by way of dividends (whether interim or otherwise) on or after 1st April, 2017 out of its current income, either in the hands of the company or the person receiving such dividend.
EXERCISE

Question 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:

1. Depreciation calculated on the basis of useful life of assets as per provisions of the Companies Act, 2013 is ₹ 50 lakhs.

2. Employer's contribution to EPF of ₹ 2 lakhs and Employees’ contribution of ₹ 2 lakhs for the month of March, 2018 were remitted on 8th May 2018

3. 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 P & L Account.

4. 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 on wage and reasonable certainty of revision once in 3 years.

5. The company had made a provision of 10% of its debtors towards bad and doubtful debts. Total sundry debtors of the company as on 31-03-2018 was ₹ 200 lakhs.

6. A debtor who owed the company an amount of ₹ 40 lakhs was declared insolvent and hence, was written off by debit to Profit and loss account.

7. 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 31-03-2018, to settle the amount at a discount of 75% of the outstanding. The amount waived is credited to Profit and Loss account.

8. The opening and closing stock for the year were ₹ 200 lakhs and ₹ 255 lakhs, respectively. They were overvalued by 10%.

9. Provision for gratuity based on actuarial valuation was ₹ 500 lakhs. Actual gratuity paid debited to gratuity provision account was ₹ 300 lakhs.

10. 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.

11. 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.

Additional Information:

1. There was an addition to Plant & Machinery amounting to ₹ 50 lakhs on 10-06-2017, which was used for more than 180 days during the year. Additional depreciation has not been adjusted in the books.
(2) Normal depreciation calculated as per income-tax rules is ₹ 80 lakhs.

(3) The company had credited a sub-contractor an amount of ₹ 10 lakhs on 31-03-2017 towards repairing a machinery component. The tax so deducted was remitted on 31-12-2017.

(4) The company has collected ₹ 7 lakhs as sales tax from its customers and paid the same on the due dates. However, on an appeal made, the High Court directed the Sales Tax 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”.


Note - The turnover of XYZ Ltd. for the P.Y.2015-16 was ₹ 55 crore.

Answer

### Computation of Total Income of XYZ Ltd. for the A.Y.2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits and Gains from Business and Profession</td>
<td></td>
</tr>
<tr>
<td>Profit as per Statement of profit and loss account</td>
<td>7,00,00,000</td>
</tr>
<tr>
<td><strong>Add: Items debited but to be considered separately or to be disallowed</strong></td>
<td></td>
</tr>
<tr>
<td>(a) Depreciation as per Companies Act, 2013 disallowed</td>
<td>50,00,000</td>
</tr>
<tr>
<td>(b) Employees’ contribution to EPF [See Note 1 below]</td>
<td>2,00,000</td>
</tr>
<tr>
<td>[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 section 36(1)(va). Since the same has been debited to profit and loss account, it has to be added back for computing business income].</td>
<td></td>
</tr>
<tr>
<td>(c) Employers contribution to EPF</td>
<td>Nil</td>
</tr>
<tr>
<td>[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 profit and loss account, no further adjustment is necessary]</td>
<td></td>
</tr>
<tr>
<td>(d) Industrial power tariff concession received from State Government</td>
<td>Nil</td>
</tr>
<tr>
<td>[Any assistance in the form of, inter alia, concession received from the Central or State Government would be]</td>
<td></td>
</tr>
<tr>
<td>(e)</td>
<td>Provision for wages payable to workers</td>
</tr>
<tr>
<td>-----</td>
<td>----------------------------------------</td>
</tr>
<tr>
<td></td>
<td>[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 profit and loss account, no adjustment is required while computing business income]</td>
</tr>
<tr>
<td>(f)</td>
<td>Provision for doubtful debts [10% of ₹ 200 lakhs]</td>
</tr>
<tr>
<td></td>
<td>[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 profit and loss account, it has to be added back for computing business income]</td>
</tr>
<tr>
<td>(g)</td>
<td>Bad debts written off</td>
</tr>
<tr>
<td></td>
<td>[Bad debts write off in the book of account is allowable as deduction under section 36(1)(vii). Since the same has already been debited to profit and loss account, no further adjustment is required]</td>
</tr>
<tr>
<td>(h)</td>
<td>Discount given by Sundry Creditors for supply of raw materials</td>
</tr>
<tr>
<td></td>
<td>[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 profit and loss account, no further adjustment is required]</td>
</tr>
<tr>
<td>(i)</td>
<td>Provision for gratuity</td>
</tr>
<tr>
<td></td>
<td>[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]</td>
</tr>
<tr>
<td>(j)</td>
<td>Commission paid to recovery agent for realization of a debt.</td>
</tr>
<tr>
<td></td>
<td>[Commission of ₹ 1 lakh paid to a recovery agent for</td>
</tr>
</tbody>
</table>

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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 profit and loss account, no further adjustment is required.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(k)</strong> Purchase of paper at a price higher than the fair market value</td>
<td>10,00,000</td>
</tr>
</tbody>
</table>

[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]

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(l)</strong> Sales tax not refunded to customers out of sales tax refund</td>
<td>1,00,000</td>
</tr>
</tbody>
</table>

[The amount of sales tax 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]

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2,83,00,000</td>
</tr>
</tbody>
</table>

Less: **Items credited but to be considered separately/permissible expenditure and allowances**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(m)</strong> Depreciation as per Income-tax Act, 1961</td>
<td>80,00,000</td>
</tr>
</tbody>
</table>

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(n)</strong> Over-valuation of stock [₹ 55 lakhs × 10/110]</td>
<td>5,00,000</td>
</tr>
</tbody>
</table>

[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]

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(o)</strong> Additional Depreciation [See Note 2 below]</td>
<td>10,00,000</td>
</tr>
</tbody>
</table>

[Additional depreciation @20% is allowable on ₹ 50 lakhs, being actual cost of new plant & machinery acquired on 10.06.2017, as the same was put to use for more than 180 days in the P.Y.2017-18.]

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(p)</strong> Payment to a sub-contractor where tax deducted last year was remitted after the due date of filing of return [See Note 3 below]</td>
<td>3,00,000</td>
</tr>
</tbody>
</table>

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[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.2017-18, since tax deducted was remitted after the due date of filing of return. However, the same is allowable in A.Y.2018-19, since the remittance has been made on 31.12.2017]

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax @30% on the above total income (since the turnover exceeded ₹ 50 crore in the P.Y. 2015-16)</td>
<td>2,65,50,000</td>
</tr>
<tr>
<td>Add: Surcharge@7% (since total income exceeds ₹ 1 crore but less than ₹ 10 crore)</td>
<td>18,58,500</td>
</tr>
<tr>
<td>Add: Education cess@2%</td>
<td>4,93,830</td>
</tr>
<tr>
<td>Secondary and higher education cess@1%</td>
<td>2,46,915</td>
</tr>
<tr>
<td>Total tax liability</td>
<td>2,54,32,245</td>
</tr>
<tr>
<td>Total tax liability (rounded off)</td>
<td>2,54,32,250</td>
</tr>
</tbody>
</table>

Notes:

(1) Employees contribution to PF deposited after the due date mentioned under the PF Act is not allowable as deduction as per section 36(1)(va). The same has also been affirmed by the Gujarat High Court in CIT v. Gujarat State Road Transport Corporation (2014) 366 ITR 170. Hence, in the above solution, employees’ contribution to PF has been disallowed while computing business income.

The CBDT has, vide Circular No. 22/2015, dated 17.12.2015, clarified that the employer contribution to provident fund remitted on or before due date of filing of return under section 139(1), is allowable as deduction while computing Business Income. Further, it has also clarified that the circular does not apply to claim of deduction relating to employee’s contribution welfare funds which are governed by section 36(1)(va) of the Act.

Alternate View - An alternate view has, however, been expressed in CIT v. Kiccha Sugar Co. Ltd. (2013) 356 ITR 351 (Uttarakhand), CIT v. AIMIL Ltd (2010) 321 ITR 508 (Del) and CIT v. Nipso Polyfabriks Ltd (2013) 350 ITR 327 (HP) that employees contribution to PF, deducted from the salaries of the employees of the assessee, shall be allowed as deduction from the income of the employer-assessee, if the same is deposited by the employer-assessee with the
provident fund authority on or before the due date of filing of return for the relevant previous year. If this view is considered, then no disallowance would be attracted in this case, since the employees’ contribution has been remitted before the due date of filing of return of income.

(2) ₹ 50 lakhs, being the addition to plant and machinery on 10.6.2017 qualifies for additional depreciation@20% under section 32(1)(iia). Since only the normal depreciation as per Income-tax Rules, 1962, has been debited to profit and loss account, additional depreciation of ₹ 10 lakhs (being 20% of ₹ 50 lakhs) has to be deducted while computing business income.

(3) Since the tax deducted during the P.Y.2016-17 was remitted only on 31.12.2017, i.e., after the due date of filing of return for A.Y.2017-18, ₹ 3,00,000, being 30% of ₹ 10 lakh would have been disallowed while computing the business income of that year. Since the tax deducted has been remitted on 31.12.2017, ₹ 3,00,000 would be allowed as deduction while computing the business income of the A.Y.2018-19.

Question 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, 2018 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, 2017 and 10th December, 2017 respectively for purchase of crab, lobster and squid to Mr. Raja, a fisherman, and Mr. Khalid, a middleman for these 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 basic salary and Dearness Allowance payable to the employees.

(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, 2016.

(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.
ASSESSMENT OF VARIOUS ENTITIES

(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 2013-14.

(j) Dividend received from a foreign company ₹ 5 lakhs.

Additional information:

(i) As a corporate debt restructuring, the bank has converted unpaid interest of ₹ 10 lakhs upto 31st March, 2017 into a new loan account repayable in five equal annual installments. The first installment of ₹ 2 lakhs was paid in March, 2018 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 2018 from a supplier of vegetables for supply made in March, 2018. The bill was omitted to be recorded in the books in March, 2018. The bill was paid in April, 2018 and the necessary entry was made in the books then.

Compute total income of Parik Hospitality Limited for the Assessment Year 2018-19 indicating the reason for treatment of each item. Ignore the provisions relating to minimum alternate tax.

Answer

Computation of Total Income of Parik Hospitality Ltd. for the A.Y.2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profits and Gains from Business and Profession</strong></td>
<td></td>
</tr>
<tr>
<td>Profit as per Statement of profit and loss</td>
<td>1,52,00,000</td>
</tr>
<tr>
<td><strong>Add: Items debited but to be considered separately or to be disallowed</strong></td>
<td></td>
</tr>
<tr>
<td>(a) Payment to middleman for purchase of crab etc. in an amount exceeding ₹ 10,000</td>
<td>30,000</td>
</tr>
<tr>
<td>[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 fishermen for purchase of crab etc. is covered by exception under Rule 6DD. However, payment of ₹ 30,000 to middlemen for purchase of crab etc. is not covered under the exception - CBDT Circular 10/2008 dated 5/12/2008].</td>
<td></td>
</tr>
<tr>
<td>(b) Contribution towards employees' pension scheme in excess of 10% of salary disallowed under section 40A(9) [Contribution to the extent of 10% of salary (basic salary + dearness allowance, if it forms part of pay for retirement]</td>
<td>50,000</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>(a) Benefits (dearness allowance) is allowable as deduction under section 36(1)(iva). In this case, it is presumed that dearness allowance forms part of pay for retirement benefits</td>
<td></td>
</tr>
<tr>
<td>(b) Payment to transport contractor without deduction of tax at source</td>
<td></td>
</tr>
<tr>
<td>[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].</td>
<td></td>
</tr>
<tr>
<td>(c) Expenses on foreign travel of two directors for a collaboration agreement which failed to materialize</td>
<td>10,00,000</td>
</tr>
<tr>
<td>[Where expenditure is incurred for a project not related 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]</td>
<td></td>
</tr>
<tr>
<td>(d) Profit on sale of plot of land to 100% subsidiary</td>
<td>12,00,000</td>
</tr>
<tr>
<td>[Short-term capital gains arises 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). Since this amount has been credited to the statement of profit and loss, the same has to be deducted for computing business income].</td>
<td></td>
</tr>
<tr>
<td>(e) Contribution to IIT for scientific research</td>
<td>1,25,000</td>
</tr>
<tr>
<td>[Contribution to IIT for scientific research programme approved by the prescribed authority qualifies for weighted deduction@150% under section 35(2AA). Since 100% of contribution has already been debited to the statement of</td>
<td></td>
</tr>
<tr>
<td>(f) Fees paid to directors without deducting tax at source [30% of `1 lakh]</td>
<td>30,000</td>
</tr>
<tr>
<td>[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]</td>
<td></td>
</tr>
<tr>
<td>Less: Items credited but to be considered separately / Expenditure to be allowed</td>
<td>1,63,10,000</td>
</tr>
<tr>
<td>Item</td>
<td>Amount</td>
</tr>
<tr>
<td>----------------------------------------------------------------------</td>
<td>---------</td>
</tr>
<tr>
<td><strong>Income under the head “Profits and Gains of Business or Profession”</strong></td>
<td>1,25,85,000</td>
</tr>
</tbody>
</table>

### ASSESSMENT OF VARIOUS ENTITIES

(h) 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]

(i) 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). Since the compensation has been credited to the statement of profit and loss, the same has to be deducted while computing business income]

(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]

(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.2017-18, the same is allowable as deduction]

(iii) Purchases omitted to be recorded in the books  
[Since the purchase is made in March, 2018 (i.e., P.Y.2017-18), in respect of which bill of ₹2 lakhs received on 31.3.2018 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.]

---

6From assessment year 2021-22 it is deductible @ 100%
### Question 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 account for the year ended on 31.3.2018:

(a) **Items debited to Statement of Profit and Loss Account**

<table>
<thead>
<tr>
<th>Description</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provision for loss of subsidiary</td>
<td>70,000</td>
</tr>
<tr>
<td>Provision for income-tax demand</td>
<td>1,05,000</td>
</tr>
<tr>
<td>Expenses on purchase/sale of equity shares</td>
<td>15,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>3,60,000</td>
</tr>
<tr>
<td><strong>Interest on deposit credited to buyers on 31.3.2018 for advance received from them, on which TDS was deducted in April 2018 and was deposited on 31.7.2018</strong></td>
<td>1,00,000</td>
</tr>
</tbody>
</table>

(b) **Items credited to Statement of Profit and Loss Account**

<table>
<thead>
<tr>
<th>Description</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long term capital gain on sale of equity shares on which securities transaction tax was paid at the time of acquisition and sale</td>
<td>3,60,000</td>
</tr>
<tr>
<td>Income from units of UTI</td>
<td>75,000</td>
</tr>
</tbody>
</table>

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:**

<table>
<thead>
<tr>
<th>F.Y.</th>
<th>Amount as per books</th>
<th>Amount as per Income-tax</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Loss ₹</td>
<td>Depreciation ₹</td>
</tr>
<tr>
<td>2014-2015</td>
<td>2,50,000</td>
<td>3,00,000</td>
</tr>
</tbody>
</table>
You are required to:

(i) **compute the total income of the company for the assessment year 2018-19** 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 Hyder Ltd for the P.Y. 2017-18 is 30%.

**Answer**

**Computation of total income of M/s Hyper Ltd. for the A.Y. 2018-19**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit as per Statement of Profit &amp; Loss Account</td>
<td></td>
<td>14,25,000</td>
</tr>
<tr>
<td><strong>Add: Items disallowed /considered separately</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Provision for loss of subsidiary [since it is not wholly and exclusively for the purpose of business of the assessee]</td>
<td></td>
<td>70,000</td>
</tr>
<tr>
<td>Provision for income-tax [disallowed under section 40(a)(ii)]</td>
<td></td>
<td>1,05,000</td>
</tr>
<tr>
<td>Expenses on transfer of shares [not deductible from business income. It is to be deducted from gross sale consideration while computing capital gains]</td>
<td></td>
<td>15,000</td>
</tr>
<tr>
<td>Interest on deposit credited on 31.3.2018 and tax deducted in April 2018 which was deposited on 31.7.2018 [not allowed under section 40(a)(ia) @ 30%].</td>
<td></td>
<td>30,000</td>
</tr>
<tr>
<td>Depreciation debited to statement of profit and loss account [only depreciation calculated as per the Income-tax Rules, 1962 is allowable as deduction]</td>
<td></td>
<td>3,60,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5,80,000</td>
</tr>
<tr>
<td><strong>Less: Items credited but not includible under business income or are exempt under the provisions of the Act</strong></td>
<td></td>
<td>20,05,000</td>
</tr>
<tr>
<td>Long-term capital gain on sale of equity shares on which securities transaction tax was paid, since it is not a business income.</td>
<td></td>
<td>3,60,000</td>
</tr>
<tr>
<td>Income from UTI, since it is not a business income.</td>
<td></td>
<td>75,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4,35,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>15,70,000</td>
</tr>
</tbody>
</table>
### DIRECT TAX LAWS

#### Less: Depreciation (allowable as per the Income-tax Rules, 1962)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation</td>
<td>2,80,000</td>
</tr>
</tbody>
</table>

#### Less: Set-off of brought forward business loss and unabsorbed depreciation

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brought forward business loss under section 72</td>
<td>4,20,000</td>
</tr>
<tr>
<td>Brought forward depreciation under section 32</td>
<td>6,40,000</td>
</tr>
</tbody>
</table>

#### Income from business

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>2,30,000</td>
</tr>
</tbody>
</table>

#### Capital Gains

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long term capital gain on sale of equity shares on which securities transaction tax was paid at the time of acquisition and sale</td>
<td>3,60,000</td>
</tr>
</tbody>
</table>

#### Less: Exempt under section 10(38)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exempt under section 10(38)</td>
<td>3,60,000</td>
</tr>
</tbody>
</table>

#### Income from Other Sources

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from units of UTI</td>
<td>75,000</td>
</tr>
</tbody>
</table>

#### Less: Exempt under section 10(35)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exempt under section 10(35)</td>
<td>75,000</td>
</tr>
</tbody>
</table>

#### Total Income

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>2,30,000</td>
</tr>
</tbody>
</table>

#### Tax Payable

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax payable @ 30%</td>
<td>69,000</td>
</tr>
<tr>
<td>Add: Education cess @ 2%</td>
<td>1,380</td>
</tr>
<tr>
<td>Secondary and higher education cess @ 1%</td>
<td>690</td>
</tr>
<tr>
<td><strong>Total Tax Payable</strong></td>
<td>71,070</td>
</tr>
</tbody>
</table>

### Computation of Book Profit under section 115JB

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit as per Statement of Profit &amp; Loss Account</td>
<td>14,25,000</td>
</tr>
</tbody>
</table>

Add: Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provision for loss of subsidiary</td>
<td>70,000</td>
</tr>
<tr>
<td>Provision for income-tax</td>
<td>1,05,000</td>
</tr>
<tr>
<td>Depreciation debited to profit and loss account</td>
<td>3,60,000</td>
</tr>
</tbody>
</table>

Total                                                   | 19,60,000 |
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 18.50% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 18.50% thereof plus education cess @ 2% and secondary and higher education cess @ 1%.

Accordingly, in this case, since income-tax payable on total income computed as per the provisions of the Act is less than 18.50% of book profit, the book profit of ₹ 10,75,000 is deemed to be the total income and income-tax is payable @ 18.50% thereof plus education cess @ 2% and secondary and higher education cess @ 1%. The tax liability, therefore, works out to be ₹ 2,04,842.

Section 115JAA 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.

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

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 section 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.
Note: Long-term capital gains on sale of equity shares through a recognized stock exchange on which securities transaction tax (STT) is paid is exempt under section 10(38). One of the adjustments to the book profit is that exempt income under section 10, which is credited to statement of profit and loss account, would be deducted in arriving at the book profit. However, long-term capital gains exempt under section 10(38) is not eligible for reduction while computing book profit under section 115JB. Consequently, expenditure to earn such income should not be added back to arrive at the book profit.

Question 4

The profit as per the statement of profit and loss account of XYZ Ltd., a resident company, for the year ended 31.3.2018 is ₹190 lacs arrived at after making the following adjustments:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹ (in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Depreciation on assets</td>
<td>100</td>
</tr>
<tr>
<td>(ii) Reserve for currency exchange fluctuation</td>
<td>50</td>
</tr>
<tr>
<td>(iii) Provision for tax</td>
<td>40</td>
</tr>
<tr>
<td>(iv) Proposed dividend</td>
<td>120</td>
</tr>
</tbody>
</table>

Following further information are also provided by company:

(a) Profit includes ₹10 lacs, being dividend received from an Indian subsidiary company.

(b) Provision for tax includes ₹16 lacs of tax payable on distribution of profit and of ₹2 lacs of interest payable on income-tax.

(c) Depreciation includes ₹40 lacs towards revaluation of assets.

(d) Amount of ₹50 lacs credited to statement of P & L account was drawn from revaluation reserve.

(e) Balance of statement of profit and loss account shown in balance sheet at the asset side as at 31.3.2017 was ₹30 lacs which includes unabsorbed depreciation of ₹10 lakhs.

Compute the book profit for the year ended 31.3.2018.
Answer

**Computation of book profit of XYZ Ltd. for the year ended 31.3.2018**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit as per Statement of Profit &amp; Loss Account</td>
<td></td>
<td>1,90,00,000</td>
</tr>
<tr>
<td><strong>Add: Net profit to be increased by the following amounts as per Explanation 1 to section 115JB</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation on assets debited to P&amp;L A/c</td>
<td></td>
<td>1,00,00,000</td>
</tr>
<tr>
<td>Reserve for currency exchange fluctuation, since the amount carried to any reserve, by whatever name called, is to be added back</td>
<td></td>
<td>50,00,000</td>
</tr>
<tr>
<td>Provision for tax (See Note below)</td>
<td></td>
<td>40,00,000</td>
</tr>
<tr>
<td>Proposed dividend</td>
<td>1,20,00,000</td>
<td>3,10,00,000</td>
</tr>
<tr>
<td><strong>Less: Net profit to be decreased by the following amounts as per Explanation 1 to section 115JB</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation other than depreciation on revaluation of assets (₹ 100 lacs - ₹ 40 lacs)</td>
<td>60,00,000</td>
<td></td>
</tr>
<tr>
<td>Withdrawal from revaluation reserve restricted to the extent of depreciation on account of revaluation of assets (₹ 50 lacs or ₹ 40 lacs, whichever is less)</td>
<td>40,00,000</td>
<td></td>
</tr>
<tr>
<td>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</td>
<td>10,00,000</td>
<td></td>
</tr>
<tr>
<td>Dividend income [since the same is exempt under section 10(34)]</td>
<td>10,00,000</td>
<td>1,20,00,000</td>
</tr>
<tr>
<td><strong>Book profit</strong></td>
<td></td>
<td>3,80,00,000</td>
</tr>
</tbody>
</table>

**Note** – For the purpose of section 115JB, book profit means the profit as per the statement of profit and loss account 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*, dividend distribution tax / tax on distributed income and interest. Therefore, the entire provision of ₹ 40 lacs for income-tax is added back for computing book profit for levy.
Question 5

Mr. Harish, aged 66, running business as a proprietor furnishes the particulars of his income for the year ended 31.03.2018 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 items for shop on 13.6.2017 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, 2017. 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 ₹ 35,000 by credit card for health insurance of himself and his family.

Compute taxable income and the amount of tax payable by Mr. Harsh on such income for the Assessment Year 2018-19.

Answer

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income from house property</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Self-occupied portion (50%)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Annual Value under section 23(2)</td>
<td></td>
<td>Nil</td>
</tr>
<tr>
<td>Less: Deduction under section 24(b)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest on housing loan [₹ 52,000 × 50%]</td>
<td>26,000</td>
<td>(26,000)</td>
</tr>
<tr>
<td><strong>Let-out portion (50%)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income of let out portion being rent of ₹ 8,500 p.m. received for 12 months (Rent received has been taken as the GAV in the absence of other information). Gross Annual Value under section 23(1) (₹ 8,500 × 12)</td>
<td>1,02,000</td>
<td></td>
</tr>
<tr>
<td>Less: 50% of municipal taxes paid allowable in respect of rented out portion (i.e., 50% of ₹ 2,500)</td>
<td>1,250</td>
<td></td>
</tr>
<tr>
<td><strong>Net Annual Value (NAV)</strong></td>
<td>1,00,750</td>
<td></td>
</tr>
</tbody>
</table>
### Less: Deduction under section 24

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>30% of NAV under section 24(a)</td>
<td>30,225</td>
</tr>
<tr>
<td>Interest on housing loan under section 24(b)</td>
<td>26,000</td>
</tr>
<tr>
<td></td>
<td>44,525</td>
</tr>
<tr>
<td>Deduction under section 24</td>
<td>18,525</td>
</tr>
</tbody>
</table>

### Profits and gains of business or profession

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per profit and loss account of wholesale business of textiles and fabrics</td>
<td>3,65,500</td>
</tr>
<tr>
<td><strong>Add:</strong> Expenses charged in profit and loss account either not allowable or to be considered separately -</td>
<td></td>
</tr>
<tr>
<td>Personal travelling expenses of proprietor</td>
<td>12,750</td>
</tr>
<tr>
<td>Purchase of furniture wrongly debited to shop expenses</td>
<td>25,000</td>
</tr>
<tr>
<td><strong>Less:</strong> Depreciation on furniture @ 10% on ₹ 25,000</td>
<td>2,500</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td>4,19,275</td>
</tr>
</tbody>
</table>

### Less: Deduction under Chapter VI-A

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Under section 80C</strong></td>
<td></td>
</tr>
<tr>
<td>Life insurance premium</td>
<td></td>
</tr>
<tr>
<td>Self</td>
<td>12,500</td>
</tr>
<tr>
<td>Wife</td>
<td>13,500</td>
</tr>
<tr>
<td>Son and daughter</td>
<td>28,000</td>
</tr>
<tr>
<td>Housing loan repaid</td>
<td>50,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,04,000</td>
</tr>
<tr>
<td><strong>Under section 80D [Medical insurance premium]</strong></td>
<td></td>
</tr>
<tr>
<td>Mediclaim insurance premium of ₹ 35,000 [maximum deductible is ₹ 30,000 where it covers a resident senior citizen]</td>
<td>30,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>2,85,275</td>
</tr>
</tbody>
</table>

Total Income (rounded off) 2,85,280

Tax on total income of ₹ 2,85,280
(The basic exemption limit for senior citizen is ₹ 3,00,000 for A.Y. 2018-19) Nil
Question 6

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. In the previous year 2016-17, one partner ‘A’ retired, but his dues have been settled in the previous year 2017-18.

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, 2017 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, 2018 shows a net profit of ₹10 lacs after debiting/crediting the following:

(a) Interest amounting to ₹5 lacs each was paid to partners on the balances standing to their capital accounts from 1st June, 2017 to 31st March, 2018.

(b) Remuneration to the partners including partner in representative capacity ₹30 lacs.

(c) Interest amounting to ₹2 lacs paid to Z on loan provided by him in his individual capacity at 16% interest.

(d) Royalty of ₹5 lacs 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, 2018 to Altaf, a hairdresser, against his bill for services rendered in January, 2018 and two payments of ₹19,000 and ₹10,000 made in cash on 1st February and 2nd February, 2018, respectively, to Priyam, an assistant cameraman, against her bill for services provided in January, 2018.

(f) Amount of ₹5 lacs provided in the books on 31st March 2018 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, 2018.

(g) Amount of ₹6 lacs 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 lacs.

(h) Interest of ₹1.20 lacs received on income-tax refund under section 244(1A) in respect of A.Y. 2015-16.

The firm has also provided the following additional information:

The amount due to A, an ex-partner, was ₹15 lacs which was settled on 30th September, 2017 by transferring a plot of land purchased one year back having book value of ₹10 lacs. The difference of ₹5 lacs was credited to partners’ capital accounts in their profit sharing ratio. The value of plot for stamp duty valuation on the date of transfer was ₹16 lacs.
Compute the total income of the firm for the assessment year 2018-19 stating the reasons for treatment of each item.

**Answer**

Computation of Total Income of M/s. Popular Cine Vision for the A.Y.2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits and Gains from Business or Profession</td>
<td></td>
</tr>
<tr>
<td>Net Profit as per Profit &amp; Loss A/c</td>
<td>10,00,000</td>
</tr>
<tr>
<td>Add: Expenses disallowed or considered separately:</td>
<td></td>
</tr>
<tr>
<td>Interest to partners in excess of 12% (Note 1)</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Disallowance under section 40A(3A) for aggregate cash</td>
<td>52,000</td>
</tr>
<tr>
<td>payment exceeding ₹ 10,000 in a single day (Note 5)</td>
<td></td>
</tr>
<tr>
<td>Provision for gratuity (Note 8)</td>
<td>4,50,000</td>
</tr>
<tr>
<td>Partners' Remuneration</td>
<td>30,00,000</td>
</tr>
<tr>
<td>Royalty paid to Partner X (Note 4)</td>
<td>5,00,000</td>
</tr>
<tr>
<td></td>
<td>43,02,000</td>
</tr>
<tr>
<td>Less: Interest on income-tax refund (Note 9)</td>
<td>1,20,000</td>
</tr>
<tr>
<td></td>
<td>53,02,000</td>
</tr>
<tr>
<td><strong>Book Profit</strong></td>
<td><strong>51,82,000</strong></td>
</tr>
<tr>
<td>Less: Partners’ remuneration allowable under section 40(b)(v)</td>
<td></td>
</tr>
<tr>
<td>(i) As per limit prescribed in section 40(b)</td>
<td></td>
</tr>
<tr>
<td>On first ₹ 3,00,000 90%</td>
<td>2,70,000</td>
</tr>
<tr>
<td>On the balance ₹ 48,82,000 60%</td>
<td>29,29,200</td>
</tr>
<tr>
<td></td>
<td>31,99,200</td>
</tr>
<tr>
<td>(ii) Remuneration actually paid or payable</td>
<td></td>
</tr>
<tr>
<td>(₹ 1,00,000 × 10 months × 3 partners) + Royalty ₹ 5 Lacs)</td>
<td></td>
</tr>
<tr>
<td>(i) or (ii) whichever is less, is deductible</td>
<td>35,00,000</td>
</tr>
<tr>
<td></td>
<td>31,99,200</td>
</tr>
<tr>
<td></td>
<td><strong>19,82,800</strong></td>
</tr>
<tr>
<td>Capital Gain</td>
<td></td>
</tr>
<tr>
<td>Short-term capital gain on transfer of land (Note 10)</td>
<td>6,00,000</td>
</tr>
</tbody>
</table>
### Income from other sources

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on income-tax refund</td>
<td>1,20,000</td>
</tr>
</tbody>
</table>

### Gross Total Income

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>27,02,800</td>
</tr>
</tbody>
</table>

### Deductions under Chapter VI-A

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Nil</td>
</tr>
</tbody>
</table>

### Total Income

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>27,02,800</td>
</tr>
</tbody>
</table>

#### 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, 2017 to 31st March, 2018 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 Lacs 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(3A) provides for disallowance of any expenditure which was allowed in the earlier year and the actual payment was made subsequently and where the aggregate payment so made is otherwise than by an account payee cheque, account payee bank draft or use of ECS through bank account in a single day to a person exceeding a sum of ₹ 10,000. Hence, the payments of ₹ 18,000 and ₹ 15,000 in cash on 1.2.2018 to Altaf, a hairdresser, shall be disallowed, since the aggregate payment of ₹ 33,000 exceeds the limit of ₹ 10,000.

6. The payment of bill of the assistant cameraman of ₹ 19,000 on 1st February is liable for disallowance under section 40A(3) since the aggregate payment in cash on a single day has exceeded ₹ 10,000.

7. 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 2018 has to be deposited latest by 31st July 2018/30th September, 2018 (as the case may be). The firm has paid the tax on 3rd June, 2018 and hence, the remuneration shall be allowed. Since the same is already debited to profit and loss account, no further adjustment is made.

8. 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 lacs paid to retired employees is allowable as deduction. Hence, the balance provision of ₹ 4.50 lacs (i.e., ₹ 6 lacs – ₹ 1.50 lacs) is to be disallowed.

9. Interest on income-tax refund is assessable under the head “Income from other sources”.

10. Distribution of a capital asset by a firm to its partner on dissolution or otherwise attracts capital gains tax liability as per the provisions of section 45(4) and the fair market value of the asset on the date of transfer is deemed to be the full value of consideration received or accruing as a result of the transfer. The words “or otherwise” includes within its scope, cases of distribution of capital assets on retirement of a partner also. [CIT vs. A. N. Naik Associates (2004) 265 ITR 346 (Bom.).] Therefore, distribution of a plot of land on retirement of a partner would attract section 45(4).

₹ 16 lacs, being the fair market value of the plot on the date of transfer, is deemed to be the full value of consideration. Therefore, the capital gain would be ₹ 6 lacs (i.e., ₹ 16 lacs – ₹ 10 lacs).

**Question 7**

PQR LLP, a limited liability partnership set up a unit in Special Economic Zone (SEZ) in the financial year 2013-14 for production of washing machines. The unit fulfills all the conditions of section 10AA of the Income-tax Act, 1961. During the financial year 2016-17, 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, 2017 and the expenditure of ₹ 75 lakhs was capitalized in the books on that date.

Relevant details for the financial year 2017-18 are as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit of unit located in SEZ</td>
<td>40,00,000</td>
</tr>
<tr>
<td>Export sales of above unit</td>
<td>80,00,000</td>
</tr>
<tr>
<td>Domestic sales of above unit</td>
<td>20,00,000</td>
</tr>
<tr>
<td>Profit from operation of warehousing facility (before considering deduction under Section 35AD)</td>
<td>1,05,00,000</td>
</tr>
</tbody>
</table>
**Compute income tax (including AMT under Section 115JC) payable by PQR LLP for Assessment Year 2018-19.**

**Answer**

**Computation of total income and tax liability of PQR LLP for A.Y.2018-19**
*(under the regular provisions of the Income-tax Act, 1961)*

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profits and gains of business or profession</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unit in SEZ</td>
<td>40,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Less: Deduction under section 10AA [See Note (1) below]</strong></td>
<td>32,00,000</td>
<td></td>
</tr>
<tr>
<td>Business income of SEZ unit chargeable to tax</td>
<td>8,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Profit from operation of warehousing facility</strong></td>
<td>1,05,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Less: Deduction under section 35AD [See Note (2) below]</strong></td>
<td>65,00,000</td>
<td>40,00,000</td>
</tr>
<tr>
<td>Business income of warehousing facility chargeable to tax</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>48,00,000</td>
<td></td>
</tr>
</tbody>
</table>

**Computation of tax liability (under the normal/regular provisions)**

- Tax@30% on ₹ 48,00,000
- **Add: Education cess@2% and SHEC@1%**
- **Total tax liability**

<table>
<thead>
<tr>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>14,40,000</td>
<td></td>
</tr>
<tr>
<td>43,200</td>
<td></td>
</tr>
<tr>
<td><strong>Total tax liability</strong></td>
<td>14,83,200</td>
</tr>
</tbody>
</table>

**Computation of adjusted total income of PQR LLP for levy of Alternate Minimum Tax**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Income (as computed above)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Add: Deduction under section 10AA</strong></td>
<td></td>
<td>32,00,000</td>
</tr>
<tr>
<td><strong>Add: Deduction under section 35AD</strong></td>
<td></td>
<td>65,00,000</td>
</tr>
<tr>
<td><strong>Less: Depreciation under section 32</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>On building @10% of ₹ 65 lakhs&lt;sup&gt;7&lt;/sup&gt;</td>
<td>6,50,000</td>
<td>58,50,000</td>
</tr>
<tr>
<td><strong>Adjusted Total Income</strong></td>
<td></td>
<td><strong>1,38,50,000</strong></td>
</tr>
</tbody>
</table>

<sup>7</sup> Assuming the capital expenditure of ₹65 lakhs is incurred entirely on buildings
Alternate Minimum Tax@18.5%  25,62,250
Add: Surcharge@12% (since adjusted total income > ₹ 1 crore)  3,07,470
Add: Education cess@2% and SHEC@1%  86,092
Tax liability under section 115JC (rounded off)  29,55,812

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@3%. Therefore, the tax liability is ₹ 29,55,810.

Notes:

1. **Deduction under section 10AA in respect of Unit in SEZ**

   \[
   \text{Profit of the Unit in SEZ} \times \frac{\text{Export turnover of the Unit in SEZ}}{\text{Total turnover of the Unit in SEZ}} = \frac{₹40,00,000 \times ₹80,00,000}{₹1,00,00,000} = ₹32,00,000
   \]

2. **Deduction@100% of the capital expenditure is available under section 35AD for A.Y.2018-19 in respect of specified business of setting up and operating a warehousing facility for storage of agricultural produce which commences operation on or after 01.04.2012.**

   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 he commences operations of his 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.2016-17 and capitalized in the books of account on 1.4.2017, being the date when the warehouse became operational, ₹ 65,00,000, being 100% of ₹ 65 lakhs would qualify for deduction under section 35AD.
Question 8

Victory Polyfibres, a partnership firm, has earned a gross total income of ₹ 300 lacs for the year ended 31-3-2018. The firm has not undertaken any international transaction or specified domestic transaction during the said year.

The above includes a profit of ₹ 220 lacs from an undertaking having a turnover of ₹ 80 crores. This is the fifth year and deduction under section 80-IA of the Income-tax Act, 1961 is available to the extent of ₹ 200 lacs.

There are some grey areas in the taxation workings and hence, the assessee is contemplating to file the return of income on 7.12.2018, 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 30-09-2018 or when the same is filed on 7-12-2018.

What is the practical solution as regards obtaining clarifications, which might or might not have an impact on the total income?

Answer

As per section 80AC, while computing the total income of an assessee of a previous year (P.Y.2017-18, in this case) relevant to any assessment year (A.Y.2018-19, 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 ₹ 200 lacs in the previous year 2017-18, it would be subject to audit under section 44AB, in which case the ‘due date’ of filing its return of income for A.Y.2018-19 would be 30th September, 2018 as per section 139(1).

Computation of total income and tax liability of M/s. Victory Polyfibres for A.Y.2018-19

I. Where the firm files its return of income on 30th September 2018:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹ in lacs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Total Income</td>
<td>300.00</td>
</tr>
<tr>
<td>Less: Deduction under section 80-IA</td>
<td>200.00</td>
</tr>
<tr>
<td>Total Income</td>
<td>100.00</td>
</tr>
<tr>
<td>Tax liability@ 30%</td>
<td>30.00</td>
</tr>
<tr>
<td>Add: Education cess@2% and secondary and higher education cess@1%</td>
<td>0.90</td>
</tr>
<tr>
<td>Regular income-tax payable</td>
<td>30.90</td>
</tr>
</tbody>
</table>
Computation of Alternate Minimum Tax payable [Section 115JC]

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Income</td>
<td>100.00</td>
</tr>
<tr>
<td>Add: Deduction under section 80-IA</td>
<td>200.00</td>
</tr>
<tr>
<td>Adjusted Total Income</td>
<td>300.00</td>
</tr>
<tr>
<td>Alternate Minimum Tax (AMT) @ 18.5% on ₹ 300 lacs</td>
<td>55.50</td>
</tr>
<tr>
<td>Add: Surcharge@12% (Since adjusted total income &gt; ₹ 1 crore)</td>
<td>6.66</td>
</tr>
<tr>
<td>Add: Education cess@2% and SHEC@1%</td>
<td>1.86</td>
</tr>
<tr>
<td>Total tax payable (AMT)</td>
<td>64.02</td>
</tr>
</tbody>
</table>

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.2017-18 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.2018-19 would be ₹ 64.02 lacs.

Tax credit for Alternate Minimum Tax [Section 115JD]

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total tax payable for A.Y.2018-19 (Alternate Minimum Tax)</td>
<td>64.02</td>
</tr>
<tr>
<td>Less: Regular income-tax payable</td>
<td>30.90</td>
</tr>
<tr>
<td>To be carried forward for set-off against regular income-tax payable (upto a maximum of fifteen assessment years)</td>
<td>33.12</td>
</tr>
</tbody>
</table>

II. Where the firm files its return of income on 7th December 2018:

Where the firm files its return on 7-12-2018, it would be a belated return under section 139(4). Consequently, as per section 80AC, deduction under section 80-IA would not be available. In such circumstances, the gross total income of ₹ 300 lacs would be the total income of the firm.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income-tax@30% of ₹ 300 lacs</td>
<td>90.000</td>
</tr>
<tr>
<td>Add: Surcharge@12% (since total income exceeds ₹ 100 lacs)</td>
<td>10.800</td>
</tr>
<tr>
<td>Income-tax (plus surcharge)</td>
<td>100.800</td>
</tr>
<tr>
<td>Add: Education cess@2% and SHEC@1%</td>
<td>3.024</td>
</tr>
<tr>
<td>Total tax liability</td>
<td>103.824</td>
</tr>
</tbody>
</table>
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., 30.9.2018, and claim deduction under section 80-IA. In such a case, the firm can claim deduction of ₹200 lacs 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) within 31.3.2019 (i.e., within the end of A.Y.2018-19) which 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 30.9.2018, its tax liability would stand reduced to ₹64.02 lacs, as against ₹103.824 lacs 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 ₹33.12 lacs. Therefore, the firm is advised to file its return of income on or before 30.9.2018.

Question 9
Prakash, a member in two AOPs, namely, “AOP & Co.” and “Prakash & Akash”, provides the following details of his income for the year ended on 31.3.2018:

(a) “AOP & Co.”, assessed at normal rates of tax, had credited in his account, amount of ₹96,000 as interest on capital, ₹4,96,000 as salary and ₹20,000 as share of profit.

(b) A house property located at Jaipur was purchased on 1.7.2009 with the borrowed capital in “Prakash & Akash” jointly shared equally and occupied by both of them for self residential purposes. Total interest paid for the year 2017-18 on the borrowed capital was ₹4,10,000.

Compute the income and the tax liability thereon for the A.Y. 2018-19 and support your answer with brief reasons and the provisions of the Act.

Answer
Mr. Prakash is a member in two AOPs, namely, AOP & Co. and Prakash & Akash. Though Prakash & Akash is an AOP, the income from the house property will not be assessed as income of the AOP, but will be included in the hands of the individual members as per section 26, since the share of each member is definite and ascertainable. Hence, Prakash’s share of income from house property would be assessed in his individual hands.

Since AOP & Co., has been taxed at normal rates of tax, Mr. Prakash’s share income from the AOP (i.e. salary, interest on capital and his share of profit) would be included in his total income. Mr. Prakash, however, would be entitled to a relief under section 86 in respect of this income which has been included in his total income but on which tax has already been paid by the AOP. As per section 110, the relief shall be allowed at the average rate of tax calculated on the total income inclusive of such income.
Hence, the tax liability in the hands of Mr. Prakash would be as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Value (½ share in house property used for own residence)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Interest on loan [½ share in ₹ 4,10,000] – Since the loan is</td>
<td></td>
<td></td>
</tr>
<tr>
<td>borrowed on or after 1.4.1999 and is used for acquiring property within</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 years, deduction would be available up to a maximum of ₹ 2,00,000. This</td>
<td></td>
<td>2,00,000</td>
</tr>
<tr>
<td>limit of ₹ 2,00,000 applies for each member separately.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loss from house property</td>
<td></td>
<td>(⁻) 2,00,000</td>
</tr>
<tr>
<td>Share income from AOP &amp; Co.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Interest on capital</td>
<td></td>
<td>96,000</td>
</tr>
<tr>
<td>- Salary</td>
<td></td>
<td>4,96,000</td>
</tr>
<tr>
<td>- Share of profit</td>
<td></td>
<td>20,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td></td>
<td>4,12,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on ₹ 4,12,000</td>
<td>8,100</td>
</tr>
<tr>
<td><strong>Add:</strong> Education Cess &amp; SHEC @ 3%</td>
<td>243</td>
</tr>
<tr>
<td><strong>Tax Liability</strong></td>
<td>8,343</td>
</tr>
<tr>
<td><strong>Less:</strong> Rebate under section 86 read with section 110 = ₹ 8343 x 100/</td>
<td>2.025%</td>
</tr>
<tr>
<td>₹ 4,12,000</td>
<td></td>
</tr>
<tr>
<td>Rebate available ₹ 6,12,000 x 2.025% = ₹ 12,393</td>
<td></td>
</tr>
<tr>
<td>Restricted to</td>
<td>8,343</td>
</tr>
<tr>
<td><strong>Tax payable</strong></td>
<td>Nil</td>
</tr>
</tbody>
</table>

**Question 10**

T and Q are individuals, who constitute an Association of Persons, sharing profit and losses in the ratio of 2:1. For the accounting year ended 31st March, 2018, the Profit and Loss account of the business was as under:

<table>
<thead>
<tr>
<th>Figures are in ₹ ‘000s</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of goods sold</td>
<td>4,250</td>
<td>Sales</td>
</tr>
<tr>
<td>Remuneration to:</td>
<td>Dividend from Indian companies</td>
<td>25</td>
</tr>
</tbody>
</table>
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 was paid on 14th January, 2018.

(c) ₹30,000 was paid in cash to an advertising agency for publicity.

(ii) Outstanding sales tax penalty was paid on 15th October, 2018. The penalty was imposed by the Sales-tax Officer 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 AOP for the assessment year 2018-19; and

(ii) Discuss the tax implication for that year in the hands of the individual members.

Answer

(i) Computation of total income of the AOP for A.Y.2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit &amp; gains of business (See Working Note below)</td>
<td>3,12,300</td>
</tr>
<tr>
<td>Long term capital gain</td>
<td>6,40,000</td>
</tr>
<tr>
<td>Income from other sources [Dividend is exempt under section 10(34)]</td>
<td>-</td>
</tr>
<tr>
<td>Total income</td>
<td>9,52,300</td>
</tr>
</tbody>
</table>
## Working Note - Computation of profits and gains of business

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per profit &amp; loss account</td>
<td></td>
<td>5,24,300</td>
</tr>
<tr>
<td><em>Add:</em> Inadmissible payments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest to members T &amp; Q (₹ 48,300 + ₹ 35,700)</td>
<td></td>
<td>84,000</td>
</tr>
<tr>
<td>Advertising [Disallowance under section 40A(3) (100% of ₹ 30,000 being a cash payment)]</td>
<td></td>
<td>30,000</td>
</tr>
<tr>
<td>Remuneration to members T &amp; Q (₹ 1,30,000 + ₹ 1,70,000)</td>
<td></td>
<td>3,00,000</td>
</tr>
<tr>
<td>Sales tax penalty <em>(See Note 3 below)</em></td>
<td>39,000</td>
<td>4,53,000</td>
</tr>
<tr>
<td><em>Less:</em> Income not taxable under this head</td>
<td></td>
<td>9,77,300</td>
</tr>
<tr>
<td>Dividend from Indian companies</td>
<td></td>
<td>25,000</td>
</tr>
<tr>
<td>Long term capital gain</td>
<td>6,40,000</td>
<td>6,65,000</td>
</tr>
<tr>
<td><strong>Profits and gains of business</strong></td>
<td></td>
<td>3,12,300</td>
</tr>
</tbody>
</table>

### 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 sales tax return is not deductible since it is on account of infraction of the law requiring filing of the return within the specified period. – *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.2018-19

Members of the AOP have to pay tax on their total income taking into account savings/ investments etc.

Since one of the members has individual income more than the basic exemption limit, the AOP will be assessed at the maximum marginal rate.

Since the AOP is taxed at maximum marginal rate, the share income of members is not taxable in their hands individually.

### Question 11

*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 2018-19, the assessee has received ₹ 3 lacs 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 exigibility to tax the aforesaid receipts in the hands of the assessee.

Answer

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, ₹ 3 lacs received as transfer fees by Pandey Co-operative Housing Society from its transferor members and its transferees, is not chargeable to tax.
SIGNIFICANT SELECT CASES

1. Where land inherited by three brothers is compulsorily acquired by the State Government, whether the resultant capital gain would be assessed in the status of “Association of Persons” (AOP) or in their individual status?

CIT v. Govindbhai Mamaiya (2014) 367 ITR 498 (SC)

Facts of the case: 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. On appeal, compensation was enhanced and the enhanced compensation was paid with interest.

Issue: The issue under consideration is regarding the status in which capital gain arising on transfer of property would be assessed. The assessees’ offered income in their status as “individual” but the Revenue sought to tax the same in their status as “Association of Persons” (AOP).

High Court’s Observations: The High Court found that the parties inherited the property and there was no material on record to suggest consensus ad idem between the brothers for formation of AOP. It referred to CWT v. Chander Sen (1986) 161 ITR 370 (SC) to hold that as per section 4 of the Hindu Succession Act, 1956, income from the asset inherited by a son from his father has to be assessed as income of the son individually. Further, as per section 8 of the Hindu Succession Act, 1956, the property of the father devolves on his son in his individual capacity and not as karta of HUF. Thus, it was held that the income is chargeable to tax in their individual status and not as AOP.

Supreme Court’s Observations: The Supreme Court referred to its earlier decision in the case of Meera & Co v. CIT (1997) 224 ITR 635 in which the earlier precedent in the case of CIT v. Indira Balakrishna (1960) 39 ITR 546 (SC) was followed. The Apex Court noted that “Association of Persons” means an association in which two or more persons join in a common purpose or common action.

The Supreme Court also referred to its judgment in G. Murugesan & Bros. v. CIT (1973) 4 SCC 211. In that case, it was held that an association of persons could be formed only when two or more persons voluntarily combined together for certain purposes.

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 parties. 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.

Apex Court’s Decision: The Apex Court, accordingly, held that the income from asset inherited by the legal heirs is taxable in their individual hands and not in the status of AOP.
2. Would the ancestral property received by the assessee after the death of his father, be considered as HUF property or as his individual property, where the assessee’s father had received such property as his share when he went out of the joint family under a release deed?


Facts of the case: In the present case, Laxmaiah Reddy had no sons and therefore, he adopted the assessee vide a registered adoption deed dated June 25, 1956. The property, which is the subject matter of the suit, originally belonged to Venkateshwaraiah (assessee’s grandfather). The assessee’s father (Laxmaiah Reddy), took his share in the joint family property and executed a release deed in favour of the remaining members of the joint family ‘vide’ a registered release deed dated November 23, 1927 and bequeathed all his properties in favour of the assessee. The assessee, in turn, distributed the property in favour of his wife and children. This was done by oral partition which was evidenced by a memorandum of partition dated August 6, 1998.

Thereafter, a transaction was entered into by the assessee with the builder for development of the property. The Assessing Officer treated the consideration received from the builder by the assessee and his wife as their individual income and assessed the same to tax in their individual hands.

Assessing Officer’s contention: The Revenue contended that when assessee’s father got the property under a release deed, it ceased to be the joint family property. Since that property was bequeathed in favour of the assessee, he became its owner after the death of his father. Therefore, it was a separate property and, consequently, the income derived therefrom is assessed to tax in the hands of the assessee as separate property.

High Court’s Observations: The High Court observed that the property originally belonged to Hindu Undivided Family (HUF). One of the members of the family (i.e., the assessee’s father) went out of the joint family under a release deed and the remaining members continued to be the members of joint family. After the death of assessee’s father and mother, the assessee, being the adopted son, became the sole surviving co-parcener. When such property came to the hands of the assessee it was not his individual property; it was the property of his Hindu Undivided Family.

High Court’s Decision: The High Court held that that when the property came to the hands of the assessee, it was not his self-acquired property; it was property belonging to his HUF. The assessee had given a portion of the property to his wife without a registered document, which is possible only if the property is a HUF property. If such property is treated as a self-acquired property, then assessee would have been able to give the portion of the property to his wife only by registered document.
3. Under which head of income is rental income from plinths inherited by individual co-owners from their ancestors taxable – “Income from house property” or “Income from other sources”? Further, would such income be assessable in the hands of the individual co-owners or in the hands of the Association of Persons?


**First Issue:** The first issue relates to the head of income under which rental income from plinths, inherited by individual co-owners from their ancestors, is taxable – whether “Income from house property” or “Income from other sources”?

**High Court’s Observations:** As regards the head of income under which rental income from plinths is assessable, the High Court referred to the Division Bench judgment in *Gowardhan Das and Sons v. CIT (2007) 288 ITR 481*, wherein it was observed that it is the income from property consisting of any building or land appurtenant thereto which is assessed under section 22 and not the income from renting out of open land or some kutcha plinth only.

**High Court’s Decision:** Therefore, the Court held that the income from letting out the plinths is assessable under section 56 as “Income from other sources” and not under the head “Income from house property”.

**Second Issue:** The second issue relates to whether such rental income is assessable in the hands of the individual co-owners or in the hands of the Association of Persons. To appreciate this issue, it is necessary to understand the complete facts of the case.

**Facts of the case:** In the present case, five persons of the Nagpal family were co-owners of the agricultural land “Nagpal farms” inherited from their forefathers. The co-owners executed a power of attorney in favour of Mr. Sudhir Nagpal, one of the co-owners, appointing him to construct plinths on the agricultural land and to further lease out such open plinths to any party on their behalf. The co-owners had, therefore, not purchased the land for the said purpose but had inherited the land. They were owners not in their joint capacity but in their individual capacity with a definite/defined proportion of share. The co-owners filed their individual returns of income disclosing their rental income and also paid tax on such income.

The Assessing Officer, however, issued notice under section 148 to all the co-owners of the property in the name of Mr. Sudhir Nagpal on the ground that there is an association of persons formed by the co-owners and therefore, income had escaped assessment in the hands of association of persons.

The assessee contended that since no land was purchased, therefore, the status of the co-owners cannot be treated as association of persons.

The Assessing Officer did not agree with the contention of the assessee and assessed the entire rental income from the plinths as income from other sources in the hands of the association of
persons and determined the tax payable by applying section 167B(2). The Commissioner (Appeals) and the Tribunal confirmed the action of the Assessing Officer.

**High Court's Observations:** On appeal, the High Court observed that in order to assess individuals as “association of persons”, the individual co-owners should have joined their resources and thereafter, acquired property in the name of association of persons and the property should have been commonly managed. It is only in such a case that income could be assessed in the hands of “association of persons”. Mere accruing of income jointly to more persons than one would not constitute them an association of persons in respect of such income. In other words, unless the associates have done some acts or performed some operations together, which have helped to produce the income in question, they cannot be termed as an association of persons. Unless the members combine or join in a common purpose, it cannot be held that they have formed themselves into an association of persons.

**High Court’s Decision:** In this case, the co-owners had inherited the property from their ancestors and there was nothing to show that they had acted as an association of persons. Thus, the High Court held that the rental income from the plinths has to be assessed in the status of individual and not association of persons and consequently, section 167B would not be attracted in this case.

4. **Would the interest earned on surplus funds of a club deposited with institutional members satisfy the principle of mutuality to escape taxability?**

   *Madras Gymkhana Club v. DCIT (2010) 328 ITR 348 (Mad.)*

   **Facts of the case:** 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.

   **High Court’s Decision:** The High Court held that 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. **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?**

   *Sind Co-operative Housing Society v. ITO (2009) 317 ITR 47 (Bom)*

   **High Court’s Observations:** On this issue, the High Court observed that under the bye-laws 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.
High Court’s Decision: 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 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. Would non-resident match referees and umpires in the games played in India fall within the meaning of “sportsmen” to attract taxability under the provisions of section 115BBA, and consequently attract the TDS provisions under section 194E in the hands of the payer?

Indcom v. Commissioner of Income-tax (TDS) (2011) 335 ITR 485 (Cal.)

High Court’s Observations: On this issue, the Calcutta High Court observed that, in order to attract the provisions of the section 194E, the person should be a non-resident sportsperson or non-resident sports association or institution whose income is taxable as per the provisions of section 115BBA.

The umpires and the match referees can be described as professionals or technical persons who render professional or technical services, but they cannot be said to be either non-resident sportsmen (including an athlete) or non-resident sports association or institution so as to attract the provisions of section 115BBA and consequently, the provisions of tax deduction at source under section 194E are also not attracted in this case. Though for the purpose of section 194J, match referees and umpires are considered as professionals, the tax deduction provisions thereunder are attracted only in case where the deductee is a resident individual, which is not so in the present case.

High Court’s Decision: Therefore, although the payments made to non-resident umpires and the match referees are “income” which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA and thus, the assessee is not liable to deduct tax under section 194E.

Note - It may be noted that since income has accrued and arisen in India to the non-resident umpires and match referees, the TDS provisions under section 195 would be attracted and tax would be deductible at the rates in force.

7. 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?

CIT v. Anil Hardware Store (2010) 323 ITR 368 (HP)
**Facts of the case:** The partnership deed of the assessee-firm provided that in case the book profits of the firm are up to ₹ 75,000, then the partners would be entitled to remuneration up to ₹ 50,000 or 90% of the book profits, whichever is more. In respect of the next ₹ 75,000, it is 60% and for the balance book profits, it is 40%. Thereafter, it is further clarified that the book profits shall be computed as defined in section 40(b) of the Income-tax Act, 1961, or any other provision of law as may be applicable for the assessment of the partnership firm. It has also been clarified that in case there is any loss in a particular year, the partners shall not be entitled to any remuneration. Clause 7 of the partnership deed laid down that the remuneration payable to the partners should be credited to the respective accounts at the time of closing the accounting year and clause 5 stated that the partners shall be entitled to equal remuneration.

**High Court’s Decision:** The High Court held that 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 under section 40(b)(v).

**Notes:**

1. Payment of remuneration to working partners is allowed as deduction if it is authorized by the partnership deed and is subject to the overall ceiling limits specified in section 40(b)(v). The limits for partners’ remuneration under section 40(b)(v) has revised upwards and the differential limits for partners’ remuneration paid by professional firms and non-professional firms have been removed. On the first ₹ 3 lakh of book profit or in case of loss, the limit would be the higher of ₹ 1,50,000 or 90% of book profit and on the balance of book profit, the limit would be 60%.

2. 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 specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration.

In this case, since the partnership deed lays down the manner of quantifying such remuneration, the same would be allowed as deduction subject to the limits specified in section 40(b)(v).

8. Can interest under sections 234B and 234C be levied where a company is assessed on the basis of book profits under section 115JB?

**Joint CIT v. Rolta India Ltd. (2011) 330 ITR 470 (SC)**

**Supreme Court’s Observations:** On this issue, the Supreme Court 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 assessees, 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 under section 115JB, it would be liable to pay interest under sections 234B and 234C.

**Supreme Court’s Decision:** The Supreme Court, therefore, held that interest under sections 234B and 234C shall be payable on failure of the company to pay advance tax in respect of tax payable under section 115JB.

**Note** – 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 18.5% 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 18.5%. 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.

9. Can long-term capital gain exempted by virtue of section 54EC be included in the book profit computed under section 115JB?

**N. J. Jose and Co. (P.) Ltd. v. ACIT (2010) 321 ITR 132 (Ker.)**

**Facts of the case:** The assessee claimed exemption under section 54E on the income from long-term capital gains by depositing amounts in specified assets in terms of the said provision. In the computation of book profit under section 115J, the assessee claimed exclusion of capital gains because of exemption available on it by virtue of section 54E. The Assessing Officer reckoned the book profits including long-term capital gains for the purpose of assessment under section 115J.

**High Court’s Decision:** The High Court held that once the Assessing Officer found that total income as computed under the provisions of the Act was less than 30 per cent of the book profit, he had to make the assessment under section 115J which does not provide for any deduction in terms of section 54E. As long as long-term capital gains are part of the profits included in the profit and loss account prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956 (now, Statement of Profit and Loss prepared in accordance with Part II of Schedule III to the Companies Act, 2013), capital gains cannot be excluded unless provided under the Explanation to section 115J(1A).

**Note** – It may be noted that the rationale of this decision would apply even where minimum alternate tax (MAT) is attracted under section 115JB, on account of tax on total income being less than 18.5% of book profits. If an assessee has claimed exemption under section 54EC by
10. 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, inspite of non-fulfillment of the condition of holding a valid certificate in respect of such ships indicating its net tonnage in force?

*CIT v. Trans Asian Shipping Services (P) Ltd* (2016) 385 ITR 637 (SC)

**Facts of the case:** The assessee-company owned a qualifying ship and fulfilled all the requisite conditions for availing tonnage tax scheme contained in Chapter XII-G of the Income-tax Act, 1961. Thus, the income generated from the qualifying ship is exigible to tax as per the said scheme, since it has exercised the requisite option in this behalf and submitted valid certificate in respect of such qualifying ship. In addition to the income from qualifying ship, it has also earned income from “slot charter” arrangement in other ships in the previous years relevant to the assessment years 2005-06 and 2008-09. In the return of income filed for the relevant previous years, the assessee company also included the income earned from such slot charter for the purpose of computation of income as per the tonnage tax scheme.

**Revenue’s contentions vis-à-vis Assessee’s contention:** The Assessing Officer opined that the income earned from slot charter arrangement did not qualify for the purpose of computation of tonnage income under the tonnage tax scheme, since the said income was not generated from the ship owned by it nor was such income earned from the entire ship chartered by it. He was also of the opinion that in order to avail the benefit of Tonnage Tax Scheme, the assessee had to show that it operated a qualifying ship and it is incumbent to produce a valid certificate in respect of such ship indicating its net tonnage as provided in section 115VX(1)(b). Thus, production of valid certificate is an essential requirement contained in section 115VD which cannot be done away with because of the formula that is contained in section 115VG for the computation of tonnage income. The Revenue further contended that computation of tonnage income under the tonnage tax scheme has to be as per the provisions of section 115VG(4) which defines "Tonnage" to mean tonnage of a ship indicated in the certificate referred to in section 115VX.

The assessee company, however, contended that the requirement of producing valid certificate would apply in respect of own ships and ships hired fully. It also contended that as per method of computation provided under section 115VG, the income for the full ship is to be computed on the basis of “net tonnage” shown in the valid certificate, whereas deemed tonnage in respect of slot charter arrangement in other ships has to be computed as per Rule 11Q(1) of the Income-tax Rules, 1962.
However, the Assessing Officer rejected the contention of the assessee and held that the income from slot charter arrangement could not be included for computation of tonnage income under the tonnage tax scheme.

The order of the Assessing Officer denying the benefit of applying the tonnage tax scheme under Chapter XII-G for slot charter arrangement was upheld by CIT (Appeals) and by the Appellate Tribunal.

**High Court’s Decision**: The High Court, however, held that the income earned under slot charter arrangement comes under definition of “deemed tonnage tax” as per Explanation to section 115VG(4), therefore, the exclusion of such income while assessing the same under the special provisions was inappropriate. Accordingly, the High Court held that the assessee is eligible for tonnage tax scheme in respect of income from slot charter arrangement also.

**Supreme Court’s Observations**: The Apex Court noted that a company would be regarded as operating a ship “if it operates any ship whether owned or chartered by it in an arrangement such as slot charter, space charter or joint charter”. Thus, even an arrangement such as slot charter would be regarded as operating a ship.

A perusal of the provisions of section 115VD, containing the conditions for a ship to qualify as a “qualifying ship” would indicate that all the conditions laid down therein are fulfilled by the assessee, except the condition stipulated in clause (c) which imposes an obligation on the assessee to produce a valid certificate in respect of such a ship indicating its net tonnage in force.

The Supreme Court, noted that provisions of section 115VG(4) are in two parts in so far as computation of tonnage is concerned. When it comes to tonnage of a ship, a valid certificate is to be produced. The second part of this provision talks about “deemed tonnage” in contradistinction to the “actual tonnage” mentioned in the certificate. *Explanation* to sub-section 115VG(4), *inter alia*, mentions that in so far as slot charter arrangements are concerned, purchase of such slot charter shall be treated as deemed tonnage.

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 and an arrangement of sharing of break-bulk vessel. This position becomes abundantly clear by reading Rule 11Q(1) which specifies the basis/formula of computing deemed tonnage in respect of arrangement of slot charter.

**Supreme Court’s Decision**: The Apex Court, accordingly, held that 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. It held that the contention of the assessee is valid and 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:

\[
2.5 \text{ TEU} = 1 \text{ Net Tonnage (1NT)}
\]

Where TEU is Twenty foot Equivalent Unit (Container of this size)